

APPENDIX 9

Acutel Consulting, Review of escalation of operational telecommunications costs, January 2009

TRANSEND NETWORKS

REVIEW OF ESCALATION OF OPERATIONAL TELECOMMUNICATIONS COSTS



8 January 2009

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1 Background

Transend submitted its Transmission revenue proposal for the regulatory control period 1 July 2009 to 30 June 2014 to the Australian Energy Regulator in May 2008.

In that proposal Transend highlighted that it was engaged in commercial negotiations with its operational telecommunications service provider to acquire the business, and would provide revised costs for this function if these negotiations result in materially different costs for the forthcoming regulatory control period.

In November 2008 Transend acquired the telecommunications business from its service provider and Acutel Consulting understands that the operations of the telecommunications business will be ring-fenced from the transmission business.

2 Scope of Work

Acutel Consulting is an expert in power system telecommunications and has been requested to review the telecommunications costs included in Transend's revenue proposal with specific focus on determining an appropriate:

- Apportionment of costs between labour and non labour; and
- Asset growth scaling factors;

that are applicable to Transend's regulated prescribed services business. It is understood that Transend will apply the above factors in its operating expenditure forecasting methodology as illustrated in Figure 6.2 in Section 6.4.2 of its Revenue Proposal in order to more appropriately escalate the cost of operational telecommunications.

3 Discussion

The Telecommunications Group provides a number of different types of service to its various customers. These are categorised as Bearer Services, Telephony Services, Mobile Radio Services and General Services (which includes projects and maintenance activities for assets owned by others). These different types of service each have a particular expenditure profile, and they vary significantly in the apportionment of costs between labour and non labour expenses.

The vast majority of Transend's operational telecommunications services are provided under the service type category of Bearer Services¹. Similar services are also provided to other customers. The costs for providing this type of service to all customers are collected under the Bearer Services activity centre. Because the services provided to all customers under this activity centre are very similar in nature, it is considered that they all have the same expenditure profile and therefore the apportionment between labour and non labour of the costs incurred to provide Transend's operational telecommunications will be essentially the same as for the total Bearer Services activity.

¹ There is a small component of operational telecommunications that is provided under the Telephony Services category of service. However, less than 2% of the total cost is attributable to this component, therefore it is not considered material in determining the apportionment of total costs between labour and non labour.

Transend has provided the following information for review by Acutel Consulting in order to prepare this advice:

- Telecommunications Group Budget for 2008-2009 at Group Level
- Telecommunications Group Budget split by Activity Centre

The Telecommunications Group Budget split by Activity Centre gives a breakdown of all costs incurred by the group, and allocates those costs to the service type that incurs them. Some costs of a general nature are allocated to Overhead activity centres.

This information was reviewed by Acutel Consulting and then applied to the Group Level Budget. Where some cost types had not already been allocated across the different activity centres, this allocation was made. In addition, the cost types allocated to the Overhead activity centres were apportioned across the Service Type Activity Centres in accordance with the direct labour expenses allocated to each one. Acutel Consulting understands this to be consistent with Transend's approved cost allocation methodology.

The result was a breakdown of the costs (by type) that are applicable to the provision of Bearer Services, and therefore to Transend's operational telecommunications service. The reflects that the proportion of those costs types which are labour and those which are non labour are considered to be the same for all services provided under this activity centre.

In apportioning the costs between labour and non labour, the following costs types were included as 100% labour costs:

- Salaries and Wages
- Allowances
- Overtime
- Payroll Tax
- Contract Labour
- Professional Services
- Consulting Charges

In apportioning the costs between labour and non labour, the following costs types were included as 90% labour costs:

- ACMA Licence Fees (recovery of ACMA and suppliers labour²)

In apportioning the costs between labour and non labour, the following costs types were included as 80% labour costs (in accordance with the Business Services labour apportionment advised by Transend):

- Corporate Overheads
- Corporate Overheads capitalised
- Overheads Recovered

² A brief review of the publicly available ACMA Budget papers supports a high apportionment of labour to non labour expenses associated with this cost type.

4 Conclusion

The outcome of this review is that the labour component of the costs incurred in providing Transend's operational communications is 63%. To ensure Transend does not overstate the labour cost contribution, it is proposed that this figure be rounded down to 60%.

Acutel Consulting was also asked to determine an appropriate asset growth scaling factor for the relevant telecommunications costs. On review of the documentation provided, it is apparent that growth of 2% has already been incorporated into the operational telecommunications service fees included in the original Revenue Proposal. This factor is considered appropriate and no asset growth scaling factor should be applied to forecast operational telecommunications costs.

5 Recommendation

It is recommended that for operational telecommunications services that are applicable to Transend's regulated prescribed services business, the

- Apportionment of costs between labour and non labour is 60% and 40% respectively;
- Asset growth scaling factor is zero;