

# Draft Decision

## Roma to Brisbane Pipeline Access Arrangement 2022 to 2027

### Attachment 5 Capital expenditure

November 2021

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## Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to APT Petroleum Pipelines Pty Limited (APTPPL)'s Roma to Brisbane Pipeline (RBP) for the 2022–2027 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

### Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

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## 5 Capital expenditure

Capital expenditure (capex) refers to the capital costs and expenditure incurred in the provision of pipeline services.<sup>1</sup> This investment mostly relates to assets with long lives and these costs are recovered over several access arrangement periods.

This attachment outlines our assessment of APTPPL's proposed conforming capex for the Roma to Brisbane Pipeline (RBP) over the 2017–22 access arrangement period (2017–22 period), which forms part of its opening capital base.<sup>2</sup> It also outlines our assessment of forecast capex for the 2022–27 access arrangement period (2022–27 period), which forms part of its projected capital base.<sup>3</sup>

### 5.1 Draft decision

#### 5.1.1 Conforming capex for 2016–17 and the 2017–22 period

Our draft decision indicates whether we approve the access arrangement proposal as submitted, based on the information that we have available at the time.<sup>4</sup>

We approve APTPPL's total net capex of \$82.4 million (\$2021–22) for the RBP for the 2017–22 period as conforming capex under rule 79(1) of the National Gas Rules (NGR) subject to updates to inflation.

We also approve APTPPL's actual capex of \$19.5 million (\$2021–22) in the 2016–17 year as conforming capex for the purpose of establishing the opening capital base for the 2017–22 period.<sup>5</sup>

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<sup>1</sup> NGR, r. 69.

<sup>2</sup> NGR, r. 77.

<sup>3</sup> NGR, r. 78(b).

<sup>4</sup> NGR, r. 59(2).

<sup>5</sup> NGR, r. 77(2).

**Table 5.1 AER approved capital expenditure by category over the 2017–22 period (\$million, 2021–22)**

Category	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22 <sup>(a)</sup>	Total (2017–22)
Expansion	1.3	0.0	–	0.0	–	–	0.0
Replacement	18.2	13.3	17.7	22.4	10.7	10.4	74.5
Non-network	–	–	–	–	1.9	5.9	7.9
Gross Total Capital Expenditure	19.5	13.3	17.7	22.4	12.6	16.3	82.4
Contributions	–	–	–	–	–	–	–
Asset disposals	–	0.0	0.0	0.0	–	–	0.0
Net Total Capital Expenditure	19.5	13.3	17.7	22.4	12.6	16.3	82.4

Source: AER analysis

(a) We have not assessed 2021–22 amounts as approved capex under this decision. This is because this value is an estimate. We undertake an assessment of whether 2021–22 is conforming capex as part of our next access arrangement decision.

### 5.1.2 Conforming capex for the 2022–27 period

We accept APTPPL's proposed total net capex for the RBP for the 2022–27 period, with adjustments to its proposed amount of \$29.3 million (\$2021–22) to reflect updated real cost escalation figures consistent with APTPPL's intent to update real cost escalations. This results in a conforming capex of \$29.2 million (\$2021–22) as conforming capex under r. 79(1) of the NGR.

We expect the real cost escalations and inflation will be further updated as part of APTPPL's revised proposal and our final decision to reflect the most up-to-date data.

Table 5.2 shows approved capex for the 2022–27 period by category.

