SUBMISSION 12: Justification of Operating Expenditure

Public Version

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1. INTRODUCTION

1.1 On 1 April 2010, DBNGP (WA) Transmission Pty Ltd (**DBP**) filed the following documents with the Economic Regulation Authority (**ERA**):

(a) proposed revised Access Arrangement (**Proposed Revised AA**); and

(b) proposed revised Access Arrangement Information (**Proposed Revised AAI**).

1.2 These documents contain the information that the National Gas Access (WA) Act 2009 (**NGA**) (which includes the Western Australian National Gas Access Law text (**NGL**) and the National Gas Rules (**NGR**)) requires to be included in order to enable them to be approved by the ERA.

1.3 The ERA also issued a Regulatory Information Notice on 2 March 2010 (**RIN**).

1.4 In addition to the Proposed Revised AA and Proposed Revised AAI, a number of additional submissions on key issues will be or are to be filed to assist the Regulator to assess the Proposed Revised AA and to address the categories of information requested in the RIN. These included the following:

1. Background Information
2. AA & AAI Compliance Checklist
3. Pipeline Services
4. Basis for Total Revenue
5. Terms and Conditions Justification
6. Explanation of Queuing Requirements
7. Capacity and Throughput Forecast
8. Rate of Return (being this submission)
9. Justification of Actual expansion Capital Expenditure (2005 – 2010)
10. Actual Stay-in-Business Capital Expenditure (2005 – 2010)
11. Forecast Capital Expenditure (2005 – 2010)
12. Actual Operational Expenditure and Forecast Operational Expenditure (being this submission)

1.5 Accordingly, this submission is aimed at supplementing the information in the Proposed Revised AA and Proposed Revised AAI in order to:

(a) address the information requested by the ERA in the RIN in relation to the forecast operating expenditure; and

(b) enable the aspects of the Proposed Revised AAI relating to the forecast operating expenditure to be approved by the ERA.

2. RELEVANT PROVISIONS OF THE NGA FOR OPERATING EXPENDITURE

2.1 The NGR requires that, for forecast operating expenditure to be included in the Total Revenue, operating expenditure must meet the following criteria.

2.2 It must be:

(a) expenditure which is within the definition of "operating expenditure" under Rule 69 of the NGR; and

(b) 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 delivering pipeline services (see Rule 91 of the NGR); and

2.3 Rule 69 of the NGR defines operating expenditure to mean operating, maintenance and other costs and expenditure of a non-capital nature incurred in providing pipeline services and includes expenditure incurred in increasing long term demand for pipeline services and otherwise developing the market for pipeline services.

2.4 As this is information in the nature of a forecast or estimate, in accordance with Rule 74 of the NGR, it must be:

(a) supported by a statement of the basis of the forecast or estimate (Rule 74(1) of the NGR); and

(b) arrived at on a reasonable basis and represents the best forecast possible in the circumstances (Rule 74(2) of the NGR).

2.5 Finally, the ERA must ensure, as is required by Rule 100 of the NGR, that the operating expenditure must be consistent with the national gas objectives. It must also be consistent with and the revenue and pricing principles of the NGL.

2.6 In assessing the forecast operating expenditure against these criteria, the ERA's discretion is limited (Rule 91 of the NGR).

3. FORECAST OPERATING EXPENDITURE

3.1 Table 1 of the Proposed Revised AAI contains the following forecast operating expenditure for the Access Arrangement Period.

TABLE 1: DBNGP FORECAST OPERATING EXPENDITURE

Operating Expenditure in 2009 $'s	2011	2012	2013	2014	2015
Wages & Salaries	25.74	26.24	26.76	27.28	27.81
Non-Field Expense	17.54	17.54	17.54	18.09	18.09
Field Expense	18.22	18.23	18.23	18.23	18.23
Government Charges	19.08	19.76	19.98	20.55	21.10
Reactive Maintenance	1.14	1.14	1.14	1.14	1.14
Fuel gas (full haul)	19.91	21.04	20.95	23.08	23.51
Total	**101.64**	**103.96**	**104.60**	**108.37**	**109.87**

3.2 DELETED

3.3 DBP submits that each of the above categories of expenditure is within the definition of operating expenditure in Rule 69 of the NGR. Each category contains costs of a non capital nature and which are incurred in providing pipeline services on the DBNGP.

3.4 DBP's business is the operation, maintenance and expansion of the DBNGP. It has therefore no other businesses in relation to which expenditure is incurred.

3.5 The above expenditure is non capital in nature in accordance with accepted accounting standards.

4. JUSTIFICATION OF PROPOSED FORECAST OPERATING EXPENDITURE

4.1 It is noted that the criterion for allowing forecast operating expenditure to be included in the calculation of Total Revenue is that it 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 delivering pipeline services (Rule 91(1) of the NGR).

