Proposed Revisions
DBNGP Access Arrangement

2016 – 2020 Regulatory Period
Supporting Submission: 53

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1.2 [redacted]

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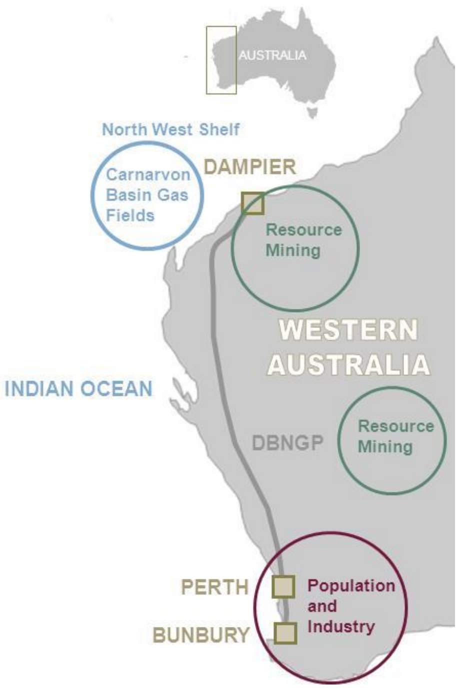
DBP Transmission (DBP) is the owner and operator of the Dampier to Bunbury Natural Gas Pipeline (DBNGP), Western Australia's most important piece of energy infrastructure.

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



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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 (this submission)

(e) Submission 54 – Response to Forecast Capital Expenditure Amendments

(f) Submission 55 – Response to Forecast Operating Expenditure Amendments

(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 53, DBP:

(a) responds to aspects of the ERA's reasoning in the Draft Decision relating to the following matters to do with the opening capital base:

(i) The inflation rate to apply in 2014 and 2015;

(ii) The actual capital expenditure made in 2014 & 2015 compared to the estimates for those years that DBP included in the Original AA proposal;

(iii) The expenditure made by DBP from 2011-2015 on expansion capital projects; and

(iv) The expenditure made by DBP from 2011-2015 on stay in business capital projects.

(b) substantiates its amendments and additions made in the relation to the proposed opening capital base that DBP included in the Amended AA Proposal; and

2. SUMMARY - REQUIRED AMENDMENT 10

2.1 In accordance with Rule 77(2) of the NGR, the opening capital base for 1 January 2016 (**AA4 Opening Capital Base**) is calculated by the addition or subtraction of a number of elements. For the purposes of this submission, they are[1]:

(a) The value of the Opening Capital Base at the beginning of the earlier access arrangement period (being the access arrangement period 2011 – 2015 or AA3); plus

(b) The value of conforming capital expenditure made or to be made in AA3 relating to expansion projects(**AA3 Expansion Capex**); plus

(c) The value of conforming capital expenditure made or to be made in AA3 relating to stay in business projects (**AA3 SIB Capex**); less

(d) Depreciation over AA3; less

(e) The value of any assets that became redundant during AA3; and less

(f) The value of any assets disposed of during AA3.

DBP's Original AA Proposal

2.2 In DBP's Original AA Proposal, the AA4 Opening Capital Base (for the notional commencement date of the AA4 (which was proposed to be 1 January 2016)) was $3,536.78 million (Real, $2015) and, in accordance with Rule 77(2) of the NGR, was calculated as shown in the table below:

Table 1: Opening capital base (Real $m at 31 December 2015)

Year ending 31 Dec	2011	2012	2013	2014	2015
Capital base at 1 Jan	3,805.08	3,862.99	3,792.18	3,709.93	3,617.40
Plus					
Conforming capital expenditure (SIB & Expansion)	162.39	34.71	24.13	15.21	20.30
Correction for over-depreciation	0.00	0.00	0.00	0.00	5.32
Less					
Redundant assets	0.00	0.00	0.00	0.00	0.00
Disposed assets	4.83	0.40	0.79	1.84	0.00
Depreciation	99.66	105.12	105.59	105.90	106.24
Capital base at 31 December	**3,862.99**	**3,792.18**	**3,709.93**	**3,617.40**	**3,536.78**

2.3 Of the total conforming capital expenditure of $256.74m made by DBP in AA3 and included in the Original AA Proposal:

(a) $117.83m related to expansion capital expenditure; and

(b) $138.91m was AA3 SIB Capex.

[1] *There are other elements prescribed by Rule 77(2) of the NGR to determine the AA4 Opening Capital Base but because DBP didn't propose any value for each other element and the ERA didn't disagree with DBP's position, they are not mentioned in this list.*

ERA Draft Decision Required Amendment 10

2.4 The ERA's Draft Decision Amendment 10 requires the AA4 Opening Capital Base to be amended to reflect the values in Table 29 of the Draft Decision (**ERA's Opening Capital Base**). The relevant part of Table 29 of the Draft Decision is replicated below, with the value of the ERA's Opening Capital Base required to be $3,497.09m

Table 2: Table 29 ERA Draft Decision (Real $m at 31 December 2015)[2]

$ million December 2015	2011	2012	2013	2014	2015
Opening Capital Base (AA3)	3,819.99	3,867.29	3,784.69	3,691.20	3,591.81
Plus: Capital Expenditure	152.19	22.90	12.82	8.25	11.41
Less: Redundant & Disposed Asset	4.85	0.40	0.79	1.85	-
Less: Depreciation	100.05	105.10	105.51	105.79	106.13
Closing Capital Base (AA3)	**3,867.29**	**3,784.69**	**3,691.20**	**3,591.81**	**3,497.09**

2.5 Table 29 of the Draft Decision effectively means that the ERA accepted DBP's approach in relation to the AA4 Opening Capital Base as set out in the Original AA Proposal except for:

(a) The methodology for correcting for over-depreciation in the roll forward of the capital base from the commencement of AA3; and

(b) The removal of $49.26m of DBP's AA3 SIB Capex, broken down across each year of the AA3 period as shown in the table below:

Table 3: ERA's treatment of AA3 SIB Capex (Real $m at 31 December 2015)

Real $ million at 31 December 2015	2011	2012	2013	2014	2015	Total
DBP Original AA Proposal	57.30	21.98	24.13	15.21	20.30	138.91
Total Reductions	(10.29)	(11.81)	(11.31)	(6.96)	(8.89)	(49.26)
ERA Draft Decision	47.02	10.17	12.82	8.25	11.41	89.66

2.6 In summary, and having regard to the matter raised in footnote 2, the following table shows the ERA's position in the Draft Decision with respect to DBP's approach to each element required to calculate the AA4 Opening Capital Base.

[2] *Although values for other elements may differ in Table 29 of the Draft Decision to the values DBP proposed in its Original AA Proposal, this is the result of changes in other matters in the Draft Decision rather than because the ERA did not accept DBP's proposed methodology for determining the value of each relevant element. The most important "other matter" from the Draft Decision that affects the value of elements in Table 29 of the Draft Decision is the inflation rate to be used for each year of AA3. It does so because all values are stated in $Real, 2015. DBP responds to this issue in section 3 of this submission.*

Table 4: ERA's position in the DD on Opening Capital Base elements

Opening Capital Base Element		ERA's Draft Decision response to DBP's approach
AA3 opening capital base		Did not accept
Conforming capital expenditure		
	Expansion conforming capital expenditure	Accept
	Stay in Business conforming capital expenditure	Did not accept
Depreciation		Accept
Redundant assets		Accept
Assets disposed		Accept
AA4 opening capital base		Did not accept

2.7 The ERA did not accept all of DBP's proposed AA3 SIB Capex because the ERA accepted the recommendations of a report from a consultant, EMCa (**EMCa Report**), in relation to AA3 SIB Capex, which dealt with:

(a) whether the criteria of Rule 79 of the NGR is met for projects for which AA3 SIB Capex was made in AA3; and

(b) the amount of any adjustment to the total AA3 SIB Capex that should be made.

2.8 Based on the EMCa Report, the ERA determined that only 64.5% ($89.66m) of the total of DBP's AA3 SIB Capex satisfies Rule 79 of the NGR.

2.9 Also based on the EMCa Report, the ERA concluded that:

(a) the information provided by DBP was sufficient to confirm that the requirements of Rule 79(1)(b) were satisfied through meeting at least one of the tests under Rule 79(2)(c). That is, DBP provided sufficient material to demonstrate that the projects were required to be undertaken to respond to the asset related issue in some manner (para 381, Draft Decision);

(b) DBP has not provided sufficient evidence to demonstrate that its forecasts or estimates met the full requirements of Rule 74(2) in being forecasts or estimates that were arrived at on a reasonable basis and represent the best forecasts or estimates possible in the circumstances;

(c) Based on EMCa's detailed review of the top 15 stay in business projects (by value) undertaken during AA3 and the information that the EMCa reviewed, there were systemic issues in the practical application of DBP's policies, processes and procedures at the project level such that EMCa and ERA could not satisfy themselves that all of the stay in business expenditure incurred across all projects that were not reviewed in detail (aside from those that were for less than $0.15m each) and most of the 15 projects that were reviewed in detail was prudent and efficient. Systemic issues include:

(i) the poor quality of documentation such as it not being signed and dated and not adhering to DBP's own internal quality insurance instructions (para 379, Draft Decision);

(ii) lack of clarity about the options considered and why the proposed solution (including the nature, timing and volume of work) was necessary (paras 382-383, Draft Decision);

(iii) lack of evidence (in the form of a cost-benefit analysis) to demonstrate that, where there was only one logical supplier of an item of plant or equipment required for a project, the selected scope and timing for the item of plant or equipment or the project was optimal (para 384, Draft Decision);

(iv) lack of clarity about what was actually delivered for the reported cost; and

(v) lack of clarity of the approach to ensure the efficient cost was efficient, such as an unclear procurement strategy and no evidence that any tendering was undertaken (para 385, Draft Decision); and

(d) In addition to the systemic issues, because EMCa's detailed review of the top 15 stay in business projects (by value) revealed other issues specific to certain projects, this was further evidence for why neither EMCa nor the ERA could not satisfy itself that all of the AA3 SIB Capex for each of these projects (and in some cases, any of the AA3 SIB Capex) was prudent and efficient. These reasons are outlined in more detail in section 8.

2.10 In deciding to disallow about 35% of the total value of DBP's AA3 SIB Capex, the percentage disallowance was not uniformly applied across each project that made up DBP's AA3 SIB Capex.

2.11 However, it is unclear just what was the actual methodology applied by the ERA (and EMCa) in deriving the total disallowance of about 35%. This is because there are a number of discrepancies between the methodology outlined in the statement of reasons in the Draft Decision (and the EMCa Report) and the methodology that was applied in the detailed spreadsheets that accompanied the EMCa Report. These discrepancies are outlined in more detail in section 5.[3]

2.12 According to the ERA's statement of reasons in the Draft Decision, the percentage disallowances applied by both EMCa[4] and ERA were as follows:

(a) For projects with an individual value less than $150,000 (totalling $8.93m) (**Small Project Expenditure**) – no reduction was applied;

(b) For all projects that had expenditure grouped by DBP in the expenditure category named "subsequent costs" (totalling [redacted]) (**AA3 SIB Subsequent Cost Capex**) – a 100% reduction was applied;

(c) For projects with a value greater than $150,000 but which were not one of the top 15 projects (by value) reviewed in detail by the ERA (totalling $25.62m) (**Not Reviewed Projects**) – a 36.7% reduction was applied to reduce the total for these projects to $16.22m); and

(d) For the top 15 projects by value that were reviewed in detail by the ERA and EMCa (totalling $75.61m) (**Reviewed Projects**) – an average reduction of 25% was applied across all projects, leading to a total for these projects of $56.96m. But again, the percentage reduction was not uniformly applied across each project value. In some instances, a 100% reduction was applied, in others either a 50% or 20% reduction was applied, while in relation to three projects, no reduction was applied.

2.13 The detailed spreadsheets that accompanied the EMCa Report reveal that, in fact, a different methodology was applied.

[3] See DBP's submissions on this point in paragraphs 5.8 to 5.11

[4] EMCa Report, paragraph 213

DBP's Amended AA Proposal & response to the ERA's Draft Decision

2.14 In DBP's Amended AA Proposal, DBP proposes the following amount of AA3 SIB Capex as conforming capital expenditure.

Table 5: Amended AA Proposal – AA3 SIB Capex

	2011	2012	2013	2014	2015	Total
Pipeline	13.88	4.80	4.85	0.59	2.59	26.71
Compression	5.55	5.10	5.74	3.36	4.48	24.23
Metering	0.38	1.97	0.99	1.22	3.66	8.22
Other	37.15	10.02	12.19	8.34	13.37	81.07
Other non-depreciable	-0.02	-0.04	0.20	0.86	3.23	4.23
Total	**56.94**	**21.84**	**23.97**	**14.38**	**27.32**	**144.45**

2.15 This amount of AA3 SIB Capex is $5.53m more than the amount of AA3 SIB Capex as was included in the calculation of the AA4 Opening Capital Base proposed by DBP in the Original AA Proposal. There are three reasons for the change:

(a) Inflation – updating inflation by calculating actual inflation for 2014 and 2015 consistent with the method adopted by the ERA in the Draft Decision as a result of Amendment 6[5] the change in the inflation rate for these years results in a reduction in the total of AA3 SIB Capex of $0.71m;

(b) 2014 & 15 estimated actuals – where estimated values were provided in the Original AA Proposal for 2014 & 2015 values of AA3 SIB Capex (because, at the time of the filing of the Original AA Proposal, the actuals for 2014 & 2015 were not able to be known), they have been replaced with actual expenditure values (and in the case of the 2015 actual expenditure, subject to the agreed upon procedures verification process for actual expenditure that DBP is presently having undertaken). This contributes a total additional $2.14m in AA3 SIB Capex over the 5 year period of AA3; and

(c) DBP has modified the value of the amount of linepack that is conforming capital expenditure. This results in the capital base increasing by [redacted]. This expenditure has been classified as part of the AA3 SIB Capex and is spread across 2014 and 2015. The reasons for this addition are explained in section 11.

2.16 These adjustments are summarised in the following table:

Table 6: Explanation of changes in total AA3 SIB Capex from Original AA Proposal to Amended AA Proposal

	Amount ($Real, 2015, $m)
Original AA Proposal – AA3 SIB Capex	$138.91m
Less Change in Inflation rates for 2014 & 15	[redacted]
Plus increase in value of actual 2014 & 2015 SIB Expenditure compared to estimate	[redacted]
Plus Adjustment to value of Linepack	[redacted]
Amended AA Proposal – AA3 SIB Capex	**$144.45m**

2.17 DBP's Amended AA Proposal also includes an additional amount of [redacted] for expansion capital expenditure that was made by DBP in 2015 (**Additional AA3 Expansion Capex**). The Original AA Proposal did not estimate any Additional AA3 Expansion Capex to be made in 2015 for an

[5] *See section 3 of this submission.*

expansion of the pipeline's capacity. This expenditure relates to the costs of complying with the conditions of the Ministerial Statement issued under the Environmental Protection Act and which was required to enable the expansion projects known as Stages 5A and 5B to be undertaken. Condition 14 of Ministerial Statement 735 requires the implementation of a rehabilitation management plan, developed, reviewed and revised in consultation with the Department of Parks and Wildlife, until such time as the completion criteria are being met. In order to meet this statutory post construction requirement, the completion criteria needed to be adjusted to establish relevance to contemporary conservation values of adjacent land. This required field assessment of botanical conditions and desktop review of environmental policy. DBP procured the services of the same environmental consultant who undertook the initial corridor surveys and post completion review of rehabilitation.

2.18 DBP submits that this Additional AA3 Expansion Capex is conforming capital expenditure for the purposes of Rule 79 because:

(a) it was required to be made in order to comply with a regulatory requirement;

(b) given the knowledge that the consultant had about the nature of the works and the rehabilitation that was assessed immediately following completion of the project, it made more economic sense to engage the same consultant than to procure a different consultant. Accordingly, no tender was undertaken for the procurement of these services. Although, it should be noted that the process of regularly reviewing the consultant's schedule of rates (as outlined in paragraph 7.92) is followed;

(c) DBP notes that the ERA has endorsed the EMCa Report which stated that projects with a level of expenditure below $0.15m is a typical threshold under which:

(i) it is often counterproductive for organisations to spend significant time to refine scope and achieve delivery efficiencies; and

(ii) expenditure can be ad hoc and reactive such that the opportunity for significant savings are limited;

(d) this is expenditure of this kind; and

(e) there was minimal flexibility for DBP in relation to the timing of this activity because the condition of the Ministerial Statement required the assessment to be undertaken at a certain time.

2.19 This submission otherwise focuses on the part of ERA's required Amendment 10 that relates to the level of AA3 SIB Capex included to calculate the value of the AA4 Opening Capital Base. In this submission, DBP provides further information to support the expenditure levels for:

(a) each project assessed by the ERA;

(b) new items of expenditure that were not included in the Original AA Proposal; and

(c) all expenditure generally.

2.20 The following sections of this submission will therefore address matters relating to these issues. They also deal with some additional matters relating to DBP's AA3 SIB Capex. The remaining sections of this submission are structured as follows:

(a) section 3 deals with DBP's response to the ERA's position on actual inflation;

(b) section 4 deals with the provision of actual expenditure details for 2014 & 2015;

(c) sections 5 - 10 deal with the ERA's reasoning for its decision on DBP's AA3 SIB Capex and DBP's response to these reasons; and

(d) section 11 deals with the addition made by DBP, in the Amended AA Proposal, to the valuation of linepack in the capital base.

2.21 In summary, DBP's Amended AA Proposal for calculating the AA4 Opening Capital Base is compared with DBP's Original AA Proposal and the ERA's Draft Decision in the following table.

Table 7: Comparison of AA4 Opening Capital Base values (Real, $2015)

Opening Capital Base Element	DBP Original AA proposal	ERA DD	DBP Amended AA Proposal
AA3 opening capital base	$3,805.08m	$3,819.99m	$3,780.68m
Correction for over-depreciation	$5.32m	-	-
Conforming Capital Expenditure			
SIB Capex	$138.91m	$89.66m	$144.44m
Expansion Capex	$117.83m	$117.82m	$117.13m
Depreciation	$517.02m	$522.584m	$519.15m
Redundant assets	$0.00m	$0.00m	$0.00m
Assets disposed	$7.86m	$7.89m	$8.98m
AA4 opening capital base	$3,536.78m	$3,497.09m	$3,514.11m

3. INFLATION

DBPs Original AA Proposal

3.1 All values stated in DBP's Original AA Proposal and the Draft Decision are stated in real $2015 terms, meaning that (relevantly) values for years prior to 2015 and after 2015 have to be adjusted for the effects of inflation.

3.2 DBP proposed one methodology for calculating actual inflation for each year of AA3 (ie 2011-2015) and another methodology for calculating the forecast inflation for each year of AA4. Relevantly for the purposes of this submission, the methodology proposed by DBP for calculating actual inflation for each year of AA3 was the annual movement in the December quarter of the Consumer Price Index (All Eight Cities) published by the Australian Bureau of Statistics (**ABS**).

3.3 DBP's Original AA Proposal was submitted in December 2014, at a time when it had to use an estimate of actual inflation for both the 2014 and 2015 years because the actual inflation rates for 2014 and 2015 were not yet published by the ABS.

3.4 DBP's estimate of actual inflation in 2014 was 2.05% and 2.02% in 2015.

ERA Draft Decision

3.5 Relevantly in the Draft Decision, the ERA used the following values for the inflation rates for 2014 and 2015:

(a) For 2014 - an inflation rate of 1.72% which is calculated using the actual December 2014 quarter CPI (all 8 cities); and

(b) For 2015 - an inflation rate of 2.75% which appears to be calculated using the methodology for forecast inflation outlined in the Draft Decision rather than the methodology for calculating actual inflation.

3.6 In Amendment 6, the ERA required DBP to use these values for these years in its Amended AA Proposal (but it did not specify the methodology to be used for calculating actual inflation for each year).

3.7 The ERA's Draft Decision was issued in December 2015 and the ERA calculated the values for all of the elements used to calculate the opening capital base for 1 January 2016 (in real $2015) using the above values.

3.8 The reason most likely for the ERA adopting a different methodology for calculating actual inflation for 2015 to that used for each other year of AA3, was because actual inflation rate for 2015 was not published by the ABS at the time of the Draft Decision. Although that this was the reason is not clear from the ERA's reasons for the Draft Decision.

DBP Amended AA Proposal & response to the Draft Decision

3.9 The 2014 and 2015 inflation rates are now available and published by the ABS. Adopting the method accepted by DBP and the ERA for calculating actual inflation, the value of inflation for 2014 is 1.72% and for 2015 is 1.69%.

3.10 However, in Amendment 6, the ERA required DBP's Amended AA Proposal to use the inflation rate for 2015 set out in table 7 of the Draft Decision – being 2.75%. As noted above, it would appear that the ERA used this figure because at the time of making its Draft Decision, the actual inflation rate for 2015 calendar year was not yet published by the ABS.

3.11 As noted above, if the actual inflation rate for 2015 (being 1.69%) is used instead of the rate for 2015 used by the ERA (being 2.75% as outlined in Table 7 in the Draft Decision), this will affect most of the values used in Table 29 of the Draft Decision.

3.12 However, if it uses the 2015 inflation figure in table 29 of the Draft Decision for reporting all values in Real $2015 values, then it will not be consistent with the methodology the ERA endorsed for determining actual inflation for each other year of AA3.

3.13 On 3 February 2016, DBP wrote to the ERA seeking confirmation that if it uses the actual inflation rate for 2015 of 1.69% for the purposes of calculating the value of each of the factors used to derive the opening capital base at 1 January 2016 instead of the value stipulated in Amendment 6 for 2015, the ERA will not decide in the final decision that DBP has not complied with Amendments 6 and 10.

3.14 On 3 February 2016, the ERA confirmed that this is an acceptable approach.

3.15 Therefore, in DBP's Amended AA Proposal, DBP has adopted an inflation rate for 2014 consistent with the ERA's Draft Decision rate of 1.72% and an inflation rate for 2015 of 1.69%.

3.16 The following table compares the inflation rates used in DBP's Amended AA Proposal for each year of AA3 with those set out in DBP's Original AA Proposal and in the ERA's Draft Decision.

Table 8: Actual Inflation

	2011	2012	2013	2014	2015
DBP Original AA Proposal	3.10%	2.20%	2.75%	2.05%	2.02%
ERA Draft Decision Amendment 6	3.10%	2.20%	2.75%	1.72%	2.75%
DBP Amended AA Proposal	**3.10%**	**2.20%**	**2.75%**	**1.72%**	**1.69%**

4. 2014 & 2015 ACTUAL INFORMATION

DBPs Original AA Proposal

4.1 DBP's Original AA Proposal was submitted in December 2014, at a time when actual expenditure information for 2014 & 2015 was not available.

4.2 The values for the 2014 & 2015 years stated in DBP's Original AA Proposal (as summarised in Table 1) were therefore estimates.

