

Proposed Revisions DBNGP Access Arrangement

2016 – 2020 Access Arrangement Period

Actual capital expenditure 2011-15 (Expansion)

Supporting Submission: 7



PUBLIC

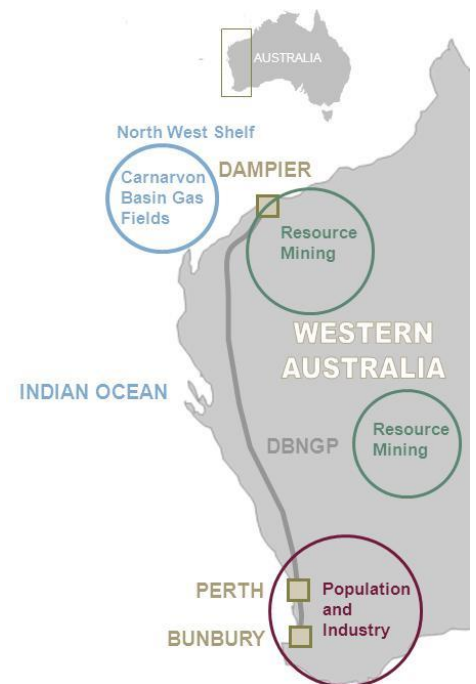
Date Submitted: 31/12/2014

CONFIDENTIALITY

- 1.1 This submission is provided to the ERA to assist it in its assessment of the proposed revisions to the DBNGP Access Arrangement.
- 1.2 Some information contained in the submission is confidential and commercially sensitive. The reasons for DBP's claim of confidentiality are outlined in Appendix D: to this submission.
- 1.3 A public version of this submission will be provided separately.
- 1.4 Accordingly, this version of the submission is provided to the ERA on the following conditions:
 - (a) it is to be used by the ERA solely for the purposes of assessing the proposed revisions to the DBNGP Access Arrangement;
 - (b) it is not to be disclosed to any person other than the following without DBP's prior written approval:
 - (i) those staff of the ERA who are involved in assisting the ERA in its assessment process; and
 - (ii) those of the ERA's consultants who are involved in assisting the ERA in its assessment process and who have appropriate confidentiality undertakings in place.

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

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



Trent Leach

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

Nick Wills-Johnson

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

DBNGP (WA) Transmission Pty Limited

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



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1. INTRODUCTION

- 1.1 On 31 December 2014, DBNGP (WA) Transmission Pty Ltd (DBP) filed the following documents with the Economic Regulation Authority of Western Australia (ERA):
 - (a) proposed revised Access Arrangement (**Proposed Revised AA**); and
 - (b) proposed revised Access Arrangement Information (**Proposed Revised AAI**).
- 1.2 These documents are proposed to cover the access arrangement period commencing on 1 January 2016 and ending on 31 December 2020 (**AA Period**)
- 1.3 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.
- 1.4 In addition to the Proposed Revised AA and Proposed Revised AAI, a number of additional supporting submissions were filed to assist the ERA in assessing the Proposed Revised AA. These included the following:
 - (a) Submission 1: Proposal
 - (b) Submission 2: Cost Controls and Governance
 - (c) Submission 3: Proposed Reference Service
 - (d) Submission 4: Terms and Conditions
 - (e) Submission 5: Non-tariff related issues
 - (f) Submission 6: Cost Verification and Allocation
 - (g) Submission 7: Actual Capital Expenditure (Expansion)
 - (h) Submission 8 Actual Capital Expenditure (Stay-in-Business) (Part 1 & 2)
 - (i) Submission 9: Forecast Capital Expenditure
 - (j) Submission 10: Forecast Operating Expenditure
 - (k) Submission 11: Capacity and throughput forecast
 - (l) Submission 12: Rate of Return
 - (m) Submission 13: Total Revenue
 - (n) Submission 14: Tariff model and tariff calculation
- 1.5 As outlined in the Access Arrangement Information¹, the conforming capital expenditure made or to be made by DBP during the 2011 to 2015 regulatory period (**Current AA Period**) has been categorised into either:
 - (a) Stay in business capital expenditure – capital expenditure made to ensure DBP is able to continue operating the pipeline to meet its statutory and contractual obligations; or
 - (b) Expansion capital expenditure – capital expenditure made for the purposes of expanding the capacity of the pipeline.
- 1.6 This submission is aimed at supplementing the information in the Proposed Revised AA and Proposed Revised Access AAI in order for the ERA to approve DBP's expansion capital expenditure as conforming capital expenditure for the purpose of National Gas Rule (NGR) 77(2)(b) (in addition to the stay in business capital expenditure, the details of which are the subject of submission 8).

¹ Refer to Section 6 of the AAI

- 1.7 For the purposes of this submission, the proposed conforming capital expenditure for the Current AA Period that is to be rolled into the opening capital base for the AA Period is expenditure made in relation to the Stage 5A and 5B expansion projects. Detailed substantiation of these expansion projects was provided to the ERA as part of its approval of the access arrangement for the Current AA Period². While DBP's Stage 5A and 5B expansion projects were largely completed during 2005-10 access arrangement period, there are amounts of expansion capital expenditure related to those expansion projects that were not included in the Opening Capital Base for the Current AA Period as they were made in 2011 and 2012³. They were therefore proposed as conforming capital expenditure in the Current AA Period. These include expenditure:
- (a) incurred to close out various aspects of the Stage 5B expansion project; and
 - (b) relating to both the Stage 5A and 5B expansion projects which, in 2010, was treated, for accounting purposes, as Capital Works in Progress (CWIP) at 31 December 2010 and therefore not capitalised (for accounting or regulatory purposes) prior to 31 December 2010.
- 1.8 DBP's proposed expansion related conforming capital expenditure made in the Current AA Period and to be included in the determination of the Opening Capital Base for the AA Period is provided in the following table:

Table 1: Expansion Conforming Capital Expenditure (\$m Nominal)

Project	2011	2012	2013	2014	2015	Total
<u>Nominal</u>						
Stage 5A	19.02	0.00	0.00	0.00	0.00	19.02
Stage 5B	77.10	11.90	0.00*	0.00	0.00	89.01
Total (Nominal)	\$96.13	\$11.90	\$0.00	\$0.00	\$0.00	\$108.03

* note that the year 2013 includes an amount of \$1268.14 (Nominal) in the Compression asset category.

- 1.9 DBP submits that the expansion capital expenditure meets the criteria contained in NGR 79 and should be approved as conforming capital expenditure made during the Current AA Period and therefore included to determine the opening capital base for the AA Period (in accordance with NGR 77(2)(b)). The remainder of this submission explains how the expansion capital expenditure meets the NGR 79 criteria.
- 1.10 A separate submission has been provided to the ERA in relation to the non-expansion or stay in business capital expenditure made, or to be made, by DBP in the Current AA Period and its justification against the same criteria (see submission 8).

² See paragraph 2.5 of this submission for the relevant submissions

³ Note that in 2013, expenditure totalling \$1,268.14 (compression) and \$1599.00 (other) (\$ nominal) was made in connection with the Stage 5B expansion.

