energy market consulting associates

ATCO Gas Australia Midwest and Southwest Gas Distribution System

REVIEW OF SELECTED ASPECTS OF ATCO'S REVISED PLAN FOR AA6

Public Version

Report prepared for:

ECONOMIC REGULATION AUTHORITY WESTERN AUSTRALIA

October 2024

Preface

This report has been prepared to *This report has been prepared to assist the Economic Regulation Authority (ERA) with its assessment of ATCO Gas Australia's (ATCO) Access Arrangement for the Mid-West and South-West Gas Distribution Systems, for the period from 1st January 2025 to 31st December 2029 (AA6), which it is required to conduct in accordance with the National Gas Law (NGL) and the National Gas Rules (NGR) as applied in Western Australia. This report covers a particular and limited scope as defined by the ERA and should not be read as a comprehensive assessment of proposed expenditure that has been conducted making use of all available assessment methods.*

This report relies on information provided to EMCa by the ERA and by ATCO up until 11 September 2024. EMCa disclaims liability for any errors or omissions, for the validity of information provided to EMCa by other parties, for the use of any information in this report by any party other than the ERA and for the use of this report for any purpose other than the intended purpose.

In particular, this report is not intended to be used to support business cases or business investment decisions nor is this report intended to be read as an interpretation of the application of the NGR or other legal instruments. EMCa's opinions in this report include considerations of materiality to the requirements of the ERA and opinions stated or inferred in this report should be read in relation to this over-arching purpose.

Some numbers in this report may differ from those shown in ATCO's Access Arrangement Information (AAI) or other documents due to rounding.

Enquiries about this report should be directed to:

Paul Sell

Managing Director
0412 559 138
psell@emca.com.au

Prepared by

Paul Sell, Mark de Laeter and Eddie Syadan

Date saved

1/11/2024 2:42 PM

Version

Final v2

Energy Market Consulting associates

ABN 75 102 418 020

Sydney Office

L25, 100 Mount Street, North Sydney NSW 2060
PO Box 592, North Sydney NSW 2059
+(61) 2 8923 2599
contact@emca.com.au
www.emca.com.au

Perth Office

L28, 140 St Georges Terrace, Perth WA 6000
contact@emca.com.au
www.emca.com.au

TABLE OF CONTENTS

LIST OF TABLES

ABBREVIATIONS

Term	Definition
AA	Access Arrangement
AA5	Access Arrangement for the period 1 January 2020 to 31 December 2024
AA6	Access Arrangement for the period 1 January 2025 to 31 December 2029
AESCSF	Australian Energy Sector Cyber Security Framework
ASD	Australian Signals Directorate
AV	Audio Visual
capex	Capital expenditure
CBD	Central Business District
CEIH	Clean Energy Innovation Hub
CIC	Customer Initiated Commercial
DEMIRS	Department of Energy, Mines Industry Regulation and Safety
Draft Decision	ERA Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems
EAM	Enterprise Asset Management
EDM	Enterprise Data Model
EMCa	Energy Market Consulting associates
EOL	End Of Life
ERA	Economic Regulation Authority
ERP	Enterprise Resource Planning
ESG	Environmental, Social, and Governance
EUC	End User Computing
FD	AA5 Final Decision
FTE	Full-time Equivalent
GRC	Governance and risk compliance
HCM	Human Capital Management
HP	High Pressure
HPR	High Pressure Regulators
IAM	Identity and Access Management
Initial Plan	ATCO Gas 2025-29 Plan Mid-West and South-West Gas Distribution System 2025-29 Access Arrangement Information
Initial Technical Report	EMCa, ATCO Gas Australia Proposed Access Arrangement for the Mid-West and South-West Gas Distribution Systems, Review of Technical Aspects of the Proposed Access Arrangement 2025-29, April 2024

Term	Definition
MAOP	Maximum Allowable Operating Pressure
MDM	Master Data Management
MPR	Medium Pressure Regulator
MSP	Managed Service Provider
NGR	National Gas Rules
opex	Operating expenditure
Revised Plan	ATCO Gas 2025-29 Revised Plan Mid-West and South-West Gas Distribution System June 2024 2025-29 Access Arrangement Information
SOC	Security Operations Centre
STEQ	Structures and Equipment
STIP	Short Term Incentive Payment
totex	Total expenditure (capex and opex)
UAFG	Unaccounted for gas

EXECUTIVE SUMMARY

Purpose of this Report

1. This report provides our assessment and findings from our review of aspects of ATCO's revisions to its Initial Plan for the 2025-29 Access Arrangement period. We consider new and updated information pertaining to aspects of capex incurred (or to be incurred) in the AA5 period, and of its proposed capex and opex allowances for the AA6 period.
2. We have undertaken our review primarily based on ATCO's revised AA6 Access Arrangement Information for the Gas Distribution Network document (Revised Plan) and the documents that ATCO provided in support of its Revised Plan, and we have considered these documents to definitively provide its revised proposal and supporting rationale. To augment these sources, we sought and were provided with a range of additional documents and information.[1]

Scope of work and review approach

3. We have assessed specific aspects of the Revised Plan that the ERA has requested us to review by considering new and updated information provided by ATCO in support of its revised forecast capital and operating expenditure.[2] We have considered matters that the ERA raised in its Draft Decision and ATCO's responses to those matters within our scope. This includes changes to ATCO's forecasting methods and updated or new assumptions, clarifications and supporting information that ATCO has applied and which form the basis of its revised submission.
4. For matters not explicitly referred to in the current report, we reaffirm the findings on those matters that we provided in our report on ATCO's Initial Plan.[3]

Review of relevant aspects of proposed AA5 capex

ATCO's Revised Plan

5. In its Initial Plan, ATCO proposed $413.7 million of AA5 conforming capex. In its Draft Decision, the ERA accepted that $398.1 million of capex incurred in AA5 was conforming under the NGR.
6. In its Revised Plan, ATCO has reduced its proposed conforming capex for AA5 to $400.2 million, being $2.1 million more than the Draft Decision and $82.3 million lower than the $482.5 million capex allowance for AA5 included in the ERA's Final decision (FD) for the AA5 period.

Assessment

ATCO has largely addressed the feedback in the Draft Decision

1 We have sought to take account of all information provided, but we disclaim responsibility for full consideration or acknowledgment in this report, of information that was provided after 11 September 2024 as the information cut-off for completion of our assessment.

2 Refer to scope description in section 1.2

3 Review of Technical Aspects of ATCO Revised Access Arrangement 2025-29, EMCa report to ERA, April 2024 (EMCa's 'Initial Technical Report')

7. ATCO's Revised Plan includes AA5 expenditure that is within $2.1 million of the Draft Decision for AA5 capex because it has largely accepted the various aspects of the Draft Decision. ATCO's Revised Growth and Structures & Equipment expenditure categories are closely aligned to the Draft Decision, and we propose no adjustments for these categories.

8. The ERA removed ATCO's contingency allowances from its 2023 and 2024 expenditure forecasts, but ATCO has retained contingency in its 2024 capex forecast. ATCO has effectively removed consideration of contingency for its 2023 program of work by including actual 2023 expenditure in its Revised Plan.

9. We propose removing the 2024 contingency allowance (because by June 2024 ATCO should have a good understanding of its 2024 capex requirements). This leads to relatively minor adjustments to the Network Sustaining and Information Technology programs.

ATCO has reprioritised its 2024 IT program following system incidents

10. Relative to its Initial Plan, ATCO has significantly reprioritised aspects of its IT program in response to findings from a current state risk assessment and some of the identified risks which manifested in early 2024 leading to system outages. We consider the reprioritisations within the 2024 program to be reasonable, with some work being deferred to 2025. The only aspect of ATCO's Revised Plan that we consider is not conforming capex is its Network Digitisation and Intelligence program, which should be self-funding on the information that ATCO has provided.

Adjustments

11. Considering only those items within our scope, we consider that a reasonable allowance for AA5 capex would require deduction of $2.25 million from the amount that ATCO has proposed in its Revised Plan.

Review of relevant aspects of proposed AA6 capex

ATCO's Revised Plan

12. In its Initial Plan, ATCO proposed $465.8 million for AA6 conforming capex. In its Draft Decision, the ERA accepted that $443.1 million of capex meets the NGR requirements.

13. In its Revised Plan, ATCO has proposed AA6 capex of $490.7 million. This is $24.9 million (5.3%) higher than the AA6 capex proposed as conforming in ATCO's Initial Plan and $47.6 million (10.7%) higher than the ERA's Draft Decision.

Assessment

ATCO has accepted many aspects of the ERA's Draft Decision but has added new programs

14. ATCO's Revised Plan has removed contingency allowances (except for 2024 carry over work and the renewable fuels program, the latter of which is out-of-scope for our review). However, ATCO has included expected increases in contractor rates, fabrication costs, and material costs, adjusted the scope of several programs, and added two new EOL replacement programs. It has also changed the scope of several projects and has proposed allowance for a significantly increased IT program.

Revised Network Sustaining AA6 capex is significantly higher than the Draft Decision

15. Whilst ATCO has removed contingency amounts, from the bulk of its Network Sustaining category of work, it has substituted contractor, and material increases which have had the

net effect of substantially increasing the capex forecast for all but a small proportion of its programs/projects. However, we consider that the contractor and material increases are adequately justified. ATCO has also introduced a large number of minor scope changes across its Asset Replacement and Asset Performance and Safety programs, but these in most instances represent scopes of work that are smaller than in its Initial Plan. ATCO has also introduced two new programs which we consider to be justified.

Revised Information Technology capex is much higher than ATCO's Initial Plan and ERA's Draft Decision

16. ATCO has made substantial changes to its IT Program for the AA6 period to the extent that we conclude that its initial forecast for the AA6 period was deficient – it omitted important programs and underestimated the cost of its largest investment (ERP Replacement) by almost $20 million (100%) relative to its revised estimate. We consider that ATCO has now provided a better-constructed IT program of work, however this comprises a much higher level of expenditure than in its Initial Plan.