4.3 The regulatory regime under the NGR is structured such that it is assumed that at the time of making decisions in relation to an access arrangement proposal, the regulator will not have available actual expenditure for every year of the prior access arrangement period. The regime recognises that the approvals process should take six months and that there will be an adjustment process in the subsequent access arrangement period to account for any difference between the forecast expenditure in the last year of the prior access arrangement period and the actual expenditure in those year.

ERA Draft Decision

4.4 Prior to the release of the Draft Decision, DBP provided the ERA and EMCa with details of its actual expenditure for 2014 given that this expenditure had been verified by DBP's external auditors in accordance with the agreed upon procedures for the verification of expenditure.

4.5 DBP did not provide an updated estimate of its expenditure for 2015 at that time because it was not available.

4.6 The EMCa Report and the ERA's Draft Decision, released on 22 December 2015, assessed and made decisions on DBP's:

(a) actual expenditure for 2014 provided prior to the Draft Decision[6]; and

(b) 2015 estimates included in the Original AA Proposal, as the actual information was not available.

4.7 The ERA then applied the requirements of Amendment 10 to these levels of expenditure for 2014 and 2015. This is represented in Table 2 of this submission.

DBP Amended AA Proposal & response to Draft Decision

4.8 DBP makes no further submissions in relation to the issue of the use by the ERA of 2014 actual expenditure levels instead of the level of expenditure for 2014 used in the Original AA Proposal (which was an estimate).

4.9 In relation to the use of estimates for 2015, DBP submits that because the actual expenditure incurred in 2015 is now available, DBP's Amended AA Proposal has:

(a) not accepted the part of the Draft Decision Amendment 10 that relies on estimated expenditure levels for 2015; and

(b) amended the Original AA Proposal by replacing the estimates for 2015 with the reported actual capital expenditure.

4.10 In including the actual expenditure for 2015 in its Amended AA Proposal, this has meant that a process that would ordinarily have been done as part of assessing AA5 – ie adjusting the estimates

[6] *See DBP's submission 19(1), Appendix P*

for the final year of the previous period (2015) to substitute the actual information for that year – can be undertaken as part of the current approvals process for AA4. This is appropriate because:

(a) it ensures that information being relied on is the best estimate; and

(b) it reduces the administrative burden for the assessment of AA5 (ie for 2021-2025).

4.11 Appendix A: contains a spreadsheet which outlines the actual AA3 SIB Capex for 2015, broken down by each project. DBP is currently undergoing the verification process it undertook for the operating and capital expenditure incurred in 2011-2014[7]. That process (which is identical to the process followed by DBP in respect of the verification of expenditure for 2011-2014) 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 Appendix A:), aligned to the reporting categories and expenditure classifications included in the Amended AA Proposal).

4.12 That reconciliation and verification process is currently 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.

4.13 The following table compares the amount of AA3 SIB Capex actually made by DBP in 2015 with the amounts that were included as estimates for that year in each of the Original AA Proposal and the ERA's Draft Decision.

Table 9: 2015 Stay in business capital expenditure (Real, $2015, $m)

	DBP Original AA Proposal	ERA Draft Decision	DBP Amended AA Proposal
Pipeline	4.63	1.82	2.59
Compressor	10.44	7.98	4.48
Metering	2.77	2.14	3.66
Other Depreciable	2.78	(0.53)	13.42
Other non Depreciable	0.00	0.00	3.23
2015 AA3 SIB Capex Total	20.30	11.416	27.38

4.14 After allowing for the effect of the change in approach to inflation between the Original AA Proposal and the Amended AA Proposal, the actual 2015 SIB Capex made by DBP is some $7.02m more than the estimate proposed by DBP in its Original AA Proposal (which was the 2015 SIB Capex estimate). The explanation of the variances in the level of expenditure between the actual 2015 AA3 SIB Capex and the estimate used in the Original AA Proposal is summarised in the following table and then each variance in the table is described in the paragraphs that follow:

[7] *See DBP's Submissions 11 and 25*

Table 10: 2015 SIB Capex Variance Analysis between Original AA estimate and Amended AA actuals (Real, $2015, $m)

SIB Capex	2015 variance between Original AA estimate and Amended AA actual
Line pack adjustment	[redacted]
Additional expenditure incurred on EMCa Reviewed Projects	$1.56m
Projects not included in Original AA Estimate	$6.09m
Original AA Projects not undertaken	($4.01m)
Additional expenditure incurred on EMCa Not Reviewed Projects	$0.15m
Total variance	[redacted]

4.15 In relation to the "Linepack adjustment" variance, as a result of the change in both the amount of Linepack and the unit price payable by DBP for system use gas, the value of the Linepack increased by [redacted]. This is further explained in section 11.

Reasons for variations

4.16 DBP has commenced review of the reasons for the variation between the 2015 estimate incorporated in the Original AA proposal and the actual 2015 expenditure included in the Amended AA proposal. Excluding Linepack, the variance in expenditure is $3.79m. The reasons for the variations include:

(a) cost variations in the planned work included in the AA3 SIB Capex;

(b) additional work undertaken in 2015 that was forecast to be undertaken in 2016 and is include in DBP's forecast conforming capital expenditure for AA4;

(c) work that was forecast to be undertaken in 2015 but which has been deferred to 2016; and

(d) new projects that were not included in the estimate for AA3 or the forecast of conforming capital expenditure for AA4.

4.17 The majority of the variations between the work undertaken and expenditure incurred (excluding Linepack) relate to work that has been undertaken in 2015 rather than 2016 or will be undertaken in 2016 rather than 2015 (that is most variations are likely to fall within the categories listed in paragraphs 4.16(b) and 4.16(c) above). These variations have occurred in the main due to the initial allocation of work to either the 2015 calendar year or the 2016 calendar year when the work program is developed on a financial year basis. For example, when preparing forecasts, work that was included in the 2015/16 work plan and budget was required to be allocated to either the 2015 calendar year or the 2016 calendar year. Therefore, even though the work may still be undertaken consistent with the work plan in 2015/16, the calendar year in which it occurs has changed. It should be noted that DBP's Original AA proposal was submitted in December 2014, mid-way through the 2014/15 work program and prior to the 2015/16 work program commenced.

4.18 DBP considers that it is reasonable to assume that the majority of additional expenditure undertaken in 2015 compared to the estimate is work that has been brought forward from 2016 and that the majority of the work that was not undertaken in 2015 will be undertaken in 2016. This results in a net increase in the AA3 conforming capital expenditure $3.79m (excluding Linepack) and a net decrease in forecast conforming capital expenditure for AA4 of $3.79m.

4.19 DBP will continue to investigate the variations and provide more detailed information once the 2015 actual expenditure has been verified by DBP's externally auditors and provided to the ERA.

Variations for the top 15 projects

4.20 An additional $1.56m in expenditure was incurred on the 15 projects reviewed in detail by EMCa in 2015 compared with the estimated expenditure for these projects that were included in the Original AA Proposal. In the Original AA Proposal, it was estimated that $7.10m in expenditure would be incurred on 9 of the 15 Reviewed Projects. However, the total amount spent was $8.66m. Although, some of the variations in expenditure may relate to variations in cost of undertaking the work, DBP considers that the larger variations reflect a change to the schedule of expenditure, so that the calendar year in which the work is undertaken has changed from 2015 to 2016 and from 2016 to 2015. The table below presents the variances for each of the 9 Reviewed Projects. For the remaining 6 Reviewed Projects, the Original AA Proposal estimated that no expenditure would be incurred in 2015 and in fact, no expenditure was actually incurred in 2015.

Table 11: 2015 Actual Expenditure for EMCa Reviewed Projects (Real, $2015, $m)

Project	2015 Expenditure as per Original AA Proposal	2015 Expenditure as per Amended AA Proposal	Variance to 2015 estimate
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

*Positive variance shows as $0.00m due to rounding.

4.21 There was a total of $6.09m in expenditure on projects that were not included in the estimate for 2015 SIB expenditure in the Original AA Proposal (**New 2015 SIB Projects**). The majority of new projects reflect projects identified to be undertaken in 2016 and included in the 2016 AA forecast. Similarly, $4.01m of expenditure on AA3 SIB projects not individually reviewed by EMCa (**Non EMCa Reviewed 2015 Projects**) expected to be incurred in 2015 was not incurred in 2015. Again, the variation in expenditure is most likely driven by the need to allocate projects between the 2015 and 2016 calendar year from a 2015/16 planned work program at the time DBP's Original AA Proposal was developed. A full list of projects is provided in Appendix A: .

4.22 DBP considers it reasonable for the net impact of the variations in 2015 (excluding Linepack) – totalling $3.79m - to be included in 2015 conforming capital expenditure and that amount to be removed from the 2016 forecast conforming capital expenditure. Further information on the variations will be provided together with DBP's 2015 actual expenditure once the review by external auditors is complete.

4.23 DBP reiterates that, as DBP's Amended AA Proposal reflects actual expenditure for AA3, there are no longer any estimates used in the AA3 SIB Capex in DBP's Amended AA Proposal means that it would be an irrelevant consideration for the ERA to decide that any part of DBP's AA3 SIB Capex was not allowed for the reason that it did not meet the requirements of Rule 74(2) of the NGR.

5. AA3 STAY IN BUSINESS CAPITAL EXPENDITURE

DBPs Original AA proposal

5.1 As outlined in section 2 of this submission, of the total conforming capital expenditure of $256.74m made by DBP in AA3 and included in the Original AA Proposal:

(a) $117.83m related to expansion capital expenditure; and

(b) $138.91m was AA3 SIB Capex.

5.2 DBP's AA3 SIB Capex was broken down by year and by asset class as shown in the following table.

Table 12: DBP Original AA Proposal AA3 SIB Capex

Category	2011	2012	2013	2014	2015[8]	Total[9]
Pipeline	13.97	4.83	4.88	0.61	4.30	28.59
Compression	5.59	5.13	5.78	3.11	10.44	30.05
Metering	0.38	1.98	0.99	1.63	2.77	7.75
Other	37.39	10.08	12.27	9.87	2.79	72.40
Other non-depreciable	-0.02	-0.04	0.20	0.00	0.00	0.14
Sub total	**57.30**	**21.98**	**24.13**	**15.21**	**20.30**	**138.91**

ERA Draft Decision

5.3 The ERA's Draft Decision required amendments to DBP's Original AA Proposal to reduce the amount of AA3 SIB Capex to be added to the AA4 Opening Capital Base, determining that only 64.5% of what DBP proposed ($89.66m) is conforming capital expenditure that satisfies Rule 79 of the NGR and that 35.5% (49.26m) of capital expenditure does not comply with the criteria set out in Rules 74 or 79. The reductions for each of the years of AA3 and by each asset class are reflected in the following table.

Table 13: ERA Draft Decision - AA3 SIB Capex Reductions

Real $ million at 31 December 2015	2011	2012	2013	2014	2015[10]	Total
DBP Original AA Proposal	57.30	21.98	24.13	15.21	20.30	138.91
Pipeline Deductions	(2.91)	(2.59)	(2.50)	(0.29)	(2.49)	(10.78)
Compression Deductions	(4.02)	(1.32)	(1.78)	(1.82)	(2.46)	(11.41)
Metering Deductions	(0.08)	(0.42)	(0.20)	(1.05)	(0.63)	(2.38)
Other Deductions	(3.27)	(7.48)	(6.82)	(3.81)	(3.31)	(24.69)
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
Total deductions	(10.29)	(11.81)	(11.31)	(6.96)	(8.89)	(49.26)
ERA Decision	**47.02**	**10.17**	**12.82**	**8.25**	**11.41**	**89.66**

[8] *Values for 2015 were estimates*

[9] *Totals and subtotals may not add up because of rounding issues*

[10] *Values for 2015 were estimates*

5.4 In deciding to disallow 35.5% to the total value of DBP's AA3 SIB Capex, the disallowance rate was not uniformly applied across each project that made up DBP's AA3 SIB Capex.

5.5 However, as outlined in section 2, it is unclear just what was the actual methodology applied by the ERA (and EMCa) in deriving the total disallowance stated in the Draft Decision. This is because there are a number of discrepancies between the methodology outlined in the statement of reasons in the Draft Decision (and the EMCa Report) and the methodology that was applied in the detailed spreadsheets that were provided to DBP to explain the calculations used by EMCa to derive the reductions to DBP's AA3 SIB Capex that are outlined in the EMCa Report (**EMCa Spreadsheets**).

5.6 According to the ERA's statement of reasons in the Draft Decision, the percentage disallowances applied by both EMCa[11] and ERA were as follows:

(a) For projects with an individual value less than $150,000 (totalling $8.93m) (**Small Project Expenditure**) – no reduction was applied;

(b) For all projects that had expenditure grouped by DBP in the expenditure category named "subsequent costs" (totalling $[redacted]) (**AA3 Subsequent Cost Capex**) – a 100% reduction was applied;

(c) For projects with a value greater than $150,000 but which were not one of the top 15 projects (by value) reviewed in detail by the ERA (totalling $25.62m) (**Not Reviewed Projects**) – a 36.7% reduction was applied to reduce the total for these projects to $16.22m); and

(d) For the top 15 projects by value that were reviewed in detail by the ERA and EMCa (totalling $75.61m) (**Reviewed Projects**) – an average reduction of 25% was applied across all projects, leading to a total for these projects of $56.96m. But again, the percentage reduction was not uniformly applied across each project value. In some instances, a 100% reduction was applied, in others either a 50% or 20% reduction was applied, while in relation to three projects, no reduction was applied.

5.7 The EMCa Spreadsheets reveals that, in fact, a different methodology was applied. There are three discrepancies between the methodology in the EMCa Spreadsheets and the methodology stated in the EMCa Report (and upon which, the ERA relied to make its Draft Decision).

5.8 The first discrepancy is that although EMCa claim that the same percentage reduction is applied to Non Reviewed Projects as is applied, on average to the total for the Reviewed Projects and this is reflected in the ERA's Draft Decision reasoning, this is not the case. In the EMCa Spreadsheets, the expenditure estimate of conforming capital expenditure determined by the ERA for Reviewed Projects is actually only, on average, 25% less than the conforming capital expenditure proposed by DBP and not the 36.7% applied. If the same percentage of 25% were applied, the ERA's Draft Decision should have included an additional $3.0m in conforming capital expenditure for a total of $92.66m.

5.9 The second discrepancy also relates to the way that the ERA (and EMCa) has applied the percentage reductions to Non Reviewed Projects. The way that the reductions referred to in paragraphs 5.6(b) and 5.6(c) have been applied in the EMCa Spreadsheets is that the ERA and EMCa have firstly removed 100% of the AA3 Subsequent Cost Capex but has also applied a further percentage reduction that is the same as was applied to the expenditure associated with the Not Reviewed Projects. This results in more than the proposed AA3 Subsequent Cost Capex in 2015 being removed.

5.10 This has the effect of reducing the amount of expenditure for certain asset categories in 2015 by more than the amount that had been proposed by DBP, effectively reducing the capital base for that asset category in that relevant year.

[11] *EMCa Report, paragraph 213*

5.11 An example of this is in relation to the “Other depreciable” asset category in 2015. DBP’s Original AA Proposal included an amount of $2.79m in AA3 Subsequent Cost Capex in that asset category in 2015. However, in Tables 28 and 29 of the Draft Decision, the methodology adopted in the EMCa Spreadsheets means that the ERA’s reduction has resulted in the ERA removing $3.31m from that asset category, reducing the capital base by $0.53m base rather than just disallowing the amount DBP proposed for that category in that year for the AA3 Subsequent Cost Capex.

5.12 This is clearly an error as the NGR does not allow the capital base to be reduced by the capital expenditure element in Rule 77(2). Had the EMCa Spreadsheets adopted the methodology outlined in the Draft Decision and the EMCa Report (and leaving aside the issues of whether the ERA was correct in reducing either the AA3 Subsequent Cost Capex or the Not Reviewed Project capex), this would result in the capital base increasing by $0.53m. This is dealt with in more detail in section 10.

5.13 The third discrepancy relates to the disallowances applied by the ERA and EMCa for the 2015 SIB expenditure. The EMCa Spreadsheets adopt a totally different methodology, summarised as follows:

(a) DBP proposed a total amount of 2015 SIB Capex of $20.3m.

(b) On reviewing the worksheet named “Capex Actual AA3” in the EMCa Spreadsheets, it would appear that, instead of limiting its detailed review of 2015 SIB Expenditure to the expenditure associated with the Reviewed Projects, EMCa undertook a review of 2015 SIB projects with a total value of $10.127m (**2015 Reviewed Capex**). This includes both the Reviewed Projects and some of the Not Reviewed Projects in that year.

(c) Projects for the remaining $10.173m of 2015 SIB Capex were not reviewed (**2015 Not Reviewed Capex**).

(d) The EMCa then applied a 22.5% reduction to the total amount of the 2015 Not Reviewed Capex. It is not clear why a 22.5% reduction was applied to this capital expenditure when the EMCa applied a different percentage reduction in other years.

(e) In relation to the 2015 Reviewed Capex, the ERA has applied varying methodologies to reduce the amount of capital expenditure for each project.

(f) The ERA has also applied a reduction to any capital expenditure for a project that was less than $0.15m, although the Draft Decision says it did not.

ERA Draft - Decision Reasons for Amendment

5.14 As summarised in section 2 of this submission, the reasons the ERA decided:

(a) that not all of DBP’s AA3 SIB Capex met the criteria of Rule 79 of the NGR; and

(b) what amount of DBP’s AA3 SIB Capex did meet the criteria of Rule 79 of the NGR,

were solely based on the recommendations contained in the EMCa Report.

5.15 The EMCa Report made the following conclusions in relation to whether DBP’s AA3 SIB Capex met the criteria of Rule 79 of the NGR:

(a) the information provided by DBP was sufficient to confirm that the requirements of Rule 79(1)(b) were satisfied through meeting at least one of the tests under Rule 79 (2) (c). That is, DBP provided sufficient material to demonstrate that the projects were required to be undertaken to respond to the asset related issue in some manner (para 381, Draft Decision);

(b) Notwithstanding paragraph (a), DBP has not provided sufficient evidence to demonstrate that its forecasts or estimates met the full requirements of Rule 74(2) in being forecasts or estimates that were arrived at on a reasonable basis and represent the best forecasts or estimates possible in the circumstances;

(c) Based on EMCa's review of the top 15 stay in business projects (by value) undertaken during AA3 (ie the Reviewed Projects), there were systemic issues in the practical application of DBP's policies, processes and procedures at the project level such that EMCa could not satisfy itself that all of the stay in business expenditure incurred was prudent and efficient. Systemic issues include:

(i) the poor quality of documentation such as it not being signed and dated and not adhering to DBP's own internal quality insurance instructions (para 379, Draft Decision);

(ii) lack of clarity about the options considered and why the proposed solution (including the nature, timing and volume of work) was necessary (paras 382-383, Draft Decision);

(iii) lack of evidence (in the form of a cost-benefit analysis) to demonstrate that, where there was only one logical supplier of an item of plant or equipment required for a project, the selected scope and timing for the item of plant or equipment or the project was optimal (para 384, Draft Decision);

(iv) lack of clarity about what was actually delivered for the reported cost; and

(v) lack of clarity of the approach to ensure the efficient cost was efficient, such as an unclear procurement strategy and no evidence that any tendering was undertaken (para 385, Draft Decision); and

(d) In addition to the systemic issues, because EMCa's review of the Reviewed Projects revealed other issues specific to certain of these projects, this was further evidence for why EMCa could not satisfy itself that all of the AA3 SIB Capex for each of these projects (and in some cases, any of the AA3 SIB Capex) was prudent and efficient.

5.16 It is important to note therefore that the ERA is satisfied that the information provided by DBP prior to the Draft Decision was sufficient to confirm that the requirements of Rule 79(1)(b) were satisfied through meeting at least one of the tests under Rule 79(2)(c). That is, DBP provided sufficient material to demonstrate that the SIB projects undertaken in AA3 were required to be undertaken.

5.17 It is also important to note the following reasoning from the Draft Decision:

(a) With a small number of significant exceptions, the ERA (by endorsing the EMCa Report) found that DBP's business frameworks, processes and procedures are consistent with good industry practice. However, the EMCa considered that there are significant gaps in the applications of the procedures.

(b) With few exceptions, the ERA (by endorsing the EMCa Report) concluded that DBP's processes, policies and systems were appropriate to manage DBP's business, if properly applied. However, EMCa found DBP's information in support of AA3 program (that EMCa had available to it for consideration) was generally inadequate to justify expenditure.

(c) Neither EMCa nor the ERA examined the incentives applying to DBP, including those associated with its contractual arrangements with its shippers. This is despite DBP making submissions to this effect in its initial submissions filed in December 2014 and also despite the ERA, in its assessment of the access arrangement for AA3, having previously concluded that these arrangements provided an even more powerful incentive framework for efficiency than was the case with the framework of the NGR itself.

(d) No adjustment was made to projects valued at less than $0.15m on the basis that this is a typical threshold under which it is often counterproductive for organisations to spend significant time to refine scope and achieve delivery efficiencies and it is generally the level under which expenditure can be ad hoc and reactive such that the opportunity for significant savings are limited.

DBP's Amended AA Proposal and response to Draft Decision

5.18 As outlined in section 2 of this submission, DBP's Amended AA Proposal has proposed a total of $144.45m of AA3 SIB Capex.

5.19 This amount of AA3 SIB Capex is $5.53m more than the amount of AA3 SIB Capex as was included in the calculation of the AA4 Opening Capital Base proposed by DBP in the Original AA Proposal. There are three reasons for the change:

(a) Inflation – updating inflation by calculating actual inflation for 2014 and 2015 consistent with the method adopted by the ERA in the Draft Decision as a result of Amendment 6[12] the change in the inflation rate for these years results in a reduction in the total of AA3 SIB Capex of $0.71m;

(b) 2014 & 15 estimated actuals – where estimated values were provided in the Original AA Proposal for 2014 & 2015 values of AA3 SIB Capex (because, at the time of the filing of the Original AA Proposal, the actuals for 2014 & 2015 were not able to be known), they have been replaced with actual expenditure values (and in the case of the 2015 actual expenditure, subject to the agreed upon procedures verification process for actual expenditure that DBP is presently having undertaken). This contributes a total additional $2.14m in AA3 SIB Capex over the 5 year period of AA3; and

(c) DBP has modified the value of the amount of linepack that makes up the capital base in the 2014 and 2015 years of AA3. This results in the capital base increasing by [redacted]. This expenditure has been classified as part of the AA3 SIB Capex and is spread across 2014 and 2015. The reasons for this addition are explained in section 11.