4.2 DBP submits that the forecast operating expenditure for the period is justified against this criterion on the following bases:

(a) The forecast is derived following a detailed internal business planning and budgeting process which is outlined in the following section of this submission. This gives a greater level of confidence not only as to the accuracy of the forecast, but also that the forecast is efficient and aimed at achieving the lowest sustainable cost of delivering pipeline services.

(b) DBP is incentivized to include in its forecast costs which achieve the lowest sustainable cost of delivering pipeline services for a number of reasons. Firstly, because of a combination of its significant debt exposure and its continual need to refinance some of this debt. A relatively minor increase in the cost of debt has a significant impact on the financial viability of DBP given the size of DBP's debt profile. DBP is about to embark on a refinancing of in excess of $1billion of its debt and the cost of debt is forecast to be significantly higher than DBP's present cost of debt. So, it is critically important for DBP to:

(i) have a greater level of confidence in the accuracy of the forecast of its operating expenditure; and

(ii) identify and realize savings in historical operating expenditure

(c) The second reason as to why DBP is incentivised to include in its forecast operating expenditure only those costs which achieve the lowest sustainable cost of delivering pipeline services is because, DBP's contractual structure with its shippers is such that it is exposed to increases in operating expenses. DBP has entered into long term standard shipper contracts with its shippers (**SSCs**). These SSCs provide for very little scope for DBP to unilaterally adjust the tariff to pass on to shippers the effects of any operating expenditure that is over and above the operating expenditure assumed by DBP (in 2004 at the time of the acquisition of the pipeline) for the period up to 31 December 2015. It can not pass on to shippers any increases above those original forecasts.

(d) The DBNGP is now a significantly larger and more complex asset than was the case in 2005. During the course of the last five years, DBP has undertaken a significant program of investment in the expansion of the capacity of the DBNGP. The level of investment is unparalleled since the pipeline was first commissioned in 1984. As a result, the DBNGP is now almost fully duplicated and has 50% more compressor units installed than was the case in 2005. This has enabled DBP to generate economies of scale – notwithstanding the fact that the capital base is now twice the value it was in 2005, operating expenditure (including fuel gas) has only increased by around 60%

(e) DBP is expecting a significant increase in government imposts during the period.

5. METHODOLOGY FOR DEVISING FORECAST OPERATING EXPENDITURE

5.1 As part of the changes to DBP's circumstances that occurred in 2009 (in this regard, reference is made to submission #1, filed on or about the date of this submission), DBP undertook a significant review of its business, functions and systems and processes in that same year. The review was undertaken to achieve the following objectives:

(a) improvement opportunities in optimisation of processes and people support;

(b) reduction in costs; and

(c) enhancement of revenue and in ensuring that the business is overall ready and able to respond to future challenges.

5.2 DBP has undertaken a rigorous business planning and budgeting process which has involved the following actions:

(a) The establishment of key business objectives aimed at maintaining costs

(b) The identification of all activities required for a rigorous process for estimating the forecast costs; and

(c) The establishment of key assumptions that were set having regard to a range of factors.

5.3 In addition, in 2009, as part of the changes to DBP's circumstances that occurred in 2009 (in this regard, reference is made to submission #1, filed on or about the date of this submission), DBP undertook a significant review of its business, functions and systems and processes. The review was undertaken to achieve the following objectives:

(a) improvement opportunities in optimisation of processes and people support;

(b) reduction in costs; and

(c) enhancement of revenue and in ensuring that the business is overall ready and able to respond to future challenges.

5.4 The period of assessment for the business planning and budgeting purpose extends for five years.

5.5 As part of the budgeting process, accurate cost forecasting requires a rigorous review of the assumptions and allowances made in relation to the following matters:

(a) The safety case that is required to be in place, under the Petroleum Pipelines Act, for the safe and reliable operation of the pipeline in accordance with the pipeline licences for the pipeline;

(b) The pipeline licence and other mandatory requirements;

(c) The requirements to comply with the climate change legislative regime that has been implemented or is about to be implemented;

(d) The pipeline maintenance planning process;

(e) Findings from audits;

(f) The need to comply with other statutory and contractual obligations; and

(g) Other relevant matters.

The Safety Case and operational expenditure planning

5.6 Many of DBP's activities on the pipeline are required for the safe and reliable operation of the DBNGP. They are identified pursuant to a Safety Case revised earlier this year, in accordance with the conditions of the pipeline licences covering the pipeline.

5.7 One of the purposes of a Safety Case is to demonstrate that a pipeline licensee has the management systems needed to systematically and continually identify and assess hazards so as to eliminate or minimise, as far as is reasonably practicable, the risks to employees working on the DBNGP facilities over the life of those facilities.

5.8 A Safety Case must be approved by the State's safety and technical regulator. Once it is approved, the Safety Case becomes the set of recognised legal requirements with which the pipeline licensee must comply in relation to the operation of the pipeline. The revised Safety Case is currently being assessed by the regulator although Operator is proceeding on the basis that it is operative.

5.9 A Safety Case comprises three elements: the facility description, the safety management system, and the formal safety assessment. The safety management system addresses all aspects of administering and managing safety on the pipeline. The formal safety assessment is represented by a risk assessment undertaken on the pipeline pursuant to Australian Standard 2885 ("Standard").