17. The information in the Revised Plan supplemented with further clarifications from ATCO has now enabled us to form the view that, despite ATCO's substantial increase relative to its Initial Plan, the majority of the AA6 forecast IT capex is likely to satisfy the NGR. The exceptions are where ATCO has included contingency amounts, which we have removed for reasons discussed in our Initial Technical Report, together with a small number of projects for which we consider the scope or proposed option is not justified.

Adjustments

18. Considering only the items within our scope, we consider that a reasonable forecast for AA6 capex would require deduction of $10.44 million from the amount that ATCO has proposed.

Review of relevant aspects of proposed AA6 Opex

ATCO's Revised Plan

19. In its Draft Decision, the ERA approved total opex of $337.4 million of the $455.9 million proposed by ATCO in its Initial Plan (a 26% reduction). Most of the reduction was from additional adjustments to ATCO's opex base (resulting in a reduction of $59.1 million), with a further reduction of $48.2 million to ATCO's proposed opex step changes.

20. In its Revised Plan, ATCO proposes $441.6 million total opex, which is 3% less than its original proposal but 31% more than ERA's Draft Decision.

Assessment

AA6 revised Base Year opex is overstated

21. The ERA accepted ATCO's proposal to use the 2022 actual as the base year, as this was the most recent year of actual expenditure at the time of ATCO's original submission. In its Revised Plan, ATCO proposes to adopt 2023 as the base year because it is now the most recent full year of actual expenditure.

22. We have assessed ATCO's proposed base opex (other than for UAFG and Ancillary Services) and find that ATCO has clarified and corrected a number of matters that led ERA to make significant negative adjustments to its base year opex allowance, in its Draft Determination. We largely consider that ATCO's proposed adjusted base opex allowance is reasonable, but we consider that there are two elements of this allowance that do not reasonably reflect prudent and efficient requirements. We propose two further adjustments for these matters.

AA6 revised step change requirements are overstated

23. ATCO has proposed a total of 20 step changes in its Revised Plan. This compares with 11 proposed in its Initial Plan. The Revised Plan includes a large number of new and relatively small opex step changes in addition to revising step changes included in its Initial Plan. Of the 13 proposed step changes within our scope and which we have therefore assessed, we find justification for four step changes but in aggregate, at a lower quantum than proposed by ATCO. For the remainder, we consider that the step changes will either be offset by avoided costs and/or they are relatively trivial and can be managed within the $400 million plus operational budget ATCO proposes.

Adjustments

Base Year adjustments

24. Further to the base year adjustment amount of -$12.43 million that ATCO has proposed, we consider that two further adjustments are required:

- a STIP adjustment of -$1.44 million, replacing the -$0.89 million adjustment that ATCO has proposed, and
- a BD and Marketing adjustment of -$0.56 million, whereas ATCO proposes no adjustment for this item.

Step change adjustments

25. We propose an aggregate adjustment of -$12.37 million to the step changes within our scope.

1 INTRODUCTION

The ERA has asked us to provide technical advice to assist it with its assessment of ATCO's revisions to its Initial Plan regarding the access arrangement for ATCO's South-West and Mid-West gas distribution systems. The requested technical advice is for specific aspects of the AA5 capex, AA6 capex and AA6 opex that ATCO has proposed in its Revised Plan, as defined in ERA's scope instructions to us, and does not encompass the entirety of ATCO's Revised Plan.

1.1 Purpose of this report

26. The purpose of this report is to provide the Economic Regulation Authority ('ERA') with our assessment of aspects of ATCO Gas Australia's ('ATCO') revised proposal for the 2025-29 Access Arrangement period ('AA6') as set out in ATCO's 2025-29 Revised Plan ('Revised Plan') submitted as ATCO's Access Arrangement Information for ATCO's Mid-West and South-West Gas Distribution System ('GDS') in June 2024. The Revised Plan responds to the ERA's Draft Decision on Proposed Revisions to the Mid-West and South-West Gas Distribution Systems Access Arrangement for 2025 to 2029, dated 24 April 2024 ('Draft Decision').

27. Our assessment builds on the analysis and findings from our assessment of aspects of ATCO's Access Arrangement Information for the GDS dated September 2023 ('Initial Plan') as set out in our Initial Technical Report.[4] For this assessment, our primary information source has been ATCO's Revised Plan and supporting documentation provided to us by the ERA and subsequently from ATCO's responses to formal Information Requests from ourselves and the ERA.

28. We have assessed those aspects of ATCO's Revised Plan that are directly relevant to the scope of requested work.[5] This does not take into account all factors, or all reasonable methods, for determining a capital allowance in accordance with the National Gas Rules (NGR). We understand that the ERA will establish capital and operational expenditure allowances for ATCO based on assessments undertaken by its own staff.

1.2 Scope of requested work

29. We are required to provide to the ERA an Updated Technical Report which covers whether, and in what manner, new information provided by ATCO or third parties in relation to our scope of review, changes conclusions drawn in the Initial Technical Report.

30. Our scope of review:

- Includes assessment of
  - AA5 capex projects/programs for which ATCO has provided a revised estimate
  - AA6 capex for which ATCO has provided a revised estimate (including new project/programs) but limiting assessment of Network Growth to the revised unit rates only, and
  - AA6 efficient base year opex and 'technical' opex step changes only (with the exception of the three step changes for which ATCO accepted the draft decision).
- Excludes assessment of

4 EMCa, ATCO Gas Australia Proposed Access Arrangement for the Mid-West and South-West Gas Distribution Systems, Review of Technical Aspects of the Proposed Access Arrangement 2025-29, April 2024

5 ERA email, 2 August 2024

- projects for which ATCO has accepted the Draft Decision adjustment
- renewable gas injection point investment, and
- the overall opex forecast, including trend parameters and adjustments relating to renewable gases, UAFG and ancillary services.

1.3 Our review approach

31. We have followed the same approach to reviewing ATCO's Revised Plan as we have undertaken in the past for the ERA, by:

- reviewing new information and clarifications provided from ATCO; and
- reviewing feedback provided by the Secretariat and by relevant third parties.

32. As requested in the scope of work, our assessment focuses on whether the new information leads us to alter our findings and conclusions provided in our Final Technical Report regarding whether or not the proposed expenditure complies with one or more of the capex or opex criteria. In accordance with our scope of work, we have not undertaken a new standalone assessment of ATCO's overall proposed conforming AA5 capex, AA6 capex and AA6 opex forecasts against the NGR (WA).

1.4 Structure of this report

33. In the subsequent four sections, we describe our assessment and conclusions regarding ATCO's new information in its amended Access Arrangement submission:

- in Section 2, we provide our assessment of the new information provided by ATCO regarding its AA5 conforming capex;
- in Section 3, we provide our assessment of the new information provided by ATCO regarding its forecast AA6 capex;
- in Section 4, we provide our assessment of the new information provided by ATCO regarding its forecast AA6 opex.

2 ASSESSMENT OF NEW INFORMATION ON SELECTED ASPECTS OF AA5 CAPEX

ATCO has updated the AA5 capex in its Revised Plan by either accepting the ERA's Draft Decision on individual project/programs or submitting an alternative estimate based on actual 2023 capex and updating its forecast 2024 capex. We have considered the supporting information provided by ATCO with its Revised Plan to address the issues identified by the ERA in its Draft Decision within our scope.

ATCO has proposed AA5 conforming capex of $400.2 million, an increase of $2.1 million from the ERA's Draft Decision. We consider that the additional justification provided by ATCO in its Revised Plan is reasonable, except for contingency provisions included for relevant capex in 2024 and its proposed business improvement related capex. After adjustment to remove these items, and considering only those items within our scope, we consider that a reasonable allowance for AA5 capex would require deduction of $2.25 million from the amount that ATCO has proposed.

2.1 Introduction

34. In this section we consider the new information provided by ATCO to justify its proposed AA5 conforming capex. We have focussed on those aspects that the ERA did not allow (partially or in full) in its Draft Decision, and any changes to AA5 capex that ATCO has introduced in its Revised Plan. We do not comment on aspects of the Draft Decision that ATCO has accepted.

35. We present our assessments from a 'projects' perspective, by expenditure category. ATCO provided further information on AA5 overhead capitalisation amounts, which we understand the ERA will assess separately.

2.2 ERA Draft Decision and ATCO's Revised Plan

36. In its Initial Plan, ATCO proposed $413.7 million of AA5 conforming capex. In its Draft Decision, the ERA accepted that $398.1 million of capex incurred in AA5 was conforming under the NGR. The main differences from ATCO's Initial Plan are:

- Removal of expenditure relating to ATCO's environmental, social and governance projects, hydrogen blending and clean energy innovation hub;
- Removal of projects that ATCO has subsequently advised will not go ahead or have been delayed and will not be undertaken in 2023 and 2024 and will move into AA6;
- Removal of contingencies from forecast projects in 2023 and 2024. [6]

37. In its Revised Plan, ATCO has reduced its proposed conforming capex for AA5 to $400.2 million, being $2.1 million more than the Draft Decision, $13.5 million lower than its Initial Plan, and $82.3 million lower than the capex allowance for AA5 included in the ERA Final decision (FD) for the AA5 period.

38. The movements in proposed AA5 capex are shown in *Table* 2.1.

[6] ERA, ATCO MWSW DGS AA6 Draft Decision, Attachment 4: Regulatory capital base - PUBLIC, page iv

Table 2.1: Summary of changes to the proposed AA5 capex - $m, real 2023)

Capex category	ERA AA5 FD	ATCO Initial Plan	ERA Draft Decision	ATCO Revised Plan
Network sustaining	242.6	214.4	205.5	204.9
Network growth	171.5	143.0	141.7	145.1
Structures and equipment	27.4	21.6	19.8	18.6
Information technology	41.0	34.6	31.0	31.6
Total	482.5	413.7	398.1	400.2

Source: AA5 capex model and ATCO 2025-29 Initial Plan, Table 7.5

39. In its Revised Plan, ATCO has:[7]

- Rejected a number of the ERA's findings described in its Draft Decision and associated adjustments; and
- Re-estimated the capex it expects to incur during AA5, including by incorporating actual capex for 2023 (replacing forecast amounts).