2. BACKGROUND - STAGE 5A AND 5B EXPANSIONS REQUIRED TO BE CONSIDERED IN TOTALITY

- 2.1 In assessing the expenditure associated with each of the Stage 5A and 5B expansion projects that DBP has proposed as conforming capital expenditure from the Current AA Period for inclusion into the opening capital base for the AA Period the subject of these submissions, the ERA should consider each project in its totality and the benefits that each entire project delivered.

Single decision in relation to each expansion project

- 2.2 The ERA determined that capital expenditure for the Stage 5A and 5B expansion projects made in the 2005-10 regulatory period:
- (a) met the requirements for conforming capital expenditure in accordance with NGR 79; and
 - (b) should be added to the opening capital base for the Prior AA Period in accordance with NGR 77(2)⁴.

However, both the construction activity and the expenditure associated with the expansion projects occurred over a number of years such that expenditure required to complete each of stages 5A and 5B was made over periods which straddle two access arrangement periods.

- 2.3 DBP's submission is that expenditure incurred over the later access arrangement period was required to complete the expansion projects, and the benefits of the expenditure made in one (later) access arrangement period cannot be considered in isolation of benefits that were generated by the expenditure for that same project in the other (earlier) access arrangement period.
- 2.4 While it could appear that the DBNGP expansion program that occurred from 2005 was a continual expansion programme that was undertaken to meet an unprecedented and continuous increase in demand for energy that spanned a 7 year period, the fact is that there were distinct decisions by the DBNGP board and its owners to fund each stage of expansion. In practice, the commencement of each of Stages 5A and 5B projects overlapped the completion of the Stage 4 and 5A projects respectively. Accordingly there was a continual flow of expansion related activity being undertaken from 2005 onwards. The only reasons why this single, continual expansion program had to be compartmentalised into distinct projects were:
- (a) the need to provide certain shippers with their requested capacity to meet their timing requirements – DBP could not hold off on the commencement of the work until all Stage 4, 5A and 5B shippers had entered into binding contracts for the additional capacity; and
 - (b) the inability of the Board to commit to the funding of the entire expansion programme in a single decision without contracts being executed by shippers for the additional capacity.
- 2.5 DBP's Submission 9 provided to the ERA at 14 April 2010 (attached as Appendix A) and Submission 52 provided to the ERA at 20 May 2011 (attached as Appendix B) detailed how the Stage 4, Stage 5A and 5B expansion capital expenditure met the requirements of NGR 79(1) and was justified under the following criteria:
- (a) NGR 79(2)(a) - the overall economic value of expenditure is positive:
 - (i) The entire capital expenditure for Stage 4, 5A and 5B expansion projects meet the requirements of NGR 79(2)(a) which was supported by analysis undertaken by consultants Marsden and Jacobs;
 - (ii) DBP's Submission 52 also agreed with paragraph 269 of the ERA's Draft Decision that stated that a number of companies had entered into commercial agreements with DBP for access to additional capacity on the DBNGP. These arrangements were entered

⁴ With the exception of the project management fee - see para 313 of the amended Final Decision for the Prior AA Period, dated 22 December 2011 - <http://www.erawa.com.au/gas/gas-access/dampier-to-bunbury-natural-gas-pipeline/access-arrangements/access-arrangement-period-2011-2015/decisions-and-proposals>

into by companies which can reasonably be assumed to be acting rationally and commercially and should be considered as evidence of expected positive economic benefit; and/or

- (b) NGR 79(2)(c)(iii) - expenditure was made to comply with a regulatory obligation or requirement:
 - (i) This was based on that expansion investment was undertaken to comply with the terms of an undertaking provided to the Australian Competition and Consumer Commission under Section 87B of the *Trade Practices Act 1974* to expand the capacity of the DBNGP, which constituted a regulatory obligation or requirement with the meaning of NGR 79(2)(c)(iii).

- 2.6 The ERA accepted that associated expenditure of the Stage 5A and 5B projects had a net economic benefit and therefore was justifiable under NGR 79(2)(a) on the following basis:

*"contractual arrangements under the standard shipper contract that either resulted in expansions in capacity being fully contracted to users in advance of the expansions occurring in circumstances where the users were fully exposed to the costs of the expansions is sufficient evidence to conclude that the expansion capital expenditure provided a net economic benefit. Accordingly, the Authority maintains its determination that the capital expenditure on expansion of the DBNGP is justified under rule 79(2)(a)."*⁵

Accounting treatment of expenditure is a key basis for why expenditure was made in 2011 and not 2010

- 2.7 Secondly, the timing of the making of the expenditure in 2011 and 2012 (for regulatory purposes) was driven more so by DBP's accounting treatment and the fact that the adoption of this treatment for regulatory purposes facilitated the ERA's process of verification of the amounts of capital expenditure for the purposes of NGR 79(1)(a).

- 2.8 As the ERA itself acknowledged in the Final Decision:

*"In presenting a revised forecast of capital expenditure for the 2011 to 2015 access arrangement period, DBP has altered the timing of addition to the capital base of some capital expenditure to take a consistent approach of adding expenditure to the capital base at the time the expenditure is entered into DBP's asset register and asset accounts. This approach was applied in order to facilitate verification of stated amounts of capital expenditure by reconciliation of the stated amounts with audited financial statements."*⁶

*"The Authority is of the view that DBP's proposed practice of coordinating the timing of adding expenditure to the regulatory capital base with addition of the expenditure and assets to the asset register and capital account facilitates verification of the amounts of capital expenditure. The practical advantage of accounting for capital expenditure at the same time (for regulatory purposes and accounting purposes) is that it avoids the need to reconcile expenditure values and make consequential adjustments to those values."*⁷

ERA has previously assessed the expenditure

- 2.9 The third reason is that, many of the costs DBP is proposing as expansion conforming capital expenditure has already been assessed by the ERA as meeting the criteria. In the ERA's Final Decision for the Current AA, it determined that expenditure recognised, in DBP's statutory accounts, as Capital Works in Progress (CWIP) at 31 December 2010 for Stage 5A and 5B and proposed by DBP in its access arrangement as forecast expenditure to be incurred in completing the remaining works required for Stage 5B project met the requirements for forecast conforming capital expenditure.

⁵ Paragraph 310 of the ERA Final Decision 31 October as amended on 22 December 2011

⁶ *Ibid.*, paragraph 332

⁷ *Ibid.*, paragraph 335

- 2.10 In regards to the CWIP expenditure, an amount of \$61.2m (Real 2010)⁸ relating to both Stage 5A and Stage 5B expansion projects had already been incurred (but not capitalised for accounting purposes at 31 December 2010) during the 2005-10 period. The ERA approved the expenditure as forecast conforming capital expenditure with the exception of a proportion of costs in respect to the BEP Lease. The ERA's determination was as follows:

"The Authority observes that the amount of capital expenditure attributed to construction works in progress and that is carried over from 2010 to 2011 is verified as part of DBP's verification of capital expenditure for 2005 to 2010.

