

# Proposed Revisions DBNGP Access Arrangement

---

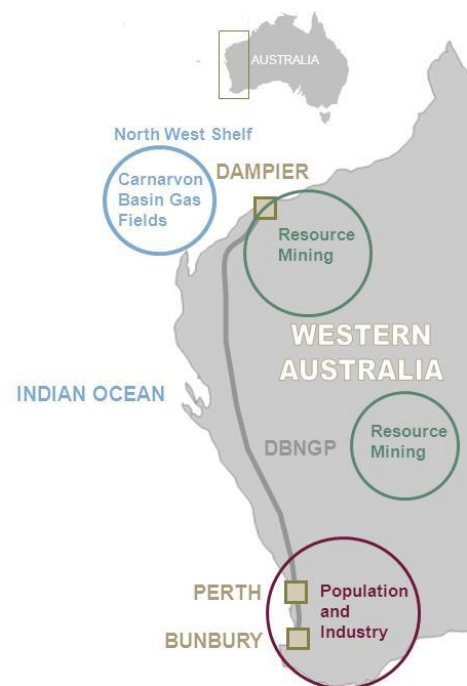
***2016 – 2020 Access Arrangement Period  
Supporting Submission: 55***



***Date Submitted: 22 February 2016***

*DBP Transmission (DBP) is the owner and operator of the Dampier to Bunbury Natural Gas Pipeline (DBNGP), Western Australia's most important piece of energy infrastructure.*

*The DBNGP is WA's key gas transmission pipeline stretching almost 1600 kilometres and linking the gas fields located in the Carnarvon Basin off the Pilbara coast with population centres and industry in the south-west of the State*



**Trent Leach**

Manager Regulatory & Government Policy  
P: (08) 9223 4357  
M: 0429 045 320

**Nick Wills-Johnson**

Manager Economic Regulation  
P: (08) 9223 4902  
M: 0477 374 246

**DBNGP (WA) Transmission Pty Limited**

ABN 69 081 609 190  
Level 6  
12-14 The Esplanade  
PERTH WA 6000  
P: +61 8 9223 4300  
F: +61 8 9223 4301

## Table of Contents

1. INTRODUCTION.....	3
2. REQUIRED AMENDMENT 9.....	4
3. OVERARCHING MATTERS.....	6
4. RESPONSE TO REASONS FOR AMENDMENT .....	8
5. DBP'S PROPOSED AMENDMENTS TO THE AA .....	33
APPENDIX A: OPEX ACTUAL AND FORECAST DATA.....	35
APPENDIX B: CONFIDENTIALITY TABLE.....	36

### List of Tables

TABLE 1: FORECAST OPERATING EXPENDITURE IN THE ORIGINAL AA PROPOSAL (REAL, \$2015) (\$M)	4
TABLE 2: FORECAST OPERATING EXPENDITURE IN THE AMENDED AA PROPOSAL (REAL \$M, 2015)	5
TABLE 3: CHANGE IN AA4 FUEL GAS REQUIREMENT (TJ/DAY)	8
TABLE 4: CORRECTED FRA DERIVATION OF APPROVED REAL LABOUR ESCALATION FACTOR	15
TABLE 6: REACTIVE MAINTENANCE AA3 ACTUAL EXPENDITURE (\$M 2015\$S)	19
TABLE 8: OPERATING EXPENDITURE BASIS SUMMARISED BY REGULATORY OPEX CATEGORY	32
	33
	33

### List of Figures

FIGURE 1: FORECAST FUEL GAS OPERATING EXPENDITURE COMPARISON (\$M 2015\$S)	11
FIGURE 3: EGWWS PREMIUM 2002 TO 2015	11
FIGURE 4: REAL AVERAGE WEEKLY EARNINGS FOR WA	14
FIGURE 5: FORECAST SALARIES EXPENDITURE (\$M 2015\$S)	15
FIGURE 6: FORECAST SALARIES - CONTRACTORS EXPENDITURE (\$M 2015\$S)	16
FIGURE 7: CONSULTING EXPENDITURE (\$M 2015\$S)	16
FIGURE 9: OFFICE AND ADMINISTRATION OPERATING EXPENDITURE COMPARISON (\$M 2015\$S)	18
FIGURE 10: EMPLOYEE EXPENSES EXPENDITURE COMPARISON (\$M 2015\$S)	20
FIGURE 11: ENTERTAINMENT EXPENDITURE COMPARISON (\$M 2015\$S)	22
FIGURE 12: SELF-INSURANCE EXPENDITURE COMPARISON (\$M 2015\$S)	23
FIGURE 13: ADVERTISING EXPENDITURE COMPARISON (\$M 2015\$S)	24
FIGURE 14: REPAIRS AND MAINTENANCE EXPENDITURE COMPARISON (\$M 2015\$S)	25
FIGURE 15: TRAVEL AND ACCOMMODATION EXPENDITURE COMPARISON (\$M 2015\$S)	26
FIGURE 16: TRAINING AND DEVELOPMENT EXPENDITURE COMPARISON (\$M 2015\$S)	26
FIGURE 17: MOTOR VEHICLES EXPENDITURE COMPARISON (\$M 2015\$S)	27
FIGURE 18: HSE PPE EXPENDITURE COMPARISON (\$M 2015\$S)	28
FIGURE 19: UTILITIES, RATES AND TAXES COMPARISON (\$M 2015\$S)	29
	30

## 1. INTRODUCTION

- 1.1 On 22 December 2015, the Economic Regulation Authority (**ERA**) made its draft decision (**Draft Decision**) in relation to the full access arrangement proposal filed by DBNGP (WA) Transmission Pty Ltd (**DBP**) on 31 December 2014 (**Original AA Proposal**).
- 1.2 The Draft Decision indicates that the ERA:
  - (a) is not prepared to approve the Original AA Proposal; and
  - (b) requires 74 amendments to the Original AA Proposal in order to make the access arrangement proposal acceptable to the ERA.
- 1.3 The Draft Decision also fixes a period for amendment of and/or addition to the Original AA Proposal (**revision period**), which revision period expires on 22 February 2016.
- 1.4 On 22 February 2016, pursuant to Rule 60 of the NGR, DBP submitted the following documents which make up the amended access arrangement proposal (**Amended AA Proposal**):
  - (a) Amended Proposed Revised Access Arrangement; and
  - (b) Amended Proposed Revised Access Arrangement Information.
- 1.5 Rule 59(5)(c)(iii) of the NGR requires the ERA to allow at least 20 business days from the end of the revision period for submissions to be made (in relation to both the Draft Decision and the Amended AA Proposal). The ERA has advised that interested parties are able to make submissions on the ERA's Draft Decision up until 4:00pm (WST) 22 March 2016.
- 1.6 While DBP has submitted to the ERA that the Amended AA Proposal contains the information that the NGA (which includes the WA National Gas Access Law text (**NGL**) and the National Gas Rules (**NGR**) requires to be included in order to enable it to be approved by the ERA, DBP also advised that it will be filing the following supporting submissions that explain and substantiate the amendments and additions in the Amended AA Proposal that have been made to address various matters raised in the Draft Decision:
  - (a) Submission 50 – Amended AA Proposal
  - (b) Submission 51 – Response to Pipeline Services Amendments
  - (c) Submission 52 – Response to Terms and Conditions Amendments
  - (d) Submission 53 – Response to Opening Capital Base Amendments
  - (e) Submission 54 – Response to Forecast Capital Expenditure Amendments
  - (f) Submission 55 – Response to Forecast Operating Expenditure Amendments (this submission)
  - (g) Submission 56 – Response to Rate of Return Amendments
  - (h) Submission 57 – Response to Other Tariff Related Amendments
  - (i) Submission 58 – Response to Other Non Tariff Related Amendments
- 1.7 In this Submission 55, DBP substantiates its amendments and additions made in the relation Amendment 9 from the Draft Decision and responds to the ERA's reasons for that amendment. It is structured as follows:
  - (a) Section 2

## 2. REQUIRED AMENDMENT 9

### Amendment #9

2.1 Amendment 9 from the Draft Decision “requires DBP to amend its forecast operating expenditure for the AA4 period to the values set out in Table 24 (Authority Approved Operating Expenditure Forecast by Cost Category) of this Draft Decision”.

2.2 Table 24 from the Draft Decision provides the following forecast of operating expenditure:

**Table 24 Authority Approved Operating Expenditure Forecast by Cost Category (AA4)**

Real \$ million at 31 December 2015	2016	2017	2018	2019	2020	Total
Wages & salaries	27.73	28.17	28.61	29.05	29.50	143.06
Non-field expenses	13.61	13.20	13.26	13.69	14.20	67.96
Field Expenses	13.65	15.56	17.10	13.32	13.21	72.84
Government charges	7.60	7.60	7.60	7.60	7.60	38.02
Reactive maintenance	1.20	1.20	1.20	1.20	1.20	6.00
System use gas	36.12	35.54	36.02	36.55	37.16	181.40
<b>TOTAL</b>	<b>99.91</b>	<b>101.27</b>	<b>103.79</b>	<b>101.42</b>	<b>102.89</b>	<b>509.28</b>

2.3 DBP’s Original AA Proposal proposed forecast operating expenditure as shown in the table below, broken down by certain categories of expenditure. It should be noted that within each of these categories, there are a number of subcategories of expenditure which were explained to the ERA in DBP’s supporting submissions for the Original AA Proposal.

**Table 1: Forecast operating expenditure in the Original AA Proposal (Real, \$2015) (\$m)<sup>1</sup>**

	2016	2017	2018	2019	2020
Wages & salaries	29.50	30.08	30.67	31.27	31.88
Non-field expenses	15.36	15.21	15.54	16.26	17.08
Field Expenses	15.96	17.87	19.41	15.64	15.53
Government charges	8.29	8.29	8.29	8.29	8.29
Reactive maintenance	1.40	1.40	1.40	1.40	1.40
System use gas	38.93	38.22	38.74	39.30	39.94
<b>Total</b>	<b>109.45</b>	<b>111.07</b>	<b>114.05</b>	<b>112.16</b>	<b>114.12</b>

2.4 This amendment represents an approximate 9.2% reduction in the forecast proposed by DBP.

### Reasons for amendment 9

2.5 The ERA’s reasons are contained in paragraphs 187 to 332 of the Draft Decision. The ERA’s reasoning mostly differs depending on the category of expenditure that had been proposed by DBP. That reasoning, including DBP’s response to each reason, is outlined in section 3.