40. As shown in *Table* 2.1, the overall effect of these changes is small, resulting in total AA5 capex that is $2.1 million higher than ERA's Draft Decision. In the following sections we consider ATCO's proposed changes to its Initial Plan where the variations represent an increase to the ERA's Draft Decision.

2.3 Network Sustaining capex

2.3.1 Background

41. As shown in *Table* 2.1, ATCO proposed $214.4 million for AA5 network sustaining capex in its Initial Plan, compared with the capex allowance of $242.6 million. In its Draft Decision the ERA determined that $8.9 million of the proposed Network sustaining capex does not satisfy NGR 79, reducing the conforming AA5 network sustaining capex to $205.5 million. ATCO has revised its proposed AA5 network sustaining capex to $204.9 million, a reduction of $9.5 million on its Initial Plan and $0.6 million lower than the Draft Decision.

42. *Table* 2.2 summarises ATCO's response to the ERA Draft Decision's adjusted items for AA5 Network Sustaining capex.[8] It shows the projects/programs for which ATCO has adjusted its Initial Plan for the adjusted items in the Draft Decision for AA5 Network Sustaining capex.

43. The table shows that, for the specific projects shown, ATCO's Revised Plan is $5.0 million less than the Draft Decision.

44. ATCO's information also implies that its Network Sustaining capex is $13.8 million less than its Initial Plan. However there is a mismatch between the total Sustaining capex reduction from the Initial Plan of $13.8 million shown from *Table* 2.2 and the $9.5 million Sustaining capex reduction that can be derived in *Table* 2.1. This anomaly is due to the distorting effect of ATCO's inclusion of the 2023 and 2024 'contingency adjustments' in *Table* 2.2 which are in fact the total 2023 and 2024 expenditure for those two years respectively and involve a degree of double counting with the line items above them in the table, therefore exaggerating the reduction. The correct overall reduction relative to ATCO's Initial Plan is $9.5 million, as per *Table* 2.1.

45. In the sub-sections that follow, we assess the five projects for which ATCO has proposed higher capex than included in the ERA Draft Decision (highlighted teal colour). And, for

[7] ATCO 2025-29 Revised Plan, page 57

[8] ATCO 2025-29 Revised Plan, page 58 and Table 7.6

completeness, we also update our assessment of the two 'contingency' items (highlighted light blue in the table).

Table 2.2: Network Sustaining proposed and revised proposal for projects that ATCO has revised relative to its Initial Plan - $m, real 2023

Project/program	ATCO Initial Plan	ERA Draft Decision	ATCO Revised Plan	*Variance to ATCO Initial Plan*
Projects for which ATCO has varied from Initial Plan				
Asset Monitoring (duplication)	0.2	0.1	0.1	*-0.1*
Confined space	0.4	0.0	0.0	*-0.4*
ESG Projects	1.4	0.0	0.0	*-1.4*
Network Reinforcement - Secret Harbour	0.5	0.0	0.0	*-0.5*
Network Reinforcement - Atwell	0.5	0.0	0.3	*-0.2*
Pigging Infrastructure	7.6	6.2	5.9	*-1.6*
EOL Replacement - Pressure Vessels	1.2	1.2	1.1	*-0.1*
Vehicle Protection	0.4	0.3	0.4	*0.0*
EOL Replacement Anodes	0.4	0.3	0.4	*0.0*
EOL Replacement - MPR	1.5	1.4	1.5	*0.0*
EOL Replacement - Billing Meters	0.9	0.6	0.9	*0.1*
EOL Replacement - Meter Facilities	1.1	0.9	0.8	*-0.3*
2023 Contingency adjustment*	42.7	40.9	39.4	*-3.3*
2024 Contingency adjustment*	48.4	46.6	42.6	*-5.8*
TOTAL (Network Sustaining)	**107.2**	**98.4**	**93.4**	***-13.8*** [9]

Source: 2025-29 Revised Plan, Table 7.6

2.3.2 Our assessment of new or updated information for relevant projects

Network Reinforcement – Atwell

46. In its Draft Decision, the ERA rejected ATCO's proposed $0.5 million capex for network reinforcement in Atwell because it considered that the project will be subject to further planning and design and would likely be deferred beyond the AA5 period.

47. In its Revised Plan, ATCO states that the project will commence in 2024 and be completed in 2025. ATCO has reduced its proposed capex for the AA5 period from $0.5 million to $0.25 million, with the balance to be incurred in the AA6 period. ATCO has provided a business case, cost estimate, and NPV analysis to support inclusion of this project in its revised capex forecast.

48. The business case[10] considers three options for addressing the capacity limit on the Atwell pipeline with Maximum Allowable Operating Pressure (MAOP) of 700kPa caused by a significant pressure drop across the pipeline, which ATCO describes as due to increasing gas demands in Wandi, Anketell, Hammond Park, and Mandogalup. ATCO proposes installing an additional HPR at the end of the 2km Atwell pipeline to increase the pipeline operating pressure, alleviating the capacity constraint.

9 While this information is as presented by ATCO, it includes partial double-counting between the contingency adjustments and some of the other 12 line items in turn leading to a difference with the aggregate Sustaining capex reduction shown in Table 2.1

10 ATCO, 07.111.00- Network Reinforcement – Atwell, Business Case

49. We are satisfied that (i) there is likely to be increasing gas demand from the extension of the distribution network in the aforementioned suburbs, (ii) the proposed option is the prudent solution, (iii) the timing of the project is appropriate, and (iv) the cost estimate is reasonable.

Vehicle protection

50. In its Draft Decision, the ERA concluded that capex for the vehicle protection program (installation of crash barriers) included estimated unit costs for 2023 and 2024 significantly higher than the most recent revealed unit costs in 2022 without sufficient justification. The ERA rejected ATCO's forecast, reducing the capex allowance by $0.2 million.

51. With its Revised Plan, ATCO has provided an updated Compliance Summary, which, among other things, identifies the actual expenditure for 2023 as $0.13 million for remediation works at four sites ($32,795 per unit) and a revised unit cost forecast for 2024 of $31,507.[11] The unit cost incurred in 2023 is approximately 50% higher than in the preceding three years due to the combined effect of increases in internal labour costs (more work by Drawing Office), contractor costs, and materials costs.[12] We accept that the revealed cost for 2023 is a reasonable basis for the 2024 estimate.

52. The Revised Plan identifies vehicle barriers to be installed at three HPR locations in 2024 at an estimated cost of $93,000. We are satisfied that the basis for the estimated cost for the remaining program as a whole is reasonable, and therefore the $0.4 million proposed by ATCO for the AA5 vehicle protection program is also reasonable.

EOL replacement anodes (corrosion protection)

53. In its Draft Decision, the ERA concludes that ATCO had not adequately justified the unit costs for the proposed 2023 and 2024 replacement anodes and reduced the allowance to $0.3 million (i.e. by $0.1 million).

54. In its Revised Plan, ATCO has provided an updated Compliance Summary,[13] with actual expenditure for 2023 and a revised forecast for the 2024 scope of work (25 units p.a. in 2022-2024, compared with 15 units p.a. in 2020 and 2021). The revealed unit cost for the 2023 program was used to forecast the 2024 cost.

55. We are satisfied that ATCO has addressed the concerns raised in the Draft Decision and consider the $0.4 million proposed by ATCO in its Revised Plan to be reasonable.

EOL replacement – MPR

56. In its Draft Decision, the ERA concludes that ATCO had not adequately justified the unit costs for the proposed 2023 and 2024 replacement MPRs and reduced the allowance to $1.4 million (i.e. reduced by $0.1 million).

57. In its Revised Plan, ATCO has provided an updated Compliance Summary[14] with actual expenditure for 2023, a revised number of MPRs to be replaced in 2024, and a revised unit cost for the 2024 work. The revealed cost for the 2023 program was used to forecast the 2024 cost, together with refinement of the scope.

58. We are satisfied that ATCO has addressed the concerns raised in the Draft Decision and consider the $1.5 million proposed by ATCO in its Revised Plan to be reasonable.

EOL replacement – Billing meters

59. In its Draft Decision, the ERA concludes that ATCO had not adequately justified the unit costs for the proposed 2023 and 2024 replacement billing meters and reduced the allowance to $0.6 million (i.e. by $0.3 million).

---

11 ATCO, 07.05.002.00 – Facility Upgrade – Vehicle Protection – Compliance Summary, page 10

12 ATCO 2025-29 Revised Plan, page 89

13 ATCO, 07.05.001.00 – Corrosion Mitigation Program – Compliance Summary, Tables 4 and 5

14 ATCO, 07.05.006.00 – EOL Replacement – Regulator Sets – Compliance Summary, Table 9

60. In its Revised Plan, ATCO has provided an updated Compliance Summary[15] with actual expenditure for 2023, a revised number of billing meters to be replaced in 2024, and a revised unit cost for the 2024 work. The revealed unit cost for the 2023 program was used to forecast the 2024 cost, noting that there was an increase in material costs because new meters needed to be purchased rather than using refurbished spares.

61. We are satisfied that ATCO has addressed the concerns raised in the Draft Decision and consider the $0.9 million proposed by ATCO in its Revised Plan to be reasonable.

2023 and 2024 contingency provisions

62. ATCO states that contingency adjustments have effectively been removed for 2023 because its revised capex forecast includes actual 2023 expenditure. However, ATCO advises that it has retained $1.1 million contingency in its revised 2024 forecast.[16]

63. We consider that ATCO should by June 2024 have a good understanding of its 2024 Network Sustaining capex requirements and that a contingency allowance is unwarranted. We therefore propose an adjustment to ATCO's 2024 Network Sustaining capex of -$1.1 million.