5.20 Subject to paragraph 5.21 below, DBP does not accept the ERA's required Amendment 10, in so far as it relates to AA3 SIB Capex, for a number of reasons. The reasons are summarised below (and expanded on in subsequent sections of this submission):

(a) There are no estimates relied on by DBP in its Amended AA Proposal in relation to AA3 SIB Capex, so any rejection of the proposed amount that relies on Rule 74(2) is unfounded. This is because this Rule is not relevant to the criteria for assessing conforming capital expenditure. That this is the case is dealt with in section 4 of this submission;

(b) In the following sections of this submission, DBP provides further supporting information for the Reviewed Projects, the remaining projects not reviewed in detail by EMCa (**Not Reviewed Projects**) and the expenditure categorised as AA3 SIB Subsequent Cost Capex. This information demonstrates not only was the ERA wrong to conclude that any of the expenditure was not prudent and efficient, but that there was, in fact, prudency of the delivered scope and efficiency of delivery and procurement such that all of the expenditure proposed by DBP is compliant with Rule 79. The following matters relating to the ERA's prudency and efficiency reasoning are addressed in the following sections of the submission

(i) Section 6 addresses some overarching concerns DBP has with the ERA's reasoning.

(ii) Section 7 addresses the reasons relied on by both the ERA and EMCa for concluding that there were systemic issues within DBP's systems and processes (rather than at a project specific level), such that the expenditure generally was prudently or efficiently incurred by DBP.

(iii) Section 8 provides additional information in response to reasons why some or all of the expenditure for each of the Reviewed Projects was not prudent or efficient.

(iv) Section 10 provides additional information in response to the reasons why all of the AA3 Subsequent Cost Capex should not be allowed as conforming capital expenditure.

[12] *See section 3 of this submission.*

(c) The ERA's methodology outlined in the Draft Decision for determining the percentage reductions that need to be made to DBP's AA3 SIB Capex suffers from a number of flaws. Firstly, it is arbitrary for each project or category of cost and in many instances, there is a lack of reasoning to understand the basis for its methodology. The estimated reductions can not be said to comply with Rule 74(2). Secondly, the methodology stated in the Draft Decision reasoning doesn't reflect what was actually done in practice. So, it is unclear what was intended by the ERA. There are a number of errors and discrepancies between the way the Draft Decision explains the methodology and the methodology that was actually adopted in the very spreadsheets that calculated the reductions for each project or expenditure category. Section 9 provides additional information in relation to each of these flaws.

(d) The ERA, in relation to at least one item of expenditure, reduced more than the amount proposed by DBP, thereby leading to a double deduction. This is inconsistent with the Revenue and Pricing Principles of the NGL. Further submissions are made by DBP on this issue in section 10 of this submission.

(e) Section 11 provides supporting information for the variations in Linepack conforming capital expenditure for 2014 & 2015.

5.21 DBP accepts the ERA's required amendment 10 in so far as it relates to accepting DBP's proposed AA3 SIB Capex for each project of less than $0.15m in value (ie Small Project Expenditure) and agrees with the ERA's reasons in this regard. However, as is outlined in section 9, it would appear that the EMCa Spreadsheets do not implement this methodology and in fact, adopt a different methodology with respect to the 2015 value of Small Project Expenditure.

6. CONCERNS WITH ERA'S REASONS

6.1 DBP has a number of high level concerns with the ERA's reasons which are relevant to many of the Reviewed Projects and the Not Reviewed Projects that have been affected by the findings of EMCa and the ERA's adoption of those findings as its reasons for its Draft Decision.

ERA has incorrectly applied its limited discretion

6.2 It is noted that in assessing whether capital expenditure made by a service provider is conforming capital expenditure the ERA has a limited discretion.[13] As provided for in NGR 40(2), this means that the ERA may not withhold its approval to capital expenditure as conforming capital expenditure if the ERA is satisfied that it complies with the applicable requirements of the NGL and is consistent with applicable criteria (if any) prescribed by the NGR.

6.3 There are three important effects of this requirement:

(a) The first effect is that the ERA can only withhold its approval if the element is outside the range of acceptable alternatives that comply with the requirements relevant to this element. If the ERA considers that a change to the relevant element might be desirable to achieve more complete conformity between the element and the principles and objectives of the NGL, it is not allowed to reject the service provider's proposal to give effect to that view in the decision making process.

(b) The second effect is that the onus is on the ERA to collect information and form a view about compliance with the requirements of the Law. If there is information that the ERA considers is relevant to its assessment of compliance with the criteria of Rule 79, the ERA can not simply conclude that there is a non-compliance with the relevant criterion if the service provider submits that a matter falls into a category, however the ERA considers that there is information missing. The ERA is required to make inquiries of stakeholders.

(c) DBP submits that the ERA failed to do this and so was wrong to conclude non-compliance for the reason that the information was missing without exercising its rights to obtain information.

(d) The third effect is that before the ERA can reject the inclusion of capital expenditure from the opening capital base that was proposed by the service provider and replace it with an alternative amount of expenditure, it must demonstrate that:

(i) Firstly, the capital expenditure that the service provider sought to have included in the opening capital base is not itself compliant with the criteria; and

(ii) secondly the ERA can not reduce the amount of capital expenditure for a project without demonstrating that the reduced amount of expenditure meets the criteria of the NGR. Moreover, the ERA is certainly not permitted to apply an arbitrary reduction and then claim the reduced amount complies with the criteria.

(e) Not only is there no evidence that the criteria was applied to the estimate recommended by the EMCa and adopted by the ERA in the Draft Decision, there is no evidence that the amount of the reduction would enable the criteria to be met.

Prudency

6.4 Under NGR79(1)(a), the capital expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services.

6.5 In deciding whether a service provider is prudent, case law and regulatory precedent indicates that the regulator must ask what would a reasonable board of directors and company management

[13] *NGR Rule 79(6)*

have decided given what they knew or reasonably should have known to be true at the time they made a decision. In making decisions, a utility must take into account the best interests of its customers, whilst still being entitled to a fair return.

6.6 This was the test was applied by the Washington Utilities and Transportation Commission hearing in relation to Puget Sound Power & Light Company in the Fourth Supplemental Order made in cause U-83-54 in September 1984 at pp 32, 33, where the Commission said:

> *"The test this Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of expenditures."*

6.7 In Canada, the issue was considered at length in a decision of the Alberta Court of Appeal, Atco Gas & Pipeline Ltd v Alberta (Energy & Utilities Board) [2005] AJ 495, 2005 ABCA 122.

6.8 In its decision, the Board applied the following test of prudence:

(a) the utility would be found prudent if it exercises good judgment and makes decisions which are reasonable at the time they are made, based on information that the owner of the utility knew or ought to have known at the time the decision was made;

(b) in making a decision, a utility must take into account the best interest of its customers while still being entitled to a fair return.

6.9 It is noted that Webster's New 20th Century Dictionary of the English language definition of prudent, provides as follows:

(a) capable of exercising sound judgment in practical matters; cautious or discreet in conduct; circumspect; sensible; not rash; characterised, dictated, or directed by prudence; as, prudent measures,

(b) synonyms include, circumspect, discreet, cautious, judicious, careful, considerate, sagacious, thoughtful, provident, frugal and economical.

6.10 The concept of prudence is therefore used to determine whether, at a particular time in question, an arrangement is or was appropriate and reasonable given the circumstances known or which ought to have been known.

6.11 The case law has also made it clear that an assessment of whether expenditure is prudent ought not to be based on hindsight. Webster's Dictionary defines hindsight as "perception of nature and demands of an event after it has happened". Applying this definition to the current context, the regulator must not impute knowledge to the service provider that the service provider could not reasonably have known at the time the utility made the decision being reviewed.

6.12 In deciding whether this test is met to be able to conclude whether a service provider is prudent, case law indicates that there is a presumption that expenditure by a service provider is prudent and that the regulator has the burden of proof to demonstrate that expenditure is imprudent. Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown. There should not be excluded from the finding of prudency, investments which, under ordinary circumstances, would be deemed reasonable. Unless the Regulator can find expenditure which is dishonest or obviously wasteful or imprudent expenditure, it will be assumed to be prudent.

6.13 It is submitted that if the following practical steps can be shown, then prudence and reasonableness in relation to expenditure will be proven:

(a) *Planning* - the ability to demonstrate that the service provider has considered an appropriate range of project contractual options given the legal and regulatory requirements and environment. Show that it has evaluated how this project differs from previous projects and that it has organised resources and developed policies and procedures to define clearly responsibilities and accountability.

(b) *Prioritise* - demonstrate that risk exposure areas have been identified, contingency plans developed for problems and flexibility maintained to adapt to changing project conditions.

(c) *Management* - demonstrate that a framework has been developed for the effective management of the project using resources, tools and reporting requirements, including timely corrective action when required.

(d) *Collaboration* - demonstrate that key stakeholders have been involved early in the process. Demonstrate the need for the project and that mechanisms are in place to monitor project conditions and take corrective action as they arise.

(e) *Documentation* - recognise the need to document all decisions and supporting rationales for actions throughout the planning and project process. This demonstrates that the utility has acted reasonably in preparing for and executing a major project.

6.14 Examples of evidence of imprudence could, subject to the specific facts and circumstances prevailing at the time, include:

(a) poorly structured contracts not matched to project needs and the resource capabilities of the utility or the contractor;

(b) failure of effectively organised owner supervision;

(c) over-reliance on contracts and litigation to remedy problems after the fact, rather than through proper contract administration;

(d) inadequate financial planning and financial resources to match project needs;

(e) lack of information to make informed decisions, including inadequate cost, schedule, quality or regulatory compliance information;

(f) poor and slow resolution of engineering problems; and

(g) inability to bring the project to a conclusion and for the owner to accept operational responsibility.

Level and quality of information provided to the ERA prior to the Draft Decision

6.15 DBP has been proactive in responding to specific information requests and similarly proactive in convening face to face meetings to discuss matters. EMCa also acknowledges the large number of documents provided to it by DBP (see paragraph 7 of the EMCa Report).

6.16 Despite this, the EMCa and consequentially the ERA, has repeatedly identified concerns with the limited information provided to support DBP's proposal that SIB expenditure was prudent and efficient and delivered at least costs. Over the course of a 5 year period, a significant amount of documentation is generated within a business to identify, initiate, substantiate, monitor and track expenditure. DBP provided some of this information in its initial submission and has responded to requests from the ERA to provide further information in response to specific questions. It is not realistic - particularly in the context of a regulatory approvals process that the law makers intended was to be completed within 6 months - to provide all of the materials.

6.17 The ERA and EMCa also identified a key concern that there was a lack of (or poor quality) documentation made available to them that demonstrated that DBP was able to ensure there was adequate monitoring by it of cost, resourcing, schedule and scope of both individual projects and the overall SIB annual programs during AA3.

6.18 The lack of this kind of information (or the lack of quality of it) is one of the key reasoning relied on by the ERA for reaching a view that there are systemic issues in the practical application of DBP's policies, processes and procedures at the project level to the extent and that these systemic issues are a key reason for concluding that DBP's AA3 SIB Capex is not prudent and efficient.[14]

6.19 There are several points to make in response to these concerns.

6.20 Firstly, it is important to note that as the material for each project is generated at different points in time during the life of a project, an overarching document outlining the process and the purpose of each supporting document for each project is not prepared. But it would appear that this is what both the ERA and EMCa expect should occur and have reached adverse conclusions based on DBP's failure to have a contemporaneous document that does not and could not exist. It is unreasonable to reach an adverse finding on prudency and efficiency based on the unavailability of documentation that could not, and does not, exist.

6.21 Secondly, DBP does not agree that there is a systemic failure of DBP's systems and processes to ensure the adequate monitoring by it of cost, resourcing, schedule and scope of both individual projects and the overall SIB annual programs during AA3.

6.22 To the contrary, DBP does monitor and track each project on a weekly, monthly and yearly basis and to differing groups within the organisation with differing levels of responsibility and authority. It has a sound governance arrangement which has been applied throughout AA3.

6.23 As an example, the following table summarises the levels of monitoring of SIB projects by various groups within the organisation and the information that is provided to each group.

Table 14: Governance for project monitoring

Governance level	Frequency of Review	Relevant Documents Reviewed	Purpose of review
Project Management Team (also referred to as the Project Steering Committee)	Weekly and Monthly	• "Traffic Light" report for all projects • Detailed report for each project • Project risk ranking list • Business case • Request for award	To review and adjust schedule, scope, resourcing & revised forecast cost against budget of each project Provide overall summary of SIB project status for presentation to the PRC
Project Review Committee	Monthly and Annually	• Monthly report on aggregate expenditure on monthly and YTD spend • Presentation for annual SIB program and Project risk ranking list • Presentation comparing actual annual expenditure v approved budget	To review and adjust schedule, scope, resourcing & budget of each project To recommend approval by board To consider and recommend for approval any potential re-prioritisation of projects or the addition of projects to the annual plan
DBP Board of Directors & Asset Management	Monthly and Annually	• Monthly operations report	To approve budget and annual program

[14] *EMCa Report, paragraph 21*

Governance level	Frequency of Review	Relevant Documents Reviewed	Purpose of review
Committee		• Presentation for annual SIB program • Project risk ranking list	To approve any changes to overall budget

6.24 Appendix E: contains samples of the following documents referenced in the above table for each year of AA3:

Table 15: Sample of Monitoring documentation provided in Appendix E:

Documents Provided	2011	2012	2013	2014	2015
"Traffic Light" report for all projects	AppE.01 AppE.02	AppE.03 AppE.04	AppE.05 AppE.06	AppE.07 AppE.08	AppE.09 AppE.10
Project risk ranking list	AppE.11	AppE.12	AppE.13	AppE.14	AppE.15
PRC monthly report on aggregate expenditure for month and YTD	AppE.16 AppE.17	AppE.18 AppE.19	AppE.20 AppE.21	AppE.22 AppE.23	AppE.24 AppE.25
Annual SIB presentation to PRC and Board	AppE.26	AppE.27	AppE.28	AppE.29	AppE.30
Presentation comparing actual annual expenditure v approved annual SIB budget	-	AppE.32	AppE.33	AppE.34	AppE.35

6.25 The "Traffic Light" report is a spreadsheet that contains individual worksheets for each project being undertaken during the relevant annual program. This includes worksheets for each of the Reviewed Projects reviewed by EMCa. These individual worksheets contain a detailed report on the status of each approved project in relation to scope, schedule, budget, risk and procurement at the end of each financial year and for multiple year projects, provide feed information the next phased program planned for the next financial year.

6.26 The third point to be made in response to these concerns is that, at the request of DBP's board of directors, DBP's project monitoring systems and processes have been the subject of an independent internal audit which found that there were well established project management tools and templates and that staff demonstrated a deep knowledge of what was required to deliver their respective projects such that there was confidence that the projects were being monitored well to ensure the budget was achieved.[15]

6.27 Based on this evidence, it would be unreasonable to reach a conclusion that:

(a) there is inadequate monitoring by DBP of cost, resourcing, schedule and scope of both individual projects and the overall SIB annual programs during AA3; and

(b) as a result, this is a reason for why not all of DBP's AA3 SIB Capex is prudent or efficient.

6.28 In section 7 of this submission, DBP will outline relevant documentation that was in place that relates to each of the alleged other types of issues that were lacking (or were of poor quality) which

[15] *For further information on the audit of DBP's project management methodology and project management office, see section 7*

led the ERA to conclude that there are systemic issues in the practical application of DBP's policies, processes and procedures at the project level to such an extent that DBP's AA3 SIB Capex is not prudent and efficient.

6.29 However, a further reason for making the above points at this stage of the submission is to make the point that, to the extent that the information provided was not the information the EMCa expected to see or was sufficient to address the EMCa's questions, DBP was not informed of this at the time and nor was it provided with the opportunity to address specific concerns. Instead, DBP was asked a series of questions without the context of the issue or concern that was being investigated.

6.30 DBP notes that there has been very little consultation on the key matters contained in the EMCa Report since March 2015. Most of the information requests and the information gathering exercise generally, occurred between January and March 2015. On its face, the version of the EMCa Report provided to DBP on 9 of December 2015, and with respect to which DBP was given 4 days to review for factual error and confidential information before the ERA released its Draft Decision on 22 December 2015, appears to have been finalised for over 3 months prior to the Draft Decision (in September 2015).

6.31 Certainly, DBP was provided no forewarning of the nature and significance of the many recommendations made, in the nature of significant disallowances of capital and operating expenditure. The disallowance by the ERA of a significant amount of AA3 SIB Capex has a significant impact on a business's financial sustainability as well as incentives for future investment. DBP considers that the ERA has a responsibility to ensure that any adjustments to past capital expenditure (with the effect of ensuring that the business receives no return on or of the capital already invested) is robust, supported by reasons and undertaken in full recognition of the impact on the businesses financial viability and incentives.

Experience and technical capability of DBP staff

6.32 DBP considers that the expertise and experience of its staff must be given weight in the assessment of project requirements and investments and cannot be dismissed by the ERA merely as a result of the ERA's consultants forming a different view or not being provided with a document that contains the information in the form expected. This is particularly important in the case of capital expenditure being a limited discretion matter under Rule 40 (and with respect to which, see the submissions in paragraphs 6.2 & 6.3 above).

6.33 The EMCa Report contains many findings and recommendations, based on what EMCa considers to be inadequate information provided by DBP or where EMCa otherwise concludes that it is unable to discern particular information from DBP's submissions and information. There are numerous instances where DBP either has provided the information which EMCa says has been omitted, or where DBP could provide additional information or clarification, but was not given notice (and could not reasonably have been on notice) of the need to do so having regard to the position to be adopted by EMCa. By way of example only of the former situation, DBP notes the following:

(a) Appendix B: , project 3 – EMCa suggests that it does not know what work has been done in AA3 despite DBP providing project scope in Submission 8, business case and a project management plan;

(b) Appendix B: – project 8 - EMCa states that DBP has not provided explanation for the average cost of the 8 units replaced prior to 2011 being 25% lower than the expenditure incurred in 2015 to replace the 9th unit. However it is contained in the business case provided. The business case that EMCa cite (App 64) contains the reason for the higher CWIP costs, as follows - "*Due to the increase of associated costs with the replacement of existing foundations, the additional scope of* [redacted] *and the increased cost in overall installation, the project budget was re-evaluated. The re-evaluation now includes the material and installation cost of the additional* [redacted] *installed on the pipeline*". In 2015, the foundations would not need to be replaced, nor new [redacted]nstalled as part of the project, as they were originally. More information on this project is contained in Appendix B: .

(c) In paragraph 288(ii) of the EMCa Report, it is suggested that DBP has not provided a compelling reason for the 3.6% increase from the most recent year (2014) of actual expenditure. It is not apparent that EMCa has made an assessment of DBP's submission contained in section 5 of Submission 10. If EMCa required further clarification, DBP would have welcomed the opportunity to provide such clarification, if given the opportunity.

6.34 In any event, DBP is, in this submission, providing additional information to support the AA3 SIB Capex levels included in the Amended AA Proposal for each of the Reviewed Projects. This will be done by providing:

(a) further explanation of the project management framework, its application in the business, and audit review findings about the requirements for documentation and DBP's staff having deep knowledge about what is required (see section 7);

(b) collating information for each Reviewed Project on that was delivered in each year (see section 8);

(c) additional information to support efficient procurement including procurement processes undertaken for each Reviewed Project in line with DBPs purchasing policy, tender procedure and preferred vendor procedure (see section 8); and

(d) additional documentation to support the efficient delivery of the projects including the project management office's approach to capturing relevant information in the project status reports (see section 8).

6.35 DBP considers that this information will demonstrate that:

(a) the systemic issues outlined by the ERA in the Draft Decision (as also identified by EMCa) are not systemic failings of the application of DBP's project management methodology and so this can not be used as a basis for rejecting any of the AA3 SIB Capex (whether for the Reviewed Projects or the Non Reviewed Projects);

(b) there are in fact adequate systems and documentation in place to ensure DBP is adequately monitoring schedule, cost, resourcing and scope for both individual projects and the overall annual program/budget and, given the EMCa concluded that these systems and procedures were appropriate, it must follow that this is a reason for concluding that all of the AA3 SIB Capex (for the Reviewed Projects and the Non Reviewed Projects) is conforming capital expenditure for the purposes of Rule 79;

(c) there is in fact adequate evidence for projects to clarify the options considered and why the proposed solution (including the nature, timing and volume of work) was necessary;

(d) there is in fact adequate evidence to demonstrate that, where there was only one logical supplier of an item of plant or equipment required for a project, the selected scope and timing for the item of plant or equipment or the project was optimal;

(e) there is also sufficient clarity about what was actually delivered for the reported cost;

(f) there is finally clarity of the approach to ensure the efficient cost was efficient, such as a clear procurement strategy and evidence that tendering was undertaken in accordance with DBP's procurement policy; and

(g) the expenditure undertaken therefore satisfies Rule 79(1)(a).

Procedural Fairness issues

6.36 DBP is also of the view that the ERA's approach to assessing actual expenditure in AA3 is fundamentally flawed for the following additional reasons that relate to procedural fairness:

(a) **Relevant considerations** - The ERA has excluded relevant considerations from EMCa's review and its own review of AA3 SIB Capex. As the ERA has accepted EMCa's recommendations as the sole basis for making its decision on DBP's expenditure, the ERA has also failed to take into account certain considerations that DBP considers are relevant considerations. An example of this is the significant incentive mechanism of DBP's transportation agreements to ensure DBP acts prudently and efficiently in all expenditure it incurs.

(b) **Governance conclusions -** There are a number of incorrect and misleading conclusions made by the ERA in relation to DBP's governance framework (as outlined in paragraphs 6.21 to 6.25. DBP submits that these have compromised the ERA's review and therefore are likely to have adversely impacted recommendations made by the EMCa and in turn, the ERA's Draft Decision.

(c) **Arbitrary reductions in the amount of expenditure** – EMCa has made claims that reductions in expenditure are required. However, it has not provided reasons for the amount of the reduction and neither has the ERA or EMCa demonstrated that the reduced amount reflects the prudent and efficient cost of delivering the work. Nevertheless, not only have both the ERA and EMCa applied reductions to the Reviewed Projects, they have applied an even greater reduction[16] to the Not Reviewed Projects without first assessing whether the projects did in fact contain deficiencies, noting that 3 of the 15 sample projects reviewed (36% based on expenditure) were prudent and efficient.

Failed to take in relevant considerations

6.37 As mentioned earlier in this submission, EMCa and the ERA have failed to appropriately consider the incentives inherent in DBP's current arrangements with its shippers. DBP has strong incentives for efficiencies in the form of:

(a) The incentive based approach to economic regulation under the NGR – this framework results in DBP being required to absorb increases in expenditure above the regulatory forecasts and benefit from reductions in expenditure compared to the regulatory forecast. As a privately owned business competing for financial capital with subsidiaries as well as other businesses in the financial capital market, DBP has strong incentives to review the necessity and efficiency of its investment.

(b) The incentives implicit in its shipper contracts – DBP has explained in section 7 of Submission 2, how it is incentivised under shipper contracts to ensure capital and operating costs are prudent and efficient. The ERA has previously formed the view that DBP's contractual arrangements 'may be stronger than those under the regulatory framework' as an incentive to ensure this outcome[17].

