

# Proposed Revisions DBNGP Access Arrangement

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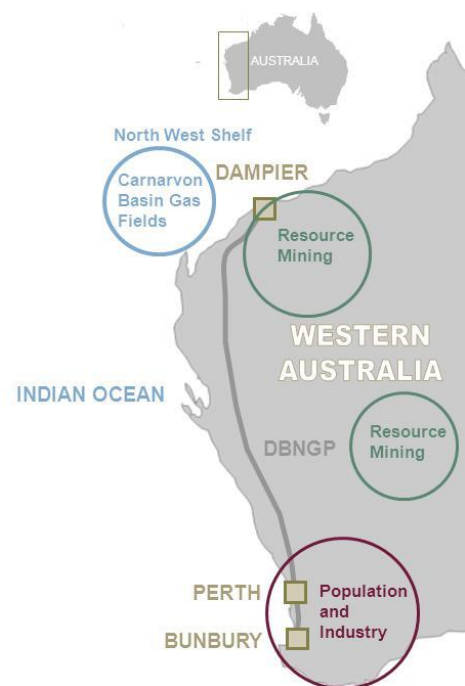
*2016 – 2020 Regulatory Period  
Projected Capital Base  
Supporting Submission: 54*



*Date Submitted: 18 March 2016*

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

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



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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, DBP submitted the following documents pursuant to Rule 60 of the National Gas Rules (**NGR**), 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 NGR requires to be included in order to enable it to be approved by the ERA, DBP also advised that it will be filing the following supporting submissions that explain and substantiate the amendments and additions in the Amended AA Proposal that have been made to address various matters raised in the Draft Decision:
  - (a) Submission 50 – Amended AA Proposal
  - (b) Submission 51 – Response to Pipeline Services Amendments
  - (c) Submission 52 – Response to Terms and Conditions Amendments
  - (d) Submission 53 – Response to Opening Capital Base Amendments
  - (e) Submission 54 – Response to Forecast Capital Expenditure Amendments (this submission)
  - (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 54, DBP:
  - (a) Responds to aspects of the ERA's reasoning in the Draft Decision relating to the following matters to do with the projected capital base:
    - (i) Forecast capital expenditure projected by DBP for 2016-2020 (amendment 11);
    - (ii) Depreciation (amendment 13); and
    - (iii) The resultant projected capital base for each year of AA4 (amendment 12);

- (b) Includes justification for three additional items of forecast capital expenditure projects that were not included in the Original AA Proposal; and
- (c) Substantiates its projected capital base amendments and additions made in the Amended Proposal for AA4.

## 2. REQUIRED AMENDMENTS 11 - 13 – FORECAST CAPEX, DEPRECIATION & PROJECTED CAPITAL BASE

### Background

- 2.1 In accordance with Rule 78, the projected capital base for each year from 2016 to 2020 (**AA4 Projected Capital Base**) is calculated by the addition or subtraction of a number of elements to the value of the opening capital base for the beginning of the AA4 access arrangement period (**AA4 Opening Capital Base**). For the purposes of this submission, they are<sup>1</sup>:
- (a) Add forecast conforming capital expenditure for the AA4 period (**AA4 Forecast Capex**);
  - (b) Subtract forecast depreciation for the AA4 period;
  - (c) Subtract the forecast value of any pipeline assets to be disposed of in the course of the period.
- 2.2 Matters concerning the interpretation of the AA4 Opening Capital Base were outlined in DBP's Submission 53. Accordingly, DBP refers the ERA to these submissions.
- 2.3 In relation to the AA4 Forecast Capex:
- (a) Rule 79 of the NGR sets the criteria for forecast conforming capital expenditure that can be added to the value of the AA4 Projected Capital Base;
  - (b) Submission 53 outlines certain issues about the interpretation of Rule 79, including the interpretation of "prudence". Reference should therefore be had to submission 53<sup>2</sup> for the purposes of this submission; and
  - (c) it is noted that the ERA has a limited discretion when it comes to assessing the forecast capital expenditure against the criteria of Rule 79 and therefore, Rule 40(2) governs the exercise of the ERA's discretion in relation to its assessment of AA4 Forecast Capex. In Submission 53, DBP also made submissions on the effect of the limited discretion on the ERA's assessment of capital expenditure<sup>3</sup> and therefore those submissions are repeated for the purposes of this submission.

### DBP's Original AA Proposal

- 2.4 In DBP's Original AA Proposal:
- (a) the AA4 Opening Capital Base as at 1 January 2016 was set at \$3,536.78m (Real \$2015)<sup>4</sup>;
  - (b) the total amount of AA4 Forecast Capex proposed was \$106.67m. That total was broken down for each year of AA4 and for each asset category as outlined in the table below;

<sup>1</sup> There are other elements prescribed by Rule 78 of the NGR to determine the AA4 Projected Capital Base but because DBP didn't propose any value for these other elements and the ERA didn't disagree with DBP's position, they are not mentioned in this list.

<sup>2</sup> Submission 53, Section 6

<sup>3</sup> Submission 53, Section 6

<sup>4</sup> Submission 53, paragraph 2.2

**Table 1: Original AA Proposal - Forecast conforming capital expenditure  
(Real \$m at 31 December 2015)**

Year	2016	2017	2018	2019	2020	Total
Pipeline	3.67	2.48	1.63	5.33	7.55	20.67
Compression	13.61	13.97	12.44	11.65	11.59	63.25
Metering	3.60	2.68	0.85	0.64	3.10	10.86
Other	2.39	2.64	2.58	1.75	2.52	11.88
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total</b>	<b>23.27</b>	<b>21.77</b>	<b>17.50</b>	<b>19.37</b>	<b>24.76</b>	<b>106.67</b>

- (c) DBP's proposed methodology for determining forecast depreciation in each year of AA4 involved use of:
  - (i) the straight line method and the current cost accounting approach; and
  - (ii) asset lives set out in Table 14 of the access arrangement information; and
- (d) DBP did not forecast the disposal of any pipeline assets in the course of AA4.

2.5 Of the total AA4 Forecast Capex of \$106.67m proposed by DBP:

- (a) 100% of the forecast related to stay in business capital expenditure (**AA4 Forecast SIB Capex**);
- (b) there was no forecast capital expenditure for the expansion, enhancement, or extension of the DBNGP; and
- (c) the level of DBP's AA4 Forecast SIB Capex was 23.3% less than DBP's proposed actual stay in business capital expenditure for the AA3 period.

## ERA Draft Decision - Required Amendments 11 - 13

2.6 In the Draft Decision, the ERA required 5 amendments relating to the calculation of the AA4 Projected Capital Base – Amendments 6, 10, 11, 12 & 13. DBP has made submissions in relation to Amendments 6 & 10 in Submissions 53 & 56 and accordingly, references those submissions in relation to these matters to do with the calculation of the AA4 Projected Capital Base.

2.7 In relation to the value of the AA4 Opening Capital Base:

- (a) issues concerning the methodology for calculating certain elements required to determine the AA4 Opening Capital Base and the values for these elements were the subject of required amendment 10 in the Draft Decision and are discussed in Submission 53; and
- (b) many of DBP's submissions made in Submission 53 are relevant also to the issues involved in the calculation of the AA4 Projected Capital Base because the ERA's reasoning for its Amendment 11 is similar to the reasoning for Amendment 10. Accordingly, where relevant to this submission, DBP cross references to relevant paragraphs from Submission 53.

2.8 In relation to the value of the forecast conforming expenditure, the ERA's Draft Decision Amendment 11 requires that the AA4 Forecast Capex proposed by DBP must be amended to reflect the values shown in Table 35 of the Draft Decision (**ERA Approved AA4 Forecast Capex**).

2.9 The ERA's Draft Decision Amendment 13 requires that forecast depreciation be amended to reflect the values in Table 41 of the Draft Decision (**ERA Approved Depreciation**).

2.10 The ERA's Draft Decision Amendment 12 requires the projected capital base in the proposed revised access arrangement must be amended to reflect the values in Table 36 (**ERA Approved**



**Projected Capital Base).** The values in Table 36 incorporate the values for ERA Approved AA4 Forecast Capex and the ERA Approved Depreciation as required by Amendments 11 and 13.

## AA4 Forecast Capex

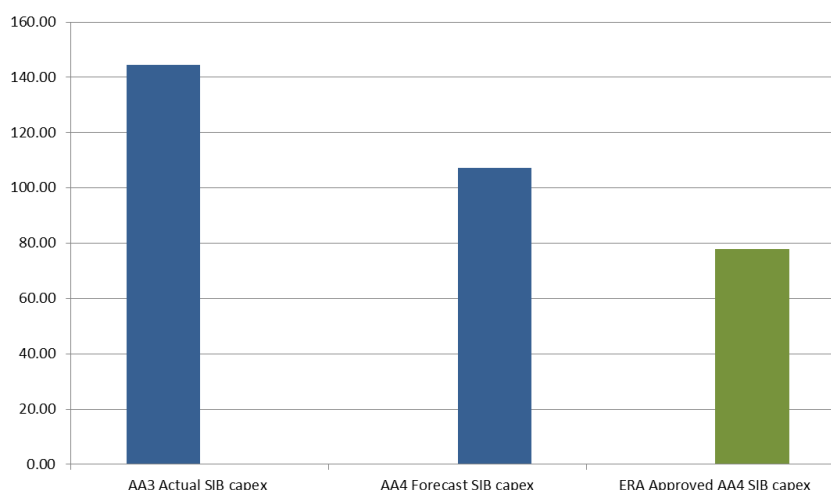
2.11 Table 35 of the ERA's Draft Decision sets out the results of the ERA's review of DBP's AA4 Forecast Capex by outlining the reduced amount of AA4 Forecast Capex required across each year and each asset category to determine the ERA Approved AA4 Forecast Capex. A copy of the table 35 follows:

**Table 2: ERA Table 35 – ERA Approved AA4 Forecasts Capex**

Real \$ million at 31 December 2015	2016	2017	2018	2019	2020	Total
Pipeline	2.94	1.99	1.30	4.27	6.04	16.54
Compression	8.84	9.08	8.08	7.57	7.53	41.11
Metering	2.88	2.14	0.68	0.51	2.48	8.69
Other	2.33	2.57	2.52	1.70	2.45	11.58
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
<b>TOTAL</b>	<b>16.99</b>	<b>15.78</b>	<b>12.58</b>	<b>14.05</b>	<b>18.51</b>	<b>77.92</b>

2.12 Table 35 of the Draft Decision means that, regardless of the fact that DBP's proposed level of AA4 Forecast SIB Capex proposed by DBP was some 23% lower than the actual SIB capital expenditure made by DBP in the AA3 period, the level of the ERA Approved AA4 Forecast Capex was reduced by a further \$28.75m (from \$106.67m proposed by DBP to \$77.92m). This represents a 46% reduction from DBP's actual AA3 SIB Capex levels. The following figure compares DBP's AA4 Forecast SIB Capex with the AA3 actual SIB Capex and the ERA Approved AA4 Forecast SIB Capex.