5.10 According to the Standard, pipeline loss of integrity (i.e. Gas release) and interruption to supply risks are to be assessed. The risk assessment therefore includes the pipeline and main line valve (MLV) sites. It does not include compressor stations and metering. However, as part of its own internal standards, Operator has applied the same approach to its compressor stations and metering facilities.

5.11 The assessment identified a number of hazardous events (ie. events resulting in a loss of pipeline integrity or interruption to continuity of supply). The risk of these events occurring was assessed by pipeline location class (ie. R1, R2 and T1) and for Sensitive/Highly Populated areas. The Operator's personnel determined that risks could be managed to "As Low as Reasonably Practicable" through the implementation of further controls and on-going monitoring/management of these risks.

5.12 It is important to note that, the Western Australian Government has announced changes to the Safety Case which will increase the level of detail for inclusion in the Safety Case and increase the compliance obligations on pipeline operators such as DBP. Accordingly, DBP has undertaken a more detailed review of its business operations to ensure that it undertakes activities in a way that ensures compliance with this increased level of obligations.

5.13 It is also important to note that in preparing the Operator's budget, any cost saving measure must not compromise DBP's ability to maintain and achieve compliance with the Safety Case.

5.14 Given this, Operator submits that its operational expenditure should be accepted by the Regulator without question.

5.15 Operator notes that the Full Court of the Supreme Court of Western Australia, in *Re: Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, found as follows in relation to expenditure required for the safe and reliable operation of the pipeline:

> *"It is clear from s2.24(c) that the ongoing safe and reliable operation of the pipeline must be taken into account. Expenditure necessary for this purpose must be taken into account* ***whether or not*** *that would occur in a competitive market or according to theories of economic efficiency." (emphasis added)*

5.16 This is equally relevant in assessing whether the criterion under Rule 91 is met, because the terminology in Rule (particularly in relation to the definition of regulatory obligation or requirement.

Pipeline licences and mandatory requirements

5.17 Pipeline licences provide mandatory conditions for the performance of operations and maintenance by the pipeline licensee. Other mandatory requirements include various Acts of Parliament and Standards to which some Acts refer.

5.18 DBP must, in operating and maintaining the pipeline and associated laterals, comply with the following licences issued under the Petroleum Pipelines Act:

(a) PL40 - Dampier to Bunbury Natural Gas Pipeline

(b) PL41 - Tiwest to Kwinana Lateral

(c) PL47 - CS10 & Lateral

5.19 Amongst other mandatory requirements, the Standards set out in the licences mentioned above are:

(a) AS3000 – testing, operating and maintaining of electrical works;

(b) AS2430 – classification of hazardous areas;

(c) AS2380 & AS2381 – installation & maintenance of electrical equipment in a hazardous area;

(d) AS1210 – testing & operating of pressure vessels;

(e) AS3788 – inspection & maintenance of pressure vessels

(f) AS3600 – testing & maintenance of concrete structures;

(g) AS4100 - testing & maintenance of structural steelwork;

(h) AS1768 - testing & maintenance of lightening protection;

(i) AS2832.1 - testing & maintenance of cathodic protection;

(j) AS2885 – operation & maintenance of pipeline;

(k) ASME/ANSI B31.3 - operation & maintenance of above ground pipework (PL's 41 & 47);

(l) AS1697 or ASME/ANSI B1.3 - operation & maintenance of above ground pipework (PL40);

(m) AS/NZS ISO 9001 – maintain & operate to recognised quality management system;

5.20 Operator, in complying with the associated pipeline licences, is required to undertake many other maintenance activities not defined in Standards.

Pipeline maintenance planning process

5.21 Maintaining assets is a complex and skilled process, and as it is the core business for DBP, planning, controlling and monitoring maintenance activities are essential in ensuring those

activities are effectively and efficiently performed. To this end systems are utilised to aid in these activities

5.22 Maintenance strategies available to DBP include:

(a) Preventive maintenance - Based on time or run hours

(b) Predictive maintenance - Based on technology of determining a machines condition without disturbing normal operations ie: Vibration analysis, thermography

(c) Proactive maintenance - Extends machinery life by applying advanced investigative & corrective technology, ie: Root cause failure analysis, bore scope inspection

(d) Reliability based maintenance - Based on Preventive, Predictive & Proactive maintenance

(e) Reactive maintenance - Based on run to failure (breakdown maintenance)

5.23 The planning process then summarises maintenance routines by:

(a) Cycle – frequency of activity

(b) Duration – time to perform activity

(c) On/offline – ability to perform activity online

(d) Rationale – basis for activity i.e. regulatory or contractual requirement

(e) Basis – preventative, predictive or proactive

(f) Expertise – skill level to perform activity

(g) System – system/equipment on which maintenance is performed

5.24 The routines are then applied to each site, thus quantifying the amount of maintenance work required to be performed across the whole pipeline asset.