<sup>1</sup> DBP’s proposed expenditure

## DBP's Response to Amendment 9 in the Amended AA Proposal

2.6 In light of the submissions outlined in this paper, DBP's Amended AA Proposal has included the following forecast of operating expenditure:

**Table 2: Forecast operating expenditure in the Amended AA Proposal (Real \$m, 2015)**

	2016	2017	2018	2019	2020
Wages & salaries	29.47	30.05	30.64	31.24	31.86
Non-field expenses	15.30	14.92	15.00	15.45	16.00
Field Expenses	13.44	15.36	16.93	13.15	13.06
Government charges	7.30	7.30	7.30	7.30	7.30
Reactive maintenance	1.40	1.40	1.40	1.40	1.40
Fuel gas	36.57	35.07	35.51	36.01	36.56
<b>Total</b>	<b>103.48</b>	<b>104.10</b>	<b>106.78</b>	<b>104.56</b>	<b>106.16</b>

### 3. OVERARCHING MATTERS

- 3.1 Before responding to each of the reasons for Amendment 9, there are a number of overarching matters to be addressed.
- 3.2 Firstly, the forecast included in the Amended AA Proposal is stated in Real, \$2015. The ERA's Table 24 of the Draft Decision also purports to be in Real, \$2015. However, it is not. The ERA has not used the actual inflation rate for 2015 – being the Consumer Price Index (All Groups, Weighted Average of Eight Capital Cities) for 2015 as published by the Australian Bureau of Statistics for the December 2015 quarter. That rate is 1.69%. The ERA used another number instead – 2.75%. It has used this number to comply with Amendment 6 from the Draft Decision. DBP has used the rate of 1.69% for the purposes of reporting its forecast operating expenditure in the Amended AA Proposal (among other purposes – in this regard, see DBP's Submission #53).
- 3.3 In using the inflation rate of 1.69% to report the forecast operating expenditure as Real, \$2015, DBP understands that this will be compliant with Amendment 6. The reasons for this are outlined in further detail in DBP's submission 53. Accordingly, for this reason alone, there is no non compliance with Amendment 9.
- 3.4 The second overarching matter relates to the use by DBP in its Original AA Proposal of the proposed actual expenditure for 2015 as the base year to set the forecast expenditure levels for each year of AA4. At the time of submitting its Original AA Proposal, DBP's actual expenditure was not revealed (because of the fact that DBP had to file its Original AA Proposal in December 2014) and so, only an estimate of DBP's actual operating expenditure for 2015 was included.
- 3.5 In the Draft Decision, in many instances, the ERA has rejected DBP's proposed forecast for a particular category on the basis that either or both:
- (a) The actual expenditure for 2015 had not been revealed; or
  - (b) While the actual expenditure for 2015 had not been revealed, it was significantly different to the level of actual expenditure for that category for 2014.
- 3.6 Since the publication of the Draft Decision, the actual operating expenditure for 2015 has been revealed. Appendix A: contains a spreadsheet which outlines the actual operating expenditure for each year of the AA3 period, including 2015.
- 3.7 DBP is currently undergoing the verification process it undertook for the operating and capital expenditure incurred in 2011-2014<sup>2</sup>. That process involves the following steps:
- (a) Firstly, the auditing, by DBP's external auditors, of expenditure incurred by DBP for the half year period ending 31 December 2015 – this was completed in January 2016.
  - (b) Secondly, the approval, by the DBP board directors, of the financial statements for the half year period ending 31 December 2015 (which include the audited expenditure figures) – this occurred on 4 February 2016.
  - (c) Finally, a reconciliation and verification of the audited expenditure with the actual expenditure reported to the ERA for 2015 (as attached in **Error! Reference source not found.**), aligned to the reporting categories and expenditure classifications included in the Amended AA Proposal).
- 3.8 That reconciliation and verification process is in the process of being undertaken by DBP's external auditors. A submission will be made to the ERA as soon as that reconciliation and verification process is complete.

---

<sup>2</sup> See DBP's Submissions 11 and 25

- 3.9 The third overarching matter is that the ERA has failed to take into consideration the relevant consideration made by DBP in its initial supporting submissions<sup>3</sup> about how DBP's actual contractual framework is a significant driver to ensure DBP is prudent and efficient in the operating and capital expenditure that it incurs. Had the ERA considered these submissions, DBP submits that it should have reached a different conclusion about the level of expenditure forecast by DBP for AA4 in the AA4 and should have accepted DBP's proposed expenditure. This is even more the case given that in the approvals process for AA3, the ERA concluded that this contractual framework as a more powerful driver for efficiency and prudence than the framework of the NGR itself.
- 3.10 DBP submits that now that it has provided the ERA with its actual expenditure for 2015, in light of the contractual framework and the incentive mechanism it creates to ensure efficiency and prudence, the ERA should accept DBP's Amended AA Proposal in relation to all categories of expenditure where DBP has used the 2015 actual expenditure as the basis for forecasting expenditure for each year of AA4.

---

<sup>3</sup> See *DBP Submission 2, section 7*





4. RESPONSE TO REASONS FOR AMENDMENT

4.1 DBP’s responds to the ERA’s reasons for Amendment 9 by addressing, in turn, the reasoning given for each category and subcategory of expenditure as reported by DBP in the Original AA Proposal.

Fuel gas

Quantity

- 4.2 At paragraph 196 of the Draft Decision the ERA accepts that the quantity of fuel gas proposed by DBP<sup>4</sup> is justified. The quantity proposed by DBP was The ERA’s decision is based on EMCa’s advice provided at Section 8.4 of “*Review of Technical Aspects of the Proposed Access Arrangement*” (**EMCa Report**).
- 4.3 Notwithstanding this, DBP’s revised proposal for fuel gas includes a revised quantity requirement. However, it is based on the same methodology accepted by the ERA. The total quality required has been updated to reflect DBP’s revised forecast of capacity and throughput provided in Submission 57.
- 4.4 As DBP proposes a reduction in the forecast throughput for AA4 from that outlined in its original proposal, the corresponding fuel requirement has therefore decreased. The following table shows the change in quantity reflecting the updated demand forecast.

Table 3: Change in AA4 Fuel Gas requirement (TJ/day)

--

Price

- 4.5 DBP’s original proposal for forecast fuel gas operating expenditure in AA4 was based on the [REDACTED] price being applied to a 100 per cent of the fuel gas requirement for AA4.
- 4.6 At paragraph 235 of the Draft decision, the ERA did not accept DBP proposed fuel gas forecast expenditure. The ERA’s reasons for its decision are contained in paragraphs 197 to 235 of the Draft Decision.
- 4.7 The ERA’s preferred methodology for determining the forecast fuel gas expenditure for each year of AA4 is outlined at paragraphs 228-233 of the Draft Decision. The ERA has estimated expenditure on the following basis:

--

<sup>4</sup> Note that in Submission 34, DBP advised that its fuel gas estimate would need to be revised to remove the amount of fuel gas that was forecast to be supplied to it by a producer under a Pipeline Impact Agreement. The figures in Table 1 have been revised accordingly.

[REDACTED]

- 4.8 DBP does not accept the following aspects of the above methodology.
- 4.9 Firstly, it does not accept that the fuel gas price contained in the [REDACTED] should be used as the ERA has taken into account a number of irrelevant considerations in determining the forecast expenditure for fuel gas in the Draft Decision.
- 4.10 Firstly, it is wrong for the ERA to consider a fuel gas price that is not for firm supply for the following reasons:
- (a) As recognised by the ERA at paragraph 206, the forecast of fuel gas operating expenditure assumes that all fuel gas will be supplied by DBP consistent with clause 5.12 of the reference service terms and conditions and the approach in the current access arrangement.
  - (b) The ERA also accepts at paragraph 205 of the Draft Decision that DBP requires some certainty with regard to supply of fuel gas on a daily basis. Operationally, the DBNGP requires a firm supply to meet reliability requirements of the reference service (DBP's submission on the requirement for firm fuel gas were provided at paragraphs 2.37 to 2.43 of Submission 30) as follows:

[REDACTED]

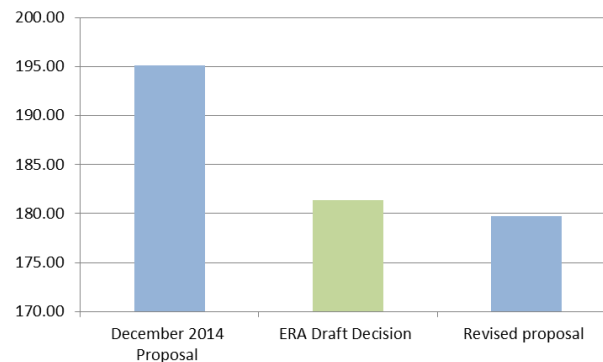
[REDACTED]

- (d) For the purpose of the reference tariff calculation total revenue is allocated across forecast full-haul gas transmission and therefore shippers only face fuel gas costs in proportion to their use of pipeline services. It is on this basis that the ERA's proposal will deprive DBP of the right to recover at least the efficient cost of service (a requirement of the revenue and pricing principles) as applying the weighted average price to the [REDACTED] proportion of fuel gas has the effect of lowering the overall forecast fuel gas expenditure and therefore total revenue that would otherwise be attributable to a single reference service shipper who's proportion of fuel gas would be related to the [REDACTED]

<sup>5</sup> Paragraph 232 of the draft decision

- (e) DBP's submissions made at paragraph 2.29-2.30 of Submission 30 still stand as DBP considers that its contracted [REDACTED] is the best reasonable proxy as it is a price that has been struck recently in the market and is an arm's-length commercial arrangement. It is for firm supply [REDACTED]
- 4.11 If the ERA is still of the mind to consider the [REDACTED] price it is incorrect for the ERA to assume the [REDACTED] price for any quantity of gas [REDACTED] following reasons:
- (a) The reasons provided above;  
[REDACTED]
  - (d) It would be inconsistent for the ERA to base [REDACTED]  
[REDACTED]
  - (e) As DBP has previously stated, the ERA should not rely upon the [REDACTED]  
[REDACTED] in its assessment of fuel gas procurement (as outlined above).
- 4.12 DBP is therefore of the view that it is incorrect for the ERA to assume that the balance of the fuel gas requirement, after the [REDACTED]  
[REDACTED]
- 4.13 DBP's approach to the forecast of fuel gas operating expenditure it has included in its Amended AA Proposal is made on the following basis:
- (a) The same approach to determining the total quantity of fuel gas required as adopted in the Original AA Proposal but:
    - (i) excluding the amount of gas to be provided under the Pipeline Impact Agreement; and
    - (ii) updated to be consistent with revised proposal for forecast capacity and throughput in AA4; and
  - (b) The price applied to 100% of the total fuel gas requirement (derived under paragraph (a)) being the [REDACTED]
- 4.14 The following figure compares the forecast of fuel gas expenditure included in:
- (a) DBP's Original AA Proposal
  - (b) the ERA's Draft Decision; and
  - (c) DBP's Amended AA Proposal.