Summary of adjustments

64. We propose one adjustment to the revised AA5 Network Sustaining capex, which is the removal of ATCO's $1.1 million provision for contingency work scheduled for 2024.

2.4 AA5 Growth capex

Background

65. The ERA's Draft Decision reduced ATCO's proposed conforming capex from $143.0 million to $141.7 million for AA5 Growth capex. ATCO's Revised Plan proposes $145.1 million capex.

66. Our scope includes the review of Customer Initiated Commercial (CIC) Metersets only.

Our assessment of new and updated information

67. ATCO has further reduced the proposed capex by $0.5 million based on the actual 2023 capex and a revised forecast for 2024 (removing forecast expenditure for one customer).

68. We are satisfied that the updated capex has been developed on a reasonable basis and consider the $5.6 million proposed by ATCO for CIC Metersets in its Revised Plan to be reasonable.

Summary of Adjustments

69. We propose no adjustment to the AA5 Growth capex.

2.5 AA5 Structures & Equipment capex

Background

70. The ERA's Draft Decision reduced ATCO's proposed conforming capex from $21.6 million to $19.8 million for AA5 Structures & Equipment (STEQ) capex.

[15] ATCO, 07.05.005.00 – Network Sustaining – Meter Projects – Compliance Summary, page 17

[16] ATCO Attachment 07.101 Contingencies vs Anticipated Contractor Rates, Table 2.1

Our assessment of new and updated information

71. ATCO's Revised Plan includes variations to the proposed conforming capex for two of the four projects within the STEQ capex category being Minor depot works and Jandakot redevelopment. The Revised Plan has increased the proposed capex by $0.1 million based on the actual 2023 capex and updated 2024 forecasts.

72. We are satisfied that the updated capex has been developed on a reasonable basis and consider the $18.6 million proposed by ATCO for STEQ projects in its Revised Plan to be reasonable.

Summary of adjustment

73. We propose no adjustment to ATCO's proposed revised AA5 STEQ capex.

2.6 AA5 Information Technology capex

2.6.1 Background

74. ATCO estimated that it would incur $31.6 million in AA5 for IT capex (which is $6.4 million lower than the ERA's AA5 Final Decision (FD)), however the ERA determined in its AA6 Draft Decision that $3.5 million capex, all pertaining to 2023 and 2024 work, was not conforming capex as follows:

- Application renewal program – reduced by $1.1 million in the Draft Decision.
- Network digitisation & intelligence program – reduced by $1.8 million in the Draft Decision.
- Project contingency expenditure – reduced by $0.5 million in the Draft Decision.

75. ATCO has not accepted the ERA's Draft Decision regarding these three matters and the ERA's determined capex allowance of $31.0 million. ATCO has revised its proposed AA5 IT capex to $31.6 million, a reduction of $3.0 million on its Initial Plan. ATCO has provided new information in its Revised Plan and which we consider in our assessment below.

2.6.2 Our assessment of new information

Revised IT program

76. *Table* 2.3 shows the changes in ATCO's IT program from the Initial Plan to the Revised Plan with the ERA's Draft Decision provided for comparison. ATCO has introduced three new projects/programs (highlighted in blue in the table) by reallocating expenditure in response to the findings of an 'expert IT Current State Assessment' and IT system downtime incidents in 2024.[17] The three other projects, for which ATCO has proposed higher than ERA's Draft Decision, are also highlighted (teal colour).

17 07.05.016.00 - IT Compliance Summary

Table 2.3: Comparison of ATCO's AA5 IT capex ($m, Dec 2023)

Project / program	Initial Plan	ERA Draft Decision	Revised Plan
Customer engagement	0.2	0.2	0.2
Network Digitalisation & Intelligence	2.8	1.0	1.6
Asset Management & Service Delivery Excellence	0.6	0.6	0.6
Enterprise Employee Enablement	3.2	3.2	3.0
Application Renewal	27.9	26.8	23.6
GET FIT (NEW)	n/a	n/a	1.7
Data Centre Migration (Azure Platform) (NEW)	n/a	n/a	0.1
Other (NEW)	n/a	n/a	1.0
Contingency adjustment	n/a	-0.5	0.0
TOTAL	**34.8**	**31.0**	**31.6**

Source: 05.016.00 AA5 Compliance Summary IT Projects (Integrated Technology Strategy), Table 3; 2025-29 Revised Plan, pages 68-69; 07.05.016.00 - IT Compliance Summary, Table 3

New 'GET FIT', Data Centre Migration and Other AA5 IT capex

77. Collectively the new 'GET FIT', Data Centre Migration, and Other AA5 IT capex programs are forecast by ATCO to incur $2.8 million in 2024.

78. The 'GET FIT' program was initiated to:

> *address the immediate system failure points and remediate the current mission critical systems to address availability and to ensure ATCO was managing it material risks as required of a critical infrastructure entity under the Security if Critical Infrastructure Act.* [18]

79. ATCO decided to redirect 2024 budget to the 'GET FIT' and technology enhancement (2024) projects as follows:[19]

- Redirect $1.8 million from the Applications Renewal program - Workforce management system upgrade project, which has been deferred to the AA6 period. We consider the deferred workforce management system upgrade project as part of our assessment of the revised AA6 capex and opex step changes.
- Redirect $0.4 million from the Network Digitisation and Intelligence program by discontinuing the Program of Digital Works, a subset of the 'parent' program.

80. The Data Centre Migration project was commenced in 2024 ($0.1 million) in response to the same security issues identified for the 'GET FIT' program with the bulk of the expenditure to be incurred as part of the new Technology Lifecycle program in the AA6 period, and which we assess in section 3.5.2.

81. The balance of the expenditure identified as Other (NEW) in *Table* 2.3 is also for addressing several [redacted][20]

82. It is common practice in IT management to reprioritise programs or components of programs in response to new information and updated risk assessment. Based on the information provided in the revised IT Compliance Summary, ATCO's response appears to be prudent, resulting in the changing mix of projects for 2024.

18 07.05.016.00 - IT Compliance Summary, page 23

19 ATCO 2025-29 Revised Plan, pages 68-69

20 ATCO response to information request IR124

Applications Renewal program

83. In its Draft Decision, the ERA reduced the Application Renewal program by $1.1 million because of doubt about ATCO's capacity to deliver the program of work.

84. ATCO does not accept the ERA's adjustment, advising that:[21]

- It has incorporated 2023 actual IT expenditure into its revised IT proposed expenditure, and
- It is *'confident that these projects will be implemented by the end of 2024 (on time and on budget)',* with its commitment to do so reinforced by the importance of the delivering the Meter Data Management, Forecasting and Accruals, and Metering Tools.

85. ATCO's revised IT Compliance Summary includes estimated capex of $23.6 million for its Applications Renewal program, which includes the 2023 actual capex ($6.4 million) and revised 2024 estimate to complete the program ($3.7 million). This is 33% less than its estimate in the September 2023 version of the IT Compliance Summary.[22] As discussed above, the driver of the reduction is the deferral of the Workforce Management System Upgrade project to the AA6 period. We are satisfied that ATCO is likely to be able to deliver its new programs and the reduced scope of the Applications Renewal program given that ATCO was able to deliver the $6.4 million 2023 program.

86. We therefore consider that ATCO's proposed conforming capex of $23.6 million is reasonable.

Network Digitisation and Intelligence Program

87. In its Initial Plan, ATCO's Network Digitisation and Intelligence program was dominated by a proposed allocation of $1.8 million to the 'Agile BI Project (Program of Digital Work)'. In its Draft Decision, the ERA considered that the $1.8 million was to develop and implement business improvement initiatives and concluded that initiatives such as these should be self-funded and removed the proposed capex.[23]

88. ATCO has updated its expected AA5 capex taking into account actual 2023 expenditure and the revised 2024 capex and proposes $1.6 million for this program as conforming capex. ATCO advises in its Revised Plan that only $0.8 million was for the Agile BI project, with the balance of $1.0 million re-directed from the business improvement initiatives to (i) the AGA – Technology Enhancement Project, and (ii) the 'GET FIT' project in response to the issues referred to above.[24] We consider that the investments in 2024 in the Technology Enhancement project and the 'GET FIT' project were prudent responses.

89. Consistent with the findings in the ERA's Draft Decision, we consider the $0.8 million ATCO now advises it has directed to business improvement initiatives should be self-funding.

Project Contingency Expenditure

90. The ERA's Draft Decision removed contingency from ATCO's AA5 IT forecasts (an aggregate adjustment of 5% in each of 2023 and 2024).

91. ATCO has applied its actual 2023 expenditure in its Revised Plan and has included a 5% ($0.3 million) contingency allowance in its 2024 forecast expenditure of $5.7 million. ATCO claims that the contingency allowance is reasonable because *'IT projects experience cost pressures and price volatility due to complexity, resource availability, support arrangements and license cost variation.'*[25]

92. We note that ATCO's actual 2023 expenditure was less than the ERA's Draft Decision and that its 2024 estimate incorporates actual expenditure data from Q1 2024. We consider that ATCO should by June 2024 have a good understanding of its 2024 IT expenditure and that

21 ATCO 2025-29 Revised Plan, page 68

22 $5.6 million, Table 15

23 ERA, ATCO MWSW DGS AA6 Draft Decision D Attachment 4: Regulatory capital base - PUBLIC, paragraphs 104-108

24 ATCO 2025-29 Revised Plan, pages 68-69

25 ATCO 2025-29 Revised Plan, pages 69

a contingency allowance is unwarranted. We therefore propose an adjustment to ATCO's 2024 IT expenditure from this source of -$0.3 million.

Summary of adjustments

93. We propose an adjustment to ATCO's revised AA5 capex of $1.1 million, comprising of the $0.8 million for business improvement work, which we consider should be self-funding, and $0.3 million for the contingency allowance included in 2024.