6.38 At paragraph 183, EMCa state that the examination of this aspect is excluded from its original scope of review.

6.39 The ERA has, however, not considered these incentives itself in the Draft Decision.

6.40 DBP considers that the operation of these strong incentive mechanisms is a critical consideration in assessing the prudency and efficiency of investment undertaken during AA3. No explanation is provided for why these incentives are not a consideration of the ERA in this AA4 review or whether (and if so, why) the ERA's position has changed compared to the AA3 review process.

Review of governance, expenditure forecasting and performance

6.41 DBP notes that its governance and cost controls framework was outlined by DBP's submission 2 and also extensively in face to face workshops conducted with EMCa, the ERA and DBP staff during February of 2015.

[16] *As outlined earlier, this may have been an error in the EMCa recommendations, inadvertently adopted by the ERA.*

[17] *ERA Draft Decision (May 2010) paragraph 194-197*

6.42 There are a number of incorrect and misleading conclusions that have been made about this framework which compromises the EMCa's review and therefore are likely to have adversely impacted recommendations made by EMCa and the ERA's Draft Decision. These include:

(a) At paragraph 66 of the EMCa Report, EMCa state that it has reviewed the incentives created by shipper contracts. However, later in its report, EMCa reveal that consideration of DBP's shipper contracts were removed from their scope of work (paragraph 183). The statement at paragraph 66 is misleading in that, while EMCa may have reviewed DBP's submissions, they were not taken into consideration. DBP is firmly of the of the view that as it has assumed risk for opex and capex overrun, then it is strong evidence that only work required to be undertaken occurs and every measure is pursued to reduce the cost without compromising the effective management and operation of the pipeline. This incentive is strengthened further where DBP's expenditure is greater than forecast. This is because the cost of financing the expenditure during the regulatory period is never recovered. Therefore, these incentives are directly related to the assessment of whether the expenditure is likely to have been prudently and efficiently incurred during AA3.

The ERA has not addressed why this important justification was explicitly excluded from EMCa's consideration or why the existence of commercial drivers under shipper contracts does not infer that DBP is incentivised to ensure expenditure is prudent and efficient. In any event, the ERA can not have taken these incentives in to account because consideration was removed from the EMCa review and the ERA has adopted the recommendations of the EMCa Report as it relates to SIB capital expenditure in their entirety.

(b) At paragraph 96, EMCa conclude that DBP's risk assessment and ranking approach represents a bias for inclusion of projects in the forecast without adequate justification. This indicates a fundamental misunderstanding of the processes adopted to determine the projects to be undertaken. EMCa's assessment of DBP's risk assessment framework is discussed in further detail in paragraphs 7.53 to 7.76.

Arbitrary capital expenditure reductions

6.43 EMCa have made seemingly arbitrary reductions to DBP's total AA3 SIB Capex. EMCa formed the view that the work undertaken during AA3 was required; that is, it satisfied Rule 79(1)(b). However, in assessing whether the expenditure amount satisfied Rule 79(1)(a), EMCa applied arbitrary adjustments. For two of the 15 projects reviewed, EMCa recommended that the efficient cost of delivering the projects was zero ([redacted]) even though there was a need for the work covered by these projects. EMCa considered that the [redacted] projects could be delivered for half of that reported by DBP, that the replacement of control systems could be delivered for 30% less, and the remaining projects reviewed could be delivered for 20% less. However, neither the ERA nor the EMCa provided reasons for why or how the projects could be delivered for so much less. Further, EMCa then applied an even greater reduction to the efficient costs for projects greater than $0.15m but not individually reviewed by the EMCa (ie Not Reviewed Projects) of 36.7% without reviewing whether the reduced expenditure was prudent or efficient and no reason was provided.

6.44 In making submissions on these issues, DBP has made certain assumptions as to what might have been the ERA's reasoning. However, if DBP's assumptions are incorrect and there were other reasons that the ERA relied on in making its decision on each issue, DBP submits that the ERA must, prior to making its final decision:

(a) provide DBP with a statement of its reasons;

(b) allow DBP an opportunity to make submissions in response to the statement; and

(c) consider these submissions.

7. REASONS FOR REJECTING CAPEX FOR MULTIPLE SIB PROJECTS

7.1 The ERA's Draft Decision to reduce the level of AA3 SIB Capex by $49.25m or 35.5% was based partly on EMCa's view that there were gaps in the information provided by DBP in respect of the Reviewed Projects. These gaps are outlined as follows:

(a) **Business documents** - DBPs documentation was typically unsigned and undated and did not fully adhere to DBP's own internal QA instructions

(b) **Business need** - DBPs project documentation was in most cases adequate to support the need to undertake work.

(c) **Options analysis** – DBP's options analysis was inadequate to support a finding that the work planned to be undertaken was prudent. The options identified are not what would be expected to see and the business cases do not present a compelling case for the timing and scope of work. Would expect to see some analysis that the scope and timing is optimal from a cost-benefit perspective. In cases where the risk was judged to be intermediate, would expect to see the details in the business case demonstrating that the proposed expenditure was justified under the ALARP test.

(d) **Procurement** – DBP's procurement policy was sound, the rationale for the procurement approach for the project and the delivery risks and risk mitigation activities to be identified. The inadequate information about the procurement process followed undermined confidence that DBP has delivered expenditure efficiently.

(e) **Delivered scope** – DBP often did not provide sufficient explanation of the reasons for variations between initially proposed/forecast expenditure (across the AA3 period) and actual expenditure or how project timing was determined. The approach to preparing business cases on an annual basis rather than a project basis and lack of closeout reports or the evidence that opportunities were taken to combine work on a zone or asset to reduce costs undermined confidence that the capex was delivered efficiently.

(f) **Delivered cost** – inadequate information that is has deployed prudent means of establishing efficient costs at the project level. Close attention is paid to the overall budget, however there were significant variations between actual and forecast expenditure, which, in the absence of explanations, is indicative of sub-optimal decision making. Scant information is provided on the procurement process actually deployed.

(g) **Close-out reports** – would expect close out reports for projects over a certain threshold (say $2m). None were provided. This makes it challenging to confidently assess the delivered cost against the business case estimate and the reasons for any significant variance. No evidence that benefits were realised was provided even where benefits were identified.

7.2 At paragraphs 413 of the Draft Decision, the ERA states that it does not approve all of DBP's proposed capital expenditure for AA3 for 12 out of the 15 Reviewed Projects. For each project reviewed, the ERA refers to the reasons outlined by EMCa and reproduced in 376 to 412 of its Draft Decision that not all of the expenditure should be allowed. EMCa's review found that the projects were compliant with Rule 79(1)(b) but not Rule 79(1)(a).

7.3 In addition, the ERA determined that the projects that had an individual value of $150,000 or more but which the ERA accepted EMCa's view and EMCa did not review individually (ie Not Reviewed Projects) also complied with Rule 79(1)(b) but not Rule 79(1)(a). DBP's proposed actual expenditure for these projects of $25.62m has been reduced by 36.7% to $16.22m in the Draft Decision (see para 213 of the EMCa Report). The ERA's Draft Decision does not provide reasoning for this reduction. However, the EMCa Report (on which the ERA's decision is based) indicates that the reduction is based on same ratio as applied to the 15 Reviewed Projects. As stated earlier in this submission, this must be an error as the reduction applied to the 15 Reviewed Projects was 25%.

7.4 EMCa recommended that no adjustment be made to projects that were less than $0.15m and projects in 2010 CWIP expenditure (ie Small SIB Capex). This was because the EMCa acknowledged that it is counterproductive to refine scope and achieve delivery efficiencies for projects less than $0.15m (and these projects are mostly ad hoc and reactive).

7.5 Finally, the ERA accepted EMCa's recommendation that none of the subsequent cost category of stay in business capital expenditure satisfied Rule 79(1)(a). This is because although EMCa considered that the majority of expenditure conforms with Rule 79(1)(b), the category subsequent cost capital expenditure consists of costs that were previously opex and have now been capitalised. In EMCa's view, to capitalise these costs would result in double dipping.

7.6 The following table summarises the findings and adjustments applied to the stay in business capital expenditure for the Reviewed Projects. All of the projects were found to satisfy Rule 79(1)(b) but not Rule 79(1)(a). The EMCa also assessed the project costs against Rule 74(2). However, this Rule is not applicable to DBPs Amended AA proposal as all AA3 stay in business capital expenditure amounts are actual incurred expenditure – not estimates or forecasts. Nevertheless, this Rule must still apply where the ERA determines an estimate for the AA3 stay in business capital expenditure as a substitute to the actual expenditure incurred. This Rule requires that any estimate must be arrived at on a reasonable basis and represent the best estimate possible in the circumstances.

Table 16: Summary of EMCa's assessment of Reviewed Projects

Project Number & Name	DBP Original AA Proposal	EMCa adjustment $	EMCa adjustment %
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

Source: EMCa Report

7.7 In relation to the 15 Reviewed Projects, both EMCa and the ERA conclude that

(a) the project need for each of the projects was justified in accordance with Rule 79(1)(b) (ie it satisfied one or more need of Rule 79(2)(c)).

(b) Three projects were accepted as complying with Rule 79(1)(a) and the remaining 12 projects were not. This resulted in only 75% of the expenditure on the Reviewed Projects satisfying the prudent service provider test (Rule 79(1)(a)) according to EMCa on the basis that the documentation did not support DBP's claims that it has completed a prudent scope of work and has undertaken the work efficiently.

7.8 The ERA's Draft Decision and the EMCa's review took place prior to the 2015 actual expenditure being available so the proposed AA3 conforming capital expenditure included an estimate for 2015. The actual expenditure undertaken in 2015 is now available and included in DBP's Amended AA Proposal.

7.9 The table below presents the amount of AA3 SIB Capex for each Reviewed Project that was included in DBP's Original AA Proposal and compares that with:

(a) the amount allowed by the ERA in the Draft Decision for each of the Reviewed Projects; and

(b) the amount proposed by DBP in the Amended AA Proposal for each of the Reviewed Projects.

Table 17: AA3 SIB Capex for Reviewed Projects – Comparison (Nominal, $m)

Project Number	Reviewed Project name	Capital expenditure in DBP Original AA Proposal ($m)	ERA Draft Decision Allowance ($m)	DBP Amended AA Proposal ($m)
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total		**69.78**	**50.97**	**71.75**

7.10 While section 8 contains submissions which focus on the specific reasons outlined by EMCa and the ERA for deciding that some or all of the expenditure for each of the Reviewed Projects was not prudent and efficient, this section responds to each of the following information gaps that the EMCa has outlined and adopted by the ERA as reasons for concluding that there were systemic issues surrounding DBP's systems and processes such that it is difficult to conclude that all of the expenditure incurred by DBP was prudent and efficient (which in turn led the ERA to adopting a reduced amount of AA3 SIB Capex):

(a) Lack of clarity on business & governance documents and close out reports

(b) Lack of evidence of business needs and options analysis

(c) Lack of certainty of procurement strategy and efficient delivered cost

(d) Lack of clarity about delivered scope

Business documents and close out reports

7.11 As outlined in section 6[18], EMCa acknowledged that DBP's processes, policies and systems (its governance framework) are appropriate to manage DBPs business, if properly applied and that its project governance structure and project management framework is consistent with industry practice. However, EMCa did not see that there was sufficient evidence of the processes being sufficiently followed. In addition, EMCa outlined concerns that some of the business cases reviewed were undated and unsigned and no close out reports were provided.

7.12 DBP does not accept that the concerns outlined by the EMCa in relation to the supporting documentation is sufficient to determine that the expenditure was not prudent or efficient because of the following reasons:

(a) Although all projects may not have a full suite of documents that are 100% compliant with DBP's Project management procedure (known as the Project Management Methodology or **PMM**), in many cases this is because the project manager has considered that documentation for what are essentially repeat projects or that preparation of numerous discrete documents increases administrative costs without adding to the value of the project management. This was validated in the audit report of the current requirements which contained recommendations that the current requirements could be streamlined to ensure that where documents are required, they add value.

(b) Where a separate document is not available, this does not mean the information is not available. Detailed information is captured in the project status report and reported monthly in the Traffic Lights Report and annually to various project management teams. The information in the project status report is sufficient to efficiently and effectively manage the project because it identifies progress against the scope, schedule and budget for each project, including explanations of variations.

(c) The existence of unsigned and undated documents reflects the situation where the preparation, review and circulation of the documents occurs electronically. DBP acknowledges this may present challenges where it is required to keep a record of the date and endorsement of a document if the relevant email is not also electronically filed.

(d) Project reports are prepared by the project manager or relevant project expert and reviewed by Manager Engineering and Operational Projects and the General Manager System Design and Operations. However, the form of the report may be different depending on the nature of the project (large, small, repetitive, ad hoc, common). Nevertheless, at a minimum, the process for closing out a project is incorporated into the weekly, monthly and annual review of the Project Status Reports included in the Traffic Light Report, examples of which are attached to this submission.

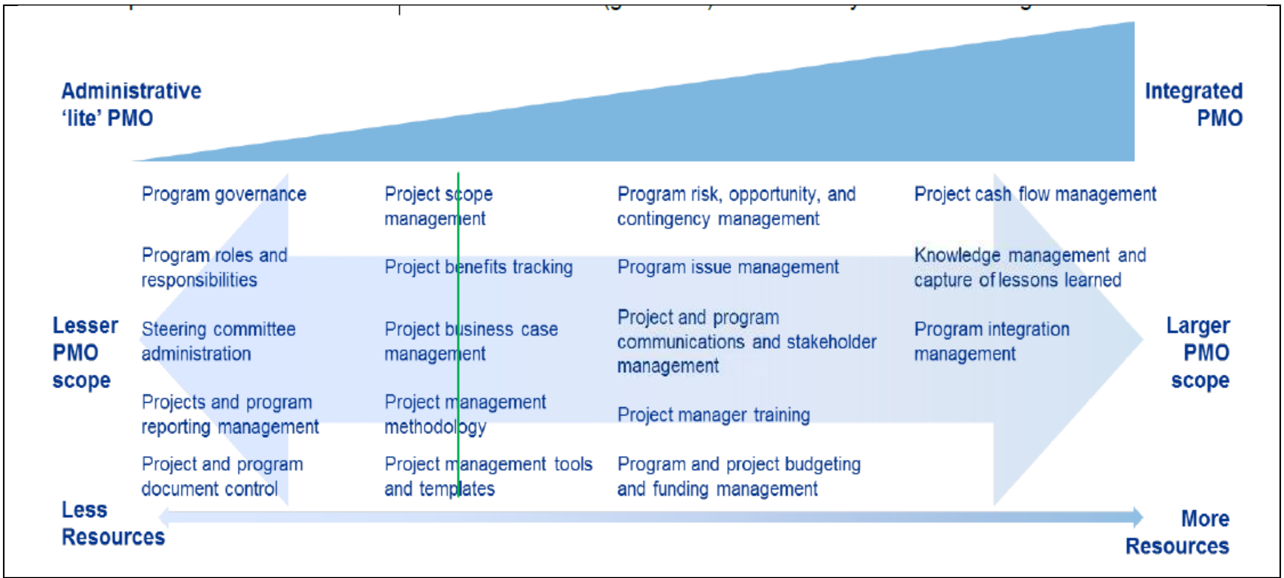
[18] *See paragraphs 6.17 to 6.27*

DBP's project management framework documentation requirements and audit

7.13 It is appropriate to consider the production of documentation required by DBP's project management framework in the context of the introduction and implementation of that framework. DBP's project management framework (formalised in the document called DBP Project Management Methodology provided to the ERA in submissions 8 & 19(1) prior to the Draft Decision) was developed and implemented by DBP in 2011. The design of the framework was based on DBP's experiences with managing the then recently completed stage 4, 5A and 5B expansion projects (with respect to which the ERA has previously concluded that almost all of the capital expenditure of $1.8 billion was prudent and efficient) and the standards outlined in the Project Management Book of Knowledge.

7.14 Accordingly, during AA3, DBP was not only implementing this new framework but it was endeavouring to deal with the teething issues associated with implementing any new system. The recent audit of the framework identified that the maturity of the PMM sits near the green line in the figure below.

Figure 1: Maturity of DBP's Project Management Methodology framework as identified in the audit report



7.15 DBP recognises that not all of the documentation required by the PMM are produced in practice which has contributed to some of the issues outlined by EMCa. Since the implementation of the PMM framework, DBP has been continually refining the framework to ensure that the system is designed and recognised as improving the efficiency and prudency of managing and implementing projects. In light of this, it would be unreasonable to conclude that the non compliances with the PMM are evidence of systemic failings to such an extent that the expenditure is inefficient and imprudent. The issues are of a result of the unavailability of discrete documents and not as a result of the unavailability of the information.

7.16 To this extent, as part of the 2014/15 strategic internal audit plan (approved by the DBP board of directors), an audit was undertaken of DBP's project management framework. The objective of the audit was to assess whether the PMM has been implemented within the Project Management Office (PMO) by confirming its application to capital expenditure projects. The focus of the audit was on two areas:

(a) The design and application of the PMM on DBP's projects. Consideration was given to how the PMM applies to different projects at different stages of the project lifecycle.

(b) The requirement for project documentation created for each project, as defined by the PMM.

7.17 To achieve the objective of the audit, the auditor examined (among other things) the PMM to assess its suitability in managing project documentation throughout the project management lifecycle. The examination:

(a) considered a high-level assessment against a defined framework (PMBOK);

(b) assessed the implementation of the PMM by walking through a sample of five active projects. The walkthroughs primarily focused on how each project has delivered the required outputs, as defined by the PMM (e.g. specific documentation needing to be produced at a particular time);

(c) assessed DBP's framework for ensuring that capable resources are deployed on projects to enable active delivery of projects on time, cost and quality, within the bounds of relevant regulatory constraints;

(d) assessed DBP's project reporting to determine whether it enables active monitoring and timely management intervention for project delivery; and

(e) followed-up the completion of the November 2012 *PMO Implementation and Contractor Management Review* internal audit findings to confirm agreed actions have been appropriately completed or closed out.

7.18 The auditor found that, in its assessment of and application of DBP's PMM in relation to the projects assessed, the overall control rating was 'Adequate'. This rating of "Adequate" meant that the overall PMM is "operating to a satisfactory standard although there are opportunities for improvement". A copy of the report prepared by the auditor is attached at Appendix D: .

7.19 Of particular note, the auditor made the following relevant findings and observations:

(a) DBP's project management group is constrained by resources and that the current PMM mandates a high level of governance to be applied to all DBP projects, which in the auditor's view is unsustainable considering the volume of projects that are required to be managed and implemented and the associated resources required to manage and govern them.

(b) Notwithstanding the significant number of projects being currently undertaken by DBP, project implementations have gone relatively smoothly.

(c) 100% compliance with the PMM framework is limited due to the significant number of projects being currently undertaken by DBP's project managers and the limited number of resources.

(d) DBP's current PMM, while suitable for large/Major projects, is too large in scale and not fit for purpose for smaller/Minor projects undertaken by DBP, causing Project Managers (PMs) to act independently of the PMM and applying their own practices based on their own experience.

(e) Despite the non compliances with the PMM, the auditor identified the following areas of good practice:

(i) There are well-established project management tools and templates.

(ii) DBP is working towards further improvements to its PMM by updating the PMM to better align with current practices.

(iii) Staff demonstrated a deep knowledge of what was required to deliver their respective projects.

(f) In light of the above, it recommended that the PMM design should be modified from a 'one solution fits all' framework to one based on scalability and prioritisation to cope with Major, Minor and No project classifications, which can support projects of varying complexity and risk through right-sized process rather than key person reliance.

7.20 DBP has already commenced implementation of these recommended changes that are aimed at achieving:

(a) a reconfigured PMM framework that will involve a scalable, priority based approach;

(b) improved administration of PMM documentation;

(c) discipline to DBP's project close out and lessons learnt practices; and

(d) better compliance with the PMM and improved quality assurance. In particular, this will involve ensuring the Project Management Plan is prepared to plan, schedule and manage the cost of implementation and transition to operation. The Project Traffic Light report will also continue to be used to capture the progress of the project and changes in scope.

7.21 DBP accepts that it does not have perfect and complete documentation for all of its projects that demonstrates strict compliance with its current PMM. However, the information expected to be captured in the documentation is captured and available in the project status reports. DBP's project governance processes result in the delivery of a prudent and efficient work program.

Project monitoring and reporting

7.22 The governance arrangements of the PMM require regular and ongoing review of all projects by a project steering committee (being the management team to review all SIB projects comprising the Manager of Engineering & Operational Projects, a Project Accountant and the relevant project managers of projects) and the Project Review Committee. As outlined in the PMM Overview document appended to Submission 8 (filed with the ERA before the Draft Decision), the composition of the Project Steering Committee can and will vary from project to project but should always include the Project Sponsor, and a suitable authorised person to approve project governance decisions. For most stay in business projects, this will be the General Manager, System Design and Operations. The number and nature of roles involved in Project governance and for the Project delivery team for a particular project will be agreed and documented at the project kick-off meeting. Tracking of expenditure and work scope is monitored on a regular basis as follows:

(a) The Project Manager is required to escalate issues and risks to the Project Steering Committee on an exceptions basis and capture these within the status report. Where those risks or issues have the potential to exceed the budget, schedule, quality or scope tolerances approved in the Project Management Plan (PMP) are updated to the PSC.

(b) There is a monthly review of all projects by the PSC which considers for each project all risks or issues that have the potential to exceed the budget, schedule, quality or scope tolerances. This is contained in the traffic light report. Samples of the information reviewed by the PSC in the traffic light report were provided to the EMCa at the initial workshops held in February and March 2015 prior to the Draft Decision and attached at Appendix E: .

(c) The PSC must escalate as required to the PRC when forecast variance exceeds the authority levels set by the PRC for the PSC.

7.23 Each week, DBP's project managers review and update the project status report that forms part of the traffic light report. This report is in the form of an excel spreadsheet that presents a summary for each project' performance against scope, schedule, costs, risks and procurement including explanations of variations. This spreadsheet includes a more detailed sheet for every project. Each month, the General Manager System Design and Operations reviews the project status report with the project managers and technical experts and approves scope changes as prudent for the safe and efficient delivery of the works. Whilst the technical and integrity related changes are approved within the framework of the asset management plan, the financial impact of these changes is approved by the Project Review Committee.

7.24 The project status report and consequential discussions are then captured in the monthly report to the project review committee (PRC). This report is in the form of a PowerPoint presentation which outlines:

(a) expenditure at an overall program level against the monthly approved budget and year to date;

(b) the key reasons for variance against budget;

(c) the likely cash flow profile for the remainder of the annual program;

(d) additional projects to the approved program or issues for the business that require a reduction in SIB expenditure (eg an unplanned reduction in revenue compared with the approved plan or an increase in other areas of expenditure such as financing costs), and updated risk ranking list of projects to inform decisions about modification to the work program; and

(e) resourcing or scheduling issues which require re-phasing of projects for the remainder of the annual program.

7.25 Samples of these presentations for each year of AA3 are attached to this submission as part of Appendix E: .

7.26 The PRC also is tasked with the following monitoring responsibilities in relation to the annual SIB program:

(a) Reviewing, on an annual basis, the overall program over the past year against the approved budget for that year – samples of these presentations made throughout AA3 are attached as part of Appendix E: .