Figure 1: Forecast fuel gas operating expenditure comparison (\$m 2015\$s)



Source: Appendix A: Opex actuals and forecast data

4.15 As DBP's forecast is based on a methodology:

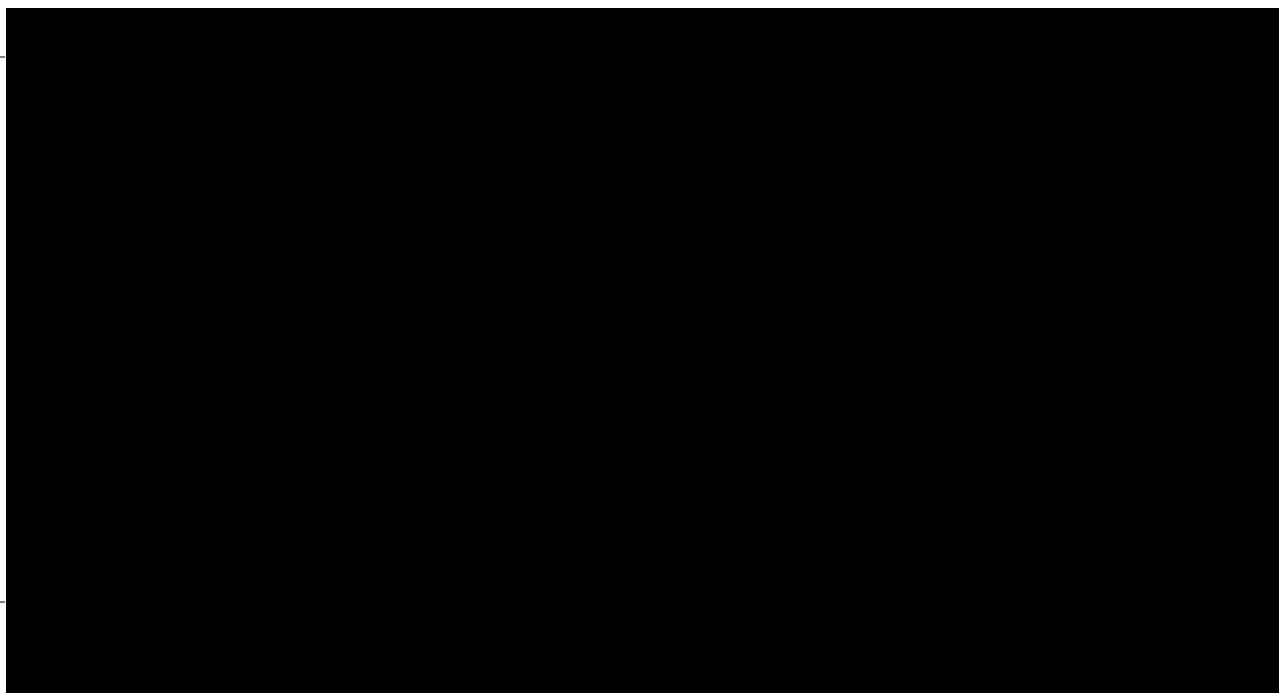
- (a) For determining the quantity that has been accepted by the ERA; and
- (b) For determining the unit price that is based on a market price for firm gas supply recently tested in the market,

DBP is therefore of the view that the forecast fuel expenditure included in DBP's Amended AA Proposal meets the requirements of rule 91 and 74.

#### Actual SUG/forecast fuel gas forecast reconciliation

4.16 At paragraph 234 of the Draft Decision, the ERA requests that DBP provides a *"reconciliation of its access arrangement forecast with its forecast financial statement values"*. DBP takes this to mean a reconciliation of actual System Use Gas expenditure in a recent calendar year of AA3 and DBP's forecast fuel gas expenditure for year one of AA4.

4.17 The following figure compares DBP's December 2014 proposal, the adopted forecast in the ERA's Draft Decision and DBP's revised proposal for forecast fuel gas operating expenditure.



4.19 It should be noted that calendar year financials are not reported in DUET MIR therefore to calculate a number comparable to that forecast for CY2016, DBP has derived the \$15.81m for CY2014 fuel gas expenditure from the following sources:

- (a) 6 months Fuel Gas to 31 Dec 2013 was \$6 million<sup>6</sup>
  - (i) 6 months fuel gas to 30 June 2014 was \$11.2m – 6.0m = \$5.2m
- (b) 12 months Fuel Gas to 30 June 2014 was \$11.2m<sup>7</sup>
  - (i) 6 months fuel gas to 31 December 2014 was \$10.6m
- (c) 6 months Fuel Gas to 31 Dec 2014 was \$10.6m<sup>8</sup>
  - (i) 12 months fuel gas to 31 December 2014 is \$10.6m + \$5.2m = \$15.8m

4.20 The figure above clearly shows that the key driver of the increase expenditure is the unit price.

## Salaries

4.21 At paragraph 246 of the Draft Decision, the ERA does not accept DBP's AA4 forecast salaries operating expenditure based on EMCa's advice and its own consideration of labour escalation. Labour escalation is discussed below at paragraphs 4.30 to 4.40 of this submission.

4.22 EMCa recommended to the ERA that DBP's forecast operating expenditure for staff salaries for each year of AA4 be based on the 2014 revealed costs. This recommendation was based on:

- (a) DBP's 2015 base year not being a revealed cost;
- (b) DBP had not provided a compelling reason for a 3.6% increase from the most recent year (2014) of actual expenditure; and
- (c) DBP's track record of underspending its forward estimates which EMCa believes has undermined its confidence in its 2015 estimate.

4.23 However, EMCa's recommended approach has lead the ERA to adopt a forecast that is not arrived on a reasonable basis nor is the best possible in the circumstances for reasons set out below.

### Incorrect use of 2014 revealed cost

4.24 EMCa was wrong to conclude that using DBP's reveal cost of salary expenses for 2014 would lead a forecast that met the requirements of Rule 74 on the following basis:

- (a) As identified at paragraph 282 of the EMCa Report, DBP advised that the actuals for salaries did not include salaries apportioned to regulatory functions. DBP provided actuals in this way so that they could be compared to the ERA's approved forecast on a consistent basis. DBP did not include salary costs in the forecast regulatory operating expenditure which was approved by the ERA. It is therefore incorrect to exclude them for the purposes of setting forecast expenditure of the AA4 period which the ERA has effectively done by requiring forecast AA4 operating expenditure based on 2014 actuals which were not provided for this purpose.
- (b) The 2015 base year forecast included internalised IT roles which were required in the transition from DBP's previous IT Service provider. DBP now has two additional IT Project managers which are employed in house. DBP notes that EMCa and the ERA have accepted the significant step decrease in costs for IT expenditure during AA4.

<sup>6</sup> Page 9 - <http://www.duet.net.au/Investor-centre/Investor-reports/Tabs/Management-information-reports/2014/5-asx-2014-02-21-management-information-report-upd.aspx>

<sup>7</sup> Page 9 - <http://www.duet.net.au/Investor-centre/Investor-reports/Tabs/Management-information-reports/2014/3-asx-2014-08-22-management-information-report.aspx>

<sup>8</sup> Page 9 - <http://www.duet.net.au/Investor-centre/Investor-reports/Tabs/Management-information-reports/2015/5-ASX-2015-02-20-Management-Information-Report.aspx>

## 2015 expenditure is not revealed

- 4.25 The ERA was wrong to reject the forecast expenditure for the reason that the use of a base year for the purposes of setting the forecast was not a revealed cost. There is no logical basis for this, particularly given that, at the time DBP submitted information to the ERA to support its Original AA Proposal, the 2015 expenditure levels were not known (because 2015 had not even commenced, let alone finished). It was therefore impossible for DBP to provide the revealed costs for 2015.
- 4.26 As mentioned in section 3, the actual level of expenditure for 2015 is now revealed and DBP is presently going through its process of having the expenditure verified following the agreed upon procedure.
- 4.27 DBP has, in this submission, provided the ERA with the actual expenditure for 2015 for this expenditure category and explained variances from the amount included in the Original AA Proposal.
- 4.28 As the expenditure for 2015 is now revealed, the ERA can no longer rely on the reason that the expenditure isn't revealed in order to reject DBP's forecast expenditure for AA4 for this category.
- 4.29 Furthermore, because the 2015 actuals (inclusive of expenditure related to regulatory functions within DBP) reflect reasonable labour assumptions that are likely to be experienced over the AA4 period, they are a reasonable basis upon which the forecast expenditure for this category for each year of AA4 should be derived.

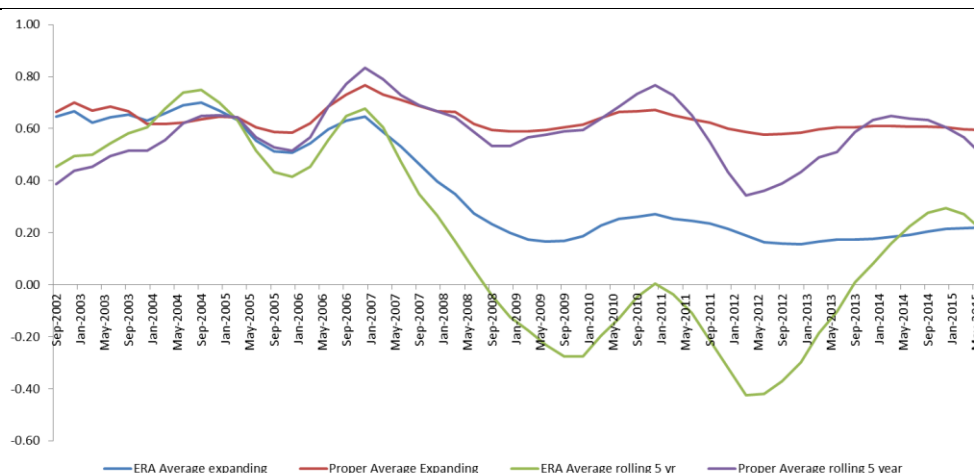
## Labour Escalation

- 4.30 In this section, DBP responds to the ERA's Draft Decision in respect of DBP's proposal for labour cost escalation rates, which DBP had proposed be set at two percent above inflation (ie 2% real). The ERA did not accept this escalation rate, instead requiring that a rate of 1.56% above inflation (ie 2% real) be used. The main reasons for requiring this change may be summarised as follows:
- (a) DBP has not made it clear how other reference material fed into its labour cost escalation calculations;
  - (b) The ERA does not agree with DBP that AWE figures are more relevant than WPI figures, and proposed to use only the latter;
  - (c) DBP's calculation of the EGWWS premium of 0.5 percent was not an "apples with apples" calculation as it compares historical EGWWS premia with forward-looking WA Treasury figures, and that instead, DBP should have compared historical EGWWS growth with historical WPI, and used this premium, which the ERA calculates at 0.14 percent.
- 4.31 In respect of the first point, DBP made use of a wide variety of internal information pertaining to the growth of the salaries of its staff in the past, and likely future trends within DBP's immediate industry based upon the judgement of internal and external human resource professionals. DBP agrees that the use of judgement can be opaque to those who are not employing it, but this provided relevant information for DBP in putting forward its position, particularly when the judgement was made by human resource experts with many years experience in the energy industry. However, DBP's position does not rely upon judgement, as explained further below.
- 4.32 In respect of the second point, the ERA notes that it believes (paragraph 241):

*"The Authority is of the opinion that productivity issues do not need to be considered for the purposes of the labour escalation factor. The Authority notes that compositional changes in the skill mix is a business choice. If a business chooses to pay for a skill mix with a higher (or lower) average wage, the business will get the associated productivity benefit (loss) of that decision. The Authority considers that a prudent and efficient service provider should only be concerned and therefore compensated for inflationary pressures associated with wages and salaries"*

- 4.33 If labour becomes more productive, it requires higher payment because it is more valuable in the marketplace as a whole. However, as it becomes more productive, it is able to make more efficient use of the other factors of production, and thus overall efficiency is increased, and overall costs lowered. If the ERA is going to ignore productivity gains in labour and the costs this imposes in respect of wages, then, logically, it must also ignore the benefits such productivity gains bring in respect of lowering costs elsewhere in the business. That is, using a lower wage index implies that the ERA must allow other costs to rise by more, as they indeed would were a firm not to invest in the productivity of its workers.
- 4.34 DBP would be happy to consider a general equilibrium formulation of overall costs within DBP that reflect changes under an assumption of no productivity growth (and hence only inflationary growth) in labour and higher cost increases for other factors of production that are now used less efficiently. No such model has been proposed by the ERA. Alternatively, one could take into consideration information from the AWE, and recognise that more productive and more costly labour can in fact reduce overall costs. This is the approach that DBP has taken. There is no logic to an approach which minimises labour costs and also seeks to impose the efficiency gains in respect of the use that can only be wrought by using more productive workers.
- 4.35 In respect of the third point, DBP contends that it is the ERA who has not made an “apples with apples” comparison. Close examination of what the ERA has done reveals that the ABS series A2603491L is the percentage change in hourly rates of pay in the EGWWS sector for *Australia*, whilst the ABS series A2607601L is the percentage change in the WPI for *Western Australia*.<sup>9</sup> This is clearly not an “apples with apples” comparison, because the jurisdictions do not match.
- 4.36 Correcting for this, and comparing the percentage change in hourly rates of pay in the EGWWS sector in Australia as a whole (A2603491L) with the percentage change in the WPI for Australia (A2603611V) in the same way as the ERA derives its incorrect figure of 0.14 percent gives a figure for the period of June 2011 to June 2015 of 0.44 percent. However, there is nothing particularly special about this time period. The figure below examines the time series of the EGWWS premium from 2002 using an expanding window, and a rolling five year window. It shows the correct approach of comparing Australian EGWWS data with Australian WPI data, and ERA’s incorrect approach, as the clear differences between the two to show the scale of the error the ERA has made.