2.7 Summary of findings and implications

2.7.1 Summary of findings

94. ATCO has updated its AA5 capex in its Revised Plan by either accepting the ERA's Draft Decision on individual project/programs or submitting an alternative estimate based on actual 2023 capex and updating its forecast 2024 capex. We have considered the additional supporting information provided by ATCO with its Revised Plan to address the issues identified by the ERA in its Draft Decision within our scope.

95. For the projects and programs that we have reviewed, we consider that:

- ATCO has addressed the feedback raised in the Draft Decision and provided new and updated information to support the revised proposal for the projects and programs included in ATCO's proposed Growth, and STEQ categories of AA5 capex.
- However, ATCO has included a contingency provision for its 2024 AA5 Network Sustaining program and for its Information technology program which we consider is not justified because we consider that ATCO should by June 2024 have a good understanding of its 2024 capex requirements.
- ATCO has also retained expenditure for business improvement activities in its IT Network Digitisation and Intelligence program, which we consider should be self-funding.

2.7.2 Implications

96. We propose the following adjustments for the items included in our scope:

- AA5 Network Sustaining capex reduced by $1.1 million to remove ATCO's contingency provision for its 2024 work program, and
- The AA5 Information technology program reduced by removing:
  - $0.3 million contingency allowance for its 2024 Information Technology program
  - $0.8 million capex directed to business improvement activities.

97. If adjustments are made only to the items within our scope, then this would result in conforming AA5 capex of $397.9 million, which is $15.8 million (3.6%) less than proposed in ATCO's Initial Plan capex of $400.2 million and $0.2 million less than the ERA's Draft Decision of $398.1 million.

98. In *Table* 2.4 we show the year-by-year proposed and adjusted amounts by category and, in *Table* 2.5, by asset type.

Table 2.4: Summary EMCa adjustments AA5 capex, $m, real 2023

Capex by Driver	2020	2021	2022	2023	2024	Total
SUSTAINING	**37.61**	**41.77**	**43.56**	**39.37**	**42.56**	**204.87**
Less Sustaining capex (not in scope)	*-37.18*	*-41.38*	*-43.08*	*-38.65*	*-41.01*	*-201.31*
Sustaining capex (in scope):	0.43	0.39	0.48	0.73	1.54	3.56
Less EMCa adjustment (contingency)	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-1.11*	*-1.11*
Subtotal with EMCa adjustments	**37.61**	**41.77**	**43.56**	**39.37**	**41.45**	**203.76**
GROWTH	**26.32**	**29.95**	**30.03**	**31.97**	**26.86**	**145.12**
Less Growth (not in scope)	*-25.50*	*-28.41*	*-28.79*	*-31.15*	*-25.65*	*-139.50*
Growth (in scope)	0.82	1.54	1.24	0.82	1.21	5.62
Less EMCa adjustment	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-0.00*
Subtotal with EMCa adjustments	**26.32**	**29.95**	**30.03**	**31.97**	**26.86**	**145.12**
STRUCTURES & EQUIPMENT (STEQ)	**4.74**	**3.70**	**2.91**	**2.80**	**4.41**	**18.56**
Less STEQ (not in scope)	*-4.41*	*-3.37*	*-2.53*	*-2.13*	*-4.13*	*-16.57*
STEQ (in scope)	0.33	0.33	0.38	0.66	0.28	1.99
Less EMCa adjustment	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-0.00*
Subtotal with EMCa adjustments	**4.74**	**3.70**	**2.91**	**2.80**	**4.41**	**18.56**
INFORMATION TECHNOLOGY	**2.85**	**8.18**	**7.59**	**7.33**	**5.68**	**31.63**
Less IT (not in scope)	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-0.00*	*-0.00*
IT (in scope)	2.85	8.18	7.59	7.33	5.68	31.63
Less EMCa adjustments:						
2024 contingency					*-0.30*	*-0.30*
Network digitisation & intelligence program	*-0.00*	*-0.00*	*-0.16*	*-0.66*	*-0.02*	*-0.84*
Subtotal with EMCa adjustments	**2.85**	**8.18**	**7.44**	**6.67**	**5.66**	**30.49**
ATCO Revised Plan AA5 capex	**71.52**	**83.61**	**84.09**	**81.46**	**79.51**	**400.19**
Less EMCa adjustments	*-0.00*	*-0.00*	*-0.16*	*-0.66*	*-1.43*	***-2.25***
TOTAL with EMCa adjustments	**71.52**	**83.61**	**83.93**	**80.81**	**78.08**	**397.94**

Source: EMCa table derived from Att. 07.101 AA5 capex model

Table 2.5: Summary adjustments by asset class - $m, real 2023

Capex by asset class	2020	2021	2022	2023	2024	Total
Medium/low pressure main	0.00	0.00	0.00	0.00	-0.54	**-0.54**
High pressure main steel	0.00	0.00	0.00	0.00	-0.22	**-0.22**
Meter and service pipe	0.00	0.00	0.00	0.00	-0.19	**-0.19**
Telemetry & monitoring	0.00	0.00	0.00	0.00	-0.05	**-0.05**
Regulators	0.00	0.00	0.00	0.00	-0.10	**-0.10**
Secondary gate station	0.00	0.00	0.00	0.00	-0.01	**-0.01**
STEQ	0.00	0.00	0.00	0.00	0.00	**0.00**
Information Technology	0.00	0.00	-0.16	-0.66	-0.32	**-1.14**
Total EMCa adjustment	**0.00**	**0.00**	**-0.16**	**-0.66**	**-1.43**	**-2.25**

Source: EMCa table derived from Att. 07.101 AA5 capex model

3 ASSESSMENT OF NEW INFORMATION ON AA6 CAPEX

ATCO has updated its AA6 capex forecast in its Revised Plan by either accepting the ERA's Draft Decision on individual projects/programs or submitting an alternative estimate based on increased costs, revised scope, and several new programs. We have considered the additional or new supporting information provided by ATCO with its Revised Plan and in response to our Information Requests for supplementary information to address the issues identified by the ERA in its Draft Decision within our scope.

ATCO has proposed AA6 conforming capex of $490.7 million, an increase of $47.6 million to the ERA's Draft Decision, with the largest increases attributable to the Information Technology and Network Sustaining categories. We consider that most of the additional justification provided by ATCO in its Revised Plan supports the proposed increase in expenditure above the ERA's Draft Decision, with exceptions underpinned by the inclusion of contingency and what we consider to be insufficiently justified scope.

Considering only the items within our scope, we consider that a reasonable forecast for AA6 capex would require deduction of $10.4 million from the amount that ATCO has proposed. This figure would need to be further adjusted to the extent that ERA considers this necessary for items that were not included in our review scope.

3.1 Introduction

99. In this section we consider the new information provided by ATCO to justify those aspects of its forecast AA6 capital expenditure that are within our scope of work. We have been asked to review those aspects that the ERA did not allow (partially or in full) in its Draft Decision, but which ATCO has re-proposed, and new forecast capex which has been introduced by ATCO in its Revised Plan.

100. We present our assessments from a 'projects' perspective, by expenditure category in sections 3.3 to 3.6, we note that our acceptance (or otherwise) of associated capex excludes consideration of the effects of labour cost escalation, which has a global impact and which we take into our account in our implications assessment in section 3.7.

3.2 ERA Draft Decision and ATCO's Revised Plan

3.2.1 Overview

101. In its Initial Plan, ATCO proposed $465.8 million for AA6 conforming capex. In its Draft Decision, the ERA accepted that $443.1 million of capex meets the NGR requirements. The main reasons for the ERA's Draft Decision adjustments are summarised as follows:[26]

- Network sustaining:

[26] ERA Draft Decision Table 4.12 and page iv

- Asset replacement: The ERA found that ATCO had included individual project contingencies for routine expenditure programs which are likely to lead to an over-estimation of the capex.
- Asset performance and safety: the ERA found that (i) ATCO's proposed expenditure of $26.4 million to voluntarily reduce carbon emissions was 'not feasible' under the current economic regulatory framework, nor would the work be the most efficient solution even if permitted under legislation. Also, that the planned inline pipeline inspection for the Bunbury pipelines was subject to further review and may not be required.

- Growth: The ERA determined that the demand forecast is higher than was included in ATCO's Initial Plan and increased the customer-initiated capex forecast accordingly.
- Information Technology: The ERA reduced the Enterprise Resource Planning (ERP) replacement project by 30% to align with the least cost technically acceptable option and moved the ERP related expenditure ($17.6 million) from opex to capex.

102. In its Revised Plan, ATCO has proposed forecast AA6 capex of $490.7 million. This is $24.9 million (5.3%) higher than ATCO's Initial Plan and $47.6 million (10.7%) higher than the ERA's Draft Decision. The main sources of variance between ATCO's Revised Plan and the ERA's Draft Decision are:

- Information Technology - which is $40.7 million (+174.7%) higher, and
- Network Sustaining capex - which is $34.0 million (+15.1%) higher.

103. In *Table* 3.1 we compare ATCO's Initial Plan, ERA's Draft Decision and ATCO's Revised Plan. In the following sections we consider ATCO's proposed changes to its Initial Plan within our scope of review.

Table 3.1: ATCO's initial and revised AA6 capex vs ERA's Draft Decision - $m, real 2023

Category	ATCO Initial Proposal	ERA Draft Decision	ATCO Revised AA6 Capex					
			2025	2026	2027	2028	2029	TOTAL
Network Sustaining	**271.6**	**218.1**	**49.1**	**49.3**	**52.7**	**50.9**	**50.0**	**252.1**
Asset replacement	214.0	196	44.9	42.0	43.6	42.0	41.2	**213.8**
Asset Performance & Safety	57.6	22.1	4.2	7.3	9.1	8.9	8.8	**38.3**
Network Growth	**157.4**	**177.9**	**25.4**	**29.2**	**31.0**	**32.3**	**33.0**	**151.0**
Customer Initiated	157.4	177.9	25.4	29.2	31.0	32.3	33.0	**151.0**
Demand Related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**
Information technology	13.0	23.3	19.3	28.5	9.4	4.7	2.1	**64.0**
Structures and Equipment	23.9	23.7	6.1	6.7	2.8	3.8	4.2	**23.6**
TOTAL	**465.8**	**443.1**	**99.9**	**113.7**	**96.0**	**91.7**	**89.4**	**490.7**

Source: ERA Draft Decision Table 4.12; 07.102 – AA6 Capex Model

3.3 Our assessment of the revised AA6 Network sustaining capex

3.3.1 Background

Scope of our assessment

104. We have assessed ATCO's revised AA6 Network Sustaining capex for project/programs where ATCO has rejected the ERA's Draft Decision and proposed a higher capex amount.

