

Greg Watkinson
CEO
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

29 August 2014

Dear Greg

RE: ATCO Gas Australia Pty Ltd proposed revisions to its Access Arrangement: IT services

As indicated in our letter of 15 August 2014, ATCO Gas Australia is pleased to provide the supporting information for the revised forecast IT costs for its proposed revisions to the Access Arrangement for the period commencing 1 July 2014.

In outline, the proposed revisions to its Access Arrangement reflect the new IT arrangements, the key features of which are as follows:

- The new arrangements result from a comprehensive competitive bid process intended to ensure maximum value and certainty in the delivery of its IT service requirements
- The new arrangements are arm's length and are not provided by a 'related party' or affiliate entity
- The reliability and quality of IT services to be provided will not be at risk due to strong governance and performance conditions being incorporated into the new arrangements
- The arrangements deliver cost savings of \$4.3 million compared to the previous IT service arrangements notwithstanding that the costs associated with the previous arrangements benchmarked favourably with the costs that have been established following a competitive market assessment

Description of the process

ATCO Gas Australia has, as part of the ATCO Australia group of companies, participated in a competitive process managed by its Canadian parent company, Canadian Utilities Limited (CUL), to identify innovative strategic global IT service delivery models and providers, with the ability to provide IT services to all ATCO companies worldwide.

The process was commenced in early 2013 by CUL for ATCO by way of confidential market approaches. The reason for requiring strict confidence was due to the need to protect existing commercial arrangements in place between ATCO's wholly owned subsidiary IT service



providers (ATCO I-Tek in Canada, and ATCO I-Tek Australia in Australia) and its customers, and to minimise disruption to service and its employees and customers.

ATCO was assisted in the process by external specialist advisers, KPMG.

ATCO considered 3 broad approaches to a new form of IT service provision: (1) joint venture; (2) outsourcing; or (3) sale.

After careful review, it was determined that the most efficient outcome was to proceed to sell the ATCO I-Tek (shares) and ATCO I-Tek Australia (IT assets) to a global IT service provider, and enter into a long term IT service contract – Master Services Agreements (**MSAs**).

A detailed review and analysis of 14 potential service providers was conducted taking into account relevant industry and technical expertise, as well as financial capability. Based on their experience in the sectors in which ATCO operates and the selection criteria above, [REDACTED] were invited to participate in the process in September 2013.

Each invitee engaged in a due diligence process and met the submission requirements in their proposals in January, 2014.

The proposals were analysed from a qualitative and quantitative perspective across all requirements (i.e. personnel, MSA, Innovation and pricing). Following the detailed review and analysis process, [REDACTED] were each assessed as having submitted competitive overall offers and were contacted for bid clarification and further negotiation.

Following further analysis, detailed discussions and clarifications, [REDACTED] were short listed for next phase of the process which involved additional negotiation of key terms of the MSA and sale agreement prior to selecting the final bidder.

A detailed process letter was sent to [REDACTED] in March, 2014 requesting their best and final offer, and included each party submitting its final proposals regarding transaction structure as well as mark-ups of the MSA and key Schedules.

[REDACTED] were each invited to and did submit their best and final offers at the end of March. Upon review, the decision was made to proceed with Wipro in April 2014 as the preferred party, based on the following:

- Wipro's assessed experience in relevant ATCO Group industries
- Wipro's offer was considered more competitive than [REDACTED] both quantitatively and qualitatively
- Wipro was assessed as better positioned to leverage ATCO I-Tek and ATCO I-Tek Australia to expand the business and retain the existing people
- reference checking supported Wipro's ability to deliver and exceeded the results of competitors
- Wipro had a positive existing relationship with ATCO Group
- Wipro's overall approach to the process and its demonstrated understanding of ATCO's requirements and its commitment meant that Wipro were assessed as more likely to execute on their commitments.

Wipro was notified in April of its status as preferred bidder and extensive negotiation with the ATCO team, including Canadian and Australian representatives, followed to finalise material transaction points (including in particular the terms of the MSAs), progress its final confirmatory due diligence, and further elaborate on its intended solution and delivery team.