**Figure 1: SIB Capex comparisons**



2.13 The ERA relied upon recommendations contained in a report prepared by EMCa (**EMCa Report**) to justify its reductions in the level of forecast conforming capital expenditure allowed for AA4. In the EMCa Report, EMCa:

- (a) reviewed 17 out of the 102 projects that formed the basis of DBP's AA4 Forecast Capex, which comprised 15 projects with the highest expenditure and 2 other projects of an atypical

nature (**Reviewed AA4 Projects**). The Reviewed AA4 Projects represented 67% (\$71.99m) of the total of DBP's AA4 Forecast Capex<sup>5</sup>;

- (b) concluded that, based on the information provided by DBP and EMCa's industry knowledge and experience, the expenditure associated with 15 of the Reviewed AA4 Projects satisfied the requirements of Rule 79(1)(b) in that it satisfied one or more of the components of Rule 79(2)(c) (**Necessary Reviewed AA4 Projects**)<sup>6</sup>;
- (c) concluded that none of the expenditure associated with two of the Reviewed AA4 Projects satisfied any of the components of Rule 79(2)(c) (**Unnecessary Reviewed AA4 Projects**)<sup>7</sup>;
- (d) recommended the removal of all of the expenditure included in DBP's AA4 Forecast Capex associated with the Unnecessary Reviewed AA4 Projects<sup>8</sup>;
- (e) in relation to the expenditure for the Necessary Reviewed AA4 Projects - found that there were a number of systemic issues about DBP's processes and systems relating to governance, management and forecasting (such as poor documentation, lack of clarity about scope of work, lack of options analysis, lack of clarity of the basis for the estimate and lack of demonstration of delivery capability)<sup>9</sup>;
- (f) found that, the existence of these systemic issues in relation to the Reviewed AA4 Projects and the systemic governance, management and forecasting issues that were outlined in section 4 of the EMCa Report, meant that it was reasonable to assume that they also apply to all other projects for which expenditure was included in DBP's AA4 Forecast Capex (**Unreviewed AA4 Projects**)<sup>10</sup>;
- (g) concluded that, based solely on the presence of these systemic issues, DBP's AA4 Forecast Capex in its Original AA Proposal does not meet the requirements of Rule 79(1)(a)<sup>11</sup>;
- (h) recommended a number of different ranges of percentage reductions by asset class, having regard to the extent to which the systemic issues were evident in various projects in each asset class. The recommended ranges were from 0% to 40%. In aggregate, the range of reductions was between 22% to 32% (\$23.71 to \$33.78m). All recommended ranges are outlined in Table 5 of the EMCa Report<sup>12</sup> and Table 33 of the Draft Decision; and
- (i) Recommended that the range of AA4 Forecast SIB Capex that meets the requirements of Rule 79 is between \$72.89m and \$82.96m.<sup>13</sup>

#### 2.14 The ERA concluded that:

- (a) taking into account the EMCa's review of DBP's AA4 Forecast Capex, it agrees with EMCa's findings that there are a number of systemic issues with the sample projects reviewed to extrapolate these findings out to be likely to be evident in all of the proposed AA4 capital expenditure;
- (b) it concurs with EMCa that not all of DBP's AA4 Forecast Capex meets the criteria to be considered conforming capital expenditure for the purposes of Rule 79<sup>14</sup>; and
- (c) a mid-point of the range of reductions recommended by EMCa for each asset class is an appropriate reduction in the amount of DBP's AA4 Forecast Capex. However, in doing so, the ERA failed to identify what parts of each project for which expenditure was included in DBP's AA4 Forecast Capex did not satisfy the Rule 79 criteria. Table 33 of the Draft Decision, which is replicated in the following table, summarises the percentage reductions in

<sup>5</sup> EMCa Report, paras 238-239

<sup>6</sup> EMCa Report, para 241

<sup>7</sup> EMCa Report, para 241

<sup>8</sup> EMCa Report, para 241

<sup>9</sup> EMCa Report, para 245

<sup>10</sup> EMCa Report, para 246

<sup>11</sup> EMCa Report, para 246

<sup>12</sup> EMCa Report, paras 247-248

<sup>13</sup> EMCa Report, Table 5

<sup>14</sup> Draft Decision, para 472

AA4 Forecast Capex for each asset class and for each year of AA4 that were outlined by EMCa and the ERA.

**Table 3: Draft Decision Table 33 – adjustments to AA4 Forecast SIB Capex**

Assessment Category	EMCa adjustment range	ERA's Draft Decision Percentage Reductions (mid-point of EMCa range)
Pipeline	15 - 25 %	20 %
Compression	30 – 40 %	35 %
Metering	15 – 25 %	20 %
Other	0 – 5%	2.5 %
Other non-depreciable	0 %	0%
BEP Lease	0 %	0%

2.15 In paragraph 478 of the Draft Decision, the ERA appears to indicate that, in addition to the reasoning outlined above, the required amended values for AA4 Forecast Capex are justified by a failure to comply with Rule 74. However, there is no assessment against Rule 74 in the Draft Decision. The only instance where an assessment of capital expenditure is made against Rule 74 is in the EMCa Report. But even in that report, EMCa concludes generally that “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.” No reasoning is outlined in the EMCa Report to support this conclusion.

2.16 The ERA sets out the required reductions in DBP's AA4 Forecast Capex and the amount of the ERA Approved AA4 Forecast Capex in paragraph 475 and Table 34 of the Draft Decision, a copy of which is reproduced in the following table.

**Table 4: Draft Decision Table 34 – Reductions in forecast capital expenditure for AA4**

Real \$ million at 31 December 2015	2016	2017	2018	2019	2020	Total
DBP AA4 Forecast Capex	23.27	21.77	17.50	19.37	24.76	106.67
Pipeline	(0.73)	(0.50)	(0.33)	(1.07)	(1.51)	(4.13)
Compression	(4.76)	(4.89)	(4.35)	(4.08)	(4.06)	(22.14)
Metering	(0.72)	(0.54)	(0.17)	(0.13)	(0.62)	(2.17)
Other	(0.06)	(0.07)	(0.06)	(0.04)	(0.06)	(0.30)
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
Total Reductions	(6.28)	(5.99)	(4.91)	(5.32)	(6.25)	(28.74)
<b>ERA Approved Forecast AA4 Capex</b>	<b>16.99</b>	<b>15.78</b>	<b>12.58</b>	<b>14.05</b>	<b>18.51</b>	<b>77.92</b>

### Forecast Depreciation

2.17 Tables 40 & 41 of the Draft Decision set out the required amount of forecast depreciation allowed by the ERA (in real and nominal terms).

2.18 While the ERA accepted DBP's proposed methodology for determining forecast depreciation in each year of AA4 (which involved use of the straight line method, current cost accounting approach and the asset lives set out in Table 14 of the access arrangement information), the ERA adopted different values for depreciation to those proposed by DBP in its Original AA Proposal. This was because the ERA required changes to the following other elements that impact the level of depreciation to be allowed in AA4:

- (a) the AA4 Opening Capital Base;

- (b) the AA4 Forecast Capex; and
- (c) inflation.

#### ERA Approved Projected Capital Base for AA4

2.19 Table 36 of the Draft Decision sets out the values for the ERA Approved Projected Capital Base for each year of AA4 as a result of the changes required by the ERA in Amendments 6, 10, 11 and 13.

**Table 5: Table 36 of ERA Draft Decision – ERA Approved AA4 Projected Capital Base**

Year	2016	2017	2018	2019	2020
<b>Total Assets</b>					
Total Capital base at 1 Jan	3,497.09	3,415.56	3,330.32	3,241.41	3,160.09
<i>Plus</i>					
Forecast conforming capital expenditure	16.99	15.78	12.58	14.05	18.51
<i>Less</i>					
Forecast depreciation	98.52	101.03	101.49	95.38	85.99
Forecast asset disposals	0.00	0.00	0.00	0.00	0.00
<b>Projected Capital Base</b>	<b>3,415.56</b>	<b>3,330.32</b>	<b>3,241.41</b>	<b>3,160.09</b>	<b>3,092.61</b>

2.20 In summary, 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 Projected Capital Base.

**Table 6: ERA's position in the DD on Projected AA4 Capital Base elements**

Opening Capital Base Element	ERA's Draft Decision response to DBP's approach
AA4 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 <sup>15</sup>
Redundant assets	Accept
Assets disposed	Accept
AA4 opening capital base	Did not accept

<sup>15</sup> see paragraph 2.18

## DBP's Amended AA Proposal and response to Draft Decision

2.21 DBP has not accepted the changes required by Amendments 11 to 13<sup>16</sup>. In its Amended AA Proposal, DBP set out the following values for the Projected Capital Base for each year of AA4<sup>17</sup>.

**Table 7: AA4 Projected Capital Base in the Amended AA Proposal**

Year	2016	2017	2018	2019	2020
Capital Base (as at 1 Jan)	3,514.11	3,442.42	3,382.41	3,297.21	3,230.42
<i>Plus</i>					
Forecast Conforming Capital Expenditure	25.68	41.82	17.59	30.12	39.09
<i>Less</i>					
Forecast Depreciation	102.69	101.82	102.79	96.91	87.93
Forecast Asset Disposals	0.00	0.00	0.00	0.00	0.00
<b>Projected Capital Base</b>	<b>3,437.10</b>	<b>3,382.41</b>	<b>3,297.21</b>	<b>3,230.42</b>	<b>3,181.58</b>

2.22 The elements from Amendment 11 relating to the calculation of the Projected Capital Base for AA4 and with respect to which DBP has not accepted are:

- (a) AA4 Opening Capital Base;
- (b) AA4 Forecast SIB Capex; and
- (c) AA4 Forecast expansion/enhancement Capex.