Given that the value of capital works in progress relates to capital expenditure in 2010 or earlier years, the Authority is of the view that, with one exception, this amount of forecast capital expenditure in 2011 is likely to be justified under rule 79 of the NGR for the reasons set out earlier in this final decision in respect of conforming capital expenditure for the 2005 to 2010 period.⁹

- 2.11 The value of the BEP Lease was later the subject of merit review at the Australian Competition Tribunal the result of which was reflected in a revised access arrangement decision pursuant to rule 64(4) at 5 October 2012.
- 2.12 In addition to CWIP expenditure, the ERA approved DBP's forecast of expansion capital expenditure of \$47.9m (Real 2010)¹⁰ relating to completion works for Stage 5B. The ERA considered that expenditure would likely be justifiable under NGR 79¹¹. Consistent with its Draft Decision the ERA determined that forecast capital expenditure for Stage 5B in 2011 was forecast conforming capital expenditure for the purpose of NGR 78 on the same basis that actual capital expenditure in 2005 to 2010 period for the Stage 5 expansion conformed to the criteria of NGR 79.
- 2.13 DBP notes that the ERA stated in its Final Decision that only a value of the actual expenditure that has been verified by audit of costs will be added to the capital base at the commencement of the next access arrangement period in 2016¹². DBP has complied with this requirement as outlined in Submission 6 - Cost allocation and verification.

⁸ *Ibid.*, paragraph 338

⁹ *Ibid.*, paragraphs 336 and 337

¹⁰ *Ibid.*, paragraph 338

¹¹ *Ibid.*, paragraph 339

¹² *Ibid.*, paragraph 321

3. CONFORMING CAPITAL EXPENDITURE CRITERIA

- 3.1 Under NGR 77(2)(b), capital expenditure from a Current AA Period can be rolled into the opening capital base for an AA Period if it is conforming capital expenditure.
- 3.2 NGR 79 provides that conforming capital expenditure is capital expenditure that conforms with the following criteria:
- (a) the capital expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services (**Prudency & Efficiency Criterion**); and
 - (b) the capital expenditure must be justifiable on a ground stated in subrule (2) (**NGR 79(2) Criterion**).
- 3.3 The grounds outlined in the NGR 79(2) Criterion are:
- (a) the overall economic value of the expenditure is positive. It is noted that, in addition to the considerations outlined in NGR 79(3) to be taken into account to determine whether the overall economic value of expenditure is positive, Schedule 1, clause 7(2) of the NGR provides that the ERA must consider material economic value that is likely to accrue directly to electricity market participants and end users of electricity from additional gas fired generation capacity; or
 - (b) the present value of the expected incremental revenue to be generated as a result of the expenditure exceeds the present value of the capital expenditure; or
 - (c) the capital expenditure is necessary:
 - (i) to maintain and improve the safety of services; or
 - (ii) to maintain the integrity of services; or
 - (iii) to comply with a regulatory obligation or requirement; or
 - (iv) to maintain the service provider's capacity to meet levels of demand for services existing at the time the capital expenditure is incurred (as distinct from projected demand that is dependent on an expansion of pipeline capacity); or
 - (d) if the capital expenditure is an aggregate amount divisible into 2 parts, one referable to incremental services and the other referable to a purpose referred to in paragraph (c), and the former is justifiable under paragraph (b) and the latter under paragraph (c).
- 3.4 The remaining paragraphs in this section of the submission outline DBP's interpretation of key terms used in NGR 79.
- 3.5 So, in effect, the expenditure will be conforming if the following criteria are met:
- (a) The service provider acted prudently in incurring the expenditure.
 - (b) The service provider was acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable costs of providing services.
 - (c) The capital expenditure meets one of the grounds in NGR 79(2).

Regulator's discretion

- 3.6 Before analysing each of the criteria, it is important to note that in assessing whether the capital expenditure is conforming capital expenditure the ERA has a limited discretion.¹³

¹³ NGR Rule 79(6)

- 3.7 As provided for in NGR 40(2), this means that the ERA may not withhold its approval to capital expenditure as conforming capital expenditure if the ERA is satisfied that it complies with the applicable requirements of the NGL and is consistent with applicable criteria (if any) prescribed by the NGR.
- 3.8 The effect of this is that the ERA can only withhold its approval if the element is outside the range of acceptable alternatives that comply with the requirements relevant to this element. If the ERA considers that a change to the relevant element might be desirable to achieve more complete conformity between the element and the principles and objectives of the NGL, it is not allowed to reject the service provider's proposal to give effect to that view in the decision making process.
- 3.9 Under NGR79(1)(a), the capital expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services.

Prudency

- 3.10 In deciding whether a service provider is prudent, case law and regulatory precedent indicates that the regulator must ask what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. In making decisions, a utility must take into account the best interests of its customers, whilst still being entitled to a fair return.
- 3.11 This was the test was applied by the Washington Utilities and Transportation Commission hearing in relation to Puget Sound Power & Light Company in the Fourth Supplemental Order made in cause U-83-54 in September 1984 at pp 32, 33, where the Commission said:
- "The test this Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of expenditures."*
- 3.12 In Canada, the issue was considered at length in a decision of the Alberta Court of Appeal, Atco Gas & Pipeline Ltd v Alberta (Energy & Utilities Board) [2005] AJ 495, 2005 ABCA 122.
- 3.13 In its decision, the Board applied the following test of prudence:
- (a) the utility would be found prudent if it exercises good judgment and makes decisions which are reasonable at the time they are made, based on information that the owner of the utility knew or ought to have known at the time the decision was made;
 - (b) in making a decision, a utility must take into account the best interest of its customers while still being entitled to a fair return.
- 3.14 It is noted that Webster's New 20th Century Dictionary of the English language definition of prudent, provides as follows:
- (a) capable of exercising sound judgment in practical matters; cautious or discreet in conduct; circumspect; sensible; not rash; characterised, dictated, or directed by prudence; as, prudent measures,
 - (b) synonyms include, circumspect, discreet, cautious, judicious, careful, considerate, sagacious, thoughtful, provident, frugal and economical.
- 3.15 The concept of prudence is therefore used to determine whether, at a particular time in question, an arrangement is or was appropriate and reasonable given the circumstances known or which ought to have been known.
- 3.16 The case law has also made it clear that an assessment of whether expenditure is prudence ought not to be based on hindsight. Webster's Dictionary defines hindsight as "perception of nature and demands of an event after it has happened". Applying this definition to the current context, the

regulator must not impute knowledge to the service provider that the service provider could not reasonably have known at the time the utility made the decision being reviewed.

- 3.17 In deciding whether this test is met to be able to conclude whether a service provider is prudent, case law indicates that there is a presumption that expenditure by a service provider is prudent and that the regulator has the burden of proof to demonstrate that expenditure is imprudent. Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown. There should not be excluded from the finding of prudence, investments which, under ordinary circumstances, would be deemed reasonable. Unless the Regulator can find expenditure which is dishonest or obviously wasteful or imprudent expenditure, it will be assumed to be prudent.
- 3.18 It is submitted that the if the following practical steps can be shown, then prudence and reasonableness in relation to expenditure will be proven:
- (a) *Planning* - the ability to demonstrate that the service provider has considered an appropriate range of project contractual options given the legal and regulatory requirements and environment. Show that it has evaluated how this project differs from previous projects and that it has organised resources and developed policies and procedures to define clearly responsibilities and accountability.
 - (b) *Prioritise* - demonstrate that risk exposure areas have been identified, contingency plans developed for problems and flexibility maintained to adapt to changing project conditions.
 - (c) *Management* - demonstrate that a framework has been developed for the effective management of the project using resources, tools and reporting requirements, including timely corrective action when required.
 - (d) *Collaboration* - demonstrate that key stakeholders have been involved early in the process. Demonstrate the need for the project and that mechanisms are in place to monitor project conditions and take corrective action as they arise.
 - (e) *Documentation* - recognise the need to document all decisions and supporting rationales for actions throughout the planning and project process. This demonstrates that the utility has acted reasonably in preparing for and executing a major project.
- 3.19 Examples of evidence of imprudence include:
- (a) poorly structured contracts not matched to project needs and the resource capabilities of the utility or the contractor;
 - (b) failure of effectively organised owner supervision;
 - (c) over-reliance on contracts and litigation to remedy problems after the fact, rather than through proper contract administration;
 - (d) inadequate financial planning and financial resources to match project needs;
 - (e) lack of information to make informed decisions, including inadequate cost, schedule, quality or regulatory compliance information;
 - (f) poor and slow resolution of engineering problems; and
 - (g) inability to bring the project to a conclusion and for the owner to accept operational responsibility.