**Table 5.2 AER approved capital expenditure by category over the 2022–27 period (\$ million, 2021–22)**

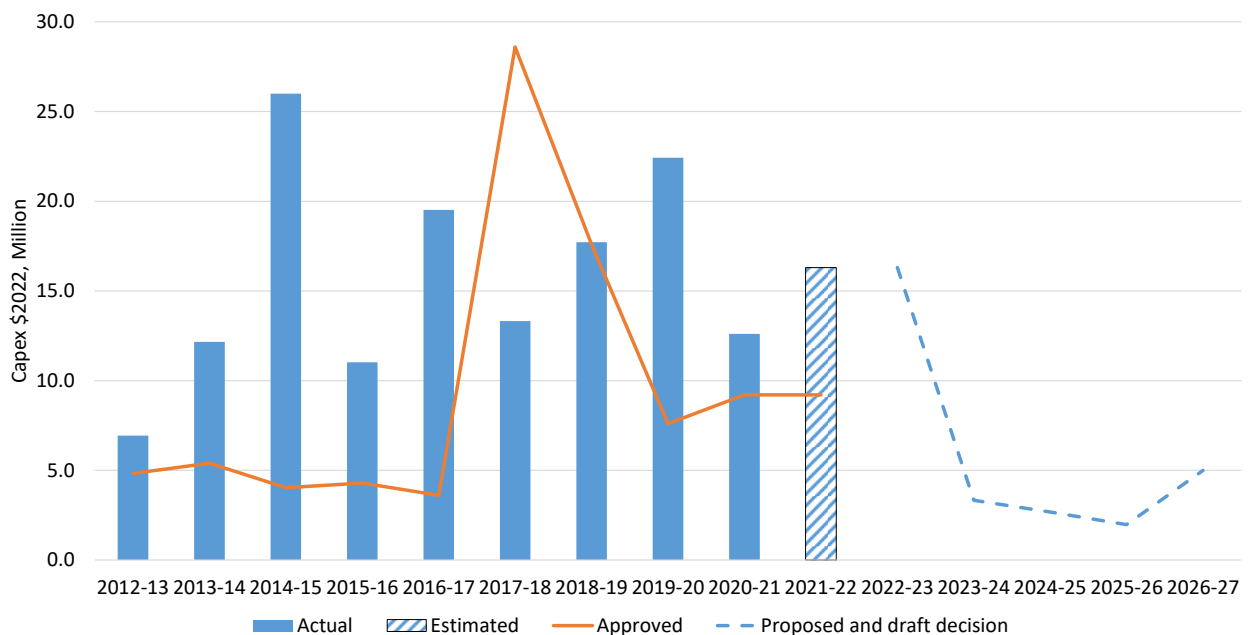
Category	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Expansion	–	–	–	–	–	–
Replacement	14.3	2.2	1.5	1.4	3.1	22.6
Non-network	2.0	1.1	1.1	0.5	1.9	6.7
Gross Total Capex	16.3	3.3	2.7	2.0	5.0	29.3
Contribution	–	–	–	–	–	–
Asset disposals	–	–	–	–	–	–
Real cost escalation and inflation adjustment	-0.0	-0.0	-0.0	-0.0	-0.0	-0.1
Net Total capital expenditure	16.3	3.3	2.7	2.0	5.0	29.2

Source: AER analysis; and APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated forecast capex model*, 30 September 2021. Numbers may not add up to totals due to rounding.

## 5.2 APTPPL’s proposal

### 5.2.1 Capex over the 2017–22 and 2022–2027 periods

**Figure 5.1 APTPPL’s capex trends**



Note: There is an immaterial difference between APTPPL’s proposed capex and our draft decision. For display purposes we have combined these two series into one.

APTPPL proposed total conforming net capex of \$82.4 million for the RBP for the 2017–22 period.<sup>6</sup> This is 15 per cent above the approved forecast of \$71.5 million for the 2017–22 period.

For the 2022–27 period, APTPPL forecast a total net capex of \$29.3 million.<sup>7</sup> This is 65 per cent below APTPPL’s actual capex for the 2017–22 period.

Figure 5.1 shows actual and estimated capex for the 2012–17 and 2017–22 access arrangement periods compared to the forecast.

APTPPL proposed capex for two categories – replacement capex (77 per cent of total forecast capex) and non-network capex (23 per cent of total forecast capex).

## 5.3 Assessment approach

We must make two decisions regarding APTPPL’s capex for the RBP.

First, we are required to assess past capex and determine whether it is conforming capex that we should add to the opening capital base.<sup>8</sup>

Secondly, we are required to assess APTPPL’s forecast of required capex for the RBP for the 2022–27 period to determine whether it is conforming capex. Capex will be ‘conforming’ if it meets the NGR’s new capex criteria.<sup>9</sup>

The following sections set out our approach and the tools and techniques we employ in forming a view on these two issues. We also need to take into account timing issues associated with the lag between actual capex data being available in the last year of the 2017–22 period and the need to forecast the opening capital base for the 2022–27 period. We explain this in the next section.

### 5.3.1 Capex in the 2017–22 period

We reviewed APTPPL’s submission and supporting material to assess its proposed capex for the RBP for the 2017–22 period. This included information on APTPPL’s reasoning and, where relevant, business cases, responses to information requests and other relevant information.

We used this information to identify whether capex over the 2017–22 period was conforming capex and, in turn, whether that capex should be included in the opening capital base.<sup>10</sup>

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<sup>6</sup> APTPPL provided an updated roll forward model which reflects updates to expansion capex and actual 2020–21 capex.