Figure 3: EGWWS premium 2002 to 2015



Source: ABS Cat no 6345.0 Tables 5B and 2b

- 4.37 Clearly, the relative premium of the EGWWS sector moves in cycles, and the five-yearly average appears to be on a downward trend. However, none of the downward or upward phases of the cycle lasts for five years, so it would appear to be inappropriate to assume that the current lows will last the whole five-year period, and that the rates will not recover by 2020. The current rolling five

<sup>9</sup> Both series come from the ABS publication 6345.0 - Wage Price Index, Australia, Sep 2015



year average for the EGWWS premium is 0.5 percent, whereas the long-run average is 0.59 percent. DBP chooses to use the more conservative number of 0.5 percent.

- 4.38 Having corrected for the above, DBP has updated the ERA's Table 22 from the Draft Decision in the following table.

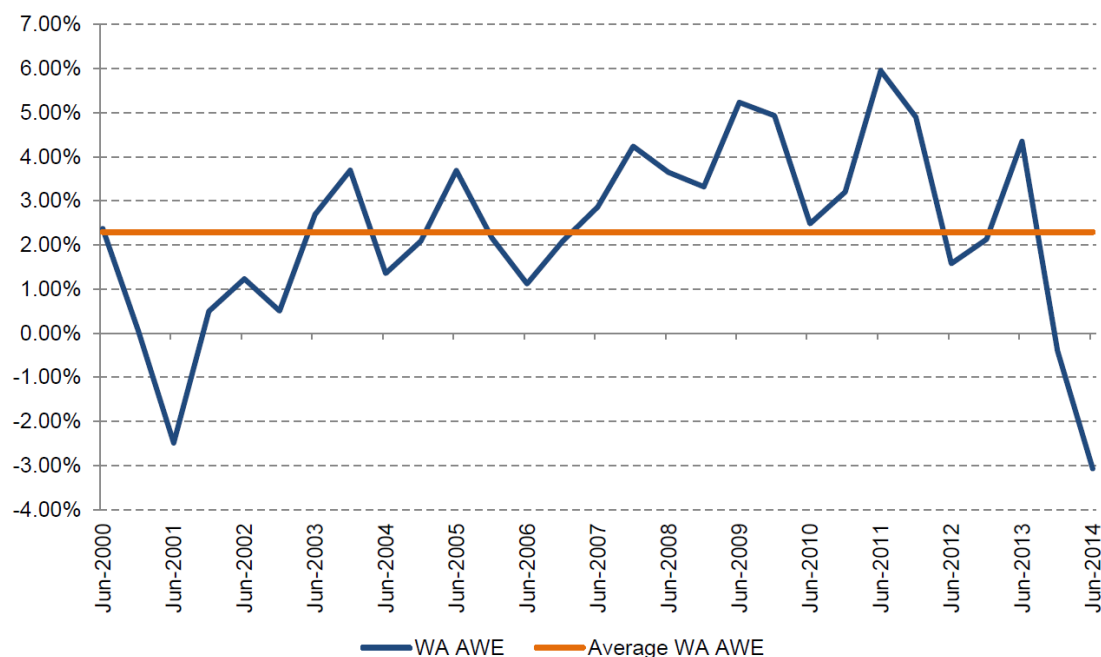
**Table 4: Corrected ERA Derivation of Approved Real Labour Escalation Factor**

Labour escalation factor component	percent
Annual Average of Western Australian WPI over AA4	3.31
Plus Premium of EGWWS WPI over Western Australian WPI	0.5
Equals Nominal Labour Escalation Forecast per annum	3.81
Less Forecast Inflation/CPI per annum	1.91
<b>Equals Authority Approved Labour Escalation Factor</b>	<b>1.9</b>

Source: ERA Draft Decision Table 22, ABS Cat no 6345.0 and DBP submission to Draft Decision for inflation forecast.

- 4.39 As shown the figure below (original provide as figure 4 of submission 10) the AWE figures point towards long-run average real average weekly earnings growth from the AWE figures of around two percent. Once the ERA's error in respect of WPI calculations is corrected, the WPI figures agree with the AWE figures. For this reason, DBP maintains its approach of using a two percent real labour escalation rate, as per its AA Proposal.

**Figure 4: Real average weekly earnings for WA**



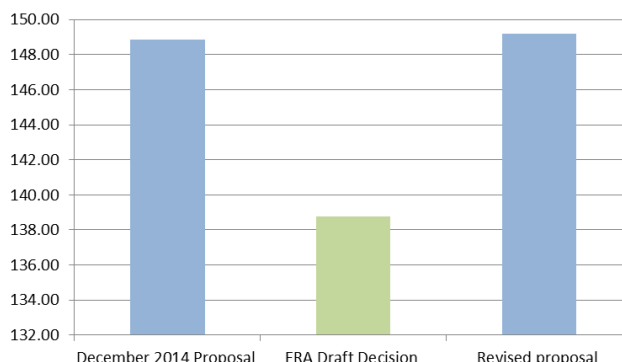
Source: Submission 10

- 4.40 DBP also notes the ERA accepted a level of real escalation (2%) for approved forecast salaries operating expenditure for the AA3 period that was considered to meet rule 91 based on its observation of the AWE measure<sup>10</sup>.
- 4.41 The following figure compares DBP's Original AA Proposal, the adopted forecast in the ERA's Draft Decision and DBP's Amended AA Proposal for forecast salaries expenditure.

<sup>10</sup> Paragraphs 830-831 ERA Draft Decision 14 March 2011



Figure 5: Forecast salaries expenditure (\$m 2015\$s)



Source: Appendix A: Opex actuals and forecast data

4.42 As DBP's forecast is based on 2015 actuals and a 2 per cent real escalation factor, DBP is of the view that forecast expenditure meets the requirements of Rules 91 and 74.

## Salaries - Contractors

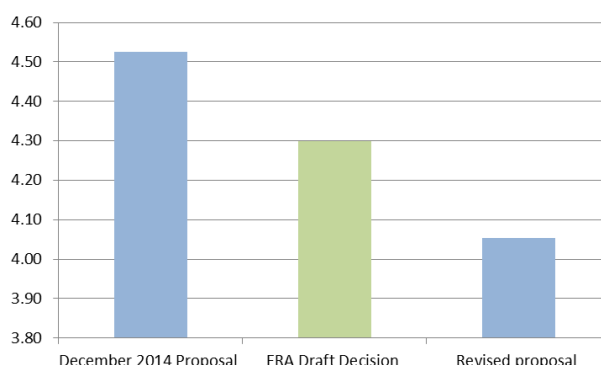
4.43 In regards to contractor payments (salaries – contractors), while not explicitly stated in the EMCa Report (as both salaries and 'contractor payments' are combined by the ERA and reported as "salaries"), it is assumed that the adoption of 2014 revealed cost is also preferred for this expenditure category and the reasons for doing so are the same as outlined in paragraph 4.22.

4.44 As DBP has provided the revealed costs for 2015 it has therefore based its revised forecast expenditure for the cost category on the 2015 revealed cost for the AA4 period. It would therefore be wrong for the ERA to reject the use of the 2015 actuals as the base year for this category solely for the reason stated in paragraph 4.22(a).

4.45 A 2% real escalation is also applied to set forecast expenditure during AA4 consistent with DBP's approach to labour based costs discussed above.

4.46 The following figure compares DBP's December 2014 proposal, the adopted forecast in the ERA's Draft Decision and DBP's revised proposal for forecast contractors operating expenditure.

Figure 6: Forecast salaries - contractors expenditure (\$m 2015\$s)



Source: Appendix A: Opex actuals and forecast data

4.47 For the following reasons, DBP is of the view that forecast expenditure meets the requirements of rule 91 and 74:

- (a) DBP's forecast is based on 2015 actuals plus a 2 per cent real escalation factor

- (b) The 2% real escalation factor is justified for the reasons outlined earlier in this submission
- (c) The level of actual expenditure incurred in 2015 is significantly lower than both the amount forecast by DBP in its Original AA Proposal and the amount allowed by the ERA in the Draft Decision.

## Non-field expenses

### Consulting

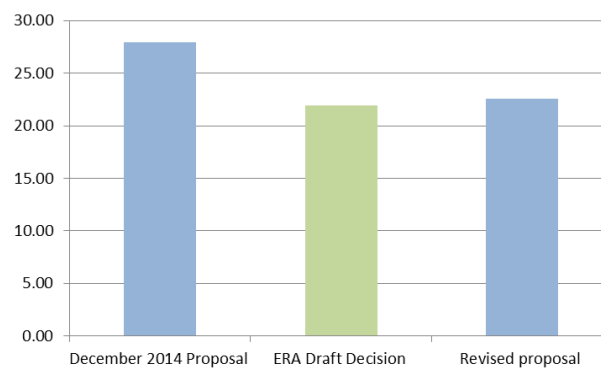
- 4.48 At paragraph 255 of the Draft Decision, the ERA's decision is to not accept DBP's forecast expenditure for consulting in AA4 is based on EMCa's advice in the EMCa Report. EMCa rejected DBP's forecast expenditure based on its view that:
- (a) DBP had not provided adequate information to demonstrate that its forecast 2015 expenditure level represented an efficient amount or that this amount is required for the balance of the AA4 period;
  - (b) the most recent revealed annual expenditure at the time (2014) is likely to be representative of an efficient annual amount for the AA4 period.
- 4.49 There are a number of problems with this reasoning.
- 4.50 Firstly, DBP notes that the EMCa Report has not taken into consideration regulatory consulting costs when adopting the 2014 revealed costs as the basis for its forecast. DBP's reported actual expenditure for consultancy for 2014 excluded consultancy costs related to regulatory work. This was done so that they could be compared consistently with that approved by the ERA as forecast expenditure for AA3.
- 4.51 DBP's forecast of consulting expenditure for AA4 however, included an allowance for consultancy costs related to regulatory work.
- 4.52 Regulatory work is an inescapable area of work for a regulated pipeline such as the DBNGP. It requires external support given the nature of the process and the matters that need to be dealt with.
- 4.53 Had expenditure for this regulatory work been included in the category of consulting costs when assessing past year is an appropriate base year for each year of the AA4, it would have shown that the use of the 2014 revealed costs for 2014 was inappropriate and that the use of the 2015 forecast proposed by DBP in the Original AA Proposal was more than reasonable.
- 4.54 Secondly, DBP does not agree with the EMCa's approach to adopting a single years' worth of revealed costs for the consulting category as costs in this category are not stable in nature. This is largely because consulting expenditure varies substantially due to legal, commercial and regulatory requirements that change from year to year. For example, compliance consultancy costs are cyclical based on when significant work is due such as safety case revisions which are undertaken on a five yearly basis. Outsourced legal work can fluctuate due to disputes that arise on an ad hoc basis and technical work in engineering is lumpy in nature when major systems are being reviewed or implemented such as the project management office (substantial external advice is required that is not capital in capture). There is also other ad hoc work that is required to be supported by consultants such as involvement in the process for harmonising OH&S legislation across the resources and energy industries, dealing with disputes with landholders and assessing and addressing risks associated with urban sprawl and its impact on pipeline integrity. These activities some time span more than one year or are more one off in nature.
- 4.55 DBP's revised forecast is based on the average actual expenditure incurred for consultants in 2013, 2014 and 2015 including all relevant expenditure undertaken for regulatory work.