(b) Reviewing the list of SIB projects proposed for a financial year and the risk ranking list for these projects – samples of these lists for each year of AA3 are attached as part of Appendix E: .

(c) Recommending to the board the SIB program for the financial year. The presentation prepared for the board for each annual program is attached as part of Appendix E: .

7.27 It should be noted that it may be difficult to reconcile the financial information in these presentations with the financial information that DBP has provided to the ERA and EMCa with respect to individual projects. This is largely because of the fact that the presentations relate to a financial year program whereas information is provided to the ERA on a calendar year basis. Notwithstanding this, it is important to remind the ERA that all expenditure actually made by DBP and included in as AA3 SIB Capex has been (or is in the process of being) the subject of an independent verification process by DBP's external auditor.

7.28 This close monitoring, supported by bottom up and top down review, together with DBP's strong incentives to minimise expenditure, result in expenditure that is prudent and efficient.

Project documentation – scope and delivery

7.29 EMCa indicated that it had been provided with insufficient documentation to support the project scope and efficiency. In particular, EMCa referred to documentation not being provided when it was required by the PMM and documentation being unsigned. These were also issues considered and assessed during the audit of the project management office and subject to recommended improvement actions. For example, the audit also identified that the PMM framework is being applied to tasks and projects which do not benefit from or require such a framework, leading to the production of unnecessary documentation. The auditor recommended that DBP's current PMM framework could be:

(a) simpler and more intuitive for project managers;

(b) less focussed on the production of governance documentation to satisfy PMM requirements; and

(c) streamlined, possibly including a 'lite', version of the framework while maintaining alignment to PMBOK. [19]

7.30 The auditor also identified the difficulty associated with locating documentation. Finding that:

DBP's current PMM folder structure should be simplified as it is currently difficult to navigate freely and contains many sub folders, which were empty for many projects sampled. Further, we observed in the five projects sampled:

1. PMM documentation is not always stored within the expected folder/subfolder. For one project sampled, the folder structure was not used at all and all project documentation was stored in a newly created folder

2. Duplicate documentation within the folder structure

3. PMM documentation naming conventions (outside of technical documentation requirement such as drawings) are not enforced.[20]

7.31 With regard to unsigned business cases, DBP recognises that this could be seen as a symptom of problems with documentation. However, DBP does not consider that this results in a lack of clarity about the project scope or that the expenditure is not efficient or prudent because:

(a) documents are managed electronically and are not always physically signed;

(b) there are other steps in the process to ensure that the definition of each project is clear and can be considered as part of the totality of projects to be undertaken under any given program. These are the Project Review Committee's review of all projects as part of the recommendation to the board that the annual program be approved and the General Manager being required to sign off on any change to project scope through a Project Change Request form; and

(c) the cost estimating guideline that DBP provided the ERA as an appendix to Submission 19(2) requires the following steps to normally be followed:

(i) Establish type of cost estimate with the type of the estimate dependent on the level of accuracy, basis for the estimate and type of project it relates to being outlined in the matrix contained in the guideline.

(ii) Scope of work and deliverables to be prepared.

(iii) Baseline Cost Estimate to be prepared.

(iv) Monte Carlo Cost Risk Analysis to be undertaken for larger projects.

(v) Prepare an estimate summary and report detailing assumptions, qualifications and comments.

Close out reports

7.32 As outlined above, EMCa claimed that for the Reviewed Projects, no close out report or benefits realisation (including lessons learned/practices changed) were provided and that this was another reason for concluding DBP's AA3 SIB Capex was imprudent and inefficient.

7.33 While DBP acknowledges that close out reports for each project of the kind referenced in the PMM are not available, that of itself, does not mean that no ongoing review or a lookback process is undertaken. To the contrary:

(a) lessons learnt are part of the weekly and monthly review of SIB projects, particularly as most have a duration of less than 12 months. More disciplined lessons learnt relate more to major

[19] Internal auditor's report - DBP Project Management Office (PMO) internal audit, October 2015, p. 8.

[20] Internal auditor's report - DBP Project Management Office (PMO) internal audit, October 2015, p. 8.

expansion projects that last 1 to 3 years (copies of which were provided to the ERA as part of the justification of expenditure for the stage 5 expansion projects). The application of lessons learnt on SIB projects that take 10 weeks to implement means that lessons learnt are implemented on the job as project change requests;

(b) there are reviews undertaken to monitor possible variations in scope and budget (for ongoing projects) and actual variations (for completed projects); and

(c) project completion and performance against budget, schedule and scope is captured in the project status reports for each project.

7.34 Before the Draft Decision, DBP provided the ERA with copies of presentations made to the Project Review Committee in relation to the full list of projects undertaken during the 2014 financial year – see appendix D to submission 19(1). This reviewed:

(a) the progress of all projects against schedule;

(b) the total actual expenditure for the year against the total approved budget;

(c) the reasons for variances between actual expenditure and the approved budget; and

(d) the actual expenditure for each project against the approved budget for each project and the reasons for variances.

7.35 It is not apparent that either the ERA or EMCa had regard to this documentation. However, it demonstrates that there is a process followed whereby DBP reviews both ongoing and completed projects on a regular basis to assess changes in either expenditure or scope.

7.36 Furthermore, as outlined above, there is the ongoing monthly project cost management process in place to ensure DBP is constantly reviewing not only the costs for each project but also the totality of costs for the overall program. For larger projects a technical project report is prepared that describes the work undertaken, the approach and captures lessons and experience to be incorporated into further projects. An example is attached in relation to Project 3 – Underground Pipework (see Appendix B3.1-6).

Summary

7.37 DBP considers that the ERA must give appropriate weight to the project monitoring and reporting and cost control process currently in place, the commercial drivers within DBP's business and the strong incentives for efficiency resulting from the incentive based regulatory framework and shipper contracts when considering whether expenditure is prudent and efficient.

7.38 Furthermore, if DBP does not consider that it would be efficient to strictly adhere to the procedures and policies associated with managing capital projects as outlined in the PMM, which, as identified in the attached audit report, may require too many unnecessary documents and could benefit from review. If these requirements were to be strictly adhered to, DBP would require additional resources to ensure effective implementation and application.

7.39 Additional resources to service the production of additional documents would also increase the costs of capital projects and be unlikely to deliver greater efficiency and prudency benefits given the nature of some of the projects but also, most importantly, because of the other incentives in place in the business to ensure efficiency and prudency. This was a point explicitly noted by the auditor in its audit report (see section 1.6 of the attached audit report).

7.40 In summary, DBP acknowledges a level of deficiency in compliance with the provision of project level documentation required under the PMM. However, sufficient governance, including information capture, monitoring and reporting, is applied to ensure the prudency and efficiency of expenditure. The audit report provides evidence that the governance framework could be modified to be more appropriate to the nature of projects currently underway and the resources available to DBP. The audit report is also further evidence that the current requirements for documentation do not always add value (this is explicitly recognised by the EMCa) and it does not mean that DBP does not properly govern and execute the projects.

Business needs and options analysis

7.41 DBP does not accept EMCa's view that:

(a) DBP's options analysis is inadequate;

(b) DBP does not incorporate a compelling case for timing and scope of projects; and

(c) DBP's risk assessment process results in a bias towards ranking risks as high or that where a risk is rated as intermediate DBP needs to demonstrate expenditure was justified under the ALARP test.

7.42 DBP does not accept that these issues lead to expenditure being imprudent or inefficient because:

(a) the nature of stay in business capital expenditure is that the options are limited (replace, upgrade) or inefficient because the work is repeated and common and options are common sense;

(b) where timing and scope of projects are not explicitly considered in the business case, they are explicitly considered through the investment prioritisation process before investment decisions are made;

(c) if there is a bias toward high risk, a relative assessment of risk and consistency with Board appetite is tested through the investment prioritisation process; and

(d) DBP is only required to demonstrate ALARP where the risk is identified to be intermediate and DBP is choosing not to take action to reduce the risk to low or negligible.

Options are sufficient

7.43 Stay in business capital expenditure relates to work DBP requires to be undertaken to continue operating the pipeline to meet its statutory and contractual obligations. Often the expenditure is required to upgrade, replace or repair a particular element of the pipeline. Therefore, the options available for consideration can be limited. Nevertheless, DBP uses front end engineering design (FEED) studies which involve a needs assessment for proposed major works and identification and investigation of options available to meet the functional requirements. DBP has provided information on the options considered in FEED studies and business cases which were not always acknowledged by EMCa (for example, for the [redacted] project, a number of options were outlined in the FEED study undertaken by [redacted] in Submission 17)). As noted, FEED studies are only conducted for large projects – eg [redacted] For a large majority of SIB projects, formal FEED studies don't apply. However, investigations and project scope estimates are carried out with sufficient information to be captured in the business case with a costing level of certainty for SIB Risk Ranking to apply in accordance with the cost estimation matrix. For a large numbers of SIB projects – options are limited to the like for like replacement of the process or equipment being replaced.

7.44 In relation to options associated with the timing of works, where a timing option is not explicitly identified in the business case or FEED study, it is implicitly considered in the risk assessment framework and investment prioritisation process. For example, once a project has been identified, the risk assessment considers the consequence of not undertaking the work. Where the timing can be deferred, this will be reflected in a lower risk rating and or a lower ranking when the project is considered for incorporation in to the annual investment program budget.

7.45 Timing issues are also considered in relation to weather. DBP is limited to the type of work that can be undertaken in extremely hot or wet conditions. While this is very rarely expressly recorded in the assessment of the risk ranking to be given to a project, it is a fundamental consideration that underpins the decision on timing of all projects. Weather will then impact on cash flow constraints of the business and overall project management requirements such as resourcing.

7.46 There is perhaps one key timing consideration that is central to all decisions on the timing of projects. That relates to the impact of a project on the pipeline's ability to meet DBP's obligations to shippers under shipper contracts. The pipeline's contracted capacity is structured to meet seasonal demand conditions. Demand on the pipeline is at its highest during the summer and winter months. Accordingly, DBP's contracted capacity profile is sculpted on a monthly basis, leading to higher levels of contracted capacity in the summer and winter months. It is therefore the case, that any SIB project which involves risk to contracted capacity is generally phased for the shoulder seasons of autumn and spring. Again, this is not expressly considered or documented but has an impact on cash flow constraints for the business and overall project management requirements such as resourcing.

7.47 Not only is the appropriate timing of each project considered at the beginning of an annual program, the risk and priority of projects (and therefore their timing) are considered on an ongoing basis, and where the urgency of the project increases, the risk rating may be modified and/or the project will be moved higher up in the prioritisation process.

7.48 There are also other timing related considerations that are taken into account by DBP.

7.49 For example, as part of the Project Review Committee's review of the overall stay in business program for a given period, an assessment is undertaken as to the ability of the project management team to undertake all work within existing resources and if so, that the work plan is staged throughout the year to ensure there is an even spread of project work throughout the year.

7.50 DBP submits that the absence of this information expressly stated in the business case does not, of itself, demonstrate inefficiency and imprudence in relation to DBP's stay in business projects for AA3. The assessment is undertaken – it is just that it isn't recorded in a particular document.

7.51 There are also other reasons why DBP considers it would be wrong to conclude DBP's AA3 SIB Capex levels are imprudent and inefficient on the basis that there is a lack of option analysis relating to the timing of carrying out the works:

(a) The ERA's statement seems to contradict EMCa's finding that "in each of the fifteen project reviewed, we found that the project was justified in accordance with one or more of the tests in Rule 79(2)(c)"[21]. If the EMCa was satisfied that all Reviewed Projects were needed to maintain or improve safety and integrity or meet a regulatory obligation or maintain the capacity to meet existing demand, it would seem inconsistent to then also conclude that DBP's information didn't present a compelling case for timing and scope of work to be undertaken in AA3. A project that did not need to be undertaken soon, would not be identified as being needed in a particular year's program.

(b) As has been previously outlined in this submission, DBP regularly reviews the schedule and timing of projects as part of the Project Steering Committee's regular review of projects and where necessary (eg if budget does not permit), the remaining projects are reviewed for the purposes of rephrasing them (either until later in the same year or into a subsequent year). The risk ranking process is applied in undertaking this assessment.

7.52 The role and operation of the risk assessment framework and process and the investment prioritisation process are outlined further in the following section.

Risk assessment facilitates prudency and efficiency

7.53 EMCa made the claim that in very few cases in the project level documentation, was there an explicit link between DBP's risk assessment and risk rankings provided. Further, EMCa considered

[21] *Paragraph 201, page 49 of the EMCa report*

that DBP's risk ratings were biased upwards resulting in DBP's expenditure forecasts being biased upwards and that there was no discussion of the concept of ALARP in any of the business cases provided.

7.54 The ERA and EMCa appear to have misunderstood the information that DBP provided to them prior to the Draft Decision on the relevance of the risk assessment process to the overall stay in business program. This misunderstanding has led the following conclusions to be incorrectly made:

(a) EMCa incorrectly concludes, at paragraph 77 of the EMCa Report, that:

> *"DBP's bespoke risk rating process leads to a bias to rate risks as "High". By definition, "High" risks require immediate action. There also appears to be a large number of residual risks rated as High or Intermediate. These risk levels drive further treatment to achieve a risk level of ALARP. We consider there is evidence in our project reviews of this resulting in an upward bias to the expenditure forecast."*

(b) Both the ERA and EMCa incorrectly conclude that DBP's expenditure is inefficient because, in very few cases in the project level documentation, was there an explicit link between DBP's risk assessment and risk rankings provided.

7.55 DBP applies its risk management framework that has been approved by DBP's board of directors and the Minister for Mines and Petroleum as an adequate model to ensure all risks associated with the pipeline (not just safety related risks) are adequately managed. Further, the risk management framework is consistent with its obligations, its project management methodology, and its processes for planning and determining work programs and budgets.

7.56 It may be EMCa's view that the process and approach result in a conservative bias when assessing risk. However, the risk assessment framework is consistent with the Board's appetite for risk and the prioritisation process ensures the framework is consistently applied across projects to assess relative risk.

7.57 DBP maintains that the risk ranking process is explicitly linked to the decision to undertake a project through consideration in the project initiation documentation (for example business case or FEED study), the workshop conducted to rank projects and the project governance processes (regular monitoring and reporting and establishment of the annual budget and longer term investment plan).

7.58 DBP utilises the risk assessment framework in three ways:

(a) To identify work that needs to be undertaken in line with good industry practice

(b) To inform a comparative assessment and prioritisation of investment to establish annual budgets and longer term plans.

(c) To ensure DBP's assets are managed in compliance with its safety obligations.

Identify the work that needs to be undertaken in line with good industry practice

7.59 As outlined in Submission 2 filed on 31 December 2014, the Asset Management Plan (which was attached to Submission 2 – Appendix I) outlines the philosophies and policies relevant to the lifecycle management of the assets that make up the DBNGP. As stated in the asset management plan, these philosophies and policies are optimised and prioritised through a risk management process, where asset related risks for the whole lifecycle are assessed and analysed. It is the risks identified in the asset management plans that identify the need for work to be undertaken to meet DBPs obligations and objectives in relation to people, environment, supply, outrage (reputation) and loss (financial).

7.60 Once the risk is assessed, depending on the rating, risk treatment actions are considered. As part of the yearly review of the asset performance, the performance of controls needs to be analysed against the required standards and performance indicators. Where required, the risk assessment is reviewed to determine currency and appropriate amendments made as necessary.

7.61 The Asset Management Plan is central to the safe and reliable operation of the pipeline, and it is appropriate that the risk assessment process is used to determine whether a project should be submitted for inclusion in a stay in business program for a given period and then costed up for consideration in that program for that given period.

To inform a relative assessment and prioritisation of investment

7.62 DBP has strong incentives to manage the pipeline within financial performance indicators and utilise capital efficiently. As a result, all stay in business capital expenditure projects are assessed based on balancing DBP's obligations and operational requirements with allocating financial capital efficiently. The risk management framework informs this process by facilitating a relative assessment of projects across a number of criteria, which are not all financial.

7.63 DBP has strong incentives to manage the pipeline within financial performance indicators and utilise capital efficiently. As a result, all stay in business capital expenditure projects are assessed based on balancing DBP's obligations and operational requirements with allocating financial capital efficiently. The risk management framework informs this process by facilitating a relative assessment of projects across a number of criteria, which are not all financial.

7.64 These tensions are reflected in the SIB Priority Scoring document which DBP created to record the process to prioritise all stay in business projects that have been identified for inclusion in a stay in business program for a given period. The projects that have been submitted to meet operational, maintenance and pipeline licensing have to be considered within the confines of what DBP can afford to fund (having regard to expected returns to owners, financing covenants, obligations to shippers etc..). Prior to the Draft Decision, DBP provided the ERA with a copy of this document (Appendix B of Submission 2, "Stay in Business – Business Process Project Priority Scoring"). It was again provided to the ERA in submission 19(1) in response to queries raised by the EMCa following its assessment of DBP's expenditure proposals.

7.65 The risk scores presented in Figure 5 on page 21 of the EMCa Report were developed to enable the distinction between risk levels for the purpose of informing the SIB investment prioritisation process[22].

7.66 The Total Score is the aggregate of the 6 individual scores. The projects that have the highest Total Score are considered relative to the rating of individual scores shall have priority to be approved. However, the score may not be relevant at all to DBP's obligations under AS2885 – this is mostly the case in relation to projects associated with DBP's Corporate obligations (eg ICT and Finance Systems).

7.67 Attached as part of Appendix E: are copies of all of the business planning presentations given to DBP's board for each financial year within AA3 that demonstrates how the risk ranking and risk prioritisation process is applied in practice.

7.68 The use of the risk management framework for this purpose results in an ongoing review opportunity for the risk assessment of individual projects as well as the consistency and relativity of risk assessment across the entire portfolio of projects. In the event that the risk associated with a particular project was considered to be too conservative at the outset, the investment prioritisation process provides an opportunity to undertake a qualitative and quantitative review of each project. If a project was considered to be conservative as a result of that assessment, the risk assessment and/or the investment priority is likely to be modified, thereby addressing any inherent bias prior to the investment decision. The risk assessment is therefore used to determine whether a project that

[22] *It has also recently (in December 2015) been reviewed and updated as a result of requirements set by the DBP board of directors. But this most recent revision has not been used as the basis for the stay in business program that forms the basis of DBP's forecast capital expenditure program for AA4.*

has been identified should be undertaken in the particular period or can be deferred based on relative risk.

7.69 The risk ranking prioritisation process is also used during the course of a business plan if there is a need to either reduce the approved SIB budget or there becomes a need to undertake a project that wasn't part of the plan approved along with the budget.

7.70 So, whether the application of DBP's own risk model might result in more projects being rated "high" than would be the case had the AS2885 risk matrix been used (which DBP does not accept is the case) does not, of itself, mean that DBP undertakes all such projects. There are more than adequate tensions between the company's obligations (contractual, financial, safety and statutory) and expected returns for shareholders to ensure that the DBP board is incentivised to set the expenditure level of a stay in business program for a given period at an efficient and prudent level.

7.71 The most important incentive or tension that exists in DBP's business to ensure DBP's expenditure is efficient, notwithstanding any potential upward biasing of a risk model (which DBP does not accept), is the contractual framework that applies to most of DBP's revenue contracts. It is noted that the EMCa was explicitly requested by the ERA not to consider these contractual frameworks in its assessment of the prudency and efficiency of DBP's expenditure proposals[23]. Moreover, it is noted that the ERA has previously concluded that DBP's contractual frameworks means that DBP is incentivised under these shipper contracts (which account for approximately 85% of DBP's firm full haul contracted capacity) to ensure that its expenditure (both capital and operating) are at least prudent and efficient. ERA has previously considered DBP's contractual arrangements 'may be stronger than those under the regulatory framework'[24]. These submissions were all made to the ERA prior to the Draft Decision but appear to have been not considered.

7.72 The above submissions do not, however, imply that DBP does not undertake measures to ensure all risks associated with a project are reduced to the ALARP standard. DBP's Safety Case (as approved by the Minister for Mines and Petroleum) summarises the processes undertaken by DBP to ensure all risks are reduced to ALARP. A copy of the safety case can be provided to the regulator on request if required.

Ensure DBP's assets are managed in compliance with its safety regulation

7.73 DBP's risk model is also used by DBP in undertaking its Formal Safety Assessment that is required under the Petroleum Pipelines Act as part of the five yearly revision of the DBNGP Safety Case. DBP combines its five yearly asset management plan risk assessment process with the formal safety assessment process required under the Act in order to streamline processes. The Department of Mines and Petroleum and the Minister for Mines and Petroleum approve this formal safety assessment and given the risk model is central to that assessment process, endorse the DBP risk model.

7.74 In ensuring compliance with AS2885, DBP will undertake a more detailed risk assessment where relevant and once a detailed design assessment is completed. The initial risk assessment will inform the identification of the need to undertake work but the information is not sufficient at that stage to form a reliable risk rating under AS2885. This does not mean that a risk may not be ranked 'high' or 'intermediate' as a result of the assessed impact on people in the initiation of a project, but rather that to adopt this rating for compliance purposes, a more formal and detailed assessment is carried out. This will include demonstration of ALARP as required when DBP is unable to reduce the risk further or the cost of reducing the risk is considered to be disproportionate to the risk impact.

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[23] *EMCa Report, paragraph 183*

[24] *ERA Draft Decision for AA3 (May 2010) paragraph 194-197*

Errors

7.75 There are errors in the EMCa's summation of DBP's risk ranking process which call into question the reasonableness of any conclusions that the EMCa makes (and any decisions the ERA makes which rely on these conclusions) about the efficiency and prudency of DBP's expenditure. They are as follows:

(a) At paragraph 93 of the EMCa Report, EMCa has made an error when it attempts to analyse the quantum of each "Extreme" risk project compared to the "low" risk projects. The "Total Score" does not inform the risk rating but rather the priority when comparing other projects rated at the same risk level given DBP's funding capabilities.

(b) DBP is also of the view that at paragraph 129 EMCa is wrong to conclude that, for any project whose implementation was deferred from the 2013/14 financial year to a subsequent year, DBP either:

(i) overestimated the expenditure for each project; or

(ii) adopted a risk framework for each project that is biased towards over-estimating risk.

As outlined in prior submissions by DBP (See Submission 2 & 8), during each project's execution phase, DBP continuously reviews projects to optimise the timing to reduce scope and spending. DBP's processes facilitate the dynamic consideration of project need, risk and efficient scheduling opportunities to achieve deferral where it is efficient to do so. The interpretation by EMCa that the deferral of a project is because the initial estimation of expenditure or risk was wrong is unhelpful and naïve. Prudent and efficient asset management practices provide for ongoing revision as a result of further or updated information.