<sup>7</sup> APTPPL provided an updated capex model which reflects changes to its group IT capex forecast.

<sup>8</sup> NGR, r. 77(2)(b).

<sup>9</sup> NGR, r. 79.

<sup>10</sup> NGR, r. 77(2)(b).



Generally, we use the same approach to assess whether both historical and forecast or estimated capex conforms with the new capex criteria. We have set out this approach in more detail in section 5.3.2 below.

We consider the following when determining the opening capital base for the 2022–27 period:

- 2016–17 capex – when we conducted the previous access arrangement review, we did not yet have actual capex for 2016–17. Consequently, we need to adjust for the difference between actual and estimated 2016–17 capex in the capital base.<sup>11</sup> Since actual capex for 2016–17 is now available, we have assessed whether this capex is conforming capex.
- 2017–21 capex – since we have actual capex data for these years, we have assessed whether this is conforming capex.<sup>12</sup> We have included conforming capex in the opening capital base for 2017–22.<sup>13</sup>
- 2021–22 capex – we do not yet have actual capex for 2021–22 and so must include an estimate in the opening capital base. We have assessed whether APTPPL’s proposed estimate is conforming capex under the NGR. At the next access arrangement review, we will assess whether APTPPL’s actual capex for 2021–22 is conforming capex under the NGR, and adjust for any differences between actual and estimated capex.<sup>14</sup>

### 5.3.2 Capex in the 2022–27 period

We have assessed the key drivers of forecast capex to consider whether APTPPL’s proposed capex for the RBP complies with the new capex criteria.<sup>15</sup> In doing so, we relied on the following information, including:

- the access arrangement submission and access arrangement information, which outline APTPPL’s capex program and the main drivers of those programs
- business cases that detail the expenditure requirements for specific projects
- APTPPL’s Regulatory Information Notice (RIN) template response
- APTPPL’s capex forecast model
- responses to information requests

For each category of capex we considered the scope, timing and cost of the proposed capex in order to form a view on whether it complies with the new capex criteria. We

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<sup>11</sup> NGR, r. 77(2)(a).

<sup>12</sup> NGR, rr. 77(2)(b) and 79.

<sup>13</sup> NGR, r. 77(2)(b).

<sup>14</sup> NGR, rr. 77(2)(a) and 79.

<sup>15</sup> NGR, r. 79(1)

also considered whether cost forecasts were arrived at on a reasonable basis and represent the best forecast possible in the circumstances.<sup>16</sup>

### 5.3.3 Interrelationships

In assessing APTPPL's total forecast capex for the RBP, we took into account other components of its access arrangement proposal, including:

- possible trade-offs between capex and operating expenditure (opex)
- any differences between capitalisation policies applied in the 2017–22 and 2022–27 periods
- the growth in the price of labour for opex and capex.

## 5.4 Reasons for draft decision

### 5.4.1 Conforming capex for 2016–17 and the 2017–22 period

#### Conforming capex for 2016–17

APTPPL proposed net capex of \$19.5 million (\$2021–22) for the RBP for the 2016–17 year. We accept this as conforming capex as it is in line with its forecast of \$19.9 million (\$2021–22).

#### Conforming capex for the 2017–22 period

APTPPL proposed net capex of \$82.4 million<sup>17</sup> (\$2021–22) for the RBP for the 2017–22 period, where capex in 2021–22 is an estimate.<sup>18</sup>

We accept APTPPL's net capex forecast of \$82.4 million (\$2021–22) as conforming capex for the 2017–22 period. As noted in our assessment approach, we will update our assessment when actual information for 2021–22 is available at our next access arrangement determination.

We note APTPPL overspent its capex forecast of \$71.5 million (\$2021–22).<sup>19</sup> APTPPL's initial proposal did not include a breakdown or the drivers of its overspend. APTPPL noted that it had underspent capex for projects that were included in our forecast and that the difference between actual and forecast capex was largely driven by capex that was not included in our forecast.<sup>20</sup>

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<sup>16</sup> NGR, r. 74(2).

<sup>17</sup> APTPPL provided an updated roll forward model. This includes adjustments to BRAEMAR 2 connection and 2021 unaudited actual capex. 30 September 2021.

<sup>18</sup> APTPPL provided updated actual unaudited capex for 2020–21 as part of its suite of model updates on 30 September 2021.