2.23 DBP has also made one addition in relation to the calculation of the Projected Capital Base for each year of AA4 in the Amended AA Proposal – it has added amounts for AA4 Forecast enhancement capital expenditure in each year of AA4.

### AA4 Opening Capital Base

2.24 DBP's Submission 53 outlines DBP's submissions as to why it has not accepted the ERA's required amendments to the value of the AA4 Opening Capital Base. Accordingly, rather than repeat those submissions in this document, DBP refers the ERA to these submissions to substantiate DBP's position on the issue of the value of the AA4 Opening Capital Base.

### AA4 Forecast Capex

2.25 In the Amended AA Proposal, DBP proposed a total amount of \$154.29m in AA4 Forecast Capex, broken down as follows:

- (a) AA4 Forecast SIB Capex - \$107.32m (Real 2015\$s).
- (b) Forecast capital expenditure for the enhancement of the DBNGP during AA4 - \$46.97m (Real, 2015\$s)

2.26 These amounts, broken down by year and by asset category, are shown in the following table which was included in the amended access arrangement information.

<sup>16</sup> DBP has also not accepted the changes required by Amendment 10 – see submission 53.

<sup>17</sup> See table 12 of DBP's Amended Access Arrangement Information

**Table 8: Amended AA Proposal – AA4 Forecast Capex (real \$m 2015\$s)**

Year	2016	2017	2018	2019	2020	Total
<b>Expansion/Enhancement/Extension</b>						
Pipeline	0.00	17.88	0.00	10.58	14.03	42.49
Compression	2.38	2.10	0.00	0.00	0.00	4.49
Metering	0.00	0.00	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00	0.00	0.00
other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
<b>sub total</b>	<b>2.38</b>	<b>19.99</b>	<b>0.00</b>	<b>10.58</b>	<b>14.03</b>	<b>46.97</b>
<b>Stay-in-business</b>						
Pipeline	3.68	2.49	1.64	5.38	7.65	20.83
Compression	13.62	14.01	12.50	11.75	11.73	63.62
Metering	3.60	2.68	0.85	0.65	3.14	10.93
Other	2.40	2.65	2.60	1.76	2.55	11.95
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub total</b>	<b>23.30</b>	<b>21.83</b>	<b>17.59</b>	<b>19.54</b>	<b>25.06</b>	<b>107.32</b>
<b>TOTAL DBNGP</b>						
Pipeline	3.68	20.37	1.64	15.96	21.67	63.32
Compression	16.01	16.11	12.50	11.75	11.73	68.10
Metering	3.60	2.68	0.85	0.65	3.14	10.93
Other	2.40	2.65	2.60	1.76	2.55	11.95
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total</b>	<b>25.68</b>	<b>41.82</b>	<b>17.59</b>	<b>30.12</b>	<b>39.09</b>	<b>154.29</b>

2.27 This amount of AA4 Forecast Capex is \$47.63m more than the amount proposed as forecast capital expenditure for AA4 in the Original AA Proposal. This variance is explained as follows:

- (a) Enhancement Capex - DBP has included an amount of \$46.97m in expenditure not included in the Original AA Proposal (see section 6 of this submission). This is associated with the need to enhance the DBNGP as a result of circumstances that have arisen since DBP filed its Original AA Proposal.
- (b) Inflation – in presenting the amounts in Real \$2015 values, DBP has used the inflation rates for 2015 and each year of AA4 as set out in Amendment 6 of the Draft Decision. In this regard, DBP refers the ERA to DBP's submissions in section 8 of Submission 56 and section 3 of Submission 53. This results in the amount of AA4 Forecast Capex being increased by \$0.66m.

2.28 The effect of each of these adjustments is summarised in the following table:

**Table 9: Explanation of changes in total AA4 Forecast Capex from Original AA Proposal to Amended AA Proposal**

	Amount (\$Real, 2015, \$m)
<b>Original AA Proposal – AA4 Forecast Capex</b>	<b>106.66</b>
Less Change in Inflation rates 2015 – 2020	0.66
Plus additional Enhancement Capex	46.97
<b>Amended AA Proposal – AA4 Forecast Capex</b>	<b>154.29</b>

2.29 Appendix D: contains a more detailed breakdown of the projects included in DBP's AA4 Forecast Capex, including the expenditure associated with each project, the year or years in which the

expenditure is forecast to be made and the asset category that the expenditure relates to. It also identifies which of the projects are the projects that were reviewed in detail by the EMCa – ie the Reviewed AA4 Projects.

### Forecast Depreciation

- 2.30 Because the ERA accepted DBP's methodology for calculating forecast depreciation and the only reason for the difference in the amount of forecast depreciation allowed is as a consequence of other amendments in the Draft Decision<sup>18</sup>, DBP has accepted the ERA's position on the methodology for calculating forecast depreciation but has not otherwise accepted the ERA's required Amendment 13 relating to the amount of forecast depreciation.
- 2.31 DBP's submissions on each of the other amendments from the Draft Decision that impact the amount of depreciation in Amendment 13 are made in this Submission 54 (for AA4 Forecast Capex), Submission 53 (for the AA4 Opening Capital Base and actual inflation) and Submission 56 (for actual and forecast inflation). Accordingly DBP refers the ERA to those submissions to explain why DBP's Amended AA Proposal does not accept Amendment 13.
- 2.32 The amount of forecast depreciation included in DBP's Amended AA Proposal is outlined in Section 1 of this Submission.
- 2.33 DBP makes no further submissions in relation to the issue of forecast depreciation.

### AA4 Projected Capital Base

- 2.34 While DBP agrees with the ERA's methodology for determining the projected capital base, DBP has not accepted amendment 12 in its Amended AA Proposal.
- 2.35 Instead, DBP's Amended AA Proposal contains the values for the AA4 Projected Capital Base for each year of AA4 as outlined in Table 7 of this Submission.
- 2.36 DBP's Amended AA Proposal for calculating the AA4 Projected Capital Base is compared with DBP's Original AA Proposal and the ERA's Draft Decision in the following table.

**Table 10: Comparison of AA4 Projected Capital Base values (Real, 2015\$s \$m)**

Projected Capital Base Element	DBP Original AA proposal	ERA DD	DBP Amended AA Proposal
AA4 opening capital base (@ 1/1/16)	\$3,536.78	\$3,497.09	\$3,514.11
SIB Capex	\$106.67	\$77.91	\$107.32
Expansion/Enhancement/Extension Capex	\$0.00	\$0.00	\$46.97
Depreciation	\$493.67	\$478.86	\$492.14
Redundant assets	\$0.00	\$0.00	\$0.00
Assets disposed	\$0.00	\$0.00	\$0.00
AA4 Projected capital base (@31/12/20)	\$3,149.77	\$3,136.40	\$3,181.58

- 2.37 The factors that drive the change in the value of the Projected Capital Base as at 31 December 2020 include:
- (a) a different AA4 Opening Capital Base value for the reasons outlined in Submission 53;
  - (b) updated inflation assumptions (the reasons for which are outlined in DBP's Submissions 53 and 56);

<sup>18</sup> See para 2.18



- (c) continued use of the same amount of conforming capital expenditure for AA4 Forecast SIB Capex that was included in the Amended AA Proposal (leaving aside the effect of using a different inflation rate);
- (d) the inclusion of an amount of forecast enhancement capital expenditure not included in the Original AA Proposal; and
- (e) updated forecast depreciation for the AA4 period. As noted above, while the ERA has accepted DBP's approach to forecast depreciation, the amount of depreciation is not the same as per the Draft Decision Amendment 12 because DBP has updated the projected capital base calculation for the changes proposed to the opening capital base and the forecast confirming capital expenditure.

2.38 In light of the above, the remainder of this submission focuses on the part of ERA's required Amendment 11 that relates to the amount of AA4 Forecast Capex included to calculate the value of the AA4 Projected Capital Base for each year of AA4. In this submission, DBP provides further information to support the levels of forecast expenditure for:

- (a) each project assessed by the ERA;
- (b) new items of forecast expenditure that were not included in the Original AA Proposal; and
- (c) all forecast expenditure generally.

2.39 The remaining sections of this submission are therefore structured as follows:

- (a) Section 3 contains submissions as to why the ERA should be able to infer that DBP's AA4 Forecast SIB Capex outlined in its Amended AA Proposal complies with the criteria of Rule 79
- (b) Section 4 provides further information regarding the 2 projects that the ERA concluded did not meet the criterion in Rule 79(1)(b) and with respect to which the ERA excluded all expenditure from conforming forecast capital expenditure on the basis of insufficient information;
- (c) Sections 5 deals with the ERA's reasoning for its decision on the prudence and efficiency of DBP's proposed AA4 Forecast SIB Capex and DBP's response to these reasons;
- (d) Section 6 deals with the addition made by DBP, in the Amended AA Proposal, to the amount of forecast capital expenditure for the enhancement of the DBNGP.



### 3. MEETING THE CRITERIA OF RULE 79(1) PURSUANT TO RULE 71 - INFERRED COMPLIANCE

- 3.1 DBP notes that, pursuant to Rule 71 of the NGR, in determining whether capital expenditure is efficient and complies with other criteria prescribed by the NGR, the ERA may, without embarking on a detailed investigation, infer compliance from the operation of an incentive mechanism or any other basis the ERA considers appropriate.
- 3.2 DBP submits that there are two alternative bases pursuant to which the ERA should decide that it can, in accordance with Rule 71 and without embarking on a detailed investigation, infer that DBP's AA4 Forecast SIB Capex meets the criteria of Rule 79(1). They are:
- (a) As the ERA has itself previously acknowledged, DBP's shipper contractual framework provides an even more powerful incentive framework for efficiency than is the case with the framework of the NGR itself; or
  - (b) The combination of the following circumstances which exist should be appropriate to infer compliance:
    - (i) The fact that no submissions were made by third parties in relation to DBP's AA4 Forecast SIB Capex;
    - (ii) The expertise and experience of DBP's workforce to ensure that the DBNGP is maintained to meet the business needs and to incur expenditure in so doing in a way that is prudent and efficient; and
    - (iii) The level of forecast expenditure proposed by DBP in its Amended AA Proposal is comparable to the level of expenditure incurred by DBP in AA3 but significantly lower than the level of expenditure that DBP forecast for AA3, which forecast was approved by the ERA in 2011.
- 3.3 Each of these bases is addressed in turn below.