NGR 79(2): “overall economic value is positive”

- 3.20 The first test of NGR 79(2) – the overall economic value of the expenditure is economic cost benefit test. The term “economic value” is not defined but, in his second reading speech on the National Gas (South Australia) Bill 2008, the South Australian Minister explained that:

The initial Rules will now include a “positive economic value” test for investment in existing pipelines designed to capture net increases in producer and consumer surpluses in upstream

and downstream gas markets, whilst also capturing the system security and reliability benefits that were considered by regulators to constitute system-wide benefits.

3.21 The intention to establish an economic cost benefit test is clearly indicated by the Minister's reference to the capture of net increases in producer and consumer surpluses. However, that test is not broadly based. Rule 79(3) limits its scope, requiring that, in deciding whether the overall economic value of capital expenditure is positive, consideration be given only to economic value directly accruing to the service provider, gas producers, shippers, and users of gas.

3.22 The transitional provisions of clause 6 of Schedule 1 to the National Gas Rules govern the application of Rule 79(3) in Western Australia until the end of the second access arrangement period commencing after the date of transition (ie in the case of the DBNGP, until 2020). Clause 6(2) states:

In making a relevant decision under rule 79(3) on whether the overall economic value of capital expenditure is positive, the AER [regulator] must consider not only economic value directly accruing to the service provider, gas producers, users and end users (as required by rule 79(3)) but also material economic value that is likely to accrue directly to electricity market participants and end users of electricity from additional gas fired generation capacity.

3.23 Clearly, clause 6(2) extends the scope of Rule 79(3) by allowing consideration of the economic value accruing to electricity market participants and to users of electricity generated from gas, in addition to the economic value accruing to the service provider, gas producers, shippers, and users of gas, in deciding whether the overall economic value of capital expenditure is positive.

3.24 Regulatory decisions by the Victorian Regulator-General, and by the ERA, have established that system wide-benefits are the positive externalities associated with pipeline expansion. That is, they are benefits accruing to others (other shippers, gas producers, users of gas, and possibly others) from new capital expenditure, and not benefits accruing to the pipeline service provider and to those shippers who contract for services provided using the facilities created by that expenditure.

3.25 System-wide benefits are, then, a part of the total economic benefits which are to be taken into account in determining overall economic value in accordance with Rule 79(2).

4. COMPARISON OF CAPITAL EXPENDITURE

4.1 The Current AA outlines the following provision for forecast expansion related capital expenditure:

Table 2: Forecast conforming capital expenditure for expansion 2011-15 approved by the ERA (\$2010)

Real (31 Dec 2010)	2011	2012	2013	2014	2015
Pipeline	13.476				
Compression	27.219				
Metering	0.141				
Other	45.174				
BEP capacity	18.858				
Non-depreciable assets					
Total	104.868				

Source: Table 13 of the ERA's AAI, Forecast conforming capital expenditure for the 2011 to 2015 access arrangement period (real \$m at 31 December 2010)

- 4.2 However, as outlined in the Proposed Revised AAI, DBP proposes that it made expansion capital expenditure totalling \$108m but over the calendar years 2011, 2012 and 2013. A breakdown of this expenditure by year and project was provided in Table 1 of this submission.
- 4.3 DBP has verified actual expenditure against audited corporate accounts as outlined by DBP's Submission 6 Cost verification and allocation.
- 4.4 The following explains the key reasons for the variance between the amount of expansion capital expenditure included in the Current AA as forecast capital expenditure in each of years 2011-2013 and the amount of capital expenditure included in the Current AA as capital expenditure made in these years.

Change in accounting treatment

- 4.5 Firstly, all amounts of expansion capital expenditure included in the Proposed Revised AA as conforming capital expenditure during 2011 to 2015 will be accounted for on an incurred basis with the exception of \$57.6m of the expenditure reflecting the CWIP balance at 31 December 2010 adjusted for the BEP Lease regulatory valuation. Determination of that valuation is discussed below.
- 4.6 In addition to the amount of CWIP the ERA approved an amount of \$47.9m (Real \$2010) as forecast conforming capital expenditure in 2011.
- 4.7 DBP's actual expansion capital expenditure on an incurred basis was \$38.50m in 2011, \$11.90m in 2012 and \$2,867 in 2013 (nominal) which has an aggregate value of \$48.64m (Real \$2010).
- 4.8 Therefore the real difference between that approved as forecast conforming capital expenditure and that incurred by DBP (and submitted as conforming capital expenditure) is \$0.74m (Real \$2010). As this only represents an approximate increase of 1.5% on what DBP had forecast to spend in 2011 and expenditure is of the same nature as that forecast to be spent in the completion of the Stage 5B project the additional \$0.74m is submitted as conforming capital expenditure.

Burrup extension pipeline lease expenditure

- 4.9 The second reason for the variance relates to the amount to be recognised for the BEP Lease. While the ERA's Final Decision determined that the BEP Lease costs were forecast conforming capital expenditure 2011, it required a change to DBP's valuation of the lease expenses. The value of forecast conforming capital expenditure for the BEP Lease was later determined in a revised access arrangement decision (5 October 2012) pursuant to rule 64(4) under order of the Australian Competition Tribunal (Tribunal) made on 26 July 2012.
- 4.10 In accordance with the Tribunal's decision the BEP Lease valuation was set at \$18.858m (2010\$) in the 5 October 2012 decision and reflected in forecast conforming capital expenditure for 2011. DBP has determined that the 2011 dollar value is \$19.42m
- 4.11 For accounting purposes, DBP capitalised \$23.04m for BEP Lease costs in calendar year 2011. Accepting the valuation set by the Tribunal for regulatory purposes, DBP has made an adjustment to figures reported by independently audited Special Purpose Financial Reports of \$3.62m so that only a value of \$19.42m is reflected in regulatory accounts.
- 4.12 The removal of the \$3.62m from DBP's audited figures is transparently demonstrated in Submission 6 Cost verification and allocation (Table 3 of Section 2).
- 4.13 DBP also confirms that adjusted BEP Lease costs have assigned to the pipeline regulatory asset category with the remaining asset life of 57 years commencing in 2011.