4.56 DBP does not consider it reasonable to modify its averaging methodology (using three years' expenditure and averaging it to create a base year) to include revealed costs information pertaining to 2011 and 2012. This is because there is a clear step change in costs from 2012 onwards.

4.57 The following figure compares the forecast consulting expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 7: Consulting expenditure (\$m 2015\$s)**



Source: Opex actuals and forecast data

4.58 DBP is of the view that its forecast consulting expenditure meets the requirements of rule 91 and 74 because:

- (a) It is based on an average of three years' of actual expenditure (plus an allowance for 2% real escalation);
- (b) An average of three years' expenditure is appropriate given the cyclical nature of some of the activities that require consultants to ensure they are undertaken effectively;
- (c) The level of expenditure forecast is not significantly different from that proposed by the ERA in the Draft Decision.

## Information Technology

4.59 At paragraph 261 the Draft Decision, the ERA accepts DBP's forecast for IT for AA4. The ERA at paragraph 260 states, that it hasn't adopted DBP's 2014 revealed costs as the base year to set the level of expenditure for each year of the AA4 period as the expenditure is derived from a contract that resulted from a competitively tendered service contract. An expenditure forecast for AA4 that is based on rates for work performed under such a contract forms the best forecast and estimate of the efficient costs.

4.60 As the ERA has accepted the forecast expenditure based on DBP's re-tendered corporate IT service contract, DBP does not seek to revise its estimate for the AA4 period.

4.61 DBP has not adopted the 2015 revealed costs as the base year in this cost category. 2015 actual expenditure does not fully reflect the ongoing costs that can reasonably be expected during AA4. DBP's actuals report an initial decrease in expenditure beyond that envisaged by DBP's proposed base year for 2015 as transitional work took longer than anticipated and work planned to lift IT service provision to a desired level has been delayed. As the transition process has largely been completed DBP and its service provider can now focus on the planned improvement in service and quality levels across DBP's business which will attract the associated minor increase in operating expenditure that has been included in the forecast provided by DBP.

- 4.62 As DBP's forecast is based on the re-tendered corporate IT service contract DBP is of the view expenditure meets the requirements of Rules 91 and 74.

## Insurance

- 4.63 DBP's original proposal for forecast insurance operating expenditure included a [REDACTED] for each year of AA4, reflecting the cyclical nature of insurance markets and that as there has been a prolonged period where the insurance market has been "soft". It was on this basis that DBP suggested it is reasonable to expect insurance costs to start increasing over the AA4 period (Section 5 of Submission 10).
- 4.64 At paragraph 267 of the Draft Decision, the ERA did not accept DBP's proposed forecast insurance operating expenditure based on the EMCa's advice. EMCa was of the view that DBP had not provided compelling information to explain the increase. EMCa recommended, and the ERA accepted, that the 2014 calendar year revealed cost was representative of the efficient level of expenditure for all years in the AA4 period.
- 4.65 However, DBP is of the view that it is wrong to use one year's worth of premiums expenditure as the basis for setting an allowance for insurance expenditure for a five year period. As DBP has previously submitted, it is commonly accepted that the insurance markets that influence insurance premiums are cyclical in nature. It is widely accepted amongst insurance commentators that insurance markets globally are "notorious for ongoing cycles" and that during these market cycles, reinsurers and insurers move from being competitive and eager to expand business (a 'soft' market), then in subsequent years dramatically increase premiums and/or withdraw from the market for certain classes of risk (a 'hard' market)<sup>11</sup>.
- 4.66 The next issue to then address is determining what is a reasonable duration of an insurance premium cycle. The authors of *Insurance and Issues in Financial Soundness* recognise the strong cyclical pattern in insurance markets detectable in all major developed markets and conclude that their average length is approximately six years<sup>12</sup>.
- 4.67 DBP is therefore of the view that a forecast based on the most recent revealed costs for a single year doesn't meet the requirements of Rule 74, specifically, that it will not be one that its arrived at on a reasonable basis or represent the best forecast possible in the circumstances. This is particularly the case when the year that has been selected as the base year is either at the bottom of the soft part of the market cycle or the top of the hard part of the market cycle. [REDACTED]

[REDACTED] As it is commonly accepted that the insurance market moves in a cyclical fashion, and as the information in the table shows that there has been a trending decline in insurance premium expenditure over the [REDACTED]

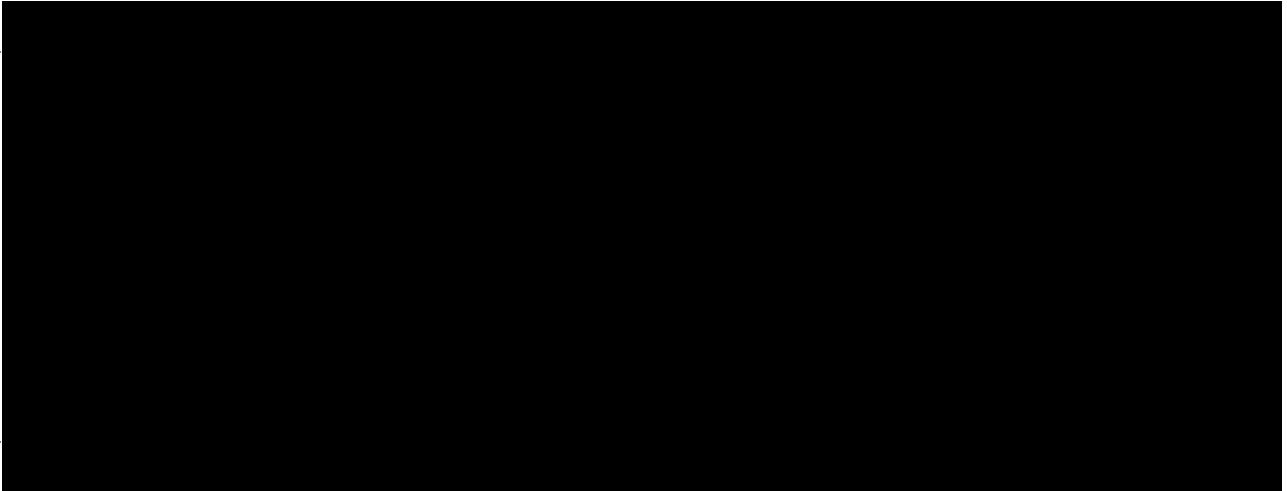
- 4.69 DBP has therefore included in its forecast operating expenditure for the insurance category for the Amended AA Proposal [REDACTED] or each year of AA4.

- 4.70 The following figure compares the forecast insurance premium expenditure allowed for in:

<sup>11</sup> *The Executives Guide to Insurance and Risk Management (2<sup>nd</sup>) Edition* by Graeme Berwick (p.98)

<sup>12</sup> *Insurance and Issues in Financial Soundness* by Udalibir S. Das, Richard Podpiera & Nigel Davis (p.34)

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.



4.71 For the above reasons, DBP is therefore of the view that forecast expenditure included in the Amended AA Proposal meets the requirements of Rules 91 and 74.

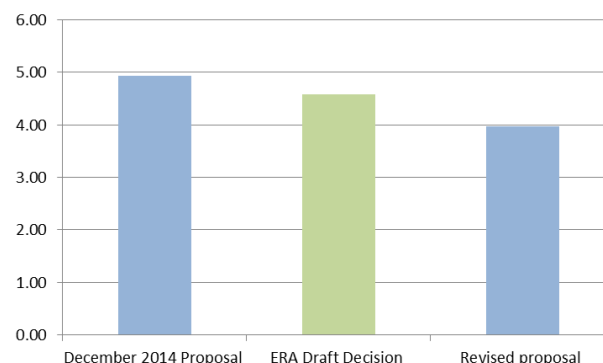
#### Office and administration

4.72 At paragraph 271 of the Draft Decision, the ERA does not accept DBP's forecast office and administration operating expenditure for AA4. The ERA's conclusion was based on EMCa's advice. EMCa was of the view that it should not be accepted solely because DBP had not provided compelling evidence to explain the increase from the most recent revealed costs in 2014.

4.73 The following figure compares the forecast office and administration expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 9: Office and administration operating expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.74 As DBP's forecast is based on 2015 actuals.

4.75 DBP is of the view that the forecast expenditure for this category included in the Amended AA Proposal meets the requirements of Rules 91 and 74 for the reasons that:

- (a) DBP has provided the ERA with its actual expenditure for 2015 and used that amount in its Amended AA Proposal as the base year for each year of AA4
- (b) The amount of 2015 actual expenditure for this category is about \$1m lower (over the AA4 period) than was originally proposed and is even lower than proposed by the ERA in the Draft Decision.

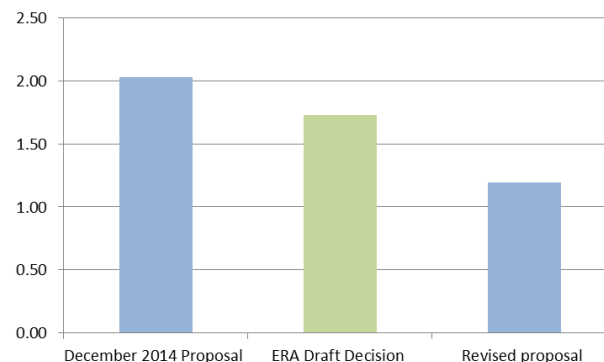
### Regulatory expenses

- 4.76 At paragraph 275 of the Draft Decision, the ERA accepts DBP's proposed regulatory expenditure for the AA4 period.
- 4.77 As DBP's forecast is based on a basis approved by the ERA in the Draft Decision, DBP and the ERA therefore agree that expenditure meets the requirements of Rules 91 and 74. This forecast has again been used in DBP's Amended AA Proposal.
- 4.78 DBP notes the regulatory expenditure category for AA4 only includes expenditure that relates to Standing Charges and Specific Fees that are charges DBP expected to have levied on it by the ERA and will be paid by DBP. This forecast was derived from the State Budget Papers for 2014 which include a forecast of the ERA's costs.
- 4.79 Actuals provided for the AA3 period for this expenditure category contained expenditure for these charges and also all other expenditure related to regulatory work (see paragraph 4.50).
- 4.80 Actuals for the AA3 period were prepared on this basis so that they were comparable with that approved as forecast conforming operating expenditure for AA3 by the ERA.
- 4.81 As has been pointed out elsewhere in this submission, if the ERA requires use of 2014 revealed costs for a particular expenditure category that now includes, for DBP's forecast expenditure, amounts that were included as actual expenditure under the regulatory category for AA3 expenditure (i.e. consulting, salaries and travel and accommodation), then in deriving the correct level for the base year, the ERA must allow an amount for each of these expenditure categories that equals the amounts that were included in the regulatory category for AA3 actuals.