#### Incentive Mechanism of DBP's shipper contracts should enable ERA to infer compliance

- 3.4 DBP has explained in section 7 of Submission 2, how it is incentivised under shipper contracts with tariff arrangements that sit outside of the regulatory framework of the NGR and NGL to ensure capital and operating costs are prudent and efficient. DBP refers the ERA to these submissions for the purposes of justifying why the ERA should infer compliance with the capital expenditure criteria of the NGR.
- 3.5 In particular, 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<sup>19</sup>.
- 3.6 In light of the above, the ERA should infer compliance from the operation of these mechanisms that DBP's AA4 Forecast SIB Capex is efficient and complies with the other criteria for conforming capital expenditure required by the NGR without undertaking a detailed analysis.

#### A combination of circumstances should enable ERA to infer compliance

- 3.7 To the extent that the ERA is not convinced that the incentive mechanism of the shipper contractual framework is, of itself, sufficient to enable the ERA to infer that DBP's AA4 Forecast Capex complies with Rule 79(1) without undertaking a detailed analysis, DBP submits that there

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<sup>19</sup> ERA Draft Decision (May 2010) paragraph 194-197

are a number of other circumstances which, when combined together, also form a basis for the ERA to infer compliance without undertaking a detailed analysis of DBP's AA4 Forecast Capex.

- 3.8 Firstly, as outlined in paragraphs 6.32 to 6.35 of DBP's Submission 53, the expertise and experience of DBP's workforce must be given significant weight in the assessment of project requirements and investments. This workforce has several individuals who have been working for the pipeline since it was commissioned in 1984. They have a detailed understanding of what is required to maintain the integrity of the pipeline. They also have developed long standing relationships with key vendors and contractors who are needed to ensure reliable operation of the pipeline. Furthermore, because of their long standing involvement in the operation of the pipeline, they are acutely aware of what are efficient costs for the services provided by vendors and contractors.
- 3.9 Secondly, the level of capital expenditure forecast by DBP is comparable to levels of expenditure previously determined by the ERA to be prudent and efficient and in similar circumstances to those proposed for AA4. In this regard, the ERA's Draft Decision required amendments to DBP's Original AA Proposal to reduce the amount of AA4 Forecast SIB Capex to be added to the AA4 Projected Capital Base, determining that only 73% of the amount DBP proposed (ie \$77.92m out of \$107.32m<sup>20</sup>) is conforming forecast capital expenditure that satisfies Rule 79 of the NGR and that 27% (\$29.40m) of DBP's proposed forecast capital expenditure does not comply with the criteria set out in Rules 74 or 79. The reductions for each of the years of AA4 and by each asset class are reflected in Table 4 of this submission.
- 3.10 Table 35 of the Draft Decision means that, regardless of the fact that DBP's proposed level of AA4 Forecast SIB Capex proposed by DBP was some 23% lower than the actual SIB capital expenditure made by DBP in the AA3 period, the level of the ERA Approved AA4 Forecast Capex was reduced by a further \$28.75m (from \$106.67m proposed by DBP to \$77.92m). This represents a 46% reduction from DBP's actual AA3 SIB Capex levels. The following figure compares DBP's AA4 Forecast SIB Capex with the AA3 actual SIB Capex and the ERA Approved AA4 Forecast SIB Capex.
- 3.11 DBP notes that the level of actual SIB Capex for AA3 includes an amount of expenditure as "CWIP" for 2010 and so the level of actual expenditure for AA3 may not be a straight comparison to the level of expenditure for AA4. If the CWIP expenditure were excluded to therefore make a more "like for like" comparison, the remaining actual AA3 SIB capex is \$101.10m. This is only \$6.22m less than the AA4 Forecast SIB Capex proposed for AA4 (Real 2015\$s). This forecast is therefore consistent with actuals.
- 3.12 Finally, compliance should be inferred without a detailed analysis being undertaken in circumstances where no third party has made submissions to the ERA raising concerns about DBP's proposal.

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<sup>20</sup> This amount is the same as the amount of \$106.67m included in DBP's Original AA Proposal, once the inflation assumptions outlined in Amendment 6 of the Draft Decision are used instead of those adopted by DBP in its Original AA Proposal.

## 4. AA4 FORECAST SIB CAPEX – COMPLIANCE WITH RULE 79(1)(B) - BUSINESS NEED

### ERA Draft Decision

- 4.1 In deciding to disallow \$28.75m of the total value of DBP's AA4 Forecast SIB Capex<sup>21</sup>, the ERA concluded that:
- (a) based on the information provided by DBP and EMCa's industry knowledge and experience, the expenditure associated with 15 of the Reviewed AA4 Projects satisfied the requirements of Rule 79(1)(b) in that it satisfied one or more of the components of Rule 79(2)(c) (**Necessary Reviewed AA4 Projects**)<sup>22</sup>;
  - (b) none of the expenditure associated with two of the Reviewed AA4 Projects satisfied any of the components of Rule 79(2)(c) and therefore this forecast expenditure did not meet the requirements of Rule 79(1)(b) (**Unnecessary Reviewed AA4 Projects**)<sup>23</sup>.
- 4.2 Given the conclusion reached by the ERA in paragraph 4.1(a), DBP makes no further submissions on the extent to which the Necessary Reviewed AA4 Projects meet the requirements of Rule 79(1)(b).
- 4.3 The Unnecessary Reviewed AA4 Projects and the amount of forecast expenditure proposed by DBP in the Original AA Proposal for each of them are outlined in the following table.

**Table 11: Unnecessary Reviewed AA4 Projects**

Project	AA4 Forecast SIB Capex proposed by DBP (\$m, Real, \$2015)	ERA Approved Forecast SIB Capex (\$m, Real, \$2015)
[REDACTED]	[REDACTED]	\$0.00
[REDACTED]	[REDACTED]	\$0.00
[REDACTED]	\$11.46	\$0.00

- 4.4 It should be noted however, that while the above projects were considered not to be necessary for the purposes of Rule 79(1)(b), it is unclear whether the ERA, in its Draft Decision, has disallowed 100% of the forecast expenditure proposed by DBP. This issue is outlined in more detail in section 5 of this submission.

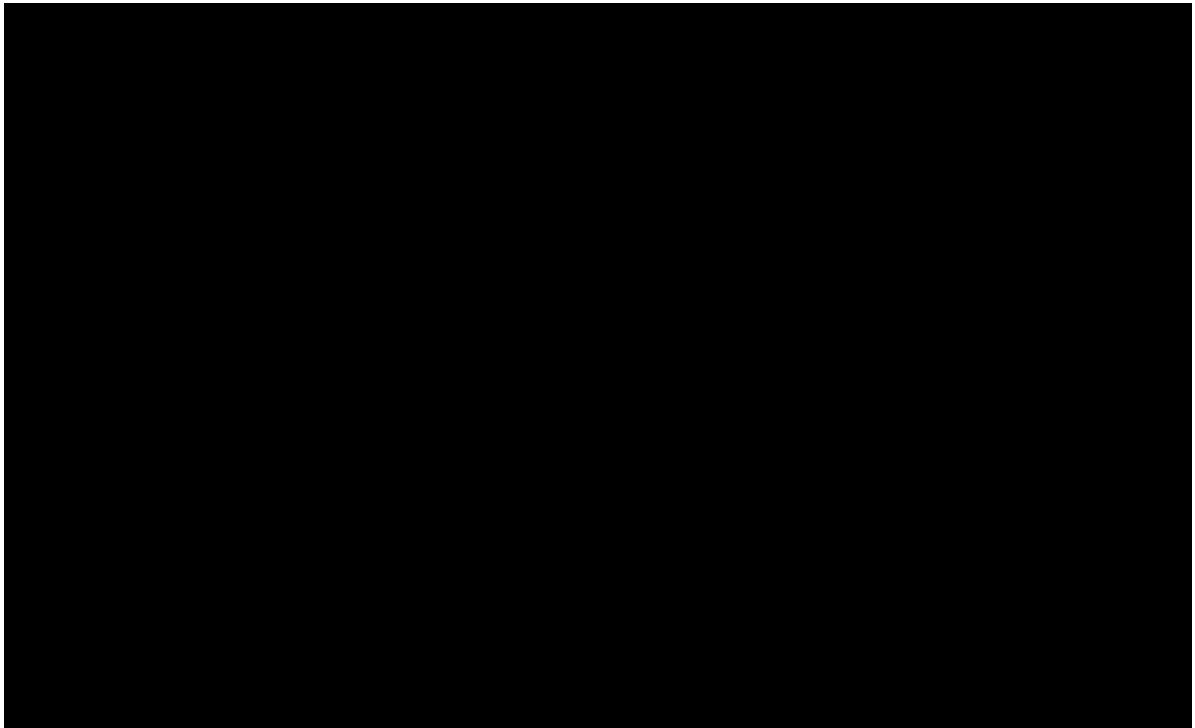
### ERA Draft Decision Reasons for Amendment

- 4.5 As summarised in section 2 of this submission, the reasons the ERA decided:
- (a) that not all of DBP's AA4 Forecast SIB Capex met the criteria of Rule 79 of the NGR; and
  - (b) what amount of DBP's AA4 Forecast SIB Capex did meet the criteria of Rule 79 of the NGR, were solely based on the recommendations contained in the EMCa Report.

<sup>21</sup> DBP proposed \$106.67m but with the reduction, the ERA Approved AA4 Forecast SIB Capex totalled \$77.92m

<sup>22</sup> EMCa Report, para 241

<sup>23</sup> EMCa Report, para 241



- 4.7 Neither the ERA nor EMCa formed any conclusions about whether these projects met the efficiency and prudence criteria under Rule 79(1)(a).