5. NATURE OF EXPANSION CAPITAL EXPENDITURE

- 5.1 For a detailed explanation of the basis of design for the Stage 5A and 5B expansion projects DBP refers the ERA to Submission 9 provided to the ERA at 14 April 2010. Submission 9 is provided as appendix 1 to this submission.
- 5.2 The following tables list the sub-projects and items capitalised in 2011 and 2012 for each expansion project:

Table 3: Stage 5A actual capital expenditure by sub-project 2011 (Nominal)

Item	Asset Category	Capex
Stage 5A Completions Station Pipework	Pipeline	
Stage 5A Completions Station Pipework - Cold Recycle	Pipeline	
Stage 5A Completions Pipeline	Pipeline	
Stage 5A Completions CS Buildings	Compression	
Stage 5A Completions Gas Compressor - Re-wheeling	Compression	
Stage 5A Completions CS GEA's - Reliability	Compression	
Stage 5A Completions GEAs	Compression	
Stage 5A Completions DEAs	Compression	
Stage 5A Completions Control System	Compression	
Stage 5A Completions CS Control System	Compression	
Stage 5A Completions Gas Turbine	Compression	
Stage 5A Completions Easement - ROW Re-instatement	Other	
Stage 5A Completions Equipment	Other	
Stage 5A Completions MAN 8x8 Truck BY75454	Other	
Maximo 6 upgrade	Other	
Total (Nominal)		\$19,024,869

Table 4: Stage 5B actual capital expenditure by sub-project 2011 (Nominal)

Item	Asset Category	Capex
WNE Project management	Other	
Fortescue River crossing	Pipeline	
Stage 5B - DBP Legal & direct costs	Other	
Stage 5B Facilities - Materials procurement	Compression	
Stage 5B Facilities - Jandakot warehouse	Other	
Emergency gas control to Jandakot - communications upgrade	Compression	
Control System for CS06 & CS09	Compression	
HMI upgrade CS1, 3, 5, 8	Compression	
Stage 5B Facilities - Fire and Gas	Compression	
Fortescue River - Northern River Study	Pipeline	
Lands by WNE operations	Other	
Re-wheeling	Compression	
Stage 5B Facilities – PTW	Compression	
Stage 5A & 5B vegetation studies	Pipeline	
Implementation of PVi database	Pipeline	
Adaptors for 10 inch MLVL vent risers	Pipeline	
MLV 117 Marginup line rectification	Pipeline	
Inventory of emergency equipment, pipes and spools	Other	
Training for custom engine control system (ESM)	Other	
Hydro-testing of Stage 5B spare pipe	Pipeline	
Stage 5B Hot Tap Installation	Pipeline	
SCADA controls at three meter stations (Kemerton, Harvey & Clifton)	Other	
Stage 5B DBP capitalised costs	Other	
BEP Lease	Pipeline	
DBNGP CP SCADA visibility	Pipeline	
Additional 3 vehicles	Other	
Replacement of CCVT at MLV sites for 5B	Pipeline	
DCVG on DBNGP at potholing locations	Pipeline	
Noise attenuation at CS including noise survey	Compression	
Replacement of battery chargers (24V)	Compression	
CS9-1 Nuova Pignone	Compression	
1001 5B DBP - Vibration works	Compression	
1001 5B DBP - ACV actuators CS2, 4 & 7	Compression	
1001 5B DBP - Compression punch list	Compression	
Intelligent pigging of Stage 5B loops	Pipeline	
1001 5B DBP - Physical asset security	Other	
Removal of defect by cutting out a coupon North of MLV 116	Pipeline	
Traffic management - Compressor stations	Compression	
BEP Integration	Pipeline	
Stage 5B Punch list	Compression	
Stage 5B ERA fees	Other	
Contractor disputes- settlement of claims	Pipeline	
Fortescue River crossing	Other	
Total (Nominal)		\$77,104,890

*Adjusted for BEP Lease value see paragraphs 4.11.

Table 5: Stage 5B actual capital expenditure by sub-project 2012 (Nominal)

Item	Asset category	Capex
WNE Project management	Other	
Stage 5B - DBP Legal & direct costs	Other	
Stage 5B Facilities - Materials procurement	Compression	
Stage 5B Facilities - Jandakot warehouse	Other	
Emergency Gas control to Jandakot - communications upgrade	Compression	
Control System for CS06 & CS09	Compression	
Stage 5B Facilities - Fire and Gas	Compression	
Fortescue River - Northern River Study	Pipeline	
Lands by WNE operations	Other	
Re-wheeling	Compression	
Stage 5B Facilities – PTW	Compression	
Stage 5A & 5B vegetation studies	Pipeline	
Implementation of PVi database	Pipeline	
Stage 5B DBP Capitalised Costs	Other	
DBNGP CP SCADA visibility	Pipeline	
Replacement of CCTV at MLV sites for 5B	Pipeline	
Noise attenuation at CS including noise survey	Compression	
Replacement of battery chargers (24V)	Compression	
CS9-1 Nuova Pignone spare engine overhaul	Compression	
1001 5B DBP - Vibration works	Compression	
1001 5B DBP - Compression punch list	Compression	
Intelligent pigging of Stage 5B loops	Pipeline	
Traffic Management - Compressor Stations	Compression	
BEP Integration	Pipeline	
Stage 5B Punch List	Compression	
Land compensation	Other	
MS Environment surveys	Other	
PV035 Capacity Upgrade	Other	
Stage 5B ERA fees	Other	
Contractor disputes- settlement of claims	Pipeline	
Fortescue River crossing	Other	
Total (Nominal)		\$11,901,039

Table 6: Stage 5B actual capital expenditure by sub-project 2013

Item	Asset category	Capex
ACV actuators CS2, 4 & 7	Compression	
Land compensation	Other	
Total (Nominal)		\$2,867

6. EXPENDITURE IS PRUDENT AND EFFICIENT

- 6.1 NGR 79(1)(a) requires that conforming capital expenditure must be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing service (prudence and efficiency requirements).
- 6.2 DBP submits that the conclusions reached by the ERA in its review of the prudence and efficiency of Stage 5A and 5B expansion project capital expenditure in the 2011 Final Decision are equally relevant to expenditure made in the Current AA Period for the reasons outlined in section 2 of this submission. Further:
- (a) The capital expenditure directly relates to works carried out under the Stage 5A and 5B projects - over 90% of expenditure for this project was already assessed by the ERA as meeting the requirements for conforming capital expenditure;
 - (b) The ERA found that forecast conforming capital expenditure in 2011 for the Stage 5A and 5B expansion projects was likely to meet the prudence and efficiency requirement on the same basis as the Stage 5A and 5B expansion capital expenditure provided as actuals in the prior regulatory period; and
 - (c) Over half of the capital expenditure had already been incurred prior to 2011 and it is just a function of DBP's accounting treatment that this expenditure is being assessed by the ERA as conforming capital expenditure made for the purposes of adding to the opening capital base for the AA Period.
- 6.3 The ERA's Draft Decision in 2010 determined that:
- "capital expenditure in the 2005 to 2010 access arrangement period largely, but not entirely, satisfies the prudence and efficiency requirements of rule 79(1)(a). This determination was based on considerations of incentives for efficiency under the scheme of regulation of the NGL and NGR, and under the terms of the standard shipper contracts with pipeline users, and expert engineering advice"¹⁴*
- 6.4 Paragraph 277 of the Draft Decision (and para 281 of the Final Decision) goes on to state that the exception to the ERA's satisfaction of the prudence and efficiency requirements was the costs incurred by DBP in payment of a project manager retained for pipeline expansions. DBP confirms that there are no project management retainer fees included in the amounts of proposed expansion conforming capital expenditure for the 2011 and 2012 years¹⁵.
- 6.5 The ERA's support for this conclusion was two-fold:
- (a) that DBP is exposed to cost overruns on expansion projects for at least the period up to 2016 as DBP would ultimately forego recovery of some depreciation allowance on the expansion capital expenditure when tariffs revert to regulated tariffs under the access arrangement.
 - (b) DBP is unable to have stay-in-business capital expenditure reflected in changes to tariffs under the SSC until at least 2016.
- 6.6 The ERA's expert consultants Halcrow & Zincara (Halcrow) also concluded that expansion capital expenditure met the prudence and efficiency requirements based on the following:
- (a) the expansion programme (Stages 4, 5A and 5B) had been properly planned in a manner consistent with that expected of a gas transmission pipeline operator;
 - (b) the adopted form of expansion represented the most efficient means of increasing capacity to meet the identified demand;