<sup>19</sup> APTPPL refers to its current period forecast as \$72.2 million. However, this figure includes a half-WACC inflation adjustment. To allow for a like with like comparison with its actual capex, we have used a forecast of \$71.5 million which does not include a half-WACC adjustment.

<sup>20</sup> APTPPL, *Roma to Brisbane Pipeline 2022–27 – Reset RIN response Schedule 2*, July 2021, p. 14.

We note that our assessment of whether current period capex is conforming applies to all of capex and not just capex above the approved forecast.<sup>21</sup>

We have focussed our assessment of conforming capex on the following three drivers:

- The transition from the DN250 pipeline to the DN400 pipeline – this is to ensure that APTPPL has not incurred more capex than is necessary for an asset it expects to decommission in the 2022–27 period.
- forecast projects – capex that was included in our 2017–22 capex forecast
- non-forecast projects – capex that was not included in our 2017–22 capex forecast

### **Transition from the DN250 pipeline to the DN400 pipeline**

The transition of customers from the DN250 pipeline to the DN400 pipeline and the subsequent decommissioning of the DN250 pipeline is a key capex and depreciation consideration in APTPPL’s initial proposal for the RBP.<sup>22</sup>

Given APTPPL will decommission its DN250 pipeline in the 2022–27 period, we have examined whether DN250 pipeline capex undertaken in the current access arrangement period is prudent and efficient.

APTPPL incurred \$30.7 million in capex that is attributed to the DN250 pipeline in the current period. This accounts for 37 per cent of its current period capex. We consider this amount of capex is material for an asset that it expects to decommission in the 2022–27 period.

We sought additional information from APTPPL as to why it undertook capex in the current access arrangement period for this asset when it had planned to decommission this pipeline.

APTPPL noted that the opportunity to transition DN250 customers to the DN400 can only occur when there was sufficient capacity available on the DN400. This occurred on January 2021. Up until that point, APTPPL had to continue to undertake capex on the DN250 to meet its contractual obligations with existing customers. APTPPL also provided a breakdown of the projects it undertook to maintain practicable safety standards on the DN250 in line with its asset management plan.<sup>23</sup>

We are satisfied the capex APTPPL incurred that is attributed to the DN250 was prudent and efficient, and is therefore conforming capex.

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<sup>21</sup> NGR, r. 77(2)(b).

<sup>22</sup> APTPPL, *Roma to Brisbane Pipeline 2022–27 Access arrangement, Overview*, July 2021, pp. 27–30.

<sup>23</sup> APTPPL, Response to information request AER IR010, 15 September 2021, pp. 4–5.

## Forecast projects

We have compared APTPPL's actual capex for projects that were included in our 2017–22 capex forecast for the RBP. We consider APTPPL's actual capex for these projects are conforming.

In further information provided to us, APTPPL identified a \$2.6 million underspend for capex projects that were included in our forecast. This was largely driven by a \$14.6 million underspend on its Toowoomba Crossing project and a \$10.0 million overspend on group information and communications technology (ICT).<sup>24</sup>

APTPL considered the reason for overspending group information technology (IT) was due to it under-forecasting its group ICT for the 2017–22 period in its previous regulatory proposal.<sup>25</sup> APTPL provided further information on its group IT projects related to its billing, accounting and asset management needs which are shared across all of APA Group. We have assessed these programs and are satisfied that they are required to support the ongoing operation of APA's IT systems.

We also note that APTPL's 2017–22 forecast group IT was 54 per cent below its actual group IT capex in the previous (2012–17) period. We are satisfied that the group IT overspend is partly driven by APTPL not sufficiently identifying its group IT needs in its 2017–22 proposal.<sup>26</sup>

We are also satisfied that overall APTPL's capex for forecast projects, which is broadly in line with what we approved in our 2017–22 final decision, is conforming capex.

## Non-forecast projects

APTPL identified new projects that were not included as part of our 2017–22 forecast for the RBP as the main driver of its capex overspend. Its initial proposal identified new connections and expenditure associated with transitioning customers from its DN250 pipeline to its DN400 pipeline.<sup>27</sup>

In response to our information request, APTPL clarified that there was a range of projects that it has undertaken that were not a part of its forecast capex. The largest component was \$3.1 million for a change in capitalisation of leases from opex to capex. The remaining overspend was for a range of projects that do not exceed \$1.5 million. We have examined these other projects and satisfied that they are required to either maintain the safety, integrity and demand for services.<sup>28</sup>

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<sup>24</sup> APTPL, Response to information request AER IR003, 30 August 2021, p. 4.