## DBP Amended AA Proposal & Response to ERA's Reasons

- 4.8 DBP's Amended AA Proposal has not accepted:
- (a) the ERA's reasons in the Draft Decision for concluding that the two Unnecessary Reviewed AA4 Projects did not meet the requirements of Rule 79(1)(b); and
  - (b) any reduction in the amount of AA4 Forecast SIB Capex relating to the Unnecessary Reviewed AA4 Projects required by the ERA in the Draft Decision .
- 4.9 DBP is of the view that all of the forecast expenditure associated with these projects is not only necessary but is also prudent and efficient and represents a forecast that meets the requirements of Rule 74.
- 4.10 DBP has developed further submissions that are particular to each Unnecessary Reviewed AA4 Project. These submissions provided further supporting explanations and documentation for each project to substantiate its compliance with the requirements of Rule 79(1)(b). In particular, they address each of the reasons referred to in paragraph 4.6.
- 4.11 A separate document has been prepared in relation to each of the Unnecessary Reviewed AA4 Projects. These are attached in Appendix A: .
- 4.12 In the meantime, and for ease of reference, the following table summarises the specific reasoning relied upon by the ERA and EMCa for concluding that each Unnecessary Reviewed AA4 Project was not compliant with the requirements of Rule 79(1)(b) and where, in each document in Appendix A: , DBP outlines its response to each reason.

**Table 12: Summary of DBP's response to ERA's reasons for deciding project was an Unnecessary Reviewed AA4 Project**

Reason for being unnecessary	Project#3	Project#7
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

## 5. AA4 FORECAST SIB CAPEX – COMPLIANCE WITH RULE 79(1)(B) - PRUDENCY & EFFICIENCY

### ERA Draft Decision

- 5.1 As outlined in section 4 of this submission, of the \$28.75m of the total value of DBP's AA4 Forecast SIB Capex<sup>24</sup> disallowed by the ERA, \$11.46m appears to have been disallowed on the basis that it related to projects for which DBP had failed to demonstrate a business need and therefore meet the requirements of Rule 79(1)(b).
- 5.2 This should mean that the remaining amount disallowed by the ERA – being \$17.29m – was disallowed on the basis that it related to the Necessary Reviewed AA4 SIB Projects where DBP had not demonstrated the expenditure met the criteria in Rule 79(1)(a) – ie that it was prudent and efficient expenditure. That this is the case is explained in paragraphs 5.35 to 5.38 of this Submission.
- 5.3 However, there is no explicit statement to this effect in the Draft Decision.
- 5.4 In fact, it would appear that the ERA has not disallowed expenditure on this basis. Instead, what can be drawn from the Draft Decision reasoning and the EMCa Report is that the ERA disallowed \$17.29m of DBP's proposed AA4 Forecast SIB Capex (and potentially all of the disallowed AA4 Forecast SIB Capex) on a different basis.
- 5.5 The Draft Decision concluded the following:
- (a) Four of the Necessary Reviewed AA4 SIB Projects met the criteria in Rules 79(1)(a) and (b) – being Projects 8, 11, 14 & 17 involving for a total amount of forecast capital expenditure of \$9.48m.
  - (b) Of the projects referred to in paragraph 5.5(a), one project met the requirements of Rule 74 (totalling \$2.39m) whereas the other three projects (totalling \$7.09m) did not.
  - (c) EMCa concluded that the remaining Necessary Reviewed AA4 SIB Projects met the criteria of Rule 79(1)(b) but not the criteria of Rule 79(1)(a). These projects had a total forecast expenditure of \$7.81m.
  - (d) Notwithstanding the above, the ERA has applied a blanket percentage reduction across all projects in a particular asset category, regardless of whether the ERA and EMCa concluded that the expenditure for a project met any or all of the requirements in Rules 79(1)(a) and (b) and Rule 74. The blanket percentage reductions are outlined in Table 4 of this submission.
- 5.6 The EMCa and ERA's views on the extent to which each Necessary Reviewed AA4 Project met the requirements of Rules 79(1)(a) and (b) and Rule 74 are summarised in the following table:

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<sup>24</sup> DBP proposed \$106.67m but with the reduction, the ERA Approved AA4 Forecast SIB Capex totalled \$77.92m

Table 13: Necessary Reviewed AA4 Projects

Project	AA4 Forecast SIB Capex proposed by DBP (\$m, Real, \$2015)	Satisfy Rule 79(1)(a)?	Satisfy Rule 79(1)(b)?	Satisfy Rule 74(2)?
		x	✓	x
		x	✓	x
		x	✓	x
		x	✓	x
		x	✓	x
		✓	✓	x
		x	✓	x
		x	✓	x
		✓	✓	✓
		x	✓	x
		x	✓	x
		✓	✓	x
		x	✓	x
		x	✓	x
		✓	✓	x

## ERA Draft Decision Reasons for Amendment

5.7 As outlined in paragraph 2.13 of this Submission, the ERA relied upon recommendations contained in a report prepared by EMCa (**EMCa Report**) in making its decision in relation to DBP's proposed AA4 Forecast SIB Capex.

5.8 In relation to the expenditure for the Necessary Reviewed AA4 SIB Projects, EMCa found that:

- (a) there were a number of systemic issues about DBP's processes and systems relating to governance, management and forecasting (such as poor documentation, lack of clarity about scope of work, lack of options analysis, lack of clarity of the basis for the estimate and lack of demonstration of delivery capability)<sup>25</sup>; and
- (b) in addition to the systemic issues, because EMCa's review of the Reviewed AA4 SIB 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.

5.9 It is 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 the AA4 project 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) In deciding the reductions to be made to AA4 Forecast SIB Capex, the ERA adopted an inconsistent approach to projects valued at less than \$0.15m (**Small Value Projects**) than it did for its assessment of similar Small Value Projects as part of its assessment of AA3 SIB Capex. In assessing the AA3 SIB Capex, the ERA did not require any reductions to the capital expenditure associated with Small Value Projects 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.

In addition, the ERA endorsed the EMCa's findings on the extent to which each of the Necessary Reviewed AA4 SIB Projects complied with the requirements of Rule 79 for being conforming capital expenditure (which are summarised in

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<sup>25</sup> EMCa Report, para 245



- (e) Table 13 of this Submission). This assessment showed that at least one of the Necessary Reviewed AA4 SIB Projects (Project 11) met the requirements of both Rules 79 and 74 and a further three of the Necessary Reviewed AA4 SIB Projects (projects 8, 14 and 17) met the requirements of Rule 79 (**ERA Compliant Projects**). It would appear therefore that, even if there were no errors with the approach of the ERA to the assessment of DBP's AA4 Forecast SIB Capex (which DBP submits is not the case):
- (i) all of the expenditure associated with at least the ERA Compliant Project known as Project 11 – replacement of 110V DC batteries and battery chargers - should have been allowed. If this were the case, an additional \$0.84m (Real \$2015) should have been allowed by the ERA as conforming forecast capital expenditure than was the case in the Draft Decision.
  - (ii) the ERA should have allowed all of the expenditure associated with those other ERA Compliant Projects that have complied with both requirements of Rule 79(1)(a) and (b). This would result in an additional \$1.12m (Real, \$2015) being allowed by the ERA as conforming forecast capital expenditure than was the case in the Draft Decision.
- 5.10 However, in relation to the AA4 Forecast SIB Capex, the ERA applied its percentage reductions even to all projects, including the capex associated with both the ERA Compliant Projects and the Small Value Projects.
- 5.11 In relation to the Small Value Projects:
- (a) It is not clear why the ERA chose, on one hand (ie for AA3 SIB Capex), to not adjust the capital expenditure for such projects but, on the other hand (ie for AA4 Forecast SIB Capex), to adjust the capital expenditure for such projects; and
  - (b) If the ERA had adopted the same approach in assessing Small Value Projects for AA4 as it adopted for assessing the Small Value Projects for AA3, this would have resulted in the level of ERA Approved AA4 Forecast SIB Capex being \$0.43m more than in the Draft Decision.
- 5.12 In relation to the ERA Compliant Projects:
- (a) It is not clear why the ERA assessed that these projects met the requirements for conforming capital expenditure in Rule 79(1) but then decided to not allow all of the expenditure for each project as conforming capital expenditure; and
  - (b) For the reasons outlined in paragraphs 0, 5.38 and 5.39 of this Submission, the ERA has incorrectly disallowed \$1.96m in capital expenditure from the AA4 Forecast SIB Capex

## DBP's Amended AA Proposal

- 5.13 As outlined in section 2, in the Amended AA Proposal, DBP proposed a total amount of \$107.32m in AA4 Forecast SIB Capex:
- 5.14 This amount, broken down by year and by asset category, is shown in the following table which was included in the amended access arrangement information.