¹⁴ Paragraph 276 of the ERA Final Decision 31 October as amended on 22 December 2011

¹⁵ DBP notes there is an amount of expenditure attributed to 'WNE Project management' expenditure in the Table 5 how this is in relation to project management fees a separate fee that was considered by the ERA to be conforming capital expenditure.

- (c) the programme had been appropriately staged;
 - (d) DBP's contractor engagement had been market tested, whilst at the same time leveraged long standing "preferred supplier" arrangements for the provision of compressor related services;
 - (e) the expansion works had been constructed to both schedule and budget; and
 - (f) the pipeline costs were consistent with expectations.¹⁶
- 6.7 DBP's original submissions regarding the prudence and efficiency of the total expenditure for Stages 5A and 5B were made in Submissions 9 (14 April 2010) and Submission 52 (May 2011) and copies are provided for reference as Appendix 1 and 2.
- 6.8 As the conditions and observations replied upon by the ERA and consultants Halcrow outlined in paragraphs 6.5 and 6.6 are equally relevant to the expenditure being considered DBP proposes that 2011 and 2012 actual capital expenditure for Stage 5A and 5B expansion projects also meet the prudence and efficiency requirements of NGR 79(1)(a).

¹⁶ Paragraph 204 of the ERA Draft Decision 14 March 2011 reprinted 5 May 2011

7. JUSTIFICATION OF CAPITAL EXPENDITURE UNDER CRITERIA OF RULE 79(2)

Box 1: NGR 79(2) justification

DBP submits that Stage 5A and 5B actual capital expenditure in 2011 and 2012 is justified against the following NGR 79(2) criteria:

- The overall economic value is positive (NGR 79(2)(a); and
- The expenditure was necessary to comply with a regulatory obligation (NGR 79(2)(c)(iii)).

On the basis that:

- The contractual arrangements under the Standard Shipper Contract that resulted in expansions in capacity being fully contracted to users in advance of the expansion occurring in circumstances where the users were fully exposed to the costs of the expansions is sufficient evidence to conclude that the expansion capital expenditure provided net economic benefit.
- The expenditure was necessary to comply with a regulatory obligation under the undertakings made to the ACCC.

7.1 Expansion capital expenditure in 2011 and 2012 solely relates to the Stage 5A and 5B expansion projects. Over 90% per cent of Stage 5A and 5B actual capital expenditure has already been determined by the ERA to have met the requirements to be conforming capital expenditure for the purpose of NGR 79 and included in the capital base as per NGR 77(2)(b).

7.2 The ERA also concluded at paragraphs 228 to 340 of its Final Decision that proposed capital expenditure associated with the close out of expansion projects yet to be incurred or capitalised for accounting purposes was conforming forecast capital expenditure in the 2011 calendar year. DBP's revised forecast of expansion capital expenditure comprised:

- (a) an amount of 'Construction Works in Progress' (CWIP) of \$61.2m (Real 2010) that had already been incurred by DBP but not yet capitalised for accounting purposes; plus
- (b) expenditure that was forecast to occur in 2011, an amount of \$47.9m (Real 2010).

7.3 The amount of \$61.2m (Real 2010) related to both the Stage 5A and Stage 5B expansion projects and had already been incurred prior to 2011, however having not been capitalised to the corporate asset base expenditure was recognised as Capital Works in Progress (CWIP) at 31 December 2010. The ERA's Final Decision at paragraph 340 concluded that:

"Given that the value of capital works in progress relates to capital expenditure in 2010 or earlier years, the Authority is of the view that, with one exception, this amount of forecast capital expenditure in 2011 is likely to be justified under rule 79 of the NGR for the reasons set out earlier in this final decision in respect of conforming capital expenditure for the 2005 to 2010 period."

7.4 The single exception the ERA refers to in the quote above relates to the BEP Lease costs which was later resolved through the Australian Competition Tribunal and reflected in a revised access arrangement decision pursuant to rule 64(4) at 5 October 2012 as outlined above in paragraphs 4.9 to 4.13 of this submission.

7.5 In addition to CWIP expenditure, the ERA approved DBP's forecast of expansion capital expenditure of \$47.9m (Real 2010) relating to completions work for Stage 5B, considering it would likely be justifiable under NGR 79 at paragraph 339 of the Final Decision. Consistent with its Draft Decision the ERA determined that forecast capital expenditure for Stage 5B in 2011 was forecast conforming capital expenditure for the purpose of NGR 78 on the same basis that actual capital expenditure in 2005 to 2010 period for the Stage 5 expansion conforms to the criteria of NGR 79.

7.6 The ERA at paragraph 321 of the Final Decision stated that, only a value of the actual expenditure that has been verified by audit of costs will be added to the capital base at the commencement of the next access arrangement period in 2016.



7.7 Actual expansion capital expenditure for 2011 and 2012 is \$108m. DBP has complied with the ERA's requirement that actual capital expenditure be verified by audit of costs as outlined in Submission 6 Cost verification and allocation.

Overall economic value of the expenditure is positive

7.8 DBP submits that the Stage 5A and 5B capital expenditure in aggregate is positive and therefore justified against the NGR79(2)(a) criteria on the basis that contractual arrangements under the Standard Shipper Contract that resulted in expansions in capacity being fully contracted to users in advance of the expansion occurring in circumstances where the users were fully exposed to the costs of the expansions is sufficient evidence to conclude that the expansion capital expenditure provided net economic benefit.

Contractual arrangements as evidence

7.9 The Standard Shipper Contracts (SSC) were the outcome of contract negotiations with existing shippers in October 2004. Given DBP's non-discrimination obligations, if any shipper [redacted] seeks access to Full Haul capacity on the DBNGP, DBP will make that capacity available on the terms and conditions of the SSC. The SSC contains a number of relevant provisions:

7.10 Clause 16 of the SSC obliges DBP to expand the pipeline for an existing shipper requiring additional T1 capacity subject to:

- (a) the shipper providing DBP 30 months' notice of its additional capacity requirement;
- (b) the shipper and DBP agreeing an amendment to the existing SSC which includes a capacity commencement date which can be no earlier than 24 months from the date of the agreement (unless otherwise agreed by the parties);
- (c) the shipper meeting certain commercial requirement of DBP (for example, creditworthiness); and
- (d) DBP being able to secure finance for the expansion on reasonable commercial terms and conditions for a verified amount.