<sup>25</sup> Ibid., p. 4.

<sup>26</sup> APTPL, Response to information request AER IR011, 14 September 2021, p. 8.

<sup>27</sup> APTPL, *Roma to Brisbane Pipeline 2022–27 – Reset RIN response Schedule 2*, July 2021, p. 14.

<sup>28</sup> NGR, r. 79(2)(c).

Based on this we are satisfied that the projects APTPPL's has classified as non-forecast capex is conforming capex.

## 5.4.2 Conforming capex for the 2022–27 period

APTPPL proposed forecast capex of \$29.3 million for the RBP for the 2022–27 period. We accept APTPPL's forecast capex. However, we have updated for real cost escalations consistent with the RBP proposal.

### Expansion

Expansion capex is capex that is required to expand the capacity of the pipeline to meet forecast demand both within and beyond the access arrangement period. APTPPL has not forecast any expansion capex in the 2022–27 period.

### Replacement

Replacement capex is required to maintain the safety and integrity of the pipeline. This category includes the refurbishment and replacement of:

- instrumentation, including metering, telemetry and remote terminal units
- pipeline hardware, including pipes, meters, valves, regulators and fittings
- site capital improvements, such as fencing and security
- specialised major spares

APTPPL proposed replacement capex of \$22.6 million (\$2021–22) for the RBP for the 2022–27 period. This is a decrease of \$50.9 million (69 per cent) from the actual and estimated replacement capex in the 2017–22 period.

We have included \$22.6 million (\$2021–22) for replacement capex in our forecast of conforming capex for the 2022–27 period. We consider this amount is sufficient for APTPPL to maintain the safety, reliability and integrity of the RBP, and is prudent and efficient.<sup>29</sup>

APTPPL's forecast replacement capex program largely relates to its pipeline integrity program (\$13.1 million) and supply security project (\$4.7 million)

### *Pipeline integrity program*

APTPPL forecast capex of \$13.1 million for its pipeline integrity program. This program is a continuation of its current in-line inspection, anomaly assessment and defect repair, and cathodic protection upgrades projects. This program, focussed largely on its DN400 and DN300 pipelines, ensures that the RBP is able to operate in accordance with its APTPPL's regulatory obligations.<sup>30</sup>

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<sup>29</sup> NGR, rr. 79(1) and 79(2)(c).

<sup>30</sup> APTPPL, *Roma to Brisbane Pipeline 2022–27 Access arrangement, Overview*, July 2021, p. 23.

The pipeline integrity program is composed of the following:

- in-line inspection program (\$1.4 million)
- validation and repair excavation program (\$3.0 million)
- cathodic protection augmentation (\$8.7 million)
- Warrego Highway upgrade pipeline protection (\$0.3 million)

We have reviewed the business cases for each of these programs and we are satisfied that these projects are conforming capex.

These programs are largely in line with APTPPL's asset management plan and historical practice. We note that most of this capex is front loaded towards the first year of the 2022–27 period. However, we do not consider this is a material concern and reflects the expected decommissioning of its DN250 pipeline.

We also acknowledge that this program is a step down from \$38.5 million spent in the current access arrangement period on pipeline integrity which reflects the expected decommissioning of the DN250 pipeline.

### ***Supply security***

APTPPL forecast capex of \$4.7 million (\$2021–22) for its supply security project. This project will provide security of supply to customers connected to the DN250 pipeline as it reaches the end of its economic life and subsequently connected to the DN400 pipeline.<sup>31</sup>

APTPPL considered significant capex would be required to maintain the safety and service quality of its DN250 pipeline. It is currently temporarily suspending parts of this pipeline from operation in order to defer replacement or repair costs.

APTPPL identified several options on how to manage the risk of pipeline failure. It identified that there would be \$30.4 million in avoided capex for maintenance and repair costs<sup>32</sup> through reduced pipeline integrity management as well as eliminate the risk of pipeline failure. However, there may be significant costs if the pipeline is returned to service.<sup>33</sup>

APTPPL also provided its demand projections to show that there was sufficient capacity to transfer its customers to the DN400 pipeline.<sup>34</sup>

We have assessed and made amendments to APTPPL's eastbound demand forecasts in Attachment 12. However, this does not affect the capacity utilisation requirements to decommission the DN250 pipeline.

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<sup>31</sup> APTPPL, *Access Arrangement overview*, 1 July 2021, p. 23.