5.25 This philosophy, strategy and framework then form one of the bases for the development of the operating budget for the pipeline.

Findings from audits

5.26 DBP has an extensive audit plan that it undertakes. Most are required to be undertaken in order to comply with regulatory obligations (**mandatory audits**). Others are undertaken, as a prudent business operator, to deal with functions of the business or key business processes which have been identified as significant or higher risk for DBP (as part of DBP's biannual enterprise wide risk assessment process).

5.27 Mandatory audits are audits under the following regulatory obligations:

(a) under the ACCC Undertakings given to the ACCC under section 87B of the Trade Practices Act – annual audits must be undertaken to assess compliance with the undertakings;

(b) under the pipeline licences issued under the Petroleum Pipelines Act

(c) under the Safety Case

(d) under the National Energy and Greenhouse Reporting Act – annual audits are required

5.28 All findings from these mandatory audits must be closed out.

5.29 As part of insurance cover for the pipeline, insurers require an annual audit of various pipeline facilities, and policies, processes and procedures for both corporate and operational functions.

5.30 To comply with the insurance program, Operator must institute, remedy or otherwise manage the findings from the insurance audit.

5.31 Compliance with insurance audit findings ranges from amending policies, remapping processes and redrafting procedures to modifications to pipeline plant and equipment itself.

5.32 The actions required to be undertaken to comply with these audits are therefore included in the development of the operating budget for the pipeline.

Other factors taken into account

5.33 Operator takes a range of other factors into account when setting its operating budget. In particular, values must be set having regard to the need to comply with the following:

(a) All budgets are "zero" based;

(b) All budgets are prepared on the basis of business as usual;

(c) Divisional plans are developed which set out business activities for each division. These are supported by business cases and prioritised.

(d) The divisional plans incorporate a high level reconciliation between forecast costs and budget costs in the previous year. This requirement does not remove the zero based budgeting approach;

(e) Health, safety and environmental issues are not compromised;

(f) No departmental budget is submitted without General Manager approval;

(g) Assumptions are made regarding the future rate of inflation;

(h) Allowances are made for employee turnover on the basis of historical rates of retention;

(i) Assumptions are made regarding recruitment costs – costs that are accounted for includes, advertising, travel and accommodation of bringing candidates to interviews, and all costs associated with the relocation process. These estimates are made on the basis of historical costs;

(j) Salaries and wages are estimated on the basis of a forecast employee headcount with provision for salary growth;

(k) Allowance is made for the employee performance incentive scheme;

(l) Allowance is made for bad debts, on the basis of historical bad debtors;

(m) Allowance is made for staff training and development;

(n) Assumptions are made regarding legal matters and proceedings;

(o) Assumptions are made regarding travel and accommodation costs – these estimates are made on the basis of a schedule of quoted fees from preferred providers;

(p) Allowance is made for a range of other business costs including:

  (i) Costs associated with annual business planning processes and board meetings.

  (ii) Costs of meals for employees whilst travelling and meals on-site.

  (iii) Costs of professional memberships paid on behalf of staff employees.

(iv) Stationery costs.
(v) Costs of software maintenance contracts.
(vi) Costs of pipeline licenses.
(vii) Council and water rates.
(viii) Other regulatory charges.
(ix) Cost of sponsorship and employee participation events.
(x) Costs of IT equipment repairs and maintenance.
(xi) Mobile phone costs (including repairs).
(xii) Costs of archiving including Worley technical support.
(xiii) Rental costs of offices.
(xiv) Costs of office equipment including, fax machines, photocopiers and franking machines.

6. COMPARISONS OF OPERATIONAL EXPENDITURE AND THE DRIVERS OF CHANGE

6.1 The following table included in the Proposed Revised AAI shows the historical expenditure for the period 2005 to 2009 and DBP's most recent forecast for 2010. Excluding fuel gas costs, this level of expenditure compares favourably with the operating expenditure included in the access arrangement approved in 2005.

Table 3: Operating Expenditure 2005 to 2010

Year ending 31 December	2005	2006	2007	2008	2009	2010
Nominal $million, dollar values at end of year						
Other Operating Expenditure	36.27	39.41	44.40	52.46	65.60	66.42
Fuel gas	24.12	21.43	30.59	15.15	18.62	21.51
Total	**60.39**	**60.84**	**74.99**	**67.61**	**84.22**	**87.93**
Real $million, dollar values at 31 December 2010						
Other Operating Expenditure	41.31	43.01	47.03	53.56	65.60	64.80
Fuel gas	27.47	23.39	32.40	15.47	18.62	20.99
Total	**68.78**	**66.40**	**79.44**	**69.03**	**84.22**	**85.78**

6.2 The table below compares the expenditure in the period 2005 to 2015 (in nominal terms)

Table 4: Operating Expenditure 2005 to 2015											
Year ending 31 December	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Nominal $million, dollar values at end of year											
Other Operating Expenditure	36.27	39.41	44.4	52.46	65.60	66.42	85.87	89.29	92.34	96.49	100.15
Fuel gas	24.12	21.43	30.59	15.15	18.62	21.51	20.92	22.66	23.13	26.11	27.26
Total	60.39	60.84	74.99	67.61	84.22	87.93	106.79	111.95	115.46	122.61	127.42

6.3 There is a general upward trend in operating expenditure (excluding fuel gas) for each year of the access arrangement period. DBP explains these changes in the remaining provisions of this section of the submission.