Overview of network sustaining capex

105. ATCO proposed AA6 network sustaining capex of $271.6 million in its Initial Plan. In its Draft Decision, the ERA determined that $53.5 million of the forecast capex does not satisfy NGR 79, reducing the forecast AA6 network sustaining capex to $218.1 million. ATCO's Revised Plan of $252.1 million is $34.0 million higher than the Draft Decision.

106. ATCO advises that in revising its forecast AA6 Network sustaining capex it has:[27]

- Removed contingency allowances except for 2024 carry over work (into 2025) and the renewable fuels program, the latter of which is out-of-scope
- Included expected increases in contractor rates, fabrication costs, and material costs
- Adjusted the scope of several programs, and
- Added two new EOL replacement programs.

107. *Table* 3.2 shows ATCO's summary of Network Sustaining capex, distinguishing between projects with and without contingency provisions, and projects which in aggregate amount to $45.0 million capex without contingency and without any cost increase. ATCO has included additional expenditure of $7.6 million for the aggregate of anticipated rate increases ($6.5 million), contingencies in its 2024 carry over program ($0.3 million), and renewable fuels program ($0.8 million),[28] of which $6.8 million is within our scope for review.

Table 3.2: ATCO's proposed revised AA6 Network Sustaining capex - $m, real 2023

Program	Underlying cost estimate	Additional expenditure	Total forecast expenditure
2024 carry over works (including contingency)[29]	3.1	0.3	3.4
Programs with anticipated rate increases	187.5	6.5	194.0
Programs without contingency or rate increases	45.0	0.0	45.0
TOTAL in scope	**235.5**	**6.8**	**242.3**
Projects with contingency (renewable fuels program) – not in scope	*8.9*	*0.8*	*9.6*
TOTAL	**244.4**	**7.6**	**252.0**

Source: ATCO, Attachment 07.101, Table 3-1; ATCO's total differs from Table 3.1 due to rounding errors

108. Noting that the renewable fuels program is out of scope for our review, we firstly assess ATCO's rationale for including contingency in its 2024 carry over works (section 3.3.2). We

27 ATCO, 2025-29 Revised Plan. Pages 70-71.

28 ATCO, Attachment 07.101, Tables 2-2, 2-4 and 2-5

29 $2.4 million is attributed in 2025-29 Revised Plan, Table 7.17 as Network Sustaining 2024 carry-over work, with the difference being the capex for 2024-EOL Replacement – PVC Mains – Fremantle ($0.79 million) and 2024 – Reinforcement Atwell ($0.26 million), the contingency amounts for which are both included in the $0.3 million total shown in this table as Additional expenditure.

then assess ATCO's justification for increasing rates and other costs and which are applied to programs originally included in the Initial Plan (section 3.3.3). In section 3.3.4, we assess the two new programs (i.e. that were not included in the Initial Plan and therefore were not assessed by ourselves or the ERA).

3.3.2 Contingency amounts on 2024 carry-over works

Background

109. ATCO proposes inclusion of $0.3 million contingency for the $3.4 million 2024 carry over work (into 2025).[30]

Our assessment of new and updated information

110. ATCO has identified eight projects from the AA5 Network Sustaining portfolio that commenced or will commence in the AA5 period, which will be completed in 2025 *and* which include aggregate contingency of $0.3 million.[31] We are satisfied that the eight underlying projects have or will be reasonably undertaken by ATCO to address end-of-life issues (six asset replacement projects) or network asset performance and safety driven issues (two projects).

111. Applying the same rationale, we provided in our Initial Technical Report[32] to the ERA regarding ATCO's proposed contingency provisions included for 2023 and 2024, we consider that no contingency provision should be required for 2024 carry-over projects in the AA6 period.

Summary of adjustment

112. We propose an adjustment of -$0.3 million to remove the contingency provision from ATCO's proposed 2024 carry over capex of $3.4 million, resulting in $3.1 million adjusted capex. This adjustment applies solely to 2025 expenditure.

3.3.3 Network sustaining programs included in the Initial and Revised Plans and subject to cost changes

Background

113. ATCO has responded to the ERA's Draft Decision by removing contingency amounts from selected projects and, essentially, replacing the contingency provisions in selected project/programs where it has or expects to incur materials and/or contractor cost increases. The impact is $6.5 million for these projects in AA6 compared with to its Initial Plan.[33]

114. We first consider ATCO's proposed materials cost increases which it has applied to its meter replacement program. We then consider ATCO's justification of changes to contractor costs.

30 ATCO, Attachment 07.101, Table 2-2

31 ATCO, Attachment 07.101, Table 2-2

32 EMCa, ATCO Gas Mid-West and South West Gas Distribution System, Review of Technical aspects of ATCO Revised Access Arrangement 2025-29, section 4.3.2

33 ATCO, 07.101 - Sustaining Capex - Contingencies vs Anticipated contractor rates ATCO's application approach, Table 2-5

Materials costs for meter replacement programs

Background

115. ATCO has increased its AA6 domestic meters replacement program by $1.0 million to $26.2 million (with no material increase to its billing commercial meters program).[34] ATCO advises that: [35]

- It has incurred a domestic meter replacement unit cost increase of real 5% in December 2023, triggered by increased component costs for its suppliers, and
- It is exploring means of mitigating the increases over the balance of the AA6 period.

Our assessment of new and updated information

116. ATCO proposes a real cost increase of 5% from 2027 onward. We asked ATCO to provide any available supplementary information to support the cost increase. We summarise ATCO's response[36] as follows:

- The Reinstatement Services contract was established in Q1 2024 after a competitive tender process
- The contract includes different rates for various reinstatement activities based on different surface categories.

117. *Table* 3.3 shows the weighted rates for the prior and current contract based on the detailed costs in a spreadsheet provided by ATCO with its response[37] which shows an estimated 8% increase.

Table 3.3: ATCO's weighted rate comparison ($2023)

	Weighted rate ($/ unit)
Prior contract	[redacted]
Current Contract (established January 2024)	[redacted]
% Increase	***8%***

Source: ATCO response to EMCa126

118. ATCO has factored in a real [redacted] rate increase into its forecasts for this component of work starting from 2027 onwards (next tender process for this contract is planned for 2027) as detailed in Attachment 07.101.

119. We consider this increase to be reasonable because it has been incurred following a competitive tender process.

Expected contract renewal cost increases

Background

120. ATCO advises that it uses long term contracts to support delivery of the sustaining capex program and that all of the contracts will be subject to a competitive tender from 2024-2027 to update the rates for the next 3-5 years. Based on 'historical observations from past rate reviews',[38] ATCO expects increases in the range of [redacted] to [redacted], as shown in *Table* 3.4.

[34] ATCO, Attachment 07.101 Contingencies vs Anticipated Contractor Rates, Table 2-5

[35] ATCO, Attachment 07.101 Contingencies vs Anticipated Contractor Rates, pages 5-6

[36] ATCO response to EMCa126

[37] ATCO, Reinstatement Assessment

[38] ATCO 2025-29 Revised Plan, page 71

Table 3.4: ATCO's proposed rate increases for the AA6 period – network sustaining

Contract name	Sustaining programs supported by the contract	[redacted]	Renewal date
Mains and Services Contract	Mains Replacement program (Mains risers & services)	[redacted]	2025
Meters and Regulators Activities Contract	Routine Meter Change (Domestic) program [39]	[redacted]	2025
PE Mains Panel	Mains Replacement program and other Network mains projects (e.g. mains extensions for Network Reinforcement)	[redacted]	2027
Fabrication Contract	EOL Meterset and Regulator Set Replacement programs	[redacted]	Late 2024
Traffic Management Panel	All programs requiring external traffic management	[redacted]	2025
Reinstatement Contract	Reinstatement services on all programs and network activities	[redacted]	2027

Source: ATCO, Attachment 7.101, Table 2-3

Our assessment of Mains and services contract cost increase

121. We note that ATCO deferred the tender process from 2023 to 2024 '*due to tight labour market conditions and high inflation…deemed prudent to wait for more favourable market conditions in the economic cycle.*' [40] We also consider this to be a prudent step, however given that we are well into the third quarter of calendar year 2024, we asked ATCO to provide any update it may have from the proposed 2024 tender process to substantiate its proposed real cost increases. If not superseded by the tender process, we asked ATCO to provide the data supporting the [redacted] real cost increase '*derived from historical observations from past rate reviews*.'

122. In response, ATCO advised that there was not yet any further information available from the tender process. ATCO elaborated on its evidence to support the expected contract rate increase of [redacted] in its response, which we summarise as follows:[41]

- Prior contract rates negotiations for this contract have resulted in real [redacted] increases
- Market conditions support an expected increase
- ATCO is moving to at least one new contractor and there will be establishment costs.

123. We consider that it is reasonable for ATCO to expect a real cost increase of [redacted] from its tender negotiations given market conditions, the cost uplifts experienced in other (more advanced) tenders ATCO is running and the incomplete status of the tender process for this contract.

Our assessment of Meters and Regulators Activities contract cost increase

124. We asked ATCO for an update on the contract tender renewal process to date to provide a more certain cost benchmarks than the assumed [redacted] real cost increase in the Revised Plan.