### Employee expenses

- 4.82 At paragraph 278 and 279 of the Draft Decision, the ERA does not accept DBP's forecast expenditure for the employee expenses category based on EMCa's advice. EMCa is of the view that labour conditions would be persistent throughout AA4 and therefore preferred the most recent revealed costs over DBP's forecast.
- 4.83 As DBP has provided the actual expenditure for 2015, it has therefore based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 revealed cost.
- 4.84 The following figure compares the forecast employee expenses expenditure allowed for in:
  - (a) DBP's Original AA Proposal
  - (b) The ERA's Draft Decision; and
  - (c) DBP's Amended AA Proposal.

**Figure 10: Employee expenses expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.85 DBP is of the view expenditure for this category that is included in the forecast operating expenditure in Amended AA Proposal meets the requirements of Rules 91 and 74 for the following reasons:

- (a) DBP's forecast for this category used in the Amended AA is based on 2015 actuals.
- (b) The forecast is less than the amount allowed by the ERA in the Draft Decision.

### Entertainment

4.86 At paragraph 284, the ERA accepts DBP's forecast was justified for the AA4 period based on EMCa's advice. EMCa observed that DBP's 2015 base year was lower than 2014 revealed costs.

4.87 It is not clear why the ERA chose to adopt the forecast proposed by DBP that was based on the estimated expenditure for 2015, when in respect of most other categories, it only accepted a forecast that was based on actual expenditure (ie the revealed costs for 2014).

4.88 DBP has provided the actual expenditure for 2015 for this category. It shows an increase from the amount that was estimated by DBP for 2015 (which was included in DBP's Original AA Proposal).

4.89 However, the amount of actual expenditure for 2015 for this category is largely consistent with the average annual expenditure for this category. Entertainment expenses should be largely consistent year on year (subject to certain exceptions – eg to allow for the celebration of major milestone events in a business). This is the case for DBP - actual operating expenditure in this category has been relatively consistent across the AA3 period.

4.90 On this basis, DBP has reconsidered its position on the amount of operating expenditure for this category that should be included in the forecast for AA4. The amount included in the Amended AA Proposal is therefore based on the 2015 actual expenditure for this category.

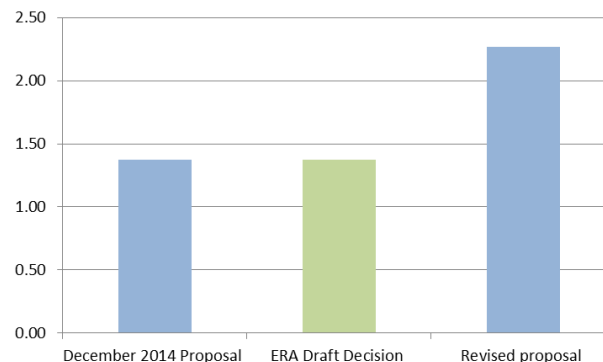
4.91 That this is reasonable is justified by the above reasoning.

4.92 The following figure compares the forecast entertainment expenses expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.



Figure 11: Entertainment expenditure comparison (\$m 2015\$s)



Source: Appendix A: Opex actuals and forecast data

- 4.93 As DBP's forecast is based on 2015 actuals and for the above reasons, DBP is of the view that the forecast expenditure for this category meets the requirements of Rules 91 and 74.

### Self-insurance

- 4.94 At paragraph 289 of the Draft Decision, the ERA does not accept DBP's forecast self-insurance costs based on EMCa's advice. EMCa's claim was that because DBP had no history of claims under this category it considered that no allowance was appropriate.
- 4.95 DBP does not agree with EMCa's view. Just because DBP's hasn't had a history of incidents of the sort that would be covered by this category can not, of itself, be the sole reason for rejecting the allowance. That an incident hasn't occurred in the last 5 years does not preclude an incident from ever happening. Such events are also more than likely to occur less frequently than once every five years.
- 4.96 In contradiction to EMCa's advice, the ERA's view at paragraph 288 Draft Decision, suggests that the ERA would consider some level of costs would be justified if DBP were to undertake a form of actuarial study to validate and justify proposed self-insurance costs.
- 4.97 Considering the level of expenditure and work required, DBP does not consider it to be prudent and efficient use of funds to perform an actuarial study to justify self-insurance costs. However, because DBP has elected not to undertaken the suggested actuarial study it does not mean that a forecast expenditure of zero is a reasonable forecast and the best possible in the circumstances.
- 4.98 DBP has therefore not revised its forecast for self-insurance costs. As outlined in Submission 10, DBP stated that self-insurance costs fall in three categories:
- (a) Physical items that DBP does not or cannot insure at all and thus bears all risk if they are damaged or stolen;
  - (b) Expenses incurred for insured events of items that fall under the deductibles for insurance products DBP will have in place over the period; and
  - (c) Risks that could be insured for under insurance products but DBP has elected not to.
- 4.99 DBP has not attempted to quantify the level it is effectively self-insured for (a) and (b) above. In some instances, DBP's deductible payable before it can be indemnified is \$1m. It is on this basis that the proposed expenditure forecast should be considered more than likely to be on the conservative side.
- 4.100 DBP has quantified at least some of the level of self-insurance it has accepted by not entering into insurance covers for events or risks that it is exposed to. To quantify the cost of self-insurance, DBP asked its broker, [REDACTED] to provide a list of insurance policies which DBP could have elect to



purchase but have not. The costs represent the conservative amount DBP would need to set aside, as self-insurance, to cover losses should they occur.

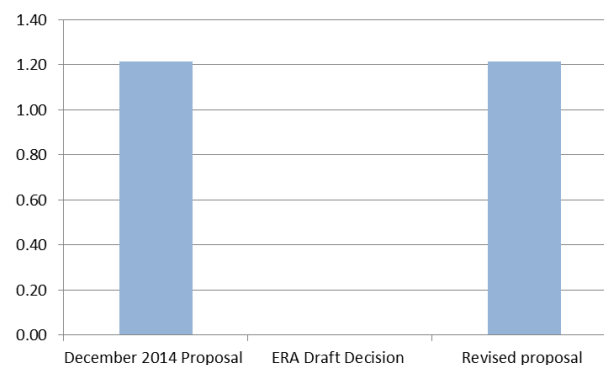
- (a) The list of insurance products include:
  - (i) Environmental liability
  - (ii) Statutory liability insurance
  - (iii) Cybercrime insurance

4.101 The aggregate premium cost of entering into the three insurance products was estimated by DBP's broker to be in the order of \$250,000 pa which has been assumed to be the self insurance allowance for the 2015 base year.

4.102 The following figure compares the forecast self insurance expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 12: Self-insurance expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.103 As DBP's forecast is based on information provided by an insurance broker with relevant market experience and for the other above reasons, DBP is of the view that forecast expenditure meets the requirements of Rules 91 and 74.

## Advertising

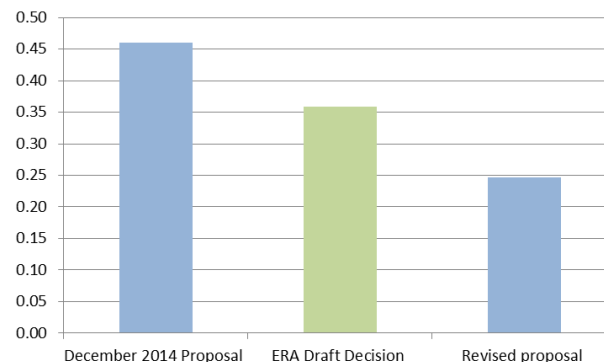
4.104 At paragraph 292 of the Draft Decision, the ERA does not to accept DBP's forecast advertising operating expenditure based on EMCa's advice. EMCa's was of the view that DBP didn't provide a compelling reason for expenditure increasing from the 2014 revealed costs.

4.105 DBP has provided the actual expenditure for 2015 for this expense category and has based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 actual expenditure for this category.

4.106 The following figure compares the forecast advertising expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

Figure 13: Advertising expenditure comparison (\$m 2015\$s)



Source: Appendix A: Opex actuals and forecast data

4.107 DBP is of the view that the forecast expenditure for this category that is included in the forecast operating expenditure in Amended AA Proposal meets the requirements of Rules 91 and 74 for the following reasons:

- (a) DBP's forecast for this category used in the Amended AA is based on 2015 actuals.
- (b) The forecast is less than the amount allowed by the ERA in the Draft Decision.

## Field expenses

### GEA & turbine overhauls

4.108 At paragraph 299 of the ERA's Draft Decision, the ERA accepts, on EMCa's advice, DBP's proposed forecast expenditure for Gas Engine Alternator (GEA) and turbine overhauls in AA4.

4.109 DBP's revised proposal therefore does not seek to change the proposed allowance for GEA and turbine overalls during AA4 that DBP included in its Original AA Proposal.

### Repairs and maintenance

4.110 At paragraph 304 of the Draft Decision, the ERA does not accept DBP's proposed forecast operating expenditure for repairs and maintenance for the AA4 period. Based on EMCa's advice the ERA adopted the 2014 revealed costs as the basis for forecast expenditure for the AA4 period.

4.111 The reasons for doing so were:

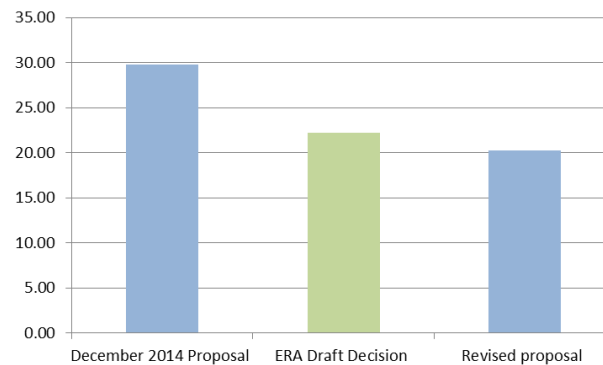
- (a) The 2014 level of expenditure is an actual level of expenditure whereas 2015 was not actual
- (b) There was a step increase in expenditure between 2013 (actual) and 2015 (estimated actual) which DBP was not able to explain adequately (given the step increase)

4.112 DBP has provided the actual expenditure for 2015 for this expense category and has based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 actual expenditure for this category.

4.113 The following figure compares the forecast repairs and maintenance expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 14: Repairs and maintenance expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.114 DBP is of the view that the forecast expenditure for this category that is included in the forecast operating expenditure in Amended AA Proposal meets the requirements of Rules 91 and 74 for the following reasons:

- (a) DBP's forecast for this category used in the Amended AA is based on 2015 actuals.
- (b) The forecast is less than the amount allowed by the ERA in the Draft Decision.