**Table 14: Amended AA Proposal – AA4 Forecast SIB Capex (real \$m 2015\$s)**

Year	2016	2017	2018	2019	2020	Total
Pipeline	3.68	2.49	1.64	5.38	7.65	20.83
Compression	13.62	14.01	12.50	11.75	11.73	63.62
Metering	3.60	2.68	0.85	0.65	3.14	10.93
Other	2.40	2.65	2.60	1.76	2.55	11.95
Other non-depreciable	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total</b>	<b>23.30</b>	<b>21.83</b>	<b>17.59</b>	<b>19.54</b>	<b>25.06</b>	<b>107.32</b>

- 5.15 This amount of AA4 Forecast SIB Capex is \$0.66m more than the amount proposed as forecast capital expenditure for AA4 in the Original AA Proposal. This variance is explained as follows:
- (a) Projects included – DBP has not removed any of the SIB projects included in the Original AA Proposal or any of the capital expenditure associated with these projects.
  - (b) Inflation – in presenting the amounts in Real \$2015 values, DBP has used the inflation rates for 2015 and each year of AA4 as set out in Amendment 6 of the Draft Decision. In this regard, DBP refers the ERA to DBP's submissions in section 8 of Submission 56 and section 3 of Submission 53. This results in the amount of AA4 Forecast Capex being increased by \$0.66m.
- 5.16 As would now be apparent to the ERA, DBP does not accept the ERA's required Amendment 11, in so far as it relates to AA4 Forecast SIB Capex. This is so for a number of reasons which are summarised below (and are expanded on in this Submission):
- (a) DBP considers that the ERA was wrong to have concluded that not all of the expenditure included as AA4 Forecast SIB Capex in DBP's Original AA Proposal was compliant with the requirements of the Rules. In the following sections of this Submission, DBP provides further supporting information for the Reviewed AA4 SIB Projects, the remaining projects not reviewed in detail by EMCa (**Not Reviewed Projects**) and the expenditure categorised as AA4 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 is, in fact, prudence in the scope of the project and efficiency of delivery and procurement such that all of the expenditure proposed by DBP is compliant with Rules 74 & 79. A number of matters relating to the ERA's prudence and efficiency reasoning are addressed in the following parts of the submission (noting that DBP has already addressed the ERA's reasoning to support its conclusions on compliance with the requirements of Rule 79(1)(b) in relation to two projects in section 4 of this Submission):
    - (i) Paragraphs 5.17 to 5.41 address some overarching concerns DBP has with the ERA's reasoning, issues which were first raised by DBP in Submission 53.
    - (ii) Paragraphs 5.42 to 5.44 of this Submission 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 forecast expenditure generally was not prudent or efficient.
    - (iii) Paragraphs 5.45 to 5.48 and Appendix B: provides additional information in response to reasons relied on by the ERA to conclude why some or all of the expenditure for each individual Necessary AA4 Reviewed SIB Project did not meet the requirements of Rule 79(1)(a).
    - (iv) DBP also provides additional information in relation to AA4 Subsequent Costs at Appendix B: of this submission.
    - (v) Paragraphs 5.49 to 5.57 address some procedural fairness issues associated with the ERA's approach to assessing DBP's proposed AA4 Forecast SIB Capex which undermines the correctness of the ERA's Draft Decision.
  - (b) The ERA's methodology outlined in the Draft Decision for determining the percentage reductions that need to be made to DBP's AA4 Forecast SIB Capex suffers from a number of flaws. They are as follows:
    - (i) Firstly, the ERA has applied an arbitrary reduction for each asset category 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).
    - (ii) Secondly, notwithstanding the fact that the ERA has formed a view that some of the Necessary Reviewed AA4 SIB Projects meet the requirements of the NGR for conforming capital expenditure (being the Compliant SIB Projects), the ERA still requires a reduction in the amount of expenditure for each such project. This is outlined in more detail in paragraphs 5.7 and 5.12 of this Submission.

- (iii) Thirdly, the ERA has adopted an approach to at least one category of expenditure for AA4 that is inconsistent with the approach it adopted for a similar category of expenditure for AA3. This is outlined in paragraphs 5.9(d), 5.11 and 5.28 of this Submission.

## Response to ERA's Reasons - Overarching concerns with ERA's reasons

### Concerns already raised in Submission 53

- 5.17 DBP has a number of high level concerns with the ERA's reasons which are relevant to many of the Necessary Reviewed AA4 SIB Projects and the projects that were not reviewed. These concerns have affected the findings of EMCa and the ERA's adoption of those findings as its reasons for its Draft Decision in connection with the AA4 Forecast SIB Projects.
- 5.18 Many of the reasons relied on by the ERA to disallow a portion of DBP's proposed AA4 Forecast SIB Capex were also relied on by the ERA to disallow a portion of DBP's proposed AA3 SIB Capex.
- 5.19 DBP raised a number of high level concerns in relation to the ERA's reasons in its Submission 53. Because of the similarity of these reasons used in responding to DBP's AA4 Forecast Capex, DBP repeats those submissions in this Submission. In particular, DBP's submissions from Submission 53 in relation to the following high level concerns are repeated for the purposes of this Submission in responding to relevant reasons relied on by the ERA to disallow a portion of DBP's proposed AA4 Forecast SIB Capex.

**Table 15: Common high level concerns for AA3 & AA4 SIB Capex reasoning**

High level concern	Relevant Submissions from Submission 53 incorporated into Submission 54
Incorrect exercise of limited discretion	6.2 - 6.3
Level and quality of information provided to ERA prior to Draft Decision	6.15 – 6.27
Experience and technical capability of DBP staff	6.32 – 6.34
Failure to take into account relevant considerations	6.37 – 6.40 & 6.42(a)
Arbitrary reductions in capital expenditure	6.43 – 6.44
Misunderstanding of DBP's risk assessment and ranking approach	6.42(b) & 7.53 – 7.76

- 5.20 There are also some other high level concerns DBP has with respect to the ERA's reasoning for rejecting part of DBP's proposed AA4 Forecast SIB Capex. DBP makes submissions on each of these concerns below.

### Arbitrariness of reductions in AA4 Forecast SIB Capex

- 5.21 DBP submits that the ERA's reduction in the amount of AA4 Forecast SIB is a result of an arbitrary and unreasonable methodology applied by the ERA. This not only means that the ERA's estimated reduction and the estimated required expenditure for each project are not estimates that are compliant with Rule 74(2), they are not consistent with the National Gas Objective. This calls into question the reasonableness of the ERA's Draft Decision on AA4 Forecast SIB Capex. That this is so is because of a number of reasons outlined below.
- 5.22 Firstly, the submissions previously made in submission 53 in relation to the arbitrary reductions in capital expenditure for AA3 apply equally to the reductions in AA4 Forecast SIB Capex
- 5.23 Secondly, EMCa and the ERA have 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.

- 5.24 Thirdly, as outlined in paragraphs 5.9(d) and 5.11 of this Submission, the ERA has made reductions to the expenditure proposed for the Small Value Projects for AA4 but did not make any reductions in expenditure in AA3 for similar small value projects.
- 5.25 Fourthly, notwithstanding the fact that the ERA has formed a view that four of the Necessary Reviewed AA4 SIB Projects meet the requirements of the NGR for conforming capital expenditure (being the Compliant SIB Projects) – being almost 25% of the projects Reviewed AA4 SIB Projects - the ERA still requires a reduction in the amount of expenditure for each such project. This is outlined in more detail in paragraphs 5.7 and 5.12 of this Submission.
- 5.26 Fifthly, the ERA has accepted the EMCa's arbitrarily applied percentage reductions which differ across each asset category 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.
- 5.27 Sixthly, there is no discernible attempt by EMCa to explain why there should be different percentage reductions depending on the class of asset the expenditure relates to (as outlined in Table 3) or why the percentage reductions are appropriate levels of reduction.
- 5.28 Seventhly, for projects which are of a similar nature to ones that were also undertaken in AA3, the ERA has adopted a different percentage reduction for the expenditure proposed for AA4 than it adopted for the actual expenditure for the similar project in AA3. This is so notwithstanding that the procurement methodology and scope of both projects are similar. This is best shown in relation to the [REDACTED]. In relation to the expenditure incurred for AA3, the ERA concluded that a 20% reduction should be applied. Whereas, in relation to the forecast expenditure for this project for AA4, the ERA only recommended a 2.5% reduction in expenditure. No reasoning was given for the different percentage reductions being required.
- 5.29 Finally, it is unreasonable to assume that none of the projects not reviewed by the ERA fully satisfy the requirements for conforming capital expenditure when this was not the case for the Reviewed AA4 SIB Projects. In fact, almost 25% of the Reviewed AA4 SIB Projects were considered by the ERA to meet the requirements of Rule 79.

#### **The work could not be delivered at the substituted cost**

- 5.30 Despite finding that all but two of the Reviewed AA4 SIB Projects were considered necessary for the purposes of Rule 79(1)(b), the EMCa considered that the work could be delivered for less.
- 5.31 EMCa applied reductions of up to 35% for the Necessary Reviewed AA4 Projects whose expenditure relate to the compressor station asset category.
- 5.32 As many of these projects consist of a number of repeated works, it is unclear whether the 35% reduction is because the ERA is of the view that DBP claims to be proposing more than 35% more work than what is necessary to be completed or whether it is because the ERA is of the view that DBP claims to proposing to spend more than 35% more than what is needed to be spent on the full work program. If it is the former, the works would be required to be scheduled for remaining years in AA4. If it is the latter, the ERA has failed to demonstrate how the work could be undertaken at such a discount during the AA4 period.
- 5.33 DBP maintains that neither of these scenarios could be the case, and nor are they reasonable assumptions given the evidence provided by DBP (as outlined in Appendix B: ). Further, the costs

and rates that were used in deriving DBP's estimate are established through DBP's purchasing policy processes which has the express objective of achieving the lowest cost for the work required. DBP could not therefore deliver the works for 35% less. In any event, DBP provides an explicit response to these issues for these projects in Appendix B: .

- 5.34 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.

#### **Extrapolation of findings from Reviewed AA4 SIB Projects to capex associated with Not Reviewed Projects**

- 5.35 Paragraph 241 of the EMCa Report finds that 15 of the 17 Reviewed AA4 SIB Projects satisfied one or more of the criteria in Rule 79(2) (ie the Necessary Reviewed AA4 Projects). Accordingly, subject to confirmation that the expenditure is prudent and efficient to satisfy Rule 79(1), the capital expenditure associated with those projects is to be considered conforming capital expenditure – Rule 79(5). The ERA's discretion in determining whether expenditure is conforming is limited – Rule 79(6).
- 5.36 It is DBP's submission that EMCa's methodology (and hence the ERA's methodology) and process to assess compliance with Rule 79(1) and to quantify the financial impact of its findings is flawed for the following reasons (discussed in greater detail below):
- (a) Satisfaction of the prudence and efficiency test is to be presumed where the board of a utility has reviewed and approved capital expenditure;
  - (b) The flaws in documentation identified by EMCa do not of themselves mean that the capital expenditure forecasts are flawed and do not provide a quantifiable basis for establishing an across the board percentage reduction in DBP's forecast capex;
  - (c) The ERA has not satisfied Rule 79 in its assessment of DBP's forecast capex and has not exercised its limited discretion under that rule correctly;
  - (d) The ERA has gone beyond its limited discretion in concluding that two of the proposed AA4 capex projects are not conforming capital expenditure due to lack of information.
- 5.37 As to the link between the flaws identified by EMCa and the percentage reductions applied to all of DBP's AA4 Forecast SIB Capex:
- (a) The flaws identified by EMCa can be summarised as a failure by DBP to document the rationale for forecast projects to the standard preferred by EMCa. Based on its assessment of flaws in DBP's process, EMCa has estimated an arbitrary percentage reduction to all forecast capital expenditure. However, there is no explanation of how the 22% to 32% across the board reduction is derived in a quantifiable measured way as a result of the flaws identified by EMCa.
  - (b) Even if the criticisms of DBP's documentation were valid, DBP submits that the flaws identified by EMCa regarding the capex projects reviewed, at most, point to failure to document the rationale for particular projects to the standard that EMCa would prefer to see. It is not axiomatic that a failure to document the projects to the preferred standard means that the relevant projects and the expenditure forecast for those projects will not be prudent and efficient.
  - (c) In other words, failure to document the decision making process for forecast expenditure to the preferred standard in itself may not be prudent or efficient for the operation of the business, however this is not the same as saying that the proposed expenditure is not prudent or efficient.