Following the negotiation process, Wipro was formally selected, and ATCO senior personnel completed further due diligence at Wipro's Global Delivery Centre in India, which included evaluating offshore capabilities and meeting Wipro's senior leadership and delivery teams.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The Australian transaction was signed and closed on August 15th, 2014, following the earlier signing of the Canadian Sale and Purchase Agreement in July 2014.

Description of the changes in the arrangements

The new arrangement is a significant change in the IT service delivery model as a result of moving from an internalised cost pass-through based model to an outsourced model based on priced services with a third party large global IT provider such as Wipro. As such, the new model replaces and brings to an end the existing model of IT services being provided by a wholly owned affiliate company (ATCO I-Tek Australia), and moves to a fully arm's length IT provider (Wipro) that was selected on a competitive basis, as described above.

The services to be provided under the new arrangements remain the same. However, the charging structure for the services has fundamentally changed. Under previous arrangements key business applications such as the Enterprise Resource Planning system, SAP, and its Document Management System were owned by ATCO I-Tek Australia and were treated as shared systems subject to a Usage Fee. Under the new arrangements, the usage fee will cease and ATCO Gas Australia will take ownership of its key business applications with the management support provided by Wipro. This change will result in the addition of these capital assets to the balance sheet of ATCO Gas Australia at the current depreciated value. Therefore, the forecast usage fee component related to applications will decrease with the depreciated value of those assets being added to the capital cost forecast.

The service arrangements consist of a fee for service model based on an established schedule of rates. The service fees are greater than those under the previous arrangements as the shared infrastructure lifecycle refresh services costs that were previously incorporated in the usage fee will now be incorporated in the services fee on a price per service basis with unit rates for each service. In addition, the new market tested rates are higher than the previous cost pass through arrangements.

ATCO (including ATCO Australia and ATCO Gas Australia) will continue to own application licences and maintenance agreements and Wipro will manage the administration and compliance of these licences and agreements. The licence fees have increased slightly as a result of the new arrangements because ATCO Gas Australia will now be required to have licences associated with the systems it will now own.

The usage rates incorporated in the new arrangements include a glide path efficiency expectation which has resulted in the forecast costs reducing over the AA4 period compared to the previous cost pass through arrangement.

Wipro will perform services in conformance with existing ATCO (including ATCO Australia and ATCO Gas Australia) technical standards. Wipro will become the exclusive provider for the services and service levels that ATCO I-Tek has been providing for the past 15 years in Canada and through ATCO I-Tek Australia for the past 3 years in Australia.

The services and service levels are outlined in the MSA with corresponding performance indicators. If the critical performance indicators are not achieved, service credits are payable.

Where other performance indicators are not achieved, Wipro must develop a recovery plan or investigate and correct the performance. The arrangements are subject to joint governance committees and reporting requirements. [REDACTED]

Variations in costs

As a result of these changes, both the IT operating cost and IT capital cost forecast for the access arrangement period commencing on 1 July 2014 have been revised. The forecast IT operating costs will reduce from \$67.1 million over the period to \$58.6 million, a saving of \$8.5 million. Whereas the IT capital cost forecast will increase by \$1.2 million from \$27.4 million to \$28.6 million as a result of ATCO Gas Australia acquiring relevant ATCO I-Tek assets and savings applied to future capital projects. The reduction in revenue over the AA4 period is \$4.3 million.

The following table is Table 22 from page 109 of the Access Arrangement Information submitted to the ERA in March 2014.

Table 22: Forecast IT operating costs: 2014 to 2019

\$ million real at 30 June 2014	July to Dec 2014	2015	2016	2017	2018	2019	Total
Usage Fee (cost of shared infrastructure)	1.4	3.3	3.7	3.9	4.1	3.6	20.1
IT Services Fee	2.7	5.5	5.9	6.3	6.4	6.7	33.5
Licence fees	1.1	2.4	2.4	2.5	2.5	2.6	13.5
Total IT operating costs	5.3	11.1	12.1	12.6	13.1	12.9	67.1

The table below presents the revised Table 22 with the forecast IT operating costs under the new IT arrangements.

\$ million real at 30 June 2014	July to Dec 2014	2015	2016	2017	2018	2019	Total
Usage Fee (cost of shared infrastructure)	0.2	0.0	0.0	0.0	0.0	0.0	0.2
IT Services fee	3.5	8.2	8.3	8.3	8.0	7.8	44.1
IT licence fee	1.2	2.5	2.6	2.6	2.7	2.8	14.4
Total	4.9	10.7	10.8	10.9	10.7	10.6	58.6

The following table is Table 72 from page 201 of the Access Arrangement Information submitted to the ERA in March 2014.