7.11 Expansions were undertaken as a result of either new shippers entering into new SSCs and then exercising rights under clause 16 of the relevant SSCs or existing shippers exercising expansion rights under their pre-existing SSCs.

7.12 The following tables provide an overview of contracted capacity by shipper under each of the Stage 5A and 5B expansion projects.

Table 7: Stage 5A contractual summary

Contracting Party	Volume	Contractual Commencement Date	Commencement Date
[Redacted Table Content]			

Source: Submission 9 DBP (2010)

Table 8: Stage 5B contractual summary

Contracting Party	Volume	Contractual Commencement Date	Commencement Date

Source: Submission 9 DBP (2010)

- 7.13 DBP's objectives in the expansion of the DBNGP were to:
- (a) Complete each phase of the expansion on time in order to be able to commence the delivery of gas to shippers within the time frame agreed to under the expansion project;
 - (b) Deliver each expansion project with minimal disruption to current gas supply levels for existing shippers;
 - (c) Ensure that, given the tight timetable for delivery of capacity to shippers, a contracting strategy was implemented to ensure work is completed on time, in the most cost effective manner and on budget. The best cost method for achieving the capacity and time requirements was through a combination of compression and looping;
 - (d) Satisfy the requirements of the facility agreements with DBP's financiers. A separate Capital Expenditure Facility Agreement was entered into for each stage;
- 7.14 Work was completed in full compliance with all occupational health and safety requirements, with minimal safety incidents occurring.
- 7.15 Work was completed within a co-operative and stable industrial relations environment so as to minimise delays in the work schedule.
- 7.16 The expansion programme was conducted in a sustainable manner through strict adherence to the environmental management and cultural management plans.
- 7.17 The ERA's Draft Decision determined that expansion capital expenditure met the requirements of NGR 79(2)(a) that the overall economic value of the expenditure was positive. In making this determination, the ERA did not accept the economic analysis provided by DBP's consultants Marsden & Jacobs rather the ERA considered that the terms of the SSC, the expansions in capacity of the DBNGP have occurred with shippers of the DBNGP contracting for the full extent of the expansions in capacity and knowingly and willingly being exposed over a long contractual term to transmission tariffs that reflect expansion costs. The ERA concluded:

“As users of the DBNGP may be assumed to be behaving in a commercially reasonable and rational manner, these contractual arrangements are prima facie evidence that expansions in capacity of the DBNGP have only occurred where the benefits to the users of the transmission services exceed the costs of the expansion as reflected, or eventually to be reflected, in transmission tariffs”.¹⁸

7.18 The ERA's 2011 Final Decision, while considering points made by third party submissions, maintained its view found in the 2010 Draft Decision contractual arrangements under the SSC resulted in expansion in capacity being fully contracted to shippers in advance of the expansions occurring in circumstances where the shippers were fully exposed to the costs of the expansions determining that:

*“was sufficient evidence to conclude that the expansion capital expenditure provided a net economic benefit. Accordingly, the Authority maintains its determination that the capital expenditure on expansion of the DBNGP is justified under rule 79(2)(a)”.*¹⁹

7.19 DBP therefore submits that actual expansion capital expenditure in 2011 to 2015 regulatory period (provided in Table 1) meets the requirements for conforming capital expenditure on the basis that contractual arrangements under the Standard Shipper Contract that resulted in expansions in capacity being fully contracted to users in advance of the expansion occurring in circumstances where the users were fully exposed to the costs of the expansions is sufficient evidence to conclude that the expansion capital expenditure provided net economic benefit.

Regulatory obligation or requirement

7.20 DBP also submits that capital expenditure incurred for Stages 5A and 5B is justified conforming capital expenditure under NGR 79(2)(c)(iii) in that capital expenditure was undertaken to comply with a regulatory obligation or requirement.

7.21 The expansion of the capacity of the DBNGP was required to meet:

- (a) DBP's obligations to the State under the Financial Assistance Agreement (FAA), an agreement entered into in October 2004 as part of the acquisition; and
- (b) obligations in accordance with enforceable undertakings given to and accepted by the Australian Competition and Consumer Commission (ACCC) pursuant to the *Trade Practices Act 1974*.

FAA Expansion Obligations

7.22 The Financial Assistance Agreement (FAA) (attached as Appendix C) is an agreement under which the State of Western Australia provided certain financial assistance to the new owners of DBNGP upon their acquisition of DBNGP in October 2004 following the insolvency of Epic Energy (WA) Transmission Pty Ltd. The relevant parts of the FFA are contained in clause 6 and in Schedule 1 of the FAA, and required that:

- (a) DBP carry out the Expansion Commitments within the timeframes specified in the Expansion Commitments (clause 6.1 of the FAA) (the Expansion Commitments being described in Schedule 1 of the FAA, and summarised below);
- (b) until 30 June 2016, DBP provide half yearly reports to the Minister setting out information regarding its performance of the Expansion Commitments (clause 6.2 of the FAA);
- (c) DBP “offer all shippers and Prospective Shippers access to Gas Transmission Capacity on a non-discriminatory basis on the terms and conditions of, and at the price specified in the SSC” (Item 2 of Schedule 1);
- (d) the SSC would specify the terms and conditions under which DBP would fund the expansion in order to provide the Requested T1 Capacity (Item 4 of Schedule 1);

¹⁸ Paragraph 295, Amended Final Decision 31 October as amended on 22 December

¹⁹ Paragraph 310, Amended Final Decision 31 October as amended on 22 December

- (e) DBP must use reasonable endeavours to enter into a SSC with a shipper or prospective shipper who has submitted an Access Request within a reasonable time of receiving the request (Item 5 of Schedule 1);
 - (f) DBP undertake certain Initial Expansion Commitments to provide additional capacity to Western Power Corporation and any other shippers who had requested capacity prior to 13 January 2004 (Item 9 of Schedule 1)(Item 9 Commitments);
 - (g) Within 5 years of acquisition of the pipeline (October 2004), DBP must expand the capacity of the pipeline by no less than 100 TJ/day and invest up to \$400 million in connection with that expansion, subject to contracts being entered into with shippers for the additional capacity (Item 10 of Schedule 1);
 - (h) Where DBP received a request for capacity on the pipeline and was not able to provide the requested capacity from capacity available to it, then DBP must undertake an expansion for the shipper(s) or prospective shipper(s), in accordance with clause 16 of the SSC (Item 11 of Schedule 1)(Future Expansion Commitments);
 - (i) DBP must use reasonable endeavours to finance Expansions required to cater for all requested capacity on the pipeline (Item 12 of Schedule 1);
 - (j) where funding is available to DBP on reasonable commercial terms and conditions for the funding of the first expansion of capacity on the pipeline after the Contract Commencement Date (as defined in the SSC), allowing for changes in financial market conditions since the Contract Commencement Date, DBP must fund the expansion of all requested T1 Capacity on the pipeline (Item 13 Schedule 1).
 - (k) the Expansion Commitments contained in the FAA cease on 1 January 2016, unless otherwise indicated in the Standard Shipper Contract (Item 14 of Schedule 1).
- 7.23 The Item 9 Commitments amounted to an additional full haul capacity of 126.9 TJ/d, and were met by the Stage 4 expansion of the pipeline. Stage 4 also discharged the obligation in Item 10 of Schedule 1 to expand by more than 100TJ/day and to spend up to \$400m within 5 years of the purchase (as set out in paragraph 7.22(g) above).
- 7.24 Stage 5A and Stage 5B expansions arose due to expansion requests made by shippers and prospective shippers for additional capacity after Stage 4 commenced, that could not be met by existing capacity available at that time, triggering DBP's Future Expansion Commitments under the FAA (as set out in paragraph 7.22(h) above).
- 7.25 Had DBP failed to undertake the Stage 5A and Stage 5B expansions, DBP would have been in breach of its Future Expansion Commitments to the State Government of Western Australia under the FAA.
- 7.26 Accordingly, DBP submits that all the expenditure made by DBP in connection with the expansion of the capacity of the DBNGP since 2005, inclusive of Stage 5A and 5B expansion projects, meet the test under NGR 79(2)(c)(iii) in that the expenditure was necessary to comply with the obligations imposed on DBP by the State Government of Western Australia contained in the FAA, given that:
- (a) Future Expansion Commitments requires DBP to expand the DBNGP, for a shipper or prospective shipper in accordance with cl.16 of the SSC; and
 - (b) Clause 12 of Schedule 1 of the FAA requires DBP to use reasonable endeavours to finance expansion.