- (d) EMCa has not demonstrated that if DBP had satisfied all of the requirements that EMCa recommended as required to establish “prudent and efficient” forecast capital expenditure, DBP’s forecast capital expenditure estimates would have been lower and if so by how much.
  - (e) Finally, it is not possible to draw a link between the documentation issues observed by EMCa and a cost impact on a particular project without undertaking an assessment of what the project is likely to cost and submitting that information to DBP to consider and comment upon.
- 5.38 In addition to the matters raised above regarding the prudence and efficiency test, the ERA has not met the requirements of the Rule 79 for the following reasons:
- (a) Applying generic percentage reductions to forecast expenditure for a particular class of assets is not permissible under Rule 79. Rule 79(5) requires that the capital expenditure be assessed and a determination be made as to whether it meets the criteria under Rule 79(1) and (2). If a particular expense does not meet the criteria in some way, it is incumbent upon the ERA to advise how and to what extent. This requirement results from Rule 79(5), which provides that “to the extent the capex does meet the criteria, it is conforming capital expenditure”. Accordingly if the ERA forms a view that it should not approve some of the capex proposed by DBP, the ERA must identify the part of the capex that does not meet the criteria and the extent to which the reduction applies.
  - (b) In summary the EMCa approach involves applying a 22% to 32% adjustment to expenditure at the asset category level rather than project by project. The ERA’s approach involves selecting a mid point of each range and using that figure for each asset category as the basis for adjusting DBP’s proposed AA4 Forecast SIB Capex. By doing so, both EMCa and the ERA have effectively ignored many of the specific findings of compliance with Rule 79 outlined in Appendix B of the EMCa Report. The incompatibility of EMCa’s and the ERA’s approaches and the requirements of Rule 79 are clearly evident where EMCa has recommended reductions to capital expenditure (by way of broad percentage reductions to an asset category) despite having formed an opinion that the forecast expenditure for specific projects meets both limbs of rule 79. DBP refers the ERA to projects 8, 11, 14 and 17 detailed in Appendix B of the EMCa Report as examples. If this expenditure were allowed, it would have resulted in an additional amount of \$1.96m being allowed as conforming forecast capital expenditure than was allowed in the Draft Decision.
- 5.39 For the reasons above, DBP’s view is that EMCa’s and the ERA’s attempts to look at DBP’s internal processes, find flaws in them and then derive a cost impact on the projects is complex, artificial and lacks a link between the flaws identified and the reductions applied. Further, aspects of the approach taken are outside the discretion that the ERA has under Rule 79.

#### ERA’s analysis

- 5.40 Paragraph 455 of the Draft Decision provides some further information regarding how the ERA asserts that it assessed DBP’s AA4 Forecast SIB Capex. The ERA states that, relying on information from EMCa, the ERA then assessed DBP’s proposed capital expenditure forecast for AA4 in accordance with the NGR using a three step framework comprising:
- (a) whether the expenditure met the criteria for inclusion as conforming capital expenditure under Rule 79(2)(c);
  - (b) whether the expenditure proposed was prudent and efficient as required by Rule 79(1)(a); and
  - (c) whether the forecasts were arrived at on a reasonable basis and represented the best forecast or estimate possible in the circumstances, so as to comply with Rule 74(2).
- 5.41 It is not apparent anywhere in the Draft Decision that the ERA carried out these steps. Instead, the ERA states at paragraph 472 that “it has reviewed EMCa’s recommended adjustment ranges and has decided to adopt a mid-point of the range for each asset class as an appropriate reduction in the over-statement of proposed capital expenditure by DBP.”

## Response to ERA's Reasons - Systemic issues within DBP's systems and processes

5.42 As noted in paragraph 2.13 of this Submission, in the Draft Decision, the ERA concluded that:

- (a) in relation to the expenditure for the Necessary Reviewed AA4 SIB Projects - there was a number of systemic issues about DBP's processes and systems relating to governance, management and forecasting (such as poor documentation, lack of clarity about scope of work, lack of options analysis, lack of clarity of the basis for the estimate and lack of demonstration of delivery capability)<sup>26</sup>;
- (b) the existence of these systemic issues in relation to the Reviewed AA4 SIB Projects and the systemic governance, management and forecasting issues that were outlined in section 4 of the EMCa Report, meant that it was reasonable to assume that they also apply to all other projects for which expenditure was included in DBP's AA4 Forecast Capex (**Unreviewed AA4 Projects**)<sup>27</sup>; and
- (c) based solely on the presence of these systemic issues, DBP's AA4 Forecast Capex in its Original AA Proposal does not meet the requirements of Rule 79(1)(a)<sup>28</sup>.

5.43 These systemic issues were the same systemic issues relied on by the ERA to reject some of DBP's actual capital expenditure incurred during AA3. DBP has made a number of submissions on these systemic issues (at a general level rather than in relation to each specific project) in Submission 53. Accordingly, they are repeated in their entirety for the purposes of this submission. The following table summarises each of the systemic issues raised by the ERA as reasons for concluding not all of DBP's AA4 Forecast SIB Capex met the requirements of Rule 79(1)(a) and the paragraphs in Submission 53 where DBP has made submissions on each such issue.

**Table 16: EMCa criticisms of DBP systems**

EMCa issue	DBP Response
<i>Poor documentation</i> - as identified in our review of the AA3 project sample, the business case documentation provided for our review of the AA4 sample projects was typically unsigned and undated and did not fully adhere to DBP's own internal QA instructions.	See paragraphs 6.16 to 6.31 7.11 to 7.28 of Submission 53
<i>Lack of clarity about the scope</i> – for a number of projects it was not clear what work was proposed to be undertaken in the AA4 period. This included 'continuation' projects for work that had been commenced in the AA3 period and that continued into the AA4 period, sometimes with a different project scope or under a different project name;	See paragraphs 7.29 to 7.40 of Submission 53
<i>Lack of options analysis</i> - whilst we do not expect detailed, approved business cases to be available for all the projects proposed to commence in the AA4 period at this point in the project lifecycle, we do expect DBP to be able to present the options considered in deciding the timing and volume of work assumed for the purpose of developing its expenditure proposal. In some cases, it is clear that the timing and volume of work is based on OEM recommendations and/or plant/equipment or system obsolescence. However, in a number of cases, we found insufficient justification for the proposed volume and timing of work;	See paragraphs 7.41 to 7.76 of Submission 53  As EMCa <i>acknowledge</i> , option analysis wouldn't be required where work is dictated by OEM replacement cycles or equipment obsolescence. It therefore would be an unreasonable to expect to see evidence of option analysis for the majority of SIB related expenditure.  DBP additional project documentation will explain why option analysis was not warranted (or otherwise) in each of the 17 projects reviewed in detail.
<i>Lack of clarity of the basis for the estimate</i> - in some case no basis for the cost estimate is given, in others the cost estimate is said to be 'preliminary'. In many cases only a breakdown of expenditure for one year was provided with no	It cannot be said that no cost estimate has been given, as submission 9 contained DBP's cost estimate for each of the projects for the AA4 period which were consistent with that formed by DBP's FY14 business planning process.

<sup>26</sup> EMCa Report, para 245

<sup>27</sup> EMCa Report, para 246

<sup>28</sup> EMCa Report, para 246

EMCa issue	DBP Response
indication of the estimate accuracy. In some cases, the cost estimate in the AAI varies materially from the estimates in the 'business cases' presented for our review. Whilst this may be an indicator of refinement of the estimate, DBP little or no explanation for these variances. We expect that, for a regulatory submission, P50 cost estimates would be derived, the basis for their derivation clearly enunciated and sufficient detail provided to demonstrate that the cost estimate is robust; and	Additional project information (provided as Appendix B) will address the further <i>information</i> required on the basis of costs estimates.
<i>Lack of demonstration of delivery capability</i> - typically no information is provided about the delivery plan. At a portfolio level, this is not a significant concern because the volume of SIB work (as measured by expenditure) proposed for the AA4 period is similar to that delivered in the AA3 period. However, at the project level, the proposed delivery strategy is an indicator of efficient cost (e.g., the majority of the work is to be delivered through a competitively established outsourcing contract).	See paragraphs 7.77 to 7.96 of Submission 53

- 5.44 To the extent that these systemic issues have been expressly relied on to justify any of the individual Reviewed AA4 SIB Projects, DBP makes further submissions in Appendix B: in response to these systemic issues in so far as they relate to the individual project.