7.76 Given the above submissions made about the risk ranking process for stay in business projects, DBP submits that:

(a) The ERA would be in error to conclude that DBP's expenditure in AA3 is not efficient or prudent because it has adopted a risk framework for each project that is biased towards over-estimating risk and therefore over-estimating expenditure;

(b) The ERA would be in error to conclude that DBP's AA3 stay in business expenditure is inefficient and imprudent because, in very few cases in the project level documentation, was there an explicit link between DBP's risk assessment and risk rankings provided;

(c) DBP's stay in business risk ranking process is evidence that DBP's AA3 stay in business expenditure is both prudent and efficient

Procurement and efficient delivered cost

7.77 EMCa claimed that for the Reviewed Projects, some of the scope variations were not supported or explained, that there was limited information on procurement process and rationale, no close out report or benefits realisation (including lessons learned/practices changed), for example:

(a) business cases provided by DBP for each project did not present a compelling case for the timing and scope of work undertaken (paragraph 383); and

(b) DBP provided inadequate information to allow a conclusion to be drawn that it has deployed a prudent means of establishing efficient costs at the project/program level (paragraph 387); and

(c) There was insufficient evidence that efficient procurement practices were employed. Procurement issues identified by EMCa included that:

(i) for projects where there was only one logical supplier of a replacement part or system, DBP has failed to demonstrate that it had explored the scope and timing options to demonstrate the selected scope and timing is optimal from a cost-benefit perspective (paragraph 384);

(ii) while DBP's procurement policy was found to be sound, the business case documentation either did not explicitly confirm the rationale for the procurement approach applied or (as was the case in most instances) was silent as to what procurement strategy was in fact followed for a project (paragraph 385);

(iii) DBP hasn't demonstrated that it tendered for the relevant external costs included in the total project expenditure for a project; and

(iv) no information was given by DBP to justify the schedule of rates approach adopted to pay consultants (EMCa Report).

7.78 DBP responds to each of the procurement issues identified in paragraph 7.77(c) when responding to each of the criticisms for each of the Reviewed Projects in section 8.

7.79 It is important for the ERA to understand that DBP's business cases do not detail the intended procurement practice to be used. At the stage of a project's progress, when a business case is prepared, there is inadequate information available to enable a detailed procurement strategy to be prepared for the relevant project. Rather, the business case is prepared and considered on the basis that the procurement and purchasing policy will be adhered to.

7.80 This does not, however, mean that a more developed procurement strategy for each project isn't developed. To the contrary, it is – it is included in the project implementation plan for each project.

7.81 DBP's additional project information for the individual Reviewed Projects is contained in Appendix B:

7.82 In the meantime however, DBP consider that its projects were efficiently delivered as a result of DBP's purchasing policy which is designed to:

(a) obtain the lowest total cost for goods and services whilst maintain quality, quantity, durability, availability, serviceability and other factors affecting service and use by DBP operations; and

(b) establish relationships with key vendors, forming Alliances where required, and introduce excellence into the selection, management and retention of preferred vendors.

7.83 The project management governance framework and processes designed to ensure that projects are efficiently and effectively delivered on schedule and within budget, and where this is not possible, variations are managed effectively.

7.84 DBP's purchasing policy[25] requires that the manager in each area of responsibility ensures that staff follow and comply with the policy. The policy includes a graduated quotation expectation, so that the greater the value of the purchase, the greater the requirements for the process as follows:

- For less than $10,000, an email quotation is sufficient and serves as the record of compliance with the policy.
- For values between $10,000 and $100,000, 2 written quotes are required and further documentation is required
- For values greater than $100,000 it is expected that a tender is conducted and tenders received from 3 vendors.

7.85 Any deviation to these requirements, for example a sole sourcing arrangement, must be accompanied by a justification and approved by the relevant General Manager.

7.86 To support the purchasing policy, DBP also adheres to the tender procedure[26] and the preferred vendor procedure[27]. Copies of these documents are attached at Appendix E:

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[25] *DBP, Purchasing Policy, DBP-PM.01, March 2015, p. 3 (See Appendix E:).*

7.87 The tender procedure outlines the responsibilities of the requesting department to determine the most appropriate method of tendering to ensure the highest level of competition, particularly where there is limited knowledge of the capacity of the market place. However, where there are known vendors who are always competitive and reliable there may be administrative savings in limiting the participation to at least three of those vendors in preference to public advertisement. The procedure outlines options to call for expressions of interest or a pre-registration process. It also outlines the option to adopt a request for quotations process which is less formal than a tender process and required less detailed documentation.

7.88 The procedure provides for the use of sole source negotiation where the services are only available through one organisation and exceptions from the requirement to undertake a tender process where a supplier is currently under contract to DBP and is capable of carrying out the services specified. The exception is applicable for either lump sum or schedule of rates work provided the following conditions are complied with:

a) For Civil or Electrical work, the estimated total value of each additional Purchase Requisition and Contract Variation does not exceed $50,000.

b) For Structural, Piping and / or Fabrication work, the estimated total value of each additional Purchase Requisition and Contract Variation does not exceed $100,000.

c) Such work must be based on a clearly defined Scope of Work and will only be issued following agreement on a fixed lump sum price or an estimate of cost based upon the schedule of rates specified in the existing contract.

d) All variations upon an existing contract must be in writing and agreed to by both DBP and the Contractor[28].

7.89 The preferred vendor procedure recognises that a tailored business relationship with a preferred vendor can generate business performance greater than that achieved individually. These arrangements provide opportunities to develop stronger relationships with key vendors to enable improved servicing of operations and rationalising the supplier base. The following steps are outlined to improve vendor relationships:

(a) DBP will routinely identify vendors whose support is crucial to DBP's operations.

(b) Vendors identified will be invited to discuss developing an on-going relationship with DBP for the supply of goods and/or services. These discussions include investigating and documenting cycle times, quality, overall cost reduction, technical assistance, product improvement/development and assistance in inventory management.

(c) Where there is more than one vendor identified as a potential supplier of goods and/or services required by DBP on an on-going basis, DBP will tender for these goods and/or services in accordance with both the DBP-PM.01 Procure to Pay Procedure[29] and DBP-CM.01.03 Tender Procedure. Copies of these documents are enclosed as part of Appendix E: .

(d) Upon reaching a satisfactory result for both parties, a formal agreement will be created (Pricing Agreement). The Pricing Agreement will be created in accordance with the DBP-PM.01.04 Pricing Agreement Creation Procedure and will include pricing which, for consumable and inventory items, will be fixed and firm for a set period of time as agreed

[26] *DBP, Preferred Vendor Procedure, DBP-PM.01.03 (See Appendix E:).*

[27] *DBP, Tender Procedure, DBP-CM.01.03 (See Appendix E:).*

[28] *DBP, Tender Procedure, DBP-CM.01.03, p. 4 (See Appendix E:).*

[29] *DBP, Procure to Pay Procedure, DBP-PM.01.01. This procedure was in place prior to the current Purchasing Policy was introduced in 2015 and is substantially similar.*

between DBP and the Preferred Vendor. A copy of this document is enclosed as part of Appendix E:

(e) In relation to services, a Services Agreement will be created and include a fixed schedule of rates for labour, plant and equipment for a set period as agreed between DBP and the Preferred Service Provider. All new Preferred Services Providers will be engaged in accordance with the Services Provider Accreditation Policy and Procedures.

(f) All Pricing Agreements will be subject to monitoring/review by DBP with the Preferred Vendor on a regular basis, as agreed with the Preferred Vendor.

(g) All Service Providers will be regularly evaluated by DBP.

7.90 DBP has developed this preferred vendor status with contractors for the purposes of undertaking specific types of work which are deemed important for the ongoing reliable operation of the pipeline. Examples of the types of work for which preferred vendor arrangements have been entered into with vendors include:

(a) Engineering consulting services for the following:

(i) Process Engineering (development of PFDs, heat and material balance, P+IDsm equipment sizing, Data Sheets preparation, HAZOP/HAZID and SIL facilitation).

(ii) Electrical and Instrumental (development of wiring diagrams, terminations, I/O line lists, Hazardous Area inspection, electrical and earthing calculations).

(iii) Mechanical (Isometric drawings, pipe stress analysis, pipe specification and mechanical drafting) design work.

(b) Specialist Communications Service Providers, SCADA, Control Systems, GEA and Electrical works, Noise and Vibration Consultants.

(c) Suppliers of Valves & fittings.

(d) Construction Contractors, Pipe Fabricators, Civil works.

(e) Compressor turbine work (eg overhauls etc).

7.91 The objectives of selecting preferred vendors include:

(a) it enables DBP to develop stronger relationships to enable improved servicing of DBP's operations; and

(b) it helps to rationalise the supplier base.

7.92 In accordance with DBP's preferred vendor procedure:

(a) vendors identified will be invited to discuss developing an on-going relationship with DBP for the supply of goods and/or services. These discussions include investigating and documenting cycle times, quality, overall cost reduction, technical assistance, product improvement/development and assistance in inventory management;

(b) where there is more than one vendor identified as a potential supplier of goods and/or services required by DBP on an on-going basis, DBP will tender for these goods and/or services in accordance with both the DBP-PM.01 Procure to Pay Procedure and DBP-CM.01.03 Tender Procedure;

(c) upon reaching a satisfactory result for both parties, a formal agreement will be created (Pricing Agreement). The Pricing Agreement will be created in accordance with the DBP-PM.01.04 Pricing Agreement Creation Procedure and will include pricing which, for consumable and inventory items, will be fixed and firm for a set period of time as agreed between DBP and the Preferred Vendor;

(d) in relation to services, a Services Agreement will be created and include a fixed schedule of rates for labour, plant and equipment for a set period as agreed between DBP and the

Preferred Service Provider. All new Preferred Services Providers will be engaged in accordance with the Services Provider Accreditation Policy and Procedures; and

(e) all Pricing Agreements will be subject to monitoring/review by DBP with the Preferred Vendor on a regular basis, as agreed with the Preferred Vendor. This may include quarterly reviews of performance, backorders and pricing reviews. DBP does not undertake a competitive pricing review each period because of the costs involved and the desire to ensure there is a knowledge of the asset built up by the vendor (given the importance of the activity to the ongoing reliable operation of the pipeline.

7.93 In relation to the process for selecting engineering consulting services, DBP issued a registration of interest document and from the expressions of interest received (from 20 consultancies), a short list was developed against an established criteria that was applied by an internal DBP committee. From that, DBP then selected the following consultancies for various types of engineering work:

(a) [redacted] for electrical and instrumental work.

(b) [redacted] for mechanical work.

7.94 Contracts were drawn up and rates were agreed upon. The schedule of rates developed at the commencement of the arrangement have been subject to the competitive tension in establishing the arrangement and are reviewed and updated regularly (mostly annually). The rates are utilised on projects where the scope of work is unknown or uncertain or where the work is regular and repeated. This allows DBP to quickly deploy the preferred vendors at previously agreed rates to avoid further negotiation or tender processes.

7.95 These are the only companies DBP has used during AA3 for SIB project engineering consultancy work. As the rates were very similar, DBP adopted a practice of alternating the projects that required assistance between the 2 companies to ensure:

(a) monetary incentives were spread fairly between the 2 companies;

(b) it kept both of the companies busy to ensure they retain their experienced staff;

(c) through building experience at these companies of the DBNGP, DBP ensures a mature design in the minimum amount of time ensuring cost effective engineering; and

(d) it reduces the risk of faulty designs through building experience in these companies.

7.96 Attached as part of Appendix E: are the following documents relating to the selection of engineering consultancies

(a) Registration of interest document

(b) Internal PowerPoint presentation recommending a short list

(c) Consultancy agreements for each of [redacted]

(d) A comparison of the schedules of rates for each shortlisted vendor

Delivered scope

7.97 When reviewing each of the Reviewed Projects, EMCa claimed that in many cases insufficient information was provided to clarify what had been delivered for each project. However, DBP provided EMCa with a copy of the project status report which includes information on how the project scope, schedule, and budget are tracking. DBP's project management methodology and review process was outlined in Submission 8, section 4. The management of projects once approved includes the following ongoing review processes:

(a) The Project Review Committee (PRC) comprised of the senior executive team determines the priority of DBP's portfolio of projects in the context of the DBP business plan and budget and meets monthly to review the program of work against schedule, scope and budget. As the key financial governance body, the risk ranking process is central to ensure that not only are projects properly ranked, but that the projects are in accordance with the drivers of the asset management plan and other corporate needs.

(b) The PRC is supported by the Project Steering Committee (PSC) which is project specific and has final responsibility for project delivery. The composition of the PSC can and will vary from project to project. However, it always includes the Project Sponsor, and a suitable authorised person to approve project governance decisions. For most projects, this will be GM SDO supported by the Manager of the Project, Project Accountant and Manager Engineering and Operational Projects.

(c) The project governance structures may vary depending upon the requirements of the project. The number and nature of roles involved in project governance and for the project delivery team for a particular project will be agreed and documented at the project kick-off meeting and sanctioned by project governance and captured in the Project Management Plan.

7.98 Section 6 of this submission outlines the project monitoring system that is applied to ensure there is adequate tracking of projects during the annual program. Evidence of the application of this system is contained in the various attachments included in Appendix E: . This monitoring system is evidence towards ensuring there is clarity on the scope of project being delivered.

8. ADDITIONAL INFORMATION IN RELATION TO THE INDIVIDUAL PROJECTS REVIEWED BY ERA AND EMCA

ERA's Draft Decision on Reviewed Projects

8.1 In relation to the Reviewed Projects reviewed by EMCa, both EMCa and the ERA conclude that

(a) the project need was justified in accordance with Rule 79(1)(b) (satisfied one or more need of Rule 79(2)(c)).

(b) only 75% of the expenditure on these projects satisfied the prudent service provider test (Rule 79(1)(a)) on the basis that the documentation did not support DBP's claims that it has completed a prudent scope of work and has undertaken the work efficiently.

ERA's Reasons for Decision

8.2 While section 7 of this submission addresses the common reasons that the ERA relied on to conclude that the expenditure for each of the Reviewed Projects (and also the Not Reviewed Projects) was not prudent or efficient, there are also some reasons specific to each Reviewed Project that are relied on by both the ERA and EMCa for not accepting all of DBP's actual AA3 SIB Capex for each Reviewed Project.

DBP Response to ERA's Reasons for Decision

8.3 DBP has developed further submissions that are particular to each project reviewed but for which the ERA has not approved all expenditure proposed by DBP. These submissions provided further supporting explanations and documentation for each project.

8.4 A separate document has been prepared in relation to each of the Reviewed Projects. These are attached in Appendix B: .

8.5 In the meantime, and for ease of reference, the following table summarises the specific reasoning for each Reviewed Project that the ERA and EMCa relied on to conclude that the expenditure proposed by DBP for that project was not efficient and prudent and where, in each document in Appendix B: , DBP outlines its response to each issue.

Table 18: Summary of DBP's response to ERA's reasons to reduce the efficient cost of the Reviewed Projects

Common and specific reasons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Primary documentation - DBPs documentation was typically unsigned and undated and did not fully adhere to DBP's own internal QA instructions	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Business need - DBPs project documentation was in most cases adequate to support the need to undertake work.	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Options analysis – DBP's options analysis was inadequate to support a finding that the work planned to be undertaken was prudent. The options identified are not what would be expected to see and the business cases do not present a compelling case for the timing and scope of work. Would expect to see some analysis that the scope and timing is optimal from a cost-benefit	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Common and specific reasons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
perspective. In cases where the risk was judged to be intermediate, would expect to see the details in the business case demonstrating that the proposed expenditure was justified under the ALARP test.												
Procurement – DBP's procurement policy was sound, the rationale for the procurement approach for the project and the delivery risks and risk mitigation activities to be identified. The inadequate information about the procurement process followed undermined confidence that DBP has delivered expenditure efficiently.	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Delivered scope – DBP often did not provide sufficient explanation of the reasons for variations between initially proposed/forecast expenditure (across the	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Common and specific reasons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
AA3 period) and actual expenditure or how project timing was determined. The approach to preparing business cases on an annual basis rather than a project basis and lack of closeout reports or the evidence that opportunities were taken to combine work on a zone or asset to reduce costs undermined confidence that the capex was delivered efficiently.				[redacted]						[redacted]	[redacted]	[redacted]
Delivered cost – inadequate information that is has deployed prudent means of establishing efficient costs at the project level. Close attention is paid to the overall budget, however there were significant variations between actual and forecast expenditure, which, in the absence of explanations, is indicative of sub-optimal decision making. Scant	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Common and specific reasons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
information is provided on the procurement process actually deployed.												
Close -out reports – would expect close out reports for projects over a certain threshold (say $2m). None were provided. This makes it challenging to confidently assess the delivered cost against the business case estimate and the reasons for any significant variance. No evidence that benefits were realised was provided even where benefits were identified.	[redacted] [redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Legend –

N/A – neither the EMCa Report nor the ERA Draft Decision referenced expressly this reason as one of its reasons for rejecting this specific project.

8.6 There are also other submissions to be made in relation to some other findings by the EMCa. These findings are not expressed as being reasons, per se, for not accepting all of the AA3 SIB Capex. However, they may be relevant and accordingly, DBP provides the following response.

Lack of rationale for deferral and the haphazard way in which DBP reassigns projects

8.7 It is noted that, of the 15 Reviewed Projects, only 7 of them were initially included in the forecast for SIB expenditure for AA3 when approved by the ERA in 2011. EMCa found that the lack of rationale for the deferral of projects in a given period diminishes the confidence in the ability of DBP to apply good project and program governance to achieve prudent and efficient outcomes.

8.8 DBP disagrees entirely with this view. DBP's program governance arrangements facilitate dynamic review of project need, scope, risk, prioritisation and scheduling opportunities. This appropriately identifies not only opportunities to efficiently defer projects, but also ensures that new and emerging issues and risks can be addressed. It is unreasonable to assume that all of the projects identified at the outset of a 5 year period will go ahead and that no new projects will be required. This would not be prudent or efficient.

9. AA3 SIB CAPEX REDUCTIONS REQUIRED BY ERA

ERA's Draft Decision

9.1 Once the ERA decides, in the Draft Decision, that the AA3 SIB Capex for a particular stay in business project doesn't meet the prudency and efficiency criteria, the ERA then decides to reduce the amount of the expenditure for each such project based on recommendations made in the EMCa Report.

9.2 In some instances, a 100% reduction is applied to the level of expenditure proposed by DBP for a project. In other cases, a 50% reduction is applied whereas in most instances, a 20% reduction is applied. This leads to, reportedly, an average 25% reduction being made across all assessed projects.

Reductions for Reviewed Projects

9.3 Appendix A of EMCa's report addresses each of the 15 Reviewed Projects under each aspect of Rule 79 and Rule 74. The following table outlines the reductions which the ERA endorsed in the Draft Decision.

Table 19: Capex expenditure % reductions for each Reviewed Project

Project #	Project name	% reduction applied
[redacted]	[redacted]	0%
[redacted]	[redacted]	0%
[redacted]	[redacted]	-50%
[redacted]	[redacted]	-100%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	-50%
[redacted]	[redacted]	-30%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	0%
[redacted]	[redacted]	-20%
[redacted]	[redacted]	-20%

9.4 The methodology followed in the EMCa Report to determine the percentage reduction to be applied for each of the Reviewed Projects is to:

(a) set a particular percentage reduction for each project without providing any justification for why it is more or less in each case. For example, in one instance a 100% reduction is applied, in others a 50% reduction is applied, the majority have been subject to a 20% reduction. In only one instance does the EMCa identify that the reduction is related to the delivered cost of a prior project (Project 10 Replacement of compressor control systems was reduced by 30% on that basis); and

(b) conclude that if the particular percentage reduction is applied to DBP's forecast level of expenditure, the remaining level of expenditure complies with 74(2), that is the amount is the best estimate of conforming capital expenditure. However, no analysis or reasons are provided for why the estimate is best or how the derivation of the estimate is reasonable.

Reductions for Not Reviewed Projects

9.5 For the other projects during AA3 that have not been individually reviewed by the EMCa or the ERA (Not Reviewed Projects), while it is not clear what methodology has been applied for the reasons outlined in paragraphs 5.5 to 5.13, the following reductions have been made by the ERA in the Draft Decision to the capital expenditure proposed by DBP (para 213 of EMCa Report):

(a) The level of expenditure for each project with an individual spend of less than $150k each is not reduced (total of $8.93m during AA3)

(b) All of the CWIP expenditure is endorsed ($8.45m)

(c) for each project with an individual value of $150k or more and not individually reviewed (ie Not Reviewed Projects), DBP's proposed total expenditure for these projects is reduced by 36.7% from $25.62m to $16.22m in the Draft Decision.

DBP's response to Draft Decision reasoning

9.6 Neither the ERA nor EMCa have provided reasons for the amount of the reductions to 11 of the 12 Reviewed Projects. Nor has the ERA provided any reasons for the amount of the reductions to the Not Reviewed Projects.

9.7 DBP considers that the ERA has erred in both determining that the proposed conforming capital expenditure does not satisfy Rule 79(1)(a) and that the substituted estimate satisfies Rule 79 (1)(a) or 74(2). This is because:

(a) The reductions applied are in all instances arbitrary and inconsistent;

(b) The resulting estimate of conforming capital expenditure is not the best estimate and no reasons are provided for the amount of the substitute estimate;

(c) The substituted estimate is not demonstrated to represent the lowest cost incurred by a prudent and efficient network service provider for undertaking the work and there is no information provided as to how the efficient cost could be achieved; and

(d) Even if all of the above arguments are rejected by the ERA, there are discrepancies between the approach to the reductions stated in the Draft Decision and the reductions in the tariff model. This is mentioned earlier in this submission.

The reductions applied are arbitrary and inconsistent

9.8 The ERA has accepted the EMCa arbitrarily applied percentage reductions which differ across each project without providing justification for the particular percentage applied other than, in some instances, to say that the reduction is based on the expert's industry experience or to account for uncertainty in the information provided. DBP staff also have expert industry experience and knowledge of the projects and track the schedule, budget and scope closely. It is inappropriate to apply a percentage reduction because of EMCa's view that there was insufficient supporting information provided by DBP for the expenditure incurred whilst EMCa and the ERA provided no supporting information at all for the substituted estimate.

9.9 There is no discernible attempt by EMCa to explain why 20%, 30%, 36.7%, 50% and 100% reductions (and in some cases reductions in excess of 100%) are appropriate levels of reduction for particular projects or why 20% is applied to one project and 50% to another.

9.10 It is unreasonable to assume that none of the Not Reviewed Projects satisfy the requirements for conforming capital expenditure when this was not the case for the sample projects (Project 1 and 2 with the highest expenditure [redacted] were found to be conforming capital expenditure as was Project 13 with expenditure of [redacted]). Further, no reasons were provided for applying a larger percentage reduction to the projects that were not reviewed (36.7%) than to those projects that were reviewed (25%).

The substituted estimate is not the best estimate and does not satisfy 79(1)(a) or 74(2)

9.11 Rule 74 requires that forecast or estimates must be supported by a statement of the basis and that forecast and estimates must be arrived at on a reasonable basis and must represent the best possible forecast or estimate possible in the circumstances. EMCa and therefore the ERA have not met the Rule 74 requirements as:

(a) The percentage reductions applied to individual projects are not supported by a statement of the basis;

(b) EMCa has not and cannot state (because of the approach taken) that resulting estimates are reasonable and the best possible in the circumstances.