125. ATCO advised that it was still in the competitive tender process, but responses shortlisted for award have included rates that are [redacted] to [redacted] higher than current rates as of May

39 Which ATCO also refers to as Meter Replacement Contractor rates in response to IR110

40 ATCO, 07.101 – Sustaining Capex – Contingencies vs Anticipated contractor rates ATCO's application approach, page 7

41 ATCO response to IR110

2023.[42] On this basis we consider that a [redacted] increase is a reasonable assumption for the services supplied under the contract, applicable from 2025 onwards.

Our assessment of PE Mains Panel contract cost increase

126. ATCO has established a panel of contracts for which it accesses contractor rates for the various aspects of the PE mains works and which vary according to '*connection size, installation method, and road surface category.'*[43] ATCO has proposed the [redacted] rate increase *'based on past rates negotiations for the Mains & Services contract.*[44]

127. ATCO's response in relation to the Mains and Services contract also applies to PE mains, and we therefore consider that the [redacted] uplift assumption is reasonable.

Our assessment of the Fabrication contract for metersets and regulator pits including welding services contract cost increases

128. As with the Mains and Services Contract, ATCO deferred the competitive tender process from 2023 to 2024. ATCO proposes a [redacted] increase because of (i) scarcity of welding resources, and (ii) there is no provision for CPI or labour escalation in the current contract.

129. We asked ATCO for an update on its tender process and were advised[45] that the tender process was active but not yet at the evaluation stage. ATCO instead provided more detail regarding its rationale for expecting higher rates, which is primarily based on:

- Scarcity of the required steel welders in Perth, and
- The current contractor rates were established without any real increase in costs and since then there are upward cost pressures.

130. We consider that the basis for the [redacted] assumed rate uplift is reasonable.

Our assessment of the Traffic Management Panel cost increase

131. ATCO provided a link[46] to the Main Roads WA website which advises of additional requirements that would apply to the Registration Scheme for traffic management, including for example a new minimum base rate of pay and mandatory direct employment of traffic management personnel. We understand from ATCO that the additional Main Roads requirements are likely to lead to increased costs for traffic management services. These changes only affect State controlled roads (under the control of MRWA), not roads under the control of local government agencies.

132. ATCO advised on the progress with its contractor tender process, specifically that it had received proposals with cost uplifts of between [redacted] which is higher than the anticipated [redacted] increase included in its Revised Plan. ATCO also advised that it does not have any basis to revise its [redacted] estimate because the tender process is still underway. and which it does not propose to resubmit[47]

133. We consider that the [redacted] uplift used in its revised forecasts is reasonable for the purpose of setting a capex allowance.

Our assessment of the Reinstatement contract cost increase

134. ATCO advised that the contract was established in Q1 2024 and it extends for 3-years. ATCO has assumed a [redacted] real cost increase from 2027 following the next tender process aligned with anticipated increases across other contracts.

135. We consider this approach and therefore the assumed cost increase to be reasonable.

---

42 ATCO response to IR110

43 ATCO, 07.101 – Sustaining Capex – Contingencies vs Anticipated contractor rates ATCO's application approach, page 9

44 ATCO, 07.101 – Sustaining Capex – Contingencies vs Anticipated contractor rates ATCO's application approach, page 9

45 ATCO response to IR110

46 ATCO 2025-29 Revised Plan, pages 71-74

47 ATCO response to IR110

Summary of assessment of material and contractor increases

136. We consider that ATCO's proposed substitution of actual and estimated materials costs increases for contingency (removed) to be a reasonable approach. We also consider that the increases proposed in the categories discussed above are all reasonable.

Asset replacement - application of net cost increases[48] to Mains and Meter Replacement Programs[49]

The ERA' Draft Decision accepted ATCO's planned Mains replacement activity but removed the contingency provision

137. ATCO advises there is no change to the planned activity for the Mains Replacement Program, so the revised forecast expenditure of $141.2 million (cf. $132.8 million in the Draft Decision) is due to net cost increases described above.[50] As we find the contractor/materials cost increases to be reasonable, we propose no adjustment.

The ERA's Draft Decision accepted ATCO's planned Meter Replacement activity but removed the contingency provision

138. ATCO advises that there is no change to the planned activity for the Meter Replacement Program, so the revised forecast expenditure of $27.7 million (cf. $25.7 million in the Draft Decision) is due to net cost increases.[51] As we find the contractor/materials cost increases to be reasonable, we propose no adjustment.

Asset Replacement - Other asset replacement programs

139. The remainder of the revised AA6 forecast comprises seven programs, which we discuss as follows:[52]

- No changes to activity / revised forecast due to net cost increases and for which we propose no adjustment:
  – Riser and services ($16.8 million revised)
  – Regulator sets and Metering Facilities ($10.3 million revised)
  – Telemetry equipment ($5.4 million revised)
  – Metallic mains ($1.0 million revised
  – Isolation valves ($1.4 million revised)
  – Warning signs ($0.4 million)
- Mechanical fittings ($5.2 million revised) – whilst ATCO proposes a -1.5% unit cost adjustment, it proposes +4.5% increased volume of work. It calculates $5.2 million for the work but there is an apparent error in its calculations as the unit cost times volume as proposed is $4.9 million,[53] requiring an adjustment of -$0.3 million

Asset Performance and safety - changes to scope and cost

Scope

140. Given that Enabling Renewable Gases is not within our scope we consider the following programs in this sub-section:

- Inline Inspection,

48 Contingency removed but with increased materials and/or contractor costs

49 ATCO 2025-29 Revised Plan, pages 71-72

50 Net of contingency

51 Net of contingency

52 ATCO 2025-29 Revised Plan, pages 74-76

53 $5,276 per unit x 184 units p.a. x 5 years

- Network reinforcement and
- 'Other asset performance programs.'

Inline Inspection (ILI)[54]

141. ATCO's Initial Plan included $24.9 million capex for In-line inspections of three Bunbury pipelines and five others. The Draft Decision was to reduce the provision to $13.0 million because of the uncertainty associated with the need for ILI of the Bunbury pipelines. ATCO's Revised Plan includes $13.8 million for direct inspection of the Bunbury pipelines and the former scope for the other five pipelines but with increased contractor rates (fabrication works). We consider the revised cost to be reasonable. We discuss the associated step change in section 4.4.

Network reinforcement[55]

142. ATCO's Initial Plan included $1.1 million for reinforcement at Secret harbour, Inglewood and Pearsall. It has removed Secret Harbour from its revised program, retaining Inglewood and Pearsall and including the carried over Atwell work from the AA5 period. This scope change together with a net cost increase leads to a revised capex forecast of $0.9 million which we consider to be reasonable.

Other performance and safety programs

143. There are eight other performance and safety programs in ATCO's Revised Plan, having withdrawn the Corrosion Protection Monitoring program. We assess the programs as follows:

- No changes to activity but revised forecast due to net cost increases and for which we propose no adjustment:
  - Step and touch hazard mitigation ($5.9 million revised)
  - Corrosion protection ($1.3 million revised)
  - Confined space ($0.1 million)
- Changes to activity and net cost increase:
  - Vehicle protection ($1.0 million revised): ATCO has revised the scope from its proposed 46 sites (which was significantly more than the ERA's DD's assumption that only 13 sites merited rectification based on the information provided in the Initial Plan); it now has a more thorough analysis underpinning its forecast of 31 sites requiring rectification. We consider the revision to be reasonable.
  - Pressure monitoring Devices (PMD, $0.5 million revised): ATCO initially proposed installing 50 PMDs which it has revised to 30 sites and applied a 4.1% cost increase using a two-year average due to significant increases in 2022 and 2023. The resultant cost is lower than in its Initial Plan and we consider it to be reasonable.
- Gate station metering ($0.6 million revised): The ERA's Draft Decision removed ATCO's proposed $0.8 million capex for installing three gate station ultrasonic meters downstream of third-party owned gate stations. The basis for the ERA's decision was that gates station owners, and not ATCO, are responsible for metered flow data accuracy and that any issues arising from meter inaccuracies would be recoverable from the gate station owner(s). In its Revised Plan, ATCO has:
  - Reduced the unit cost of the meters by 25%, reducing the total cost to $0.6 million (-$0.2 million), and
  - Reiterated its rationale from its Initial Plan that it considers it is in the best interests of end users for there to be metering downstream to verify the accuracy of metered flow, providing qualitative information via a revised business case.

[54] ATCO 2025-29 Revised Plan, pages 84-86

[55] ATCO 2025-29 Revised Plan, pages 86-87

- – ATCO has not sufficiently addressed the feedback provided in the Draft Decision. We consider that without demonstration by ATCO that there is likely to be a net benefit to end-use customers after cost recovery of any impacts from the gate station owners, the proposed expenditure is not sufficiently justified.

- Picarro leak survey technology ($1.9 million revised): The ERA's Draft Decision removed ATCO's proposed $1.9 million capex for procuring and installing the Picarro gas leakage detection technology because insufficient justification was provided. ATCO has subsequently completed a trial over 390 km of gas distributions mains to prove its effectiveness and cost savings, and reports on the trial as follows: [56]
  - – *The trial demonstrated significant benefits in terms of efficiency, data accuracy, safety, and cost management. Safety improvements for ATCO's operators are particularly notable, as they can now work from within a temperature-controlled vehicle rather than using the current method of an electric bike. This change significantly reduces the risks associated with impacts, aggressive dogs, and adverse weather conditions.*
  - – ATCO also notes DEMIRS' support for the Picarro technology. The cost estimate is 'based on a vendor quote obtained in April 2023 and does not contain any contingencies.'
- We consider that ATCO has provided sufficient information to justify the proposed capital expenditure. In section 4.4.7, we consider the substantial efficiency savings referred to by ATCO in the context of its proposed opex step change.

Summary of our assessment – Network Sustaining programs that were included in the Initial and Revised Plan

144. We consider that an aggregate adjustment of -$0.9 million is required:

- $4.9 million of the proposed $5.2 million proposed by ATCO for Mechanical compression fittings is reasonable, representing an adjustment of -$0.3 million, and
- None of the proposed $0.6 million proposed by ATCO for Gate station metering is conforming capex, representing an adjustment of -$0.6 million.