#### Travel and accommodation

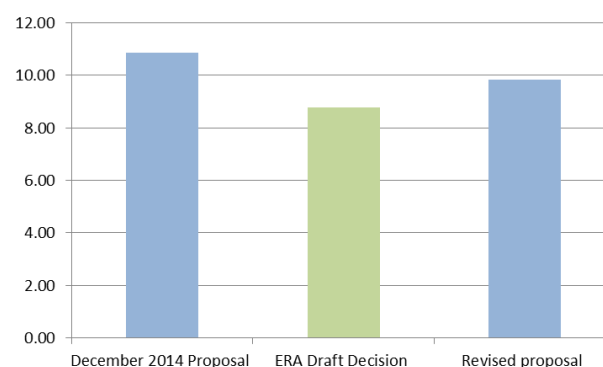
4.115 At paragraph 308 of the Draft Decision, the ERA does not accept DBP's forecast travel and accommodation expenditure for the AA4 period based on EMCa's advice. EMCa was of the view that DBP did not provide adequate information to demonstrate that the 2015 forecast expenditure level represented an efficient amount because it was not able to explain why it reversed the downward trend of actual expenditure that had been experienced throughout the term of AA3 . EMCa recommended that AA4 costs be based on the most recent revealed costs.

4.116 DBP has provided the actual expenditure for 2015. It is lower than what DBP estimated would be incurred in this category and which was used as the basis for the forecast in its Original AA Proposal. This is one reason why DBP has based its revised forecast operating expenditure for AA4 that was included in the Amended AA Proposal on the 2015 revealed cost.

4.117 The following figure compares the forecast travel and accommodation expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 15: Travel and accommodation expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.118 DBP is of the view expenditure meets the requirements of Rules 91 and 74 for the following reasons:

- (a) DBP's forecast is based on the latest revealed cost for travel and accommodation;
- (b) The increase in the level of expenditure for this category from 2014 to 2015 is driven by a number of factors such as:
  - (i) The reliability issues being experienced by the pipeline as a result in the change in shipper behaviour (particularly the increased peakiness of shipper deliveries) has resulted in the need to send more engineering staff to sites to repair and maintain equipment and to the depots of manufacturers (eg Solar Turbines) to oversee repairs. This is likely to continue given that the volatility of demand is likely to increase during AA4.
  - (ii) A drive by senior management to increase their presence in the field observing work being performed by staff to assess adherence to policies and procedures. DBP experienced a series of near misses which were identified to have been caused by workers not adhering to work instructions and procedures. This is expected to continue during AA4.

### Training and development

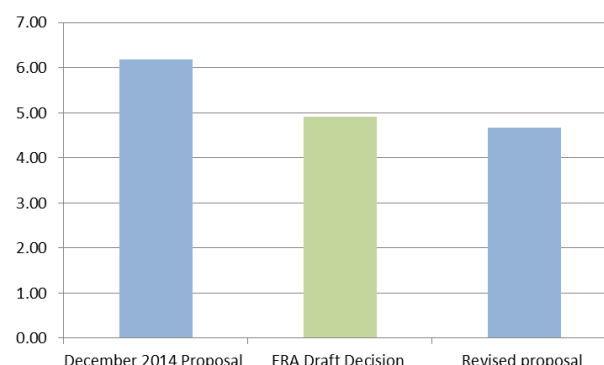
4.119 At paragraph 313 of the Draft Decision, the ERA does not accept DBP's forecast training and development expenditure for the AA4 period based on EMCa's advice. EMCa was of the view that DBP did not provide adequate information to demonstrate that the 2015 forecast expenditure level represented an efficient amount. In particular, DBP did not explain the step increase from 2014 actuals to the 2015 EMCa recommended that AA4 costs be based on the most recent revealed costs.

4.120 DBP has provided the actual expenditure for 2015 for this expense category and has based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 actual expenditure for this category.

4.121 The following figure compares the forecast repairs and maintenance expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 16: Training and development expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.122 DBP is of the view that the forecast expenditure for this category that is included in the forecast operating expenditure in Amended AA Proposal meets the requirements of Rules 91 and 74 for the following reasons:

- (a) DBP's forecast for this category used in the Amended AA is based on 2015 actuals.
- (b) The forecast is less than the amount allowed by the ERA in the Draft Decision.

### Motor vehicles

4.123 At paragraph 317 of the Draft Decision, the ERA does not accept DBP's forecast motor vehicle operating expenditure for the AA4 period based on EMCa's advice. EMCa was of the view that DBP did not provide any information to explain the change in the level of expenditure between the 2014 actuals and the 2015 estimated actuals so as to demonstrate that the 2015 estimated expenditure level represented an efficient amount

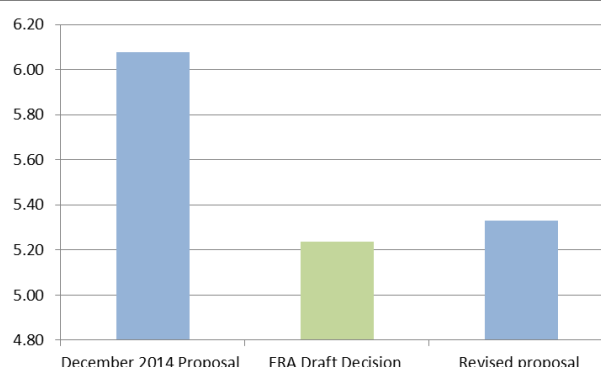
4.124 EMCa recommended that AA4 costs be based on the most recent revealed expenditure – being the actual expenditure for 2014. The ERA accepted this recommendation.

4.125 DBP has provided the actual expenditure for 2015 for this expense category and has based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 actual expenditure for this category.

4.126 The following figure compares the forecast motor vehicles expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 17: Motor vehicles expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.127 DBP is of the view that the level of forecast expenditure for AA4 this expenditure category meets the requirements of Rules 91 and 74 for the following reasons:

- (a) The EMCa and ERA, in setting the base year to determine the AA4 forecast as the 2014 actuals, failed to acknowledge that the levels of expenditure for this category in all other years of AA3 were between \$100k and \$500k greater than in 2014. Given vehicle costs, over time, should not change dramatically, it would be unreasonable to choose the year during AA3 which has the lowest level of expenditure incurred for vehicles. It would be prudent to choose a level of expenditure that represents an average over a period.
- (b) The forecast put forward by DBP in the Original AA Proposal was less than the average of actual annual expenditure in AA3. Moreover, the forecast put forward by DBP in the Amended AA Proposal was even lower than in the Original AA Proposal.

- (c) DBP has been required to purchase additional vehicles over time to reflect the additional travel required as a result of the growth of the asset – this in turn increases both the running and maintenance costs for vehicles for DBP. By choosing the year during AA3 which has the lowest level of expenditure incurred for vehicles fails to recognise this reality and is unreasonable.
- (d) In light of the above matters, the adoption of the most recently revealed actuals as the base year to set the forecast expenditure for each year of AA4 is consistent with DBP's approach adopted for the majority of the expenditure categories.

### Health, safety and environment - PPE

4.128 At paragraph 323 of the Draft Decision, the ERA does not accept DBP's forecast of PPE expenditure, preferring to base its forecast for each year of AA4 on the revealed actual expenditure for 2014, despite advice from the EMCA that the 2015 estimate of actual expenditure should be used as the base. The only reason given by the ERA for adopting this approach was that the ERA's approach is to use the revealed cost where appropriate and in the case of this category of expenditure, there is no circumstance present as to why it should deviate from this approach.

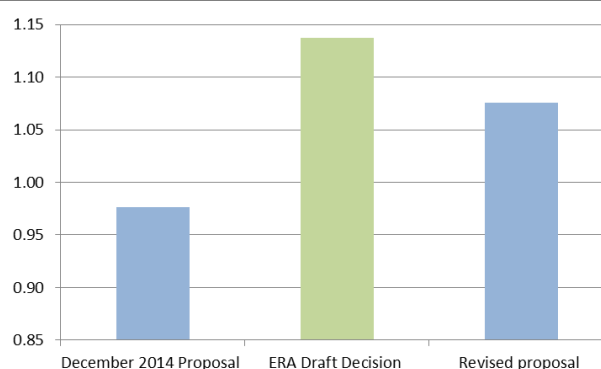
4.129 The result is to increase DBP's allowance for this cost category during the AA4 period compared to what DBP allowed for in the Original AA Proposal.

4.130 DBP now has to hand the actual expenditure for 2015 for this expense category. DBP has based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 actual expenditure for this category.

4.131 The following figure compares the forecast HSE – PPE expenditure allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 18: HSE PPE expenditure comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.132 DBP is of the view that the forecast expenditure for this category that is included in the forecast operating expenditure in the Amended AA Proposal meets the requirements of Rules 91 and 74 for the following reasons:

- (a) DBP's forecast for this category used in the Amended AA is based on the revealed 2015 actuals.
- (b) The forecast is less than the amount allowed by the ERA in the Draft Decision.

## Utilities, rates and taxes

4.133 At paragraph 328 of the Draft Decision, the ERA does not accept DBP's forecast utilities, rates and taxes operating expenditure (referred to as government charges in the ERA's Draft Decision) for the AA4 period based on EMCa's advice. EMCa was of the view that:

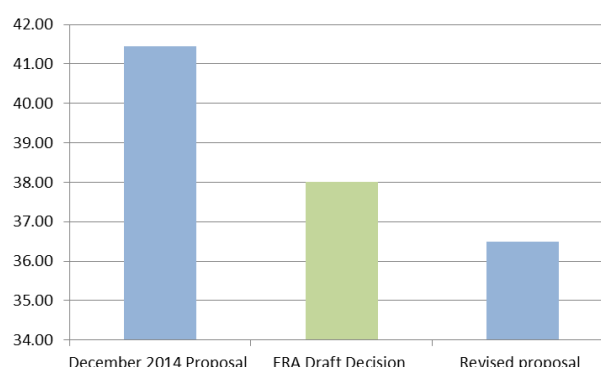
- (a) DBP's regulated business activities are likely to be relatively stable in real terms;
- (b) The explanation given by DBP to explain the step increase in the level of expenditure for this category was not adequate.
- (c) the most recently revealed costs (which at the time was the 2014 actual expenditure) represented an efficient level of costs.

4.134 DBP now has to hand the actual expenditure for 2015 for this expense category. DBP has based its revised forecast expenditure for AA4 in the Amended AA Proposal on the 2015 actual expenditure for this category.

4.135 The following figure compares the forecast Utilities, rates and taxes category allowed for in:

- (a) DBP's Original AA Proposal
- (b) The ERA's Draft Decision; and
- (c) DBP's Amended AA Proposal.