9.12 By way of example, EMCa agree with DBP that it would have been required to undertake Project 5 in Appendix A '[redacted]specifically that it was required to maintain and improve safety of services and integrity of services. However, based on its assessment under Rule 79(1)(a) EMCa applied an arbitrary 50% reduction to DBP's incurred expenditure for the project during AA3. It would simply be impossible to deliver the project which EMCa's states is necessary at half the incurred cost. The EMCa provided no evidence that the work could have been delivered for 50% less, that 50% of the costs incurred were due to inefficiency, or that it attempted to test whether a 50% reduction in expenditure was reasonable.

9.13 Despite these findings EMCa suggest that under its Rule 74(2) assessment DBP has not provided sufficient information to support forecast expenditure, which clearly contradicts its finding under Rule 79(1)(a). EMCa do not provide any supporting information for why its estimate is reasonable or the best estimate.

9.14 For Project 10 (Replacement of compressor control) where the 30% reduction was applied, EMCa indicates that this is based on the cost achieved for a previous project. However, EMCa has not considered whether the previous project was the same or different scope. EMCa did not even consider if the estimate reflected the same work. The estimate adopted by the EMCa was for different work and was not the best estimate for the work identified. It is an error to assume that different work can be delivered for the same cost.

9.15 Indeed, for the projects greater than \$0.15m not individually reviewed by EMCa, it is entirely unreasonable to assume none of these projects comply with Rule 79(1)(a) and that a reduction of nearly 40% would represent the efficient cost of undertaking this work. Further, given that all of these projects are less than \$1m in value, and by their nature repeated and commonly undertaken, the they are less likely to require the formal documentation the EMCa expects (for example, EMCa recognise that a formal close out report would not be expected for a project of less than \$2m) and more likely to delivered by DBP staff and preferred vendor arrangements. That is, they are less likely to suffer from the deficiencies EMCa found in the Reviewed Projects.

The work could not be delivered at the substituted cost

9.16 Despite finding that the work was necessary under Rule 79(1)(b), the EMCa considered that the work could be delivered for less, and in some cases for no expenditure at all. For example, EMCa considered that work undertaken in [redacted]could be delivered for no cost. EMCa claimed that this project consisted of unjustified scope changes and it was not possible to determine what the expenditure was spent on, whether there were variations to budget or whether the expenditure was efficient. DBP believes it provided EMCa with sufficient information to address these issues including the FEED study for the project that outlined the scope of the project, monthly and annual reports that included the budget and progress against budget and scope including explanations of variations and the procurement process. DBP has included further information in Appendix B: . In any event, even if the concerns outlined by EMCa were founded, the work supported by EMCa could not be delivered at zero cost. This is an unreasonable estimate in every circumstance.

9.17 EMCa applied a 50% reduction to [redacted] The general reasons for reductions to these projects were that there were uncertainties about the procurement of external contractors, the work delivered and whether the work was in fact delivered. Again, DBP has provided EMCa with supporting information on the procurement process to establish the lowest cost and rates, detailed project status reports which are updated weekly and reviewed monthly that outlines the ongoing monitoring, tracking and explanations of variances. As these projects consist of a number of repeated works, it is unclear whether the 50 percent reduction is because DBP claims to have completed twice as much work as was actually completed or whether it is because DBP claims to have spent twice as much as that which was actually spent. If it is the former, the works would be required to be scheduled for AA4. If it is the latter, this is inconsistent with the externally reviewed accounts accepted by the ERA as verifying the expenditure actually spent by DBP during the AA3 period.

9.18 DBP maintains that neither of these scenarios is the case, and nor are they reasonable assumptions given the evidence provided by DBP (as outlined in Appendix B: and Appendix E:). Further, the costs and rates were established through DBP's purchasing policy processes with the express objective of achieving the lowest cost for the work required. DBP could not deliver the works for 50% less. In any event, DBP provides an explicit response to these issues for these projects in Appendix B: .

9.19 For the remaining Reviewed Projects where a 20% reduction has applied, the concerns raised by EMCa varied widely from issues associated with documentation, uncertainty around whether the procurement process was applied and insufficient explanations of variances between cost and scope. There was no consideration as to whether the provision of this information would reduce the cost or whether the project could be delivered for 20% less.

9.20 The flaws in EMCa's approach are illustrated in the assessment of vehicle replacements. EMCa considers that this expenditure satisfies Rule 79(1)(a) based on its observation that DBP has provided "reasonable detailed information" about the vehicles to be replaced together with estimates based on the previous year's expenditure. EMCa also specifically state that the cost estimate of $0.68m per year is reasonable. Nevertheless, EMCa reduced the amount of conforming capital expenditure by 20% because of conflicting expenditure information and lack of information on procurement processes.

9.21 DBP maintains that it has tested the prices it pays for its fleet with alternative providers and benefits from the preferred vendor arrangements to access the lowest price for its fleet requirements. It is unreasonable to assume that in an industry with such low margins, that DBP could achieve a 20% reduction in prices. Further, even if a small reduction could be achieved, this would need to be offset against the additional cost of undertaking the tender process. Relevant considerations have not been taken in to account by EMCa in developing their best estimate of the conforming capital expenditure on vehicles, and this disregard for relevant considerations and absence of reasons when determining an estimate is applies to all the reduced estimates proposed by EMCa.

9.22 Furthermore, no apparent effort has been made to identify which specific items of expenditure were inefficient or imprudent and should be disallowed, and why. Those matters are material, both in relation to ERA's (and DBP's) ability to assess the reasonableness of any particular recommended disallowance and, significantly, DBP's ability to respond effectively to any decision which may be based on a particular recommended disallowance.

Discrepancies between statement of reasons and EMCa Spreadsheets

9.23 Even if the ERA does not accept the above reasons, a further example of the arbitrariness of the reductions made by the ERA is that it has relied on the EMCa Report in circumstances where the report outlines a methodology for determining the quantum of the reductions to apply to certain categories of DBP's AA3 SIB Capex but its detailed spreadsheets in fact adopt a different methodology. There are at least three discrepancies.

(a) As outlined in paragraphs 5.5 to 5.13 of this submission, the first discrepancy is that although EMCa claim that the same percentage reduction is applied to Non Reviewed Projects as is applied, on average to the total for the Reviewed Projects, and this is not reflected in the ERA's Draft Decision on conforming capital expenditure or in the EMCa Spreadsheets. In the EMCa Spreadsheets, the expenditure estimate of conforming capital expenditure determined by the ERA for Reviewed Projects is actually only 25% less than the conforming capital expenditure proposed by DBP rather than the 36.7% applied by EMCa. When the 25% is also applied to Not Reviewed Projects, the ERA's Draft Decision should have included an additional $3.0m in conforming capital expenditure for a total of $92.66m.

(b) The second discrepancy also relates to the way that the ERA (and EMCa) has applied the percentage reductions to Non Reviewed Projects. The way that the reductions referred to in paragraphs 5.6(b) and 5.6(c) have been applied in the EMCa Spreadsheets is that the ERA and EMCa have firstly removed 100% of the AA3 Subsequent Cost Capex but has also applied the 36.7% reduction that was applied to the expenditure associated with the Not Reviewed Projects to some of the expenditure DBP proposed for the AA3 Subsequent Cost Capex.

(c) An example of this is in relation to the "Other depreciable" asset category in 2015. DBP's Original AA Proposal included an amount of $2.78m in AA3 Subsequent Cost Capex in that asset category in 2015. However, in Tables 28 and 29 of the Draft Decision, the methodology adopted in the EMCa Spreadsheets means that the ERA's reduction has resulted in the ERA removing more than the capital expenditure estimated to be undertaken, effectively reducing the capital base.

(d) So, DBP proposed an estimated $2.78m for this asset category in 2015, whereas the ERA has disallowed $3.31m for that asset category in 2015. The effect of this disallowance is that the value of this part of the capital base is reduced by $0.53m rather than not being allowed to increase at all. This is clearly an error as the NGR does not allow the capital base to be reduced by the capital expenditure element in Rule 77(2). Had the EMCa Spreadsheets adopted the methodology outlined in the Draft Decision and the EMCa Report (and leaving aside the issues of whether the ERA was correct in reducing either the AA3 Subsequent Cost Capex or the Not Reviewed Project capex), this would result in the capital base increasing by $0.53m.

(e) When reviewing the "**Summary Adjusment" (sic)** worksheet of the EMCa Spreadsheets, the error is explained as follows:

(i) Cell AA17 has the negative amount (-0.52m) and derives this from the sum of cells M17 and T17

(ii) Cell M17 – this figure of $2.79m is the amount of AA3 SIB Capex proposed by DBP for "other assets" in 2015 in its Original AA Proposal

(iii) Cell T17 – this cell has a formula: "=SUMIF('Capex actual AA3'!$K$8:$K$279,"Other",'Capex actual AA3'!$S$8:$S$278)/1000000+'Capex actual AA3'!$M$279*'Summary Adjusment'!M17/'Summary Adjusment'!$M$19/1000000"

(iv) The red coloured section of the formula is consistent with the formulas for 2011-2014, whereas the black section is unique to the calculations for 2015 capex reductions

(v) The red coloured section sums all of the defined "other" capex for the 2015 year – in this case it removes all of the "other" capex which is one project (subsequent costs ~$2.79m)

(vi) This data comes from the "Capex actual AA3" sheet

(vii) The black coloured section of the formula then prorates an amount of unreviewed capex which does not have an asset category. Where:

'Capex actual AA3'!$M$279 is the amount which is being prorated (~$2.6m)

'Summary Adjusment'!M17/'Summary Adjusment'!$M$19 is the prorating formula which takes the total "other" assets submitted for 2015 (2.79) and divides it by the total assets (20.30)

(viii) It is because the prorating is based on the raw capex figures that the problem occurs.

(f) The third discrepancy relates to the disallowances applied by the ERA and EMCa for the 2015 SIB expenditure. The EMCa Spreadsheets adopt a totally different methodology, summarised as follows:

(i) DBP proposed a total amount of 2015 SIB Capex of $20.3m. Based on the worksheet named "Capex Actual AA3" in the EMCa Spreadsheets, EMCa undertook a review of 2015 SIB projects with a total value of $10.127m (**2015 Reviewed Capex**). This includes the Reviewed Projects and some of the Not Reviewed Projects.

(ii) Projects for the remaining $10.173m of 2015 SIB Capex were not reviewed (**2015 Not Reviewed Capex**).

(iii) The EMCa then applied a 22.5% reduction to the total amount of the 2015 Not Reviewed Capex. It is not clear why a 22.5% reduction was applied to this capital expenditure

(iv) In relation to the 2015 Reviewed Capex, the ERA has applied varying methodologies to reduce the amount of capital expenditure for each project.

(v) The ERA has even applied a reduction to any capital expenditure for a project that was less than $0.15m.

10. STAY IN BUSINESS SUBSEQUENT COST CATEGORY

10.1 DBP maintains that all of the AA3 SIB Capex in the 'subsequent cost' category is conforming capital expenditure.

DBP's Original AA Proposal

10.2 In its Original AA Proposal, DBP proposed to have included in the opening capital base for AA4 the amounts of AA3 SIB Capex categorised as 'subsequent costs' outlined in the first row of Table 20. The ERA disallowed all of these amounts.

Table 20: AA3 Subsequent costs (Nominal)

$m Nominal	2011	2012	2013	2014	2015
Original AA Proposal	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Draft Decision	0.00	0.00	0.00	0.00	0.00

10.3 This category of expenditure did not exist within DBP's accounting system at the time that DBP proposed to the ERA its forecast of capital expenditure in AA3. However, the expenditure now captured in the category of subsequent costs was made in AA3. This fact has been verified by DBP's external auditors by the agreed upon procedures verification process undertaken for each calendar year during AA3.

10.4 DBP's explanation of its treatment of subsequent costs is best outlined in Submission 35 which was made in response to ERA's further information request referred to as ERA04. In summary, DBP advised that:

(a) As outlined in Submission 8, DBP's 'subsequent costs' expenditure item captured expenditure for projects that meets the requirements of AASB116 Property Plant and Equipment (**PP&E**) as a condition of continuing to operate an item of PP&E. In particular, it covers maintenance expenditure that has benefit to the asset of more than 12 months (eg overhauls and repair costs that are carried out every 2, 3, 4, 5, 6, 7 years or longer). Reactive costs are deemed under this category if, once spent, they add value consistent with an overhauled asset. The Subsequent Costs allocation also includes planned overhaul and replacement of equipment that are not serviced annually – such as pressure vessels, unit suction and discharge valves, pressure control valves, recycle valves, actuators, 10 year calibration of flow meters and painting.

(b) As outlined in Submission 19(2), that a change in accounting practice was the reason there was no 'subsequent costs' expenditure category proposed for AA3 (and therefore not approved as forecast conforming capital expenditure). Only during AA3 did DBP change its accounting practice and start applying AASB116 – as a result, expenditure that met AASB116 was recorded in the capital expenditure category called 'subsequent costs'.

(c) Before the change in accounting practice, some of the expenditure recorded in 'subsequent costs' would have been classified under the reactive maintenance operating expenditure category while other expenditure would previously have been captured in project specific capital expenditure.

ERA Draft Decision

10.5 EMCa found that the majority of expenditure captured in the category of subsequent costs conforms with Rule 79(1)(b) and that the capitalisation of these costs is reasonable given the accounting standard.

10.6 However, at paragraph 208 of the EMCa Report, EMCa assumes that DBP received an operating expenditure ‘allowance’ by the ERA in its Final Determination for the AA3 period (as part of its forecast operating expenditure) and that DBP had replaced that amount with capex (that is what was forecast as an expense has now been capitalised). EMCa then concludes that allowing this expenditure to be treated as conforming capital expenditure for the purposes of Rule 77(2) would be “double-dipping” by DBP. Without further analysis, it then concludes that none of the amount of subsequent costs should be classified as conforming capital expenditure for AA3.

10.7 In reaching this conclusion, EMCa appeared to also have assumed (although it is not expressly stated in the EMCa Report) that the allowance in the AA3 opex forecast related to activities that are now captured in the ‘subsequent costs’ category of DBP’s AA3 SIB Capex.

10.8 In the Draft Decision, the ERA:

(a) agrees with the EMCa that, as a matter of principle, the expenditure classified as ‘subsequent costs’ is expenditure of a capital nature[30] and that the majority of the expenditure meets one or more of the criteria in Rule 79(2)(c) of the NGR such that the requirements of Rule 79(1)(b) are met;

(b) without further analysis, accepted this ‘double-dipping’ concept and concludes (at paragraphs 401-402 of the Draft Decision) that, as it does not have the scope to claw-back operating expenditure allowed in the reference tariff calculation from the AA3 period, if the ERA was to allow the AA3 subsequent costs to be included in conforming capital expenditure it would result in a ‘double-counting’ of these costs; and

(c) for the above reasons, and also without further analysis, concludes that it is disallowing 100% of the AA3 SIB Capex categorised by DBP as subsequent costs.

10.9 The EMCa and ERA assume that the ERA’s AA3 forecast operating expenditure included an allowance for the same activities that DBP has captured in the subsequent costs category for AA3 SIB Capex and that the amounts allowed for each activity are the same in the ERA’s AA3 forecast operating expenditure and DBP’s subsequent costs for AA3 capital expenditure[31].

DBP Amended AA Proposal and response to DD reasoning

10.10 DBP submits that the majority of expenditure captured in the subsequent cost category of AA3 SIB Capex is conforming capital expenditure because:

(a) The expenditure in the subsequent cost category of SIB expenditure is capital expenditure and satisfies Rule 79(1)(b). This is supported by the EMCa and the ERA in its Draft Decision.

(b) There is no ‘double-counting’ of an expenditure allowance accrued by DBP as a result of determining the capital expenditure to be conforming capital expenditure.

(c) The expenditure in the subsequent cost category of SIB expenditure is capital expenditure consistent with the least cost of undertaking the work as would be incurred by a prudent and efficient network operator, that is, it satisfies Rule 79(1)(a).

[30] *Draft Decision, paragraph 399*

[31] *EMCa Report, paragraph 208*

Subsequent cost SIB capital expenditure is not subject to double counting

10.11 The expenditure in the subsequent cost category of SIB expenditure consists of:

(a) expenditure that was always capital expenditure and not operating expenditure now capitalised - many of the activities for which capital expenditure has been categorised in the subsequent costs category of actual AA3 SIB Capex are capital expenses and would always have been capitalised. This expenditure was captured in the capital expenditure forecasts for AA3 and were not transferred from an operating expense to a capital expense as a result of the accounting standard AASB 116. That is, this expenditure was never expenditure that would have been included in operating expenditure forecasts in AA3 or any other period. This amount totals [redacted] (“**Always Capital Expenditure**”);

(b) expenditure that has now been capitalised as a result of adopting accounting standard AASB116 (**Other Subsequent Cost Expenditure**). This amount of [redacted] comprises:

(i) One activity which was forecast in the operating expenditure allowance for AA3 and was capitalised in the actual expenditure during AA3 - this activity was for unplanned major overhauls of turbines included in DBP’s forecast for reactive maintenance operating expenditure for AA3 (**Turbine Reactive Maintenance Expenditure**) [32]. This amount was [redacted]. The activities for which expenditure was included in DBP’s forecast of operating expenditure for AA3 were only for the reactive maintenance and repairs of compressor turbines (**Turbine Reactive Maintenance Opex**). As stated previously, until AA3, DBP had never included in its forecasts an allowance for expenditure to cover reactive maintenance (ie repairs and maintenance of plant and equipment that was unplanned). It began doing so in AA3 because of an increase, during AA2, in the number of unplanned repairs that were being required for DBP’s compressor turbines. This increase was mainly due to the ageing nature of these assets. It therefore became prudent to include an allowance for these unplanned repairs from AA3 onwards. However:

there was only an allowance made for the repair and maintenance (on an unplanned basis) of compressor turbine equipment; and

the only “building block” where such an allowance was made in the AA3 tariff calculation was in the category of forecast operating expenditure for AA3 known as ‘reactive maintenance’.

(ii) There have been other activities that have been capitalised in subsequent cost SIB capex that were not included in the AA3 operating expenditure allowance. For the purposes of this submission, the remaining Other Subsequent Cost Expenditure is called **Non Turbine Reactive Maintenance Expenditure**. This amount was [redacted].

10.12 DBP incurred expenses associated with reactive maintenance operating expenditure during AA3. This expenditure was not related to Turbines and could not be capitalised under accounting standard AASB 116. The following table summarises the sub-categories of ‘subsequent cost’ SIB capex and the previous and current category of expenditure.

Table 21: Categories of expenditure

Category of expenditure	AA3 forecast	AA3 Actual	AA4 forecast
Project expenditure	Capital expenditure	Subsequent cost capital expenditure	Subsequent cost capital expenditure
Turbine Reactive Maintenance Expenditure	Reactive maintenance operating expenditure	Subsequent cost capital expenditure	Subsequent cost capital expenditure
Non-Turbine Reactive Maintenance Expenditure	Not included	Subsequent cost capital expenditure	Subsequent cost capital expenditure
Reactive maintenance operating expenditure	Reactive maintenance operating expenditure	Reactive maintenance operating expenditure	Reactive maintenance operating expenditure

[32] *DBP submissions 8, 19(1), 19(2) and 35*

10.13 DBP notes that, in making the Draft Decision on whether the subsequent cost category of stay in business capital expenditure was conforming capital expenditure, neither EMCa nor the ERA:

(a) acknowledged that in its Original AA Proposal, DBP outlined that its actual operating expenditure incurred during AA3 included operating expenditure for reactive maintenance;

(b) acknowledged that DBP's Original AA Proposal expenditure relating to reactive maintenance was captured in actual capital expenditure in AA3, and was included in both capital expenditure and operating expenditure for AA4. The ERA did accept that the reactive maintenance operating expenditure meets the requirements of the NGR;

(c) assessed whether the expenditure on activities captured in the subsequent cost category of SIB capex for AA3 was the same as the activities for which there was an allowance made by the ERA in the forecast operating expenditure for AA3; and

(d) assessed whether the operating expenditure allowance that the EMCa claimed to be for the expenditure now captured in the subsequent cost SIB capex was more or less than the expenditure incurred.

Double count of operating expenditure forecast allowance

10.14 DBP accepts that if there was operating expenditure for which an operating expenditure allowance was recovered through reference tariffs, and that expenditure is subsequently capitalised, then DBP may receive an allowance for the same expenditure through reference tariffs again in future periods. However, this can only be the case where:

(a) There was an allowance for expenditure on an activity in the operating expenditure forecast and the expenditure associated with the same activity is subsequently capitalised; and

(b) The expenditure on the activity was less than the expenditure allowance.

10.15 DBP submits that this is not the case for the majority of subsequent cost capital expenditure. Firstly, the subsequent cost capital expenditure, **Always Capital Expenditure,** was not included in the operating expenditure forecast allowance. This expenditure consists of capital expenditure that would previously have been forecast and captured in project specific capital expenditure categories. Continuing to capitalise this expenditure does not result in recovering the costs in both past and future periods and so no double count occurs.

10.16 Secondly, the subsequent cost capital expenditure, **Other Subsequent Cost Expenditure** reflects expenditure on a number of activities, only one of which was included in the forecast operating expenditure allowance. Therefore, the expenditure on the **Non Turbine Reactive Maintenance Expenditure** (those activities not included in the forecast operating allowance for AA3) was not recovered during AA3. Capitalising this expenditure will result in DBP being provided an allowance for this investment in AA4, however, as no allowance was provided in AA3, it would not receive an allowance in both past and future periods.

10.17 Thirdly, actual expenditure on reactive maintenance operating expenditure, including expenditure on overhaul of turbines that does not meet accounting standard AASB116, during AA3 was almost the same as the forecast allowance for reactive maintenance operating expenditure in AA3 ($0.1M less than forecast). Therefore, any allowance DBP received during AA3 for **Other Subsequent Cost Expenditure** was limited to $0.1m. If the **Other Subsequent Cost Expenditure** is not included in AA4 as conforming capital expenditure, no allowance will be received in AA4 either.

Actual reactive maintenance operating expenditure compared with forecast operating expenditure allowance

10.18 The amount of operating expenditure actually incurred by DBP during AA3 and classified as "reactive maintenance" operating expenditure averages $1.14m (2010$s) per annum[33].