Table 72: Forecast IT capital expenditure by business driver in AA4

\$ million real at 30 June 2014	Jul to Dec 2014	2015	2016	2017	2018	2019	Total
Network operation	0.6	2.0	2.6	2.3	3.1	2.1	12.6
Commercial operation	1.1	2.8	1.8	0.8	0.5	1.1	8.1
Business support improvements	0.5	0.6	0.5	0.8	0.8	0.9	4.1
Business support upgrades	0.2	0.2	0.2	0.4	0.5	0.3	1.9
IT hardware and software	0.0	0.2	0.2	0.1	0.1	0.1	0.7
Total	2.4	5.8	5.3	4.4	5.0	4.5	27.4

The table below presents the revised Table 72 with the forecast IT capital costs under the new IT arrangements.

Revised Forecast IT capital expenditure by business driver in AA4

\$ million real at 30 June 2014	Jul to Dec 2014	2015	2016	2017	2018	2019	Total
Acquisition of ATCO Gas Australia unique IT infrastructure from ATCO I-tek	3.0	0.0	0.0	0.0	0.0	0.0	3.0
Network operation	0.8	1.2	1.9	1.5	2.1	1.2	8.8
Commercial operation	0.7	1.9	1.4	0.6	0.3	0.6	5.4
Business support improvements	0.4	3.1	2.1	1.7	0.7	0.8	8.8
Business support upgrades	0.3	0.3	0.3	0.4	0.4	0.3	2.0
IT hardware and software	0.0	0.2	0.2	0.1	0.1	0.1	0.7
Total	5.1	6.6	5.9	4.3	3.6	3.1	28.6

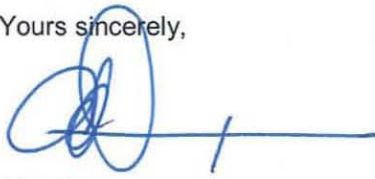
ATCO Gas Australia requests that its proposed revisions to the Access Arrangement be updated to include this latest information in relation to forecast IT operating and capital costs.

Attached to this letter are the revised sections of the Access Arrangement information submitted on 31st March 2014, including replacement of Table 10 (Forecast operating cost for 2014 to 2019), Table 22 (Forecast IT operating costs: 2014 to 2019), Table 54 (Forecast capital expenditure by category), Table 72 (Forecast IT capital expenditure), Table 97 (AA4 Haulage Reference Tariffs and charging parameters) and Table 98 (Average price impacts by Reference Tariff customer class). Also **attached** is an updated Tariff Model incorporating the revised IT cost forecast.

Please note that the Reference Tariff contained in Table 98 incorporates the impacts of removing the carbon tax from Reference Tariffs for the period of 1 July 2014 to 1 January 2015 and the impact of the reduced unaccounted for gas costs as outlined in my letter of 30 July 2014.

If you have any further questions about these changes, please don't hesitate to contact Sally McMahon on 08 6163 5007.

Yours sincerely,



Alan Dixon
President

Cc: by email to Tyson Self (Tyson.self@erawa.gov.au)

Attachment 1: Revised forecast IT costs for the proposed revisions for the AA4 regulatory period

6.3 Forecast operating expenditure summary

Table 10: Forecast operating cost for 2014 to 2019

\$ million real at 30 June 2014	Jul to Dec 2014	2015	2016	2017	2018	2019	Total
Network	15.3	31.4	33.0	33.6	34.5	35.3	183.1
UAFG	4.4	7.6	7.7	7.9	8.0	8.1	43.7
Corporate	11.5	23.9	22.8	23.6	24.8	25.5	132.1
Information technology	4.9	10.7	10.8	10.9	10.7	10.6	58.6
Total operating expenditure	36.1	73.6	74.4	76.0	78.0	79.5	417.5