Asset Growth

6.4 Since 1999 there have been a number of major expansions on the pipeline to increase capacity. These expansions have increased the capacity through both looping and additional compression (in this regard and for more detail in connection with the expansions undertaken since 2005, see submission #9 filed with the regulator on or about the date of this submission). Both forms of expansion create additional operating expenses for all areas of DBP. The table below summarises the pipeline in both 1999 and 2009/10.

Table 5: DBNGP asset growth from 1999 to 2009/2010

Unit	2004	2009/10	Increase
Km of pipeline	1,563	2,791	79%
Number of Compressor Units	18	27	50%

Inflationary factors

6.5 In 1999, the operational expenditure (less fuel gas) total of $21.6 million that $10.6 million which could be grouped as labour. This included:

(a) $9.1 million in salaries and consultants; and

(b) $1.5 million in the notional organisation

6.6 Note: this does not include overheads or intercompany expenses, both of which may contain labour.

6.7 Therefore approximately 50% of OPEX would increase at the AWE rate, whilst the rest would increase at CPI.

(i) AWE (average weekly earnings) for WA from Nov 1999 to Nov 2009 increased by 75%. Assuming a 4.5% per year increase, this will be 83% by Nov 2010.

(ii) CPI for WA from Sep 1999 to Sep 2009 has increased by 38%. Assuming a 2.5% per year increase, this will be 42% by Sep 2010

(b) The overall rate of increase is therefore 62% (i.e. 83% x 50% + 42% x 50%)

Movement in other key operational expenses since 2005

6.8 In addition to inflationary factors and asset growth there have been a number of individual expense increases that have occurred.

Operation & Maintenance increases

(a) Fees payable under the Access Right to the Land Access Minister (this instrument is the basis of DBP's tenure over the land in which the DBNGP is located and is granted under the Dampier to Bunbury Pipeline Act) are forecast to dramatically increase. DBP is in receipt of invoices from the Minister as a result of a review of the fee under the Access Right. This represents a 300% increase in fees to be paid from those paid in 2009. This accounts for over half of the $11m in expenses attributable to the category of "Utilities Rates and Taxes".

(b) Aerial surveillance of the DBNGP pipeline and corridor. Since 2005 costs have more than doubled due to an increased risk of encroachment and to maintain the security of supply. [DELETED]. fixed wing flights have been phased out due to their ineffectiveness at being able to immediately address risks to the integrity of the pipe. All flights are now made by helicopter (helicopter rates are more than double that of fixed wing). In the metro area a flight every second day is conducted. In remote areas flights are conducted less frequent however the frequency has been increased from one every three months to a fortnightly basis. This has resulted in an increase in the surveillance expense of approximately $550,000 per annum.

(c) Microwave maintenance costs have increased as they are no longer shared with Western Power. Western Power has decided to exit the original agreement for the sharing of the costs of maintaining the microwave system that underpins DBP's communication system on the pipeline. Instead of paying 67% of the total costs DBP now pays 100%. This has resulted in an increase in the maintenance expense of approximately $400,000 per annum.

(d) DBP has also had to install a new microwave system because the previous system was no longer supportable. However, the new system of itself, has higher maintenance costs than the prior, unsupported, system.

(e) Engineering consultancy costs have increased as additional resources have been required to deliver on the Asset Management Plan, integrity management in areas of CP and SSC surveys and monitoring, Hazardous Areas Audits and reconciliation and consolidation of DBNGP design basis standards. With the resurrection of the resources boom a real possibility, this is likely to place a strain on the availability of skilled engineers and this will also push prices upwards.

Corporate Changes

(f) DELETED

(g) Audit costs are expected to increase for a number reasons:

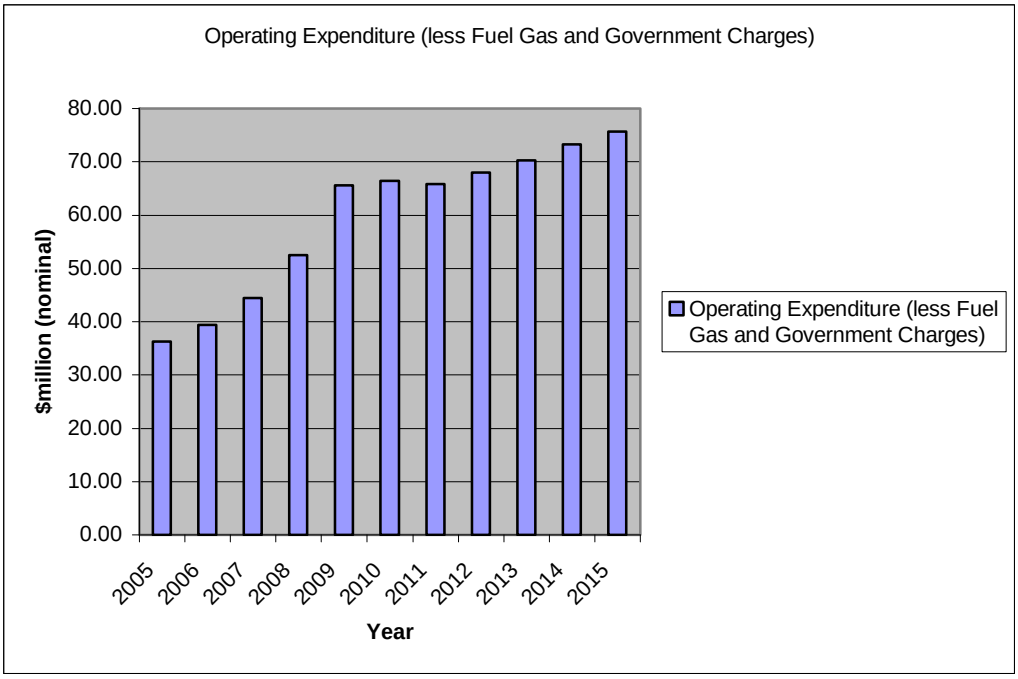
(i) The increased obligations of compliance under laws such as the National Gas Law, the NGERS Act,

(ii) the changes to the Petroleum Pipelines Act

(iii) increased compliance costs under the ACCC Undertakings

(iv) and risk costs have seen lower internal audit costs be offset by consolidation of all compliance costs, one off costs for the safety case review.

(h) Government charges have increase significantly since 2005. If the cost of government charges were removed, the following graph shows the year on year change of other operating expenditure (excluding fuel gas).

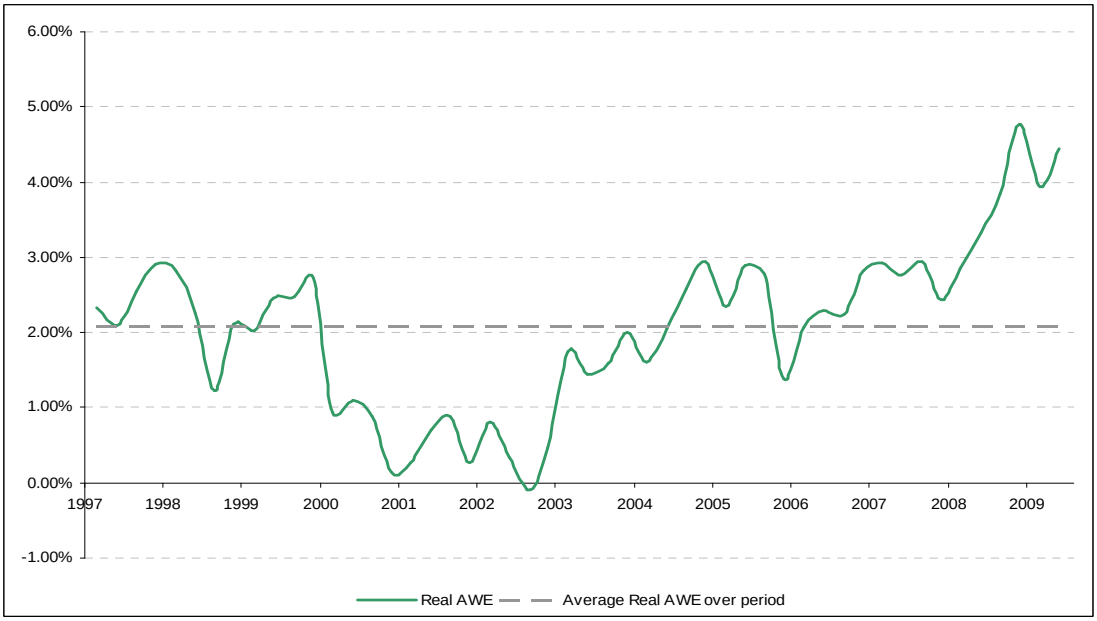


Labour market outlook

6.9 DBP has escalated the labour cost proportion of the Operational Expenditure at a rate of 2% above the increase in CPI (that is, DBP has assumed a 2% per annum real increase in labour rates). This assumption has been made in light of continuing upward pressure on labour rates in the WA resource sector.

6.10 The following figure shows the trend in real average weekly earnings in Western Australia.

Figure 1: Real Average Weekly Earnings – Western Australia



6.11 The Chamber of Minerals and Energy of Western Australia's Growth Outlook describes projections of strong labour demand as a result of activity within the minerals and energy sector. Survey results included in the Growth Outlook study suggested the State-wide demand for labour from the minerals and energy sector would grow significantly between 2008 and 2014, projected to grow by an annual average of 7 percent by 2014. Labour demand was forecast to peak in 2012 as a result of the coincident timing of a number of major construction projects.