ACCC Undertakings expansion obligations

- 7.27 On 22 October 2004, the current owners of the DBNGP, and DBP itself, gave undertakings in accordance with section 87B of the *Trade Practices Act 1974*, whereby they allayed concerns the ACCC had with the potential implications of their acquisition of the pipeline for competition in energy markets.

- 7.28 These undertakings were given as part of court enforceable undertakings given under section 87B of the *Trade Practices Act* as part of the 2004 acquisition of the DBNGP (2004 Undertakings).
- 7.29 The 2004 Undertakings comprise two undertakings instruments provided to and accepted by the ACCC as follows:
- (a) The undertakings provided by the DBP Consortium Members, DBP Holdings and AAM and accepted by the ACCC on 25 October 2004 (Consortium Undertakings); and
 - (b) The undertakings provided by the Operator (then known as Epic Energy (WA) Transmission Pty Ltd (EEWAT) and accepted by the ACCC on 1 November 2004 (EEWAT Undertaking).
- 7.30 As DBP understands it, AAM provided and the ACCC accepted undertakings from AAM because it was (at that time) a wholly owned subsidiary of Alinta and a party to the DBNGP Operating Services Agreement (OSA), under which it was (at the time) to provide asset management and network services in relation to the operation, construction and maintenance of the DBNGP.
- 7.31 At the time of the acquisition by the DBP Consortium Members, Alinta:
- (a) through a wholly owned subsidiary, Alinta DBNGP Pty Ltd, ultimately had a 20% ownership interest in DBP;
 - (b) through a wholly owned subsidiary, Alinta Sales Pty Ltd, was ultimately a shipper on the DBNGP; and
 - (c) through its wholly owned subsidiary, AAM, agreed to provide asset management, operation, maintenance and construction management services to DBP in respect of the DBNGP under the OSA.
- 7.32 At the time of the acquisition of DBP by the DBP Consortium Members, the ACCC had expressed concern about Alinta's vertical integration as an owner of and shipper on the DBNGP and as to the ability of Alinta to adversely affect competition in downstream markets for gas retail and electricity generation because of AAM's involvement in operating the DBNGP.
- 7.33 Given this and the unsatisfied demand that had arisen prior to 2004, the ACCC required the inclusion of certain expansion obligations in the 2004 Undertakings. They are as follows:
- (a) Under clause 5.7 of the 2004 Undertakings:
 - (i) subject to clause 5.7, DBNGP Holdings Pty Ltd is to expand the capacity of the DBNGP between DOMGAS Dampier Plant Inlet Point and CS10 by not less than 100 TJ/day, in aggregate, to meet the known capacity requirements of contracted Shippers or Prospective Shippers who enter Standard Shipper Contracts that comply with clause 5.6 under and in accordance with the terms of those contracts (the "Expansion");
 - (ii) each Expansion is to occur no later than 5 years following completion of the acquisition of the DBNGP; and
 - (iii) DBNGP Holdings is to invest up to \$400 million in connection with the Expansion provided that the Shippers that require expanded Capacity have entered into Standard Shipper Contracts.
 - (b) Clause 5.6(a) of the 2004 Undertakings provide that "subject to clause 5.6(b), DBNGP Holdings undertakes to ensure that the Operator offers to all Prospective Shippers who require a T1 Service a Standard Shipper Contract that contains Capacity Expansion Rights that are not materially less favourable than the Capacity Expansion Rights contained in any other Shipper Contract for a T1 Service." Relevantly, clause 5.6(b) provides that nothing in clause 5.6(a) requires the DBP group parties to enter into a Standard Shipper Contract with a Prospective Shipper if it would not be required to do so under the Gas Access Law and the DBNGP Access Arrangement.

- 7.34 The ERA's Final Decision accepted that the Stage 4 expansion was justified under NGR 79(2)(c)(iii) while it did not accept that any expansion beyond Stage 4 could be considered necessary to comply with the undertaking provided to the ACCC²⁰.
- 7.35 However, DBP maintains that Clause 5.7 did impose an obligation to expand the DBNGP (i.e. minimum of 100 TJ in aggregate) to meet the known capacity requirements of contracted shippers and prospective shippers within a certain timeframe (i.e. 5 years), subject only to:
- (a) an assessment by DBP as to whether such an expansion was technically or economically feasible;
 - (b) the shipper who requested the expansion having a SSC (which meets the requirement in clause 5.6(a) that the contract include non-discriminatory capacity expansion rights as compared to other shipper contracts for a T1 service); and
 - (c) the expansion being carried out in accordance with the terms of that contract.
- 7.36 That is, if DBP's feasibility assessment found that any requested expansion satisfied the feasibility criteria and the requesting shipper had a relevant existing contract, DBP was, in fact, compelled by clause 5.7 to undertake an expansion to meet the required capacity in accordance with the terms of the shipper contract (which in the case of the standard shipper contract includes at clause 16 provisions dealing with funding contributions by the shipper) and the ACCC Undertaking.
- 7.37 Accordingly, DBP submits that all the expenditure made by DBP in connection with the expansion of the capacity of the DBNGP since 2005, inclusive of Stage 5A and 5B expansion projects, meet the test under NGR 79(2)(c)(iii) in that it is necessary to comply with the regulatory obligation of clause 5.6(a) of the 2004 Undertakings, given that all the expansions since 2005 have been undertaken as a result of the operation of clause 16 of the SSCs (except in relation to the capacity provided for Alcoa under the Exempt Contract).

²⁰ ERA Final Decision, paragraph 304 (31 October 2011 as amended on 22 December 2011)

APPENDIX A: SUBMISSION 9 (APRIL 2010)

APPENDIX B: SUBMISSION 52 (MAY 2011)



APPENDIX C: FINANACIAL ASSISTANCE AGREEMENT



APPENDIX D: CONFIDENTIALITY CLAIMS