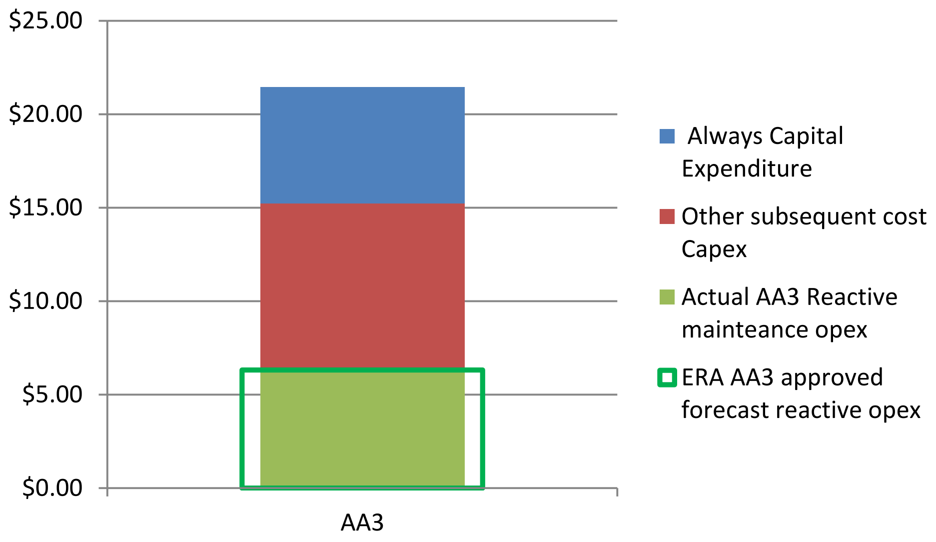
[33] *See DBP's App A to Submission 55 (Tab: Ave expenditure)*

10.19 Approximately the same amount was included in the forecast of operating expenditure for AA3 that was categorised as reactive maintenance.

10.20 Therefore, any reactive maintenance that has been incurred in AA3 but accounted for as capital expenditure and classified as 'subsequent costs' is in addition to the amount in the operating expenditure forecast allowance and has not been previously recovered through reference tariffs in AA3. There is therefore no double counting.

10.21 The following figure shows the total expenditure actually incurred by DBP for reactive (ie unplanned) maintenance and repair of turbines during AA3 split between Turbine Reactive Maintenance Expenditure in the SIB capex category and Reactive Maintenance Opex category, compared with the forecast allowance in AA3 for forecast reactive maintenance operating expenditure. It also includes the items of AA3 SIB Subsequent Cost Capex that DBP has identified as "Always Capital Expenditure"

Figure 2: Comparison of AA3 reactive maintenance – actuals v forecast ($m)



10.22 In summary, it shows that:

(a) the reactive maintenance operating expenditure allowance in AA3 was only $0.1m more than that actually spent on reactive maintenance operating expenditure;

(b) the reactive maintenance operating expenditure allowance in AA3 was significantly less than that incurred on reactive maintenance (both expensed and capitalised)

(c) the reactive maintenance operating expenditure allowance in AA3 was not sufficient to have included forecast expenditure in Other subsequent cost capex or Always SIB capex.

10.23 To further demonstrate the prudency and efficiency of the amounts, it is noted that DBP's forecast of operating expenditure for AA4 also includes an annual allowance for reactive maintenance ($1.43m)[34], which still includes an allowance for expenditure relating to the overhaul of turbines that does not meet accounting standard AASB116.

[34] *DBP Submission 10*

No Double count of expenditure allowance in revenue received through reference tariffs

10.24 DBP further submits that DBP can not receive a double count of an allowance for expenditure incurred in AA3 again in AA4 because DBP has not received an allowance for expenditure through reference tariffs during AA3.

10.25 Regardless of the analysis about the activities and cost items that are included in the forecast opex and actual AA3 SIB Capex, DBP did not receive any revenue through reference tariffs or revenue that was in any way determined based on operating expenditure forecasts determined in the AA3 period because its shipper contracts are all negotiated under a tariff structure that sits outside the regulatory framework during AA3. Therefore, DBP has not received an allowance for operating expenditure through reference tariffs during AA3.

10.26 In any event, the concept of "double-counting" or "double-dipping" is not prohibited under the NGL. The revenue and pricing principles of the NGL (which the ERA is obliged to take into account when making its decision on this issue) is to provide the service provider with a reasonable opportunity to recover ***at least*** the efficient costs the service provider incurs in providing reference services (see section 24(2)(a) of the NGL). DBP has incurred the expenditure in the subsequent costs SIB capital expenditure category and this expenditure will contribute to the provision of reference services during AA4 (and are therefore, properly included in AA4 reference tariffs). On this matter, reference is made to DBP's submissions in section 3 of submission 51.

All of DBP's Subsequent Cost SIB Capex meets the criteria of Rule 79(1)

10.27 In relation to satisfying the criterion in Rule 79(1)(b), DBP notes that the ERA and EMCa have already acknowledged that there is a need for all expenditure in the subsequent costs category. Accordingly, the criterion is satisfied.

10.28 In relation to satisfying the criterion in Rule 79(1)(a):

(a) The actual expenditure has been verified as having been incurred by DBP by DBP's external auditors (noting that the verification process for 2015 expenditure is ongoing as at the date of this submission).

(b) DBP reiterates its position in submission 8 and 10 that this expenditure is prudent and efficient.

(c) DBP considers that it is reasonable to apply the same review framework to the expenditure in subsequent cost SIB capital expenditure as is applied to other SIB capital expenditure. Therefore, to support the review framework adopted by the EMCa, DBP presents the 160 items of expenditure in the same tranches of expenditure considered by EMCa in its review and the ERA in its decision for consistency of treatment:

   (i) 125 items representing 27% of subsequent cost expenditure in AA3 have incurred less than $0.15m in expenditure;

   (ii) 32 items that represent 53% of the total subsequent cost expenditure in AA3 have incurred expenditure in excess of $0.15m and less than the expenditure incurred by DBP's top 15 AA3 capital expenditure projects reviewed individually by EMCa; and

   (iii) 3 items have expenditure consistent with the top 15 projects (close to greater than $1m) and make up almost 20% of the total expenditure that has been categorised as subsequent costs. The following table provides expenditure on these 3 projects (**Reviewed Subsequent Costs**).

10.29 Consistent with the approach taken by EMCa and accepted by the ERA, DBP presents additional information to support the 3 largest items in subsequent cost SIB capital expenditure below **Reviewed Subsequent Cost**. The following table provides a summary of these items and expenditure for the AA3 period. Further information relating to the items is provided below.

Table 22: Subsequent Cost items reviewed in detail (Real, $2015, $m)

Object	2011	2012	2013	2014	2015	TOTAL
[redacted]			[redacted]	[redacted]	[redacted]	[redacted]
[redacted]			[redacted]	[redacted]	[redacted]	[redacted]
[redacted]			[redacted]	[redacted]	[redacted]	[redacted]
Total			[redacted]	[redacted]	[redacted]	[redacted]

10.30 The Reviewed Subsequent Cost items:

(a) All relate to the unplanned repairs of compressor turbines

(b) The unplanned repairs and maintenance of compressor turbines resulted in either overhauls of the turbines or replacement of faulty seals. Without these turbines in service, DBP is exposed to not being able to deliver contracted capacity to shippers for which there is a significant liability exposure for DBP.

(c) Two of the three turbines were made by the one manufacturer [redacted].

(d) All turbine repairs were undertaken in accordance with DBPs asset management plan

(e) Materials were procured from preferred vendors and sole suppliers to the DBNGP

(f) Key considerations in procurement include the ability of a vendor to service remote locations and a workforce trained, inducted and experienced in working in operational sites. The vendors and workforce are managed by experienced DBP staff who can isolate and work safely in an operational environment.

10.31 In relation to the item "[redacted]

(a) The work involved an engine exchange due to an unplanned failure of first stage blades. The investigation into the cause of the incident is still ongoing as the work required the shipment of the turbine to the manufacturer's depot in Italy.

(b) The key expenditure was DBP internal labour and the services of the turbine manufacturer.

(c) Other minor expenditure was obtained in accordance with DBP's procurement policy.

(d) Work was scheduled to fit into the outage plan organised between DBP and its shippers, so as to minimise the risk of impact on contracted capacity.

10.32 In relation to the project named [redacted]

(a) The work involved the hot end repair of the turbine due to the cracks on second stage nozzles.

(b) The key expenditure was DBP internal labour and the services of the turbine manufacturer

(c) Work was scheduled to fit into the outage plan organised between DBP and its shippers, so as to minimise the risk of impact on contracted capacity.

10.33 In relation to the item [redacted]:

(a) The work involved the hot end repair of the turbine due to the cracks on the first stage disc.

(b) The key expenditure was DBP internal labour and the services of the turbine manufacturer, provided under the alliance agreement with that manufacturer.

(c) Other minor expenditure was obtained in accordance with DBP's procurement policy.

(d) Work was scheduled to fit into the outage plan organised between DBP and its shippers, so as to minimise the risk of impact on contracted capacity.

10.34 Given the above submissions, DBP submits that its Amended AA Proposal includes $19.66m (Nominal) in conforming AA3 SIB Capex under the ‘subsequent costs’ expenditure category.

10.35 DBP’s amended proposal for stay in business conforming capital expenditure is presented in the table below.

Table 23: Subsequent Cost AA3 SIB Expenditure

	DBP’s original proposal (Real)	ERA Draft Decision (Table 27)	DBP Amended AA proposal (Nominal)
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

11. LINEPACK VALUATION

11.1 Linepack is the amount of gas in the pipeline to allow the pipeline to operate. It is classified as a non-current asset in accordance with the Australian Accounting Standards Board's standard named AASB 116 Property, Plant and Equipment (**AASB116**). It is therefore a capital asset.

11.2 A copy of AASB116 is attached as Appendix F: . The relevant part of AASB116 is reproduced below:

> *7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:*
>
> *(a) it is probable that future economic benefits associated with the item will flow to the entity; and*
>
> *(b) the cost of the item can be measured reliably.*
>
> *8 Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.*
>
> *Property, plant and equipment are tangible items that:*
>
> *(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and*
>
> *(b) are expected to be used during more than one period."*

11.3 The value of Linepack has increased for 2014 and 2015 above the amount estimated. This has been identified as part of the process of updating the AA3 SIB Capex estimates with actual values for 2014 and 2015. Therefore, DBP's Amended AA Proposal includes an additional [redacted] of capital expenditure to reflect the increase in the value of the Linepack.

11.1 A value representing Linepack has always formed part of the capital base for the DBNGP. However, because of the way that the initial capital base for the DBNGP was determined by the regulator in 2003, no part of the initial capital base was specifically attributed to the value of linepack as at 1 January 2000 (ie the intended commencement date of the initial access arrangement period).

11.2 Notwithstanding this, there have been changes in the value of Linepack since 2000. The sole reason for the change to that value has been due to changes in the amount of Linepack required when expansions of the DBNGP occurred between 2006 and 2011. Additional Linepack was required to be purchased to fill the additional loops constructed as part of the expansions. The expense incurred in purchasing that additional amount of Linepack was added to the capital base as conforming capital expenditure. The following table summarises the expense incurred by DBP in each of these years and the resultant amounts of conforming capital expenditure that the capital base was changed by in each year.

Table 24: Changes in Linepack value

Year	Linepack Adjustments (Real, $2015, $m)
2006	[redacted]
2007	[redacted]
2008	[redacted]
2009	[redacted]
2010	[redacted]
2011	[redacted]

11.3 These amounts of conforming capital expenditure were reflected in the annual movements to the projected capital base in each prior access arrangement. The changes were made to the "Other Non Depreciable" asset category as part of the conforming capital expenditure for the relevant year of an access arrangement.

11.4 In DBP's Original Proposal, DBP also provided for additional amounts of conforming capital expenditure relating to the changes in the value of Linepack. These amounts reflected the difference between the actual value DBP paid for the additional amount of Linepack required to fill the loops and the forecast of that expenditure that was included in the AA3 as forecast conforming capital expenditure. The amount of changes for AA3 are summarised in the following table were proposed by DBP:

Table 25: Changes in Linepack value in AA3

Year	DBP Original AA Proposal
2011	[redacted]
2012	[redacted]
2013	[redacted]
2014	[redacted]
2015	[redacted]
TOTAL	[redacted]

11.5 To date therefore, the only reasons for making changes to the value of Linepack have been:

(a) to account for the value of additional Linepack required to fill any capacity that is created through an expansion of the pipeline (eg through the installation of a loop); and

(b) to address differences between the actual expenditure and the forecast expenditure that was allowed for in the prior access arrangement (eg 2011 and 2012).

11.6 In addition to the above however, DBP is now of the view that, consistent with AASB116, conforming capital expenditure should also include an allowance for the value of Linepack required during a reporting period to manage the efficiency of the pipeline.

11.7 Based on the design assumptions for operating the DBNGP (following the commissioning of stage 5B expansion), a set amount of Linepack is required to exist in the pipeline to ensure the pipeline is operated efficiently. Since the commissioning of Stage 5B, the set amount is [redacted] (**Required Linepack**).

11.8 This assumption is then used as the basis for setting other elements of the total revenue calculation, particularly the required amount of fuel gas.

11.9 During a year however, changes occur in the amount of Linepack as a result of DBP's efficient operation of the pipeline. There will be times where Linepack is used to address such matters as amounts of gas unaccounted for and shippers exercising their behavioural rights under access contracts (eg imbalance rights).

11.10 The amount of Linepack will change from month to month in a given period (eg a financial year) to account for a number of factors but the overarching requirement is to try to ensure that the amount of Linepack at the end of the relevant year matches as closely as possible to the Required Linepack amount.

11.11 To ensure that the amount of Linepack throughout the period is always maintained close to the Required Linepack amount, additional gas may be required to be purchased (where the amount of Linepack is less than the Required Linepack amount). This is consistent with the efficient management of the pipeline.

11.12 DBP has a policy to reflect the above requirements of AASB in so far as it relates to accounting for Linepack. This policy has been in place since 2011. A copy of DBP's policy for pipeline gas accounting is attached as Appendix G: . Relevantly, the policy provides that firstly, the amount of Linepack needs to be determined from one reporting period to the next (ie from financial year to financial year). In this regard, the policy provides the following:

(a) The amount of Linepack is usually denominated in either Terajoules which is determined by multiplying the amount of molecules (measured in million metric standard cubic metres) by a heating value.

(b) After the initial amount of Linepack is recognised on acquisition or construction of the pipeline, the amount of Linepack may subsequently be varied for any one of the following reasons:

   (i) The amount required during the period to manage the efficiency of the pipeline; or

   (ii) The amount required to fill any capacity that is created through an expansion.

(c) The amount of Linepack needs to be accounted for to reflect the amount of Linepack used in the year for the efficient management of the pipeline. The following matters are considered in determining that amount:

   (i) Changes in the "Pipeline Imbalance" - The difference between the gas that DBP has purchased for use in the pipeline in a year and what it has consumed as fuel gas in the year.

   (ii) Changes in the "Shipper Imbalance" – this is the difference between the amount of gas the shippers deliver for receipt by DBP at the inlet points of the pipeline in a year and the amount of gas the shippers are delivered by DBP at outlet points in the year under all pipeline services provided by DBP to all shippers during the course of that year.

11.13 The next part of the policy is to determine the value to be attributed to both the initial amount of the Linepack required to fill any new capacity and any Linepack used during the year for the efficient management of the pipeline. The following provisions of the policy are relevant:

(a) Firstly, the value of the initial amount of Linepack required to operate the pipeline (being the amount accounted for at the time of construction or acquisition of a pipeline) is recognised at cost at the date that it is acquired.

(b) The same principle applies to the valuation of any additional amount of Linepack required as a result of the expansion of a pipeline.

(c) As to valuing the amount of Linepack required during the year for the efficient management of the pipeline, the then prevailing cost of purchasing gas under a long term firm fuel gas supply contract is used.

11.14 The final part of the policy is to determine whether the carrying value of the total of the three types of Linepack referenced is paragraphs 11.13(a) to 11.13(c) is greater or less than the net realisable value of that Linepack. In accordance with the AASB116, if the carrying value is less than the net realisable value of the amount of Linepack, then the carrying value is used to value the change in the amount of Linepack in the period. In this regard:

(i) To calculate the net realisable value, consideration is given to the cost of transporting the gas to the point of sale and also any permanent adjustments to the value of Linepack. This ensures compliance with AASB 136 (Impairment of Assets) which defines the recoverable amount as the higher of an asset's or cash generating unit's fair value less costs to sell and its value in use.

(ii) To calculate the carrying value of the total of the three types of Linepack referenced is paragraphs 11.13(a) to 11.13(c), a weighted average cost method of valuation is used so as to apply the weighted average unit price to the total. The weighted average cost method involves applying the prevailing cost of purchasing gas under a long term firm gas supply contract for any additional amount of Linepack acquired during the year and creating a weighted average cost with the value of the initial amount of Linepack purchased and recorded under items (a) and (b) above.

11.15 For the purposes of determining the weighted average cost of Linepack on the DBNGP, while DBP has not changed the value of the amounts of Linepack referred to in paragraphs (a) and (b) above, for the purposes of paragraph (c), the cost of additional gas purchased after 1 July 2014 increased as a result of the change in the price payable under DBP's long term firm system use gas agreements. This has been one of the key drivers for the increase in the value of Linepack during 2014 and 2015. It is noted that the ERA accepted the prices payable under these contracts as the basis for setting the amount of fuel gas to be included in DBP's forecast of operating expenditure for AA4. Accordingly, it is appropriate, for the purposes of determining the carrying value of Linepack, to use these contracts as the basis for determining the value of any additional amount of Linepack acquired during a year to compensate DBP for using Linepack during the year to efficiently run the pipeline.

11.16 The effect of the above is that capital expenditure relating to the change in the value of the Linepack has increased in the Amended AA Proposal from what was proposed in the Original AA Proposal by a total of [redacted] over 2014 and 2015 as outlined in the following table:

Table 26: Changes in value of Linepack during AA3 (Real, $2015, $m)

Year	DBP Original AA Proposal	DBP Amended AA Proposal
2011	[redacted]	[redacted]
2012	[redacted]	[redacted]
2013	[redacted]	[redacted]
2014	[redacted]	[redacted]
2015	[redacted]	[redacted]
TOTAL	[redacted]	[redacted]

11.17 The calculation of the change in value for each half year of 2014 and 2015 is presented in the following table.

Table 27: Derivation of Linepack valuation changes – 2014 & 2015 (Real, $2015, $m)

Relevant Period	Value of Linepack @ start of period ($m, Real $2015)	Value of Linepack @ end of period ($m, Real $2015)	Change in value of Linepack
HYE 30/6/14	[redacted]	[redacted]	[redacted]
HYE 31/12/14	[redacted]	[redacted]	[redacted]
HYE 30/6/15	[redacted]	[redacted]	[redacted]
HYE 31/12/15	[redacted]	[redacted]	[redacted]

11.18 So, in summary, there are two reasons for why the value of linepack that is included in the capital base in 2014 & 2015 has been changed in DBP's Amended AA Proposal. They are:

(a) The amount of Linepack now includes an amount to reflect what is required for the efficient operation of the pipeline;

(b) In determining the weighted average cost of Linepack for the purposes of determining the value of the Linepack that forms part of the capital base, the cost of the additional Linepack is determined by reference to the price paid under DBP's long term system use gas agreements.

Justification of change of Linepack value under Rule 79

11.19 The following paragraphs contain DBP's submissions to justify this change in value of Linepack in 2014 and 2015 against the criteria in Rule 79.

Expenditure has been made by DBP

11.20 The change in the value for 2014 has been verified by DBP's external auditors and the value for 2015 is in the process of being verified by them (both following the verification process outlined earlier in this submission).

11.21 Accordingly, it is expenditure that has been "made by DBP" for the purposes of Rule 79.

Justification under Rule 79(1)(a)

11.22 The expenditure has been incurred by a prudent and efficient operator at the least cost (Rule 79(1)(a)) for the following reasons:

(a) It is prudent and efficient for DBP to use its Linepack (together with purchases of fuel gas) to manage overall system use gas requirements to ensure contracted capacity is delivered to shippers in accordance with DBP's contractual obligations. It is noted that in the ERA's reasoning in respect of the allowance in the forecast operating expenditure for AA4, the amount of fuel gas included in that forecast was set on the assumption that DBP would use its Linepack efficiently as part of managing the overall system use gas requirements for the pipeline during AA4.

(b) It is efficient that the prices payable under DBP's long term firm gas supply contracts are used to value the additional Linepack for the purposes of determining the weighted average cost of the Linepack and therefore the value to be attributed to the change in the amount of Linepack as a result of it being used in the period to efficiently manage the pipeline.

Justification under Rule 79(1)(b)

11.23 DBP submits that this criterion is satisfied because it meets the provisions of Rule 79(2)(c)(ii), (iii) or (iv) in that:

(a) The Linepack is required to maintain the integrity of services;

(b) The change in the valuation is following the regulatory requirement to account in accordance with AASB 116; or

(c) The amount of Linepack is required to maintain DBP's capacity to meet levels of demand for services existing at the time the capital expenditure was made.

11.24 DBP also submits that if no allowance is to be made to change the value of the capital base as proposed by DBP:

(a) DBP will have been denied the opportunity of recovering its efficient costs; and

(b) the ERA should, for AA4 allow a higher amount for fuel gas in the forecast of operating expenditure for AA4 than it has in the Draft Decision. That amount should equal the amount for each year of AA4 that DBP adjusted the value of Linepack in its statutory accounts.

APPENDIX A: ACTUAL 2015 AA3 SIB CAPEX

APPENDIX B: ADDITIONAL SUBSTANTIATION OF TOP 15 PROJECTS

This appendix contains a series of separate project documents that are intended to respond to EMCa's specific criticisms contained in Appendix A of the EMCa Report.

Documents are attached and are referenced as follows:

[redacted]

APPENDIX C: BREAKDOWN OF SUBSEQUENT COSTS FOR AA3

APPENDIX D: INTERNAL AUDIT REPORT ON PROJECT MANAGEMENT METHODOLOGY

APPENDIX E: SAMPLE PMM DOCUMENTATION

Documents Provided	2011	2012	2013	2014	2015
"Traffic Light" report for all projects	AppE.01 AppE.02	AppE.03 AppE.04	AppE.05 AppE.06	AppE.07 AppE.08	AppE.09 AppE.10
Project risk ranking list	AppE.11	AppE.12	AppE.13	AppE.14	AppE.15
PRC monthly report on aggregate expenditure for month and YTD	AppE.16 AppE.17	AppE.18 AppE.19	AppE.20 AppE.21	AppE.22 AppE.23	AppE.24 AppE.25
Annual SIB presentation to PRC and Board	AppE.26	AppE.27	AppE.28	AppE.29	AppE.30
Presentation comparing actual annual expenditure v approved annual SIB budget	AppE.31	AppE.32	AppE.33	AppE.34	AppE.35

App 36 - DBP, Purchasing Policy, DBP-PM.01, March 2015, p. 3.

App 37 - DBP, Preferred Vendor Procedure, DBP-PM.01.03

App 38 - DBP, Tender Procedure, DBP-CM.01.03

App 39 - *the DBP-PM.01 Procure to Pay Procedure*

App 40 - *the DBP-PM.01.04 Pricing Agreement Creation Procedure*

APPENDIX F: AASB 116

APPENDIX G: DBP GAS ACCOUNTING POLICY PAPER