**Figure 19: Utilities, rates and taxes comparison (\$m 2015\$s)**



Source: Appendix A: Opex actuals and forecast data

4.136 In response to the ERA's reasons:

- (a) the level of actual expenditure for 2015 and for each other year of the AA3 period reveals that it is wrong to conclude that the level of expenditure is likely to be stable in real terms. There have been significant swings in the level of expenditure from one year to the next during AA3. That this was made clear to the ERA and EMCa was apparent in the EMCa's own report when it produced its graph of expenditure for the period 2011 to 2020 (Figure 41).
- (b) The items of expenditure included in this category are outside of DBP's control – they are a necessity to enable DBP to operate the pipeline. 85% of the expenditure initially proposed by DBP under this category related to three items – telecommunications charges, land access fees and rental fees. Without incurring this expenditure, DBP is unable to operate the pipeline in compliance with laws. Operating the pipeline in non compliance with laws, not only exposes DBP to fines and penalties, it also places DBP in breach of its financing covenants with its financiers and accordingly, places the company at risk of financial default.
- (c) Given the nature of this expenditure is not something that DBP has any control over, it is a very conservative approach by DBP to base its expenditure level on the most recently revealed level of annual actual expenditure – which it has done in its Amended AA Proposal by using the 2015 actual expenditure. A more prudent approach, given the above (and one

which perhaps would be considered a better estimate), would be to base the forecast on the average annual expenditure across AA3.

- 4.137 Having said the above, the derivation of a forecast based on a single years' worth of actual expenditure in circumstances where there has been significant variances in the level of expenditure over the last five years would not place the operator in a position where it is denied the opportunity of recovering its efficient costs if there is a pass through mechanism in place that gives the operator certainty that the reference tariffs will be adjusted should the level of expenditure change from the forecast. DBP has proposed just this in its Amended AA Proposal.
- 4.138 However, it should be noted that the changes to the tariff variation mechanism required by the ERA as a result of Amendments 70-73 provide DBP with significantly less certainty that changes in this type of expenditure will be able to be reflected in a variation to the reference tariffs.
- 4.139 Accordingly, if the ERA does not accept DBP's position in relation to the tariff variation mechanisms in the Amended AA Proposal, DBP submits that the ERA should, in the Final Decision, adopt a level of expenditure for this category for each year of AA4 that is based on the average annual expenditure for this category over the last five years.

## Reactive Maintenance

- 4.140 At paragraph 332 of the Draft Decision, the ERA does not accept DBP's forecast for reactive maintenance operating expenditure, preferring to base its forecast on EMCa's recommended allowance of \$1.2m per year.
- 4.141 EMCa noted that DBP's proposed forecast expenditure for the cost category was \$1.4m per year which was lower than actual expenditure in 2014 but 17% higher than the average over the AA3 period.
- 4.142 EMCa's recommendation to the ERA was based on:
- (a) DBP's maintenance operations being aligned with good industry practice, which should ensure that reactive maintenance costs are relatively stable over a five year period;
  - (b) Under the subsequent costs category DBP intends to capitalise a significant amount of expenditure on activities that the ERA understands were previously treated as reactive maintenance.
  - (c) In EMCa's view DBP did not provide compelling information to support an expenditure level in excess of the average rate of expenditure in AA3.
- 4.143 Firstly, EMCa and the ERA are incorrect in its understanding of the subsequent cost category. DBP refers to the detailed explanation provided for the subsequent costs category provided in Submission 53. The reactive maintenance expenditure that is to be capitalised under the "subsequent costs" category are not the same types of reactive maintenance expenditure that is to be expensed. It is not a like for like comparison
- 4.144 Secondly, while DBP does not agree that the average expenditure incurred for reactive maintenance is representative of a forecast expenditure that can be expected over the AA4 period, DBP notes that its forecast reactive maintenance expenditure for the AA3 period was approved by the ERA, based on its then engineering advisor advice that it be based on the average of three years of actual costs<sup>13</sup>. Actual Expenditure for the AA3 period is provided in the following table.

---

<sup>13</sup> Paragraph 862 of the Draft Decision 14 March 2011



**Table 6: Reactive maintenance AA3 actual expenditure (\$m 2015\$s)**

2011	2012	2013	2014	2015
0.42	0.81	1.78	1.55	1.82

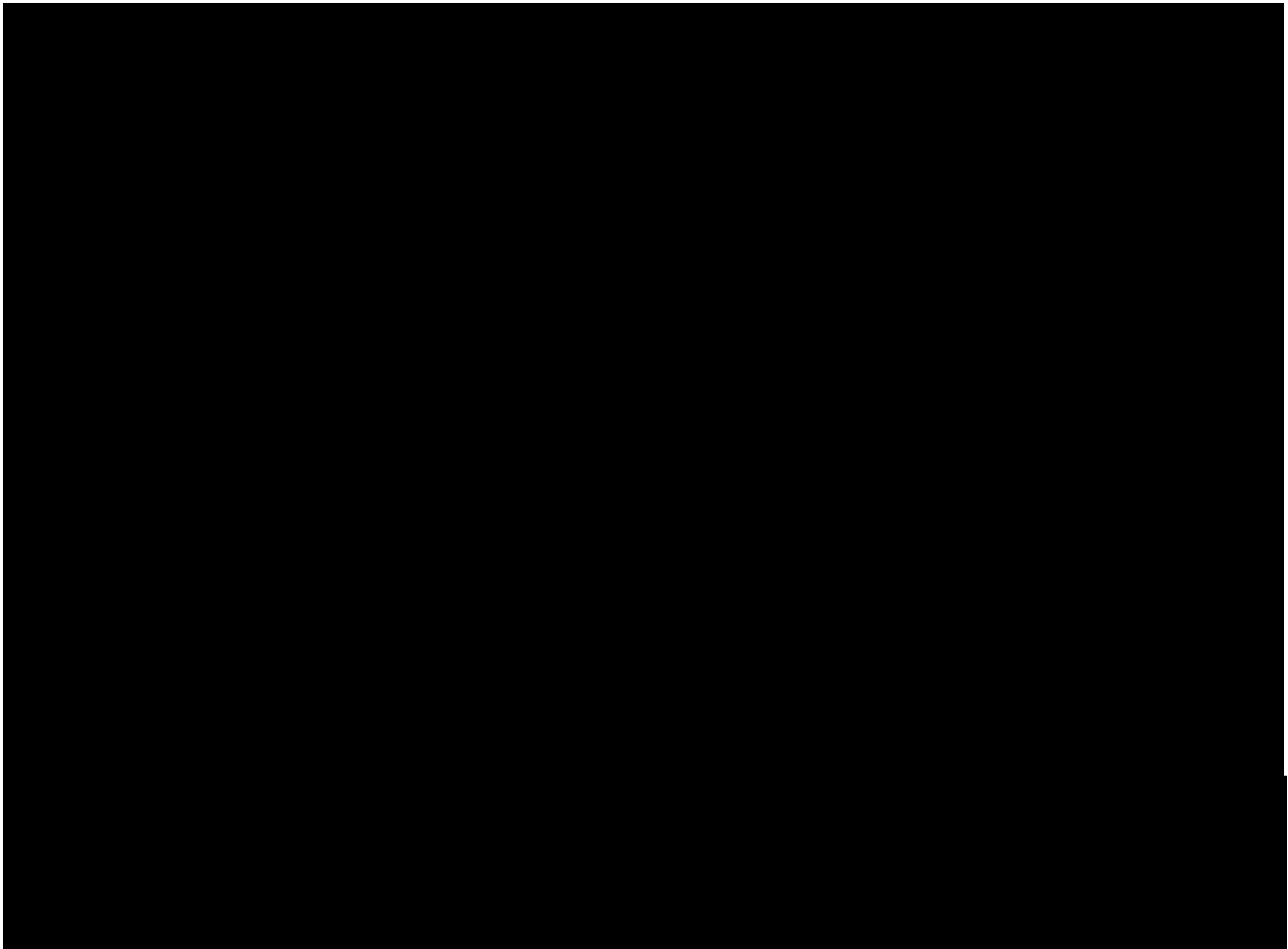
Source: App A Submission 55

- 4.145 DBP's current three year average of actual expenditure in the reactive maintenance is \$1.72m (2015\$s). This is significantly higher than the forecast proposed by DBP in the AA4 forecast opex included in the Amended AA Proposal.
- 4.146 DBP notes that EMCa found that as DBP's maintenance operations are aligned with good industry practice, which should ensure that reactive maintenance costs are relatively stable<sup>14</sup>. It therefore follows that the average expenditure for the last three years represents a reasonable indicator of expenditure going forward.
- 4.147 DBP does however acknowledge there is some level of volatility in this costs category. It therefore adopts the same \$1.4m per year forecast expenditure as original proposed noting that it is substantially lower than the current 3 year average.
- 4.148 As DBP's forecast is lower than the average actual expenditure from 2012 to 2015 for reactive maintenance and for the reasons outlined above in relation to subsequent costs, DBP submits that this expenditure forecast proposed by DBP in the Amended AA Proposal meets the requirements of Rules 91 and 74.

<sup>14</sup> Page 88 of the EMCa report, repeated in the ERA's Draft Decision at paragraph 331.

## 5. DBP'S PROPOSED AMENDMENTS TO THE AA

- 5.1 For the reasons outlined in Section 4 of this submission DBP's revised forecast operating expenditure for AA4 is provided in the following table.



### Summary statement of basis

- 5.2 The following table is a short summary of the basis relied on by DBP to derive the estimate of expenditure for each regulatory year of AA4 for each reporting category of the forecast operating expenditure.

**Table 8: Operating expenditure basis summarised by regulatory opex category**

Regulatory cost category	Forecast basis
System Use Gas	Quantity requirement determined based on forecast throughput, quantity methodology consistent with that accepted in Draft Decision & updated price assumptions. Price requirement – determined in accordance with same methodology proposed in the Original AA Proposal
Salaries	2015 revealed costs adopted as base year plus 2% real escalation
Salaries – Contractors	2015 revealed costs adopted as base year plus 2% real escalation
Consulting	Three year average (2013, 2014 & 2015) adopted as base year plus 2% real escalation
IT	Based on the re-tendered corporate IT services contract. No change from original proposal accepted by the ERA in Draft Decision.
Insurance	Average of actual costs over 10 years (2005-15) adopted as base year
Office and administration	2015 revealed costs adopted as base year

Regulatory cost category	Forecast basis
Regulatory	Base on forecasts published in Stage Budget papers. No change from original proposal accepted by the ERA in Draft Decision.
Employee expenses	2015 revealed costs adopted as base year
Entertainment	2015 revealed costs adopted as base year
Self-insurance	Based on insurance premiums for uninsured risks
Advertising	2015 revealed costs adopted as base year
GEA/turbine overhauls	Adopts original proposal accepted by the ERA
Repairs and maintenance	2015 revealed costs adopted as base year
Travel and accommodation	2015 revealed costs adopted as base year
Training and development	2015 revealed costs adopted as base year
Motor vehicle	2015 revealed costs adopted as base year
HSE – PPE	2015 revealed costs adopted as base year
Government charges	2015 revealed costs adopted as base year
Reactive maintenance	Adopts original proposal of \$1.4m pa consistent with 4 year average actual expenditure.

5.3 To assist the ERA, Appendix A: contains further details of DBP's actual operating expenditure for the AA3 period updated for actuals in 2015. As outlined earlier, DBP is currently undergoing the verification process it undertook for the actual expenditure in the earlier years of AA3. The submission will be made available to the ERA as soon as possible.

5.4 The spreadsheet also contains DBP's forecast operating expenditure.

## APPENDIX A: OPEX ACTUAL AND FORECAST DATA

## APPENDIX B: CONFIDENTIALITY TABLE