6.12 According to the Growth Outlook, under a moderately constrained growth scenario labour demand growth was forecast to be relatively slow until 2010, followed by a sharp upturn in 2011 with incremental demand in 2012. Under a severely constrained growth scenario, flat or negative labour demand is expected until 2011 followed by a sharp upturn in 2012 with incremental demand in 2012.

6.13 The Growth Outlook anticipates that, so far as the minerals and energy sector is concerned, the recent commencement Chevron's Gorgon project will lead to the creation of 10,000 jobs during construction and over 3,500 jobs during its ongoing operation. This single project alone represents a material shift in demand for labour and can be considered to require skill types that DBP itself will be competing for in the labour market. The article that appeared on the cover of the West Australian, 23 February 2010, describing pay levels of non-skilled labour to be employed on the Gorgon LNG project suggest of the wage pressures that will exist in the WA market place.

6.14 DBP will be under significant pressure to incentivise its workforce to avoid a loss of staff.

Fuel gas

6.15 The cost of fuel gas has been estimated from forecasts of:

(a) the quantity of gas used as compressor fuel; and

(b) the quantity of gas used in all other operational activities, including gas used as fuel in gas engine alternators and heaters, gas replacing gas which has leaked from the DBNGP, and gas replacing gas vented during maintenance activities.

6.16 DBP has developed a model for forecasting the quantity of gas used as compressor fuel. The model forecasts compressor fuel use using a polynomial function with the total throughput, less the quantity of gas transported to delivery points in the Pilbara and Mid-west, as the independent variables.

6.17 As no capacity enhancement is being planned during the access arrangement period fuel curves are the same for all years.

6.18 DELETED:

6.19 DELETED

6.20 DELETED

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6.24 DELETED

6.25 DELETED

6.26 DELETED

6.27 DELETED

6.28 DELETED

Insurance costs

6.29 Since 2005, DBP has managed to secure a significant reduction in the rate used to determine the premiums payable under DBP's property policy. This reflects both the softer insurance market during this period and a greater awareness by insurers of the operational risks associated with operating a pipeline in conditions in Western Australia.

6.30 However, while the rate has declined, the rate is applied to the asset value to determine the premiums payable. Given the doubling of the value of the asset in the last five years, this has offset all of the savings that have been achieved with the reduced rate.

6.31 DELETED

Allowance for Self Insurance of Asymmetric Risks

6.32 DBP has made allowance in its recurrent operational expenditure for compensation for certain risks for against which it is has not sought to insure either because of cost, or because it is unable to obtain cover. An amount of $0.2 million per year (escalating with inflation) was included on the basis of the allowances approved for GasNet Australia Pty Ltd by the Australian Competition Tribunal.

6.33 Subsequent to its lodgment of the Proposed Revised Access Arrangement, DBP sought from its insurers proposals for renewals of its insurances. The proposals it received identified a large number of risks for which DBP would remain uninsured if it continued with its present insurance program. These risks are of the type for which compensation is sought through the allowance for self insurance risk.

6.34 DELETED

Future Climate Change Reform

6.35 A Bill to enact the CPRS is presently in the parliament for approval. The government's stated objective is to pass the legislation in its present form. It considers the CPRS to be the central policy plank in its climate change response. Accordingly, there is a significant chance that the Bill will become law within the next few months.

6.36 If the Bill is enacted, DBP is a liable entity responsible for surrendering Australian Energy Units under the CPRS.

6.37 If the Bill is enacted, the liability for surrendering AEUs will commence in July 2010 – this is provided for in proposed section 5 of the Bill.

6.38 For the first year of its operation, the Bill provides that each unit will attract a $10 fixed cost – i.e. from July 2010 to June 2011. this is provided for in proposed section 89 of the Bill and is reconfirmed in the announcement accompanying the re-introduction of the Bill into parliament in February 2010

http://www.climatechange.gov.au/government/initiatives/cprs/cprs-progress/~/media/publications/cprs/summary_changes_to_exposure_draft_bills.ashx

6.39 After 1 July 2012, the price for the AEUs will be set by a market price b.

6.40 The forecast CO_2 emissions from the pipeline are based on the following:

(a) The methodology required to be used under the National Greenhouse and Emissions Reporting Scheme (NGERS) for calculating emissions is method 1.

(b) DBP has calculated emissions from the DBNGP based on the use of an amount of fuel gas equal to the fuel gas used to determine DBP's forecast fuel gas costs

6.41 The cost of surrendering units has therefore been assumed to be as follows:

(a) For the calendar year 2011 – for the first half of the year, the cost will be the emissions (tonnes) multiplied by $10/t. For the second half of the year, assume $25/t

(b) For the calendar year 2012 – assume $25/t increased by 5%

(c) For each subsequent calendar year – assume the prior year's price increased by 5%

6.42 There is a real risk that under its SSC, DBP will not be able to pass on the effects of complying with the CPRS to shippers, on the basis that the costs of surrendering the AEUs is not a new Tax. Accordingly, it is prudent for these costs to be included to be passed on to shippers taking the reference tariff.