6.10 IT Operating costs

Table 22: Forecast IT operating costs: 2014 to 2019

\$ million real at 30 June 2014	July to Dec 2014	2015	2016	2017	2018	2019	Total
Usage Fee (cost of shared infrastructure)	0.2	0.0	0.0	0.0	0.0	0.0	0.2
IT Services fee	3.5	8.2	8.3	8.3	8.0	7.8	44.1
IT licence fee	1.2	2.5	2.6	2.6	2.7	2.8	14.3
Total	4.9	10.7	10.8	10.9	10.7	10.6	58.6

1.6 IT capital expenditure

Table 72: Forecast IT capital expenditure by business driver in AA4

\$ million real at 30 June 2014	Jul to Dec 2014	2015	2016	2017	2018	2019	Total
Acquisition of ATCO Gas Australia unique IT infrastructure from ATCO I-tek	3.0	0.0	0.0	0.0	0.0	0.0	3.0
Network operation	0.8	1.2	1.9	1.5	2.1	1.2	8.8
Commercial operation	0.7	1.9	1.4	0.6	0.3	0.6	5.4
Business support improvements	0.4	3.1	2.1	1.7	0.7	0.8	8.8
Business support upgrades	0.3	0.3	0.3	0.4	0.4	0.3	2.0
IT hardware and software	0.0	0.2	0.2	0.1	0.1	0.1	0.7
Total	5.1	6.6	5.9	4.3	3.6	3.1	28.6

12.7 Proposed Reference Tariffs for AA4

Table 97: AA4 Haulage Reference Tariffs and charging parameters

Charging parameter (\$ real at 30 June 2014)	Units	Jul to Dec 2014	2015	2016	2017	2018	2019
Reference tariff A1							
Standing charge	\$/year	46,168.92	47,336.68	48,533.97	49,761.55	51,020.17	52,310.63
Demand charge							
First 10 km	\$/GJ km	194.59	199.51	204.55	209.73	215.03	220.47
Distance > 10 km	\$/GJ km	102.42	105.01	107.67	110.39	113.18	116.04
Usage charge							
First 10 km	\$/GJ km	0.04128	0.04233	0.04340	0.04450	0.04562	0.04677
Distance > 10 km	\$/GJ km	0.02063	0.02115	0.02168	0.02223	0.02279	0.02337
Reference tariff A2							
Standing charge	\$/Year	25,561.56	26,208.09	26,870.98	27,550.63	28,247.47	28,961.94
First 10 TJ	\$/GJ	2.47	2.53	2.60	2.66	2.73	2.80
Volume > 10 TJ	\$/GJ	1.32	1.36	1.39	1.43	1.46	1.50
Reference tariff B1							
Standing charge	\$/Year	1,287.65	1,320.22	1,353.62	1,387.85	1,422.96	1,458.95
First 5 TJ	\$/GJ	4.92	5.04	5.17	5.30	5.44	5.57
Volume > 5 TJ	\$/GJ	4.22	4.32	4.43	4.55	4.66	4.78
Reference tariff B2							
Standing charge	\$/Year	322.66	337.00	345.52	354.26	363.22	372.41
First 100 GJ	\$/GJ	8.21	8.34	8.56	8.77	8.99	9.22
Volume > 100 GJ	\$/GJ	4.89	4.97	5.10	5.23	5.36	5.49
Reference tariff B3							
Standing charge	\$/Year	70.11	129.93	133.22	136.59	140.04	143.58
First 2 GJ	\$/GJ	13.78	-	-	-	-	-
Volume > 2 <10 GJ	\$/GJ	13.78	9.60	9.84	10.09	10.35	10.61
Volume > 10 GJ	\$/GJ	5.95	4.14	4.25	4.35	4.46	4.58

12.7.1 Average prices

Table 98: Average price impacts by Reference Tariff customer class over AA4

Annual tariff increase (%)	2015	2016	2017	2018	2019	Average annual % change
A1	2.3%	1.3%	4.4%	0.6%	0.4%	1.8%
A2	2.3%	2.8%	2.2%	1.8%	1.8%	2.2%
B1	2.1%	3.1%	2.9%	2.8%	2.8%	2.7%
B2	3.5%	4.6%	4.3%	4.2%	4.1%	4.2%
B3	-2.6%	2.7%	2.5%	2.4%	2.4%	1.5%
All customer average	-1.7%	0.9%	2.1%	2.2%	2.1%	1.1%