<sup>32</sup> APTPPL, *Response to information request 10a*, 15 September 2021, p. 7.

<sup>33</sup> APTPPL, *Attachment 1 Lifecycle Management Plan*, A-6, 1 July 2021, p. 5.

<sup>34</sup> APTPPL, *Response to information request 10a*, 15 September 2021, p. 9.

We are satisfied that based on the expected demand and avoided maintenance costs that it is reasonable for APTPPL to undertake its supply security project.

## **Non-network**

Non-network capex is comprised of information technology, property and fleet.

### ***Group IT***

APTPPL proposed an updated group IT capex forecast of \$3.3 million. This reflects a change from its initial proposal of \$5.4 million to take into account updated cost allocations.

The APTPPL's group IT capex is based on a 5 per cent allocation of shared costs from APA Group IT systems consistent with APTPPL's cost allocation methodology. We are satisfied with APTPPL's group IT cost allocation.

We also recognise that APTPPL's forecast group IT capex is lower than the current period. This reflects expected greater migration to cloud-based services.<sup>35</sup>

At this stage, we consider APTPPL's forecast group IT capex is reasonable. However, we note that there is an interrelationship between group IT opex and capex. Attachment 6 sets out our draft decision on APTPPL's proposed opex for the RBP.

### ***Property and fleet***

APTPPL's forecast \$2.0 million and \$0.6 million for property and vehicle leases respectively. This reflects a change in accounting treatment of leases from opex to capex which occurred in the current access arrangement period.

APTPPL based this forecast on historic lease costs. We have reviewed these costs and are satisfied that the lease capex forecast is prudent and efficient.

## **Cost escalation and reconciliation**

In our draft decision for the 2022–27 period, we have considered the inputs:

- Actual inflation prior to 2021–22 and forecast inflation for 2021–22.
- Labour real cost escalators based on Deloitte Access Economics (DAE) forecasts (Attachment 6 – Operating expenditure).

For current period capex, we are satisfied with APTPPL's inflation from 2017–22. As 2021–22 uses an estimate of 2.42 per cent, we will update this figure for actual inflation in our final decision.

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<sup>35</sup> APTPPL, *Response to information request 2 response to further questions*, 10 September 2021, p. 3.

For forecast capex, we have updated inflation to 2.25 per cent to be consistent with our weighted average cost of capital (WACC) forecast. We will also update this inflation forecast as part of our final decision.

APTPL forecast its labour price to be in line with Powerlink's January 2021 regulatory proposal.<sup>36</sup> These WPI forecasts reflect an average of BIS Oxford Economics' (BIS) Queensland utilities wage price index (WPI) and DAE's forecast of Australian utilities WPI prepared for our September 2020 draft decision for Victorian distributors. APTPL also recognised that its escalators will be updated as part of our determination process.<sup>37</sup>

Consistent with our opex assessment in attachment 6, we have updated APTPL's labour cost escalations to reflect the latest forecasts from DAE.

We also note that APTPL's forecast WPI for 2021–22 is based on the opex model inputs for Energex's final decision. These forecasts use an average of BIS Oxford's October 2019 report and DAE's March 2020 report. We consider these forecasts are outdated. In particular these forecasts do not factor in the effect of the COVID-19 pandemic. For the purposes of a draft decision, we have only included DAE's latest forecasts for Queensland. We expect APTPL to update its WPI for 2021–22 alongside its other WPI forecasts. This approach of only adopting the best available post COVID-19 pandemic forecasts is consistent with our approach for our Victorian electricity distribution determination draft decisions.<sup>38</sup>

The net effect of our updated inflation and WPI forecast is a \$76,507 (\$2021–22) decrease in APTPL's forecast capex.

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<sup>36</sup> APTPL, *Reset RIN response schedule 2*, 13 July 2021, p. 28.

<sup>37</sup> APTPL, *Reset RIN response schedule 2*, 13 July 2021, p. 38.

<sup>38</sup> AER, *AusNet Services 2021–26 draft decision Attachment 5 – capital expenditure*, September 2020, p. 17.



## A. Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
APTPPL	APT Petroleum Pipelines Pty Limited
BIS	BIS Oxford Economics
Capex	Capital expenditure
DAE	Deloitte Access Economics
ICT	Information and communications technology
IT	Information technology
NGR	National Gas Rules
Opex	Operating expenditure
RBP	Roma to Brisbane Pipeline
RIN	Regulatory Information Notice
WACC	Weighted average cost of capital
WPI	Wage price index