6.43 DBP considers that it is also prudent to include an allowance for these costs in the Total Revenue calculation on the assumption that, if the Bill either doesn't get passed, or it is enacted and the liability for DBP under the regime is for a different amount to the amount forecast, that there exists a mechanism for a regular adjustment of the reference tariff. This is provided for in the reference tariff variation mechanism.

6.44 In addition to the above, there are a number of non recurrent items that DBP expects to incur during the access arrangement period. These are outlined below:

Regulatory Review Costs

6.45 Regulatory costs are the costs which DBP expects to incur in:

(a) preparing and submitting a revised access arrangement,

(b) participating in the subsequent approval process through to the Regulator's Final Approval; and

(c) implementation of the approved access arrangement.

6.46 DBP does not maintain a cadre of specialist regulatory staff beyond a manager. DBP therefore relies on external advisors for the technical, economic and legal work required in access arrangement revision.

6.47 Based on its previous experience with access arrangement approval, DBP expected to spend approximately $0.8 million on external advisors in 2010 to complete the current access arrangement assessment process.

6.48 Operator expects to spend, in 2014 and 2015, a similar amount in the preparation of the access arrangement due to be lodged in 2015. This will also cover the expense incurred in preparing and submitting further revisions to the Access Arrangement for the DBNGP, on participation in the approval process, and on implementing a revised access arrangement.

Compressor Overhauls

6.49 With the increase in compression that has been installed since 2005 (a 50% increase) and the fact that the DBNGP is designed only to meet contracted capacity, an increased allowance will need to be made for the expenses associated with compressor turbine overhauls than was the case in 2005.

Reactive Maintenance

6.50 In previous periods DBP has not made an allowance for reactive maintenance – effectively unplanned maintenance. While DBP is moving to an operating philosophy of reliability based maintenance, it has experienced unplanned repairs and maintenance each year over a number of years. Accordingly, it is prudent to make an allowance in the forecast operating expenditure for such an amount. The forecast used by DBP ($1.2 million pa) is an average of DBP's actual unplanned repairs and maintenance over the past few years.

7. DELETED

APPENDIX 1: GORGON WORKERS TO GET PAY BONANZA

KIM MACDONALD, The West Australian February 23, 2010, 2:45 am

WA News / Michael Wilson ©

Thousands of low-skilled construction workers on the massive Gorgon LNG project will each earn about $150,000 a year under a deal which will set a new WA wages benchmark.

Construction union boss Kevin Reynolds said Gorgon tradesmen would become the industry's highest-earning workers in WA and would be on par with the best paid in Australia.

Calculations by the Master Builders Association show the union agreement with contractor Thiess would deliver wages of nearly $3000 a week, including allowances, to semi-skilled employees such as concrete workers and labourers.

Separate calculations by the Australian Mines and Metals Association show qualified tradesmen such as excavators would get at least $160,000 annually.

The Thiess agreement signed last month will cover thousands of workers building the accommodation village on Barrow Island off the Pilbara coast. The Chevron project's total workforce will swell to up to 10,000 during peak construction of the $43 billion gas plant.

Mr Reynolds, secretary of the Construction, Forestry, Mining and Energy Union, said: "I think it's probably equal to any of the best paying construction jobs in Australia and is the most lucrative in WA.

"They are getting the big money because they will be working very long hours in some of the harshest conditions in the world."

MBA industrial spokesman Kim Richardson, who calculated the $150,000 salary based on an expected 70-hour week, said the deal would have a serious impact on commercial and residential construction.

Mr Richardson said metropolitan employers would be unable to match the wages paid by mining and resources contractors.

This would drain the city of tradesmen, forcing a blow-out in local building times and putting pressure on prices.

AMMA spokesman Geoff Bull said the project offered slightly higher remuneration through better site allowances and leave arrangements compared with other resource projects because of its remoteness and quarantine requirements.

Under the Thiess agreement, employees would get a nine-day break every 26 days, as well as four to five weeks of annual leave.

The agreement, also signed by the Australian Workers Union, includes an arrangement called "Special Gorgon Leave" which provides an extra 34 hours paid leave, or 3½ days, for every 26 days that is worked without industrial action or other disruptions.

The deal provides superannuation in addition to the salary.

Mr Reynolds said Gorgon would replace Pluto and Cape Preston as the best-paying jobs in WA.

Mining giant Woodside recently claimed Pluto LNG project workers earned at least $140,000 annually, though several tradesmen disputed this with claims of lower pay.

That project has been plagued by a dispute over "motelling", under which workers are given a different accommodation unit each work cycle instead of having a permanent unit.

Chevron, which runs Gorgon, would not comment. Thiess could not be contacted.

APPENDIX 2: DELETED