## Response to ERA's Reasons - Additional information in relation to the individual projects reviewed by the ERA and EMCa

- 5.45 Appendix B: contains additional information to support the AA4 Forecast SIB Capex levels included in the Amended AA Proposal for each of the AA4 Reviewed SIB Projects. This is 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 of submission 53));
  - (b) Where relevant to projects in AA4, information for each Reviewed AA4 Project on what was delivered in each year of AA3 has been provided (see also section 8 of Submission 53);
  - (c) Where a project commenced in AA3 and is continuing into AA4, additional information has been provided to support efficient procurement including procurement processes undertaken for each Reviewed AA4 SIB Project in line with DBPs purchasing policy, tender procedure and preferred vendor procedure (see also section 8 of submission 53);
  - (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 also section 8 of submission 53); and
- 5.46 A separate document has been prepared in relation to each of the Reviewed AA4 SIB Projects. These are attached in Appendix B.
- 5.47 In the meantime, and for ease of reference, the following table summarises the specific reasoning for each Reviewed AA4 SIB 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 17: Summary of DBP's response to ERA's reasons to reduce the efficient cost of the Reviewed Projects

ERA's Reasons for concluding imprudent or inefficient	Proj. 1 App B1	Proj. 2 App B2	Proj. 3 App A3	Proj. 4 App B4	Proj. 5 App B4	Proj. 6 App B6	Proj. 7 App A7	Proj. 8 App B8	Proj. 9 App B9	Proj. 10 App B10	Proj. 11	Proj. 12 App B12	Proj. 13 App B13	Proj. 14 App B14	Proj. 15 App B15	Proj. 16 App B16	Proj. 17 App B17
<b>Inadequate documentation provided</b> – including sufficient information to support forecast allowance	1.7 – 1.10	1.6 – 1.14	1.7 – 1.18	1.9 – 1.25	1.2 – 1.6	1.6 – 1.19	1.7 – 1.24	1.7 – 1.9	1.7 – 1.15	1.8 – 1.24	N/A	1.7 – 1.13	1.7 – 1.22	1.8 – 1.15	1.7 – 1.16	1.7 – 1.14	1.7
<b>Risk Assessment</b> – not provided	N/A	N/A	1.19 – 1.20	EMCA was able to conclude project was needed without risk assessment	EMCA was able to conclude project was needed without risk assessment	N/A	1.9 – 1.19	N/A	EMCA was able to conclude project was needed without risk assessment	EMCA was able to conclude project was needed without risk assessment	N/A	EMCA was able to conclude project was needed without risk assessment	EMCA was able to conclude project was needed without risk assessment	EMCA was able to conclude project was needed without risk assessment	N/A	N/A	EMCA was able to conclude project was needed without risk assessment
<b>Options analysis</b> – 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	N/A	N/A	N/A	N/A	N/A	N/A	1.20	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

ERA's Reasons for concluding imprudent or inefficient	Proj. 1 App B1	Proj. 2 App B2	Proj. 3 App A3	Proj. 4 App B4	Proj. 5 App B4	Proj. 6 App B6	Proj. 7 App A7	Proj. 8 App B8	Proj. 9 App B9	Proj. 10 App B10	Proj. 11	Proj. 12 App B12	Proj. 13 App B13	Proj. 14 App B14	Proj. 15 App B15	Proj. 16 App B16	Proj. 17 App B17
expect to see the details in the business case demonstrating that the proposed expenditure was justified under the ALARP test.																	
<b>Work scope is unclear</b> and/or justification for the work scope is not clear	N/A	N/A	N/A	N/A	1.2 – 1.6	1.6 – 1.19	N/A	N/A	1.7 – 1.10	1.8 – 1.24	N/A	1.7 – 1.13	1.7 – 1.22	N/A	1.7 – 1.16	1.7	N/A
<b>Procurement strategy -</b> the business case for a project lacked a procurement strategy	N/A	1.16	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>Dis-similar expenditure for a similar project -</b> didn't explain how the forecast level of expenditure for a project related to other similar project	N/A	N/A	1.2	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>Forecast not linked to AA3 expenditure-</b> didn't explain how the forecast level of expenditure for a project related to spend already incurred during AA3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.11 – 1.15	1.17 – 1.21	N/A	N/A	N/A	N/A	N/A	1.8 – 1.11	N/A

**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.

5.48 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 AA4 Forecast SIB Capex (whether for the Reviewed AA4 SIB Projects or the Non Reviewed Projects or both);
- (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 AA4 Forecast SIB Capex (for the Reviewed AA4 SIB 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) is 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 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
- (f) the expenditure undertaken therefore satisfies Rule 79(1)(a).

### Response to ERA's Reasons - Procedural Fairness issues

5.49 DBP is also of the view that the ERA's approach to assessing AA4 Forecast SIB Capex 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 AA4 Forecast 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 of Submission 53. 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.

### Failed to take in relevant considerations

5.50 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<sup>29</sup>.

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

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

5.53 DBP considers that the operation of these strong incentive mechanisms is a critical consideration in assessing the prudence and efficiency of investment undertaken during AA3 and forecast to be incurred throughout AA4. 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

5.54 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.

5.55 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 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 into 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 and not relied on any other information to support its conclusions.

- (b) At paragraph 96 of the EMCa Report, 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 of Submission 53.

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<sup>29</sup> ERA Draft Decision (May 2010) paragraph 194-197

### Arbitrary capital expenditure reductions

- 5.56 As outlined earlier in this section of the Submission, EMCa and the ERA have made arbitrary reductions to DBP's total AA4 SIB Capex. EMCa formed the view that the work undertaken during AA4 is 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 based on findings made in relation to systemic issues found with AA4 forecast expenditure.
- 5.57 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.

## 6. NEW PROJECT INFORMATION

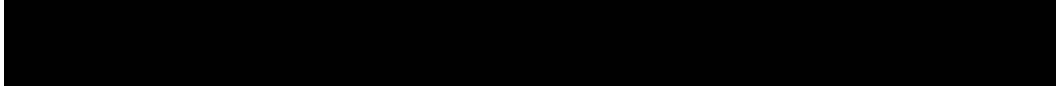
- 6.1 In the course of responding to the ERA's draft decision, DBP has identified 3 new capital projects for the enhancement of the DBNGP with a total value of \$46.97m that should be included in DBP's forecast capital expenditure for AA4.
- 6.2 The three projects that the additional forecast capital expenditure relates to are:



- 6.3 DBP submits that these projects should be included in the forecast capital expenditure for AA4. If the ERA refuses to consider including them in the forecast of capital expenditure and the ERA does not accept DBP's submission on the tariff variation mechanism for New Costs, DBP would be forced to submit an intra period access arrangement revision proposal to ensure that they are incorporated into AA4 or to make an application under Rule 80. Either of these processes would be an inefficient use of time and resources for DBP and the Regulator given the stage that the ERA is at with its assessment of this AA Proposal for AA4.
- 6.4 Appendix C: contains a separate document for each of these projects proposed by DBP that seeks to substantiate the expenditure as conforming forecast capital expenditure.

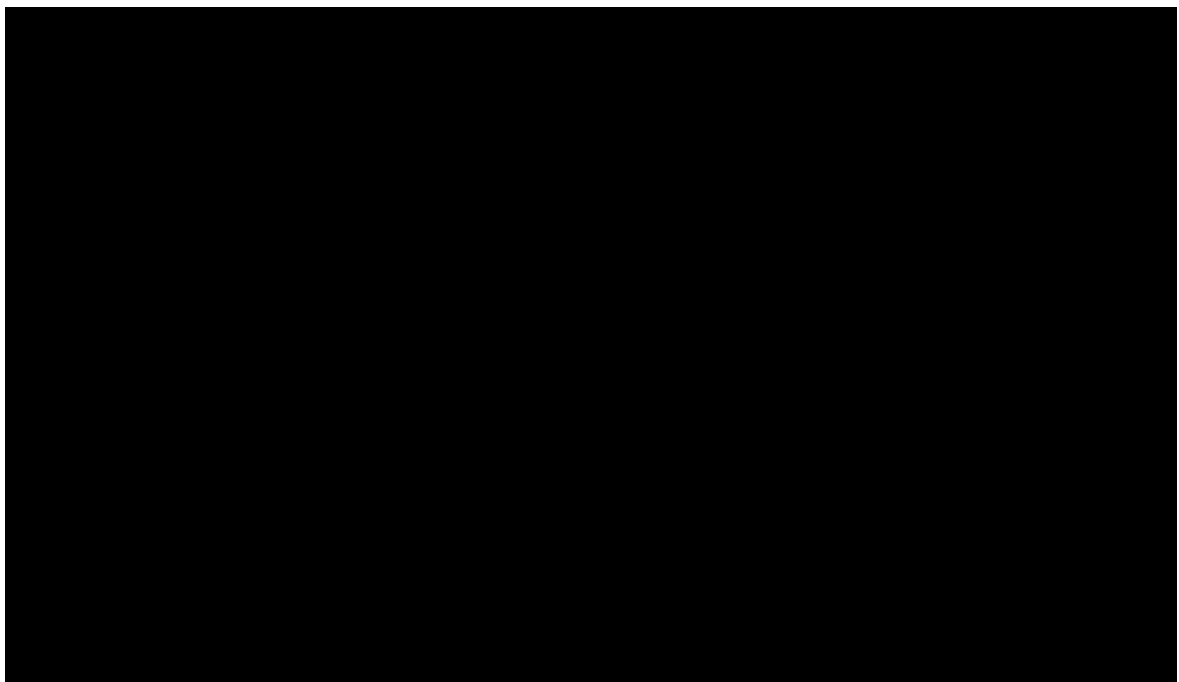
## APPENDIX A: ADDITIONAL PROJECT INFORMATION FOR UNNECESSARY REVIEWED AA4 PROJECTS

This appendix contains a separate document for each of the projects proposed by DBP but which the ERA concluded was an Unnecessary Reviewed AA4 SIB Project. Each document contains further information to substantiate compliance with the requirements of Rule 79(1)(b) and in so doing, focuses on the reasoning relied on by EMCa for concluding that these requirements in Rule 79(1)(b) were not met.



## APPENDIX B: ADDITIONAL PROJECT INFORMATION TO SUBSTANTIATE PRUDENCY AND EFFICIENCY OF NECESSARY REVIEWED AA4 PROJECTS

This appendix contains a separate document for each of the projects proposed by DBP but which the ERA concluded were Necessary Reviewed AA4 SIB Projects but where not all of the expenditure for each such project met the prudency and efficiency requirements of Rule 79(1)(a). Each document contains further information to substantiate compliance with the requirements of Rule 79(1)(a) and in so doing, focuses on the reasoning relied on by EMCa for concluding that these requirements in Rule 79(1)(a) were not met.





## APPENDIX C: NEW PROJECT INFORMATION



## APPENDIX D: AA4 DETAILED PROJECT BREAKDOWN