3.3.4 New network sustaining program – EOL Replacement – HPR

Overview of program

145. ATCO has proposed a new program for the replacement of four High Pressure Regulators (HPRs) at a total cost of $2.14 million in its Revised Plan. Following annual review of the EOL condition risk factors in April 2024, ATCO has identified four units (out of its HPR population of 223) that are at end-of-life, where maintenance is no longer effective or possible, and that require replacement. HPRs are identified for replacement when they meet at least two 'High' condition risk factors.

146. The four HPRs were identified after additions to ATCO's condition assessment criteria, with two new EOL condition risks which ATCO classified as 'High':

- Discontinuation of production of HPR – ATCO has 30 'Cocon' HPRs in its network and is concerned that there will be inadequate supply of spares to either proactively or reactively repair the units
- Single stream design in a non-backgassed network – these design/locations are now considered critical as there is no redundancy within the HPR to ensure security of supply (i.e. if the HPR fails, customer loss is expected).

147. The bases for replacement of the four units are summarised in Table 3.5.

[56] ATCO 2025-29 Revised Plan, pages 91-92

Table 3.5: ATCO's assessment of HPRs to be replaced in 2025-30 period

HPR	Condition risk factors	Risk rating	Replacement year
HS015	Structural damage Does not comply with design guideline	High	2026
HS096	Corrosion rating 3 (high) Non-maintainable (obsolete parts)	Intermediate (non-ALARP)	2027
HN074	Single stream design in non-backgassed network Non-maintainable (obsolete parts)	Intermediate (non-ALARP)	2028
HS115	Single stream design in non-backgassed network Non-maintainable (obsolete parts) Corrosion rating 2 (medium)	Intermediate (non-ALARP)	2029

Source: 07.110.00 - End of Life (EOL) Replacement - HPR - Business Case, Table 1.2

Our assessment

148. ATCO identifies five options for addressing the risks described in the table above in its business case. We comment on ATCO's options analysis as follows:

- Option 1 – Do nothing (run to failure): we are of the same view as ATCO that this option does not address the safety, corrosion, and obsolescence issues and is not the prudent approach.
- Option 2 (ATCO **recommended**) – Replace 4 HPRs that meet the EOL replacement criteria (recommended by ATCO): for reasons discussed below, we do not consider the extent of this option to be prudent, though we do find that ATCO has made a compelling case to replace at least some of the HPRs in the next regulatory period.
- Option 3 – Partial repair of faulty components: ATCO dismisses this option because '*it does not resolve the condition risk ranking factors related to the current scope.*'[57] Whilst we consider that this would not be a suitable option for managing the risks associated with all of the identified HPRs, in our view it could be part of an alternative option as discussed below.
- Option 4 – Increase frequency of routine maintenance and repair as required: as with Option 3, we consider that increased maintenance is a viable component of an alternative option.
- Option 5 – Decommission the HPRs – we consider this to be a technically infeasible option until at least the end of the next regulatory period.

149. We consider that Options 1 and 5 are not prudent paths for managing the identified HPRs. Instead of selecting a single option from the remaining three proffered by ATCO, we propose an approach that combines features of options 2-4.

150. Firstly, we consider that the reasons for replacing HPR HS015 are compelling based on the evidence presented in the business case, which includes pictures of the structural damage and the hazards presented by the open pit one-off design with the roller-shutter cover.

151. The case presented for replacement of HS096 within the next regulatory period also appears to be prudent based on the information provided in the business case. The corrosion is described as severe, and its replacement would release spare parts for other Cocon 13-type HPRs.

[57] 07.110.00 - End of Life (EOL) Replacement - HPR - Business Case, Table 2.1

152. However, ATCO has not presented sufficient compelling condition information (e.g. statistical information and/or cost-benefit analysis) to demonstrate that it is prudent to replace one or both of HN074 or HS115 in the next regulatory period. Specifically:

- There appears to be no condition-based reason to expect that there is an elevated likelihood of failure of HN074 in the next five years and ATCO has not identified the consequence of failure in monetary terms. HS115 has medium level corrosion and whilst this may deteriorate over the next five years, ATCO has not provided compelling information to confirm that the rate of deterioration could not be slowed or stopped with targeted maintenance, noting that the scheduled replacement is near the end of the AA6 period
- As with HN074, ATCO has not provided compelling information to allow us to conclude that replacing HN115 in the next regulatory period is prudent, noting again that ATCO's proposed replacement is at the end of the AA6 period, and
- If one of these Cocon type 26 HPRs is replaced early in the next RCP due to condition or if ATCO otherwise identifies a compelling business case for doing so, the replaced unit can provide spare parts for the other (and other Cocon type 26 HPRs).

153. Based on information available at this time. we therefore consider that the prudent approach to allow for regulatory forecasting purposes would be for ATCO to replace HS015 and HS096 in the next regulatory period, increase the maintenance on HS115 and HN074, and defer replacement of HS115 and HN074 to the 2030-35 regulatory period.

Summary of our assessment

154. We propose a reduced level of conforming capex for replacement of HPRs in the AA6 period, resulting in a 50% adjustment to $1.06 million.

3.3.5 New network sustaining program – Facility Upgrade – Meter Compliance

Overview of program

155. ATCO has proposed a new program of work in its Revised Plan to rectify non-compliant meters at a cost of $2.7 million (no contingency but including overheads) that it expects to find in the AA6 period.

156. ATCO expects to find (and rectify) the same number of non-compliant meters in the next regulatory period (346) as it has found in the 5 year period from 2019-2023. It 'finds' non-compliant meter installations when it undertakes '*replacement and reactive works*.' [58]

157. The proposed program also includes scope to rectify 61 identified hazardous area high pressure (HP) meterset locations identified in 2024 as a once-off program.[59]

Our assessment

The program was not developed at the time of the Initial Plan

158. We asked ATCO why this program was not included in the Initial Plan because it was not obvious from our review of its Revised Plan when the need for this work was identified. We summarise ATCO's response as follows:[60]

- The initial focus of the program was on addressing non-compliant meter sites within the Central Business District (CBD), which will be completed in the AA5 period.

58 07.109.00 - Asset Performance - Meter Compliance - Business Case, page 1

59 ATCO has identified 61 HP meterset locations with high inlet pressure of above and equal to 1050 kPa that require rectification works to ensure compliance to hazardous area standard requirement (AS/NZS 60079)

60 ATCO response to IR113

- The focus has expanded to non-compliant sites identified during routine and reactive operational activities as well as Formal Safety Assessments.
- The program was not included in the Initial Plan due to timing (the scope and risk review had not been finalised). The risk review as part of 2023 Natural Gas Network Formal Safety Assessment was completed in July 2023 with detailed HAZID review in early 2024 to support the business case.

159. In our view, ATCO could have reasonably included in its Initial Plan an estimate of its forecast costs for rectifying non-compliant meters outside of the CBD with the appropriate caveats. Nevertheless, we have reviewed the proposed program based on the information now provided.

Options analysis indicates Option 2 is the prudent approach

160. ATCO identifies four options in its business case for addressing the non-compliant meters/HP meterset locations. We comment on ATCO's options analysis as follows:

- Option 1 – Do nothing (do not rectify non-compliant installations): we are of the same view as ATCO that this option does not address identified issues, assuming that there are likely to be at least some non-compliant meters found in the next regulatory period (in addition to the hazardous area rectification).
- Option 2 – Proactive rectification of non-compliant gas meter installations (ATCO **recommended option**): we discuss this option below.
- Option 3 – Rectification of non-compliant gas meter installations when a leak is reported on metering site: our understanding of this option is that ATCO will not rectify the identified non-compliant meters unless and when they leak (i.e. when the leak is reported or found). ATCO presents a cost estimate of $2.4 million (all opex) for Option 3 which is the same as the capex estimate for Option 2, but for a very different scope. This does not appear to be credible. Further ATCO claims elsewhere in the business case that Option 3 would be less expensive than Option 2 – but this is only if capex, rather than totex is compared [61] Regardless, we consider that if ATCO has identified a non-compliant meter/meterset, it is not prudent to wait until the meter leaks (which could be many years later) before addressing the non-compliance.
- Option 4 – Opex maintenance frequency increase – suburb leak survey activities from 5 yearly to yearly: although not quantified, ATCO estimates that the long run cost of this option will be significantly higher than the preferred option. We are satisfied that it is not the prudent option.

161. Whilst we consider that Option 2 is likely to be the prudent approach, the business case does not provide sufficient information to confirm that ATCO's assumed volume of work or the cost of the work are both reasonable forward estimates. We therefore requested further information from ATCO regarding incurred annual volumes and unit costs. We also sought confirmation from ATCO that there was no likelihood of duplication between this program and its end-of-life meter replacement program.[62]

No duplication of scope or cost is likely across related programs

162. ATCO advises that the EOL Replacement – Billing Meter program is focused on replacing meters that have reached their EOL and involves replacing only the meter itself and does not generally extend to the supporting infrastructure. The Meter Compliance program primarily addresses issues related to the location or associated infrastructure of the meter, rather than the meter itself. *If a meter has recently been replaced under the EOL program, the Meter Compliance program will not replace that meter again; instead, it will focus on rectifying any non-compliant infrastructure*.[63]

[61] 07.109.00 - Asset Performance - Meter Compliance - Business Case, page 13

[62] ATCO response to IR113

[63] ATCO response to IR113

163. We are satisfied that there is sufficient separation between the two programs to avoid duplication.

Historical volumes and expenditure may overstate the requirements, and once corrected results in a lower forecast capex requirement

164. ATCO advises that it used the 5-year historical non-compliant meter replacement volumes and unit costs to forecast its AA6 expenditure:[64]

- ATCO's average annual non-compliant meter 'find rate' is 69 meters
- The average per-unit rectification cost over the same period was $5,840.

165. Using instead the 2021-2023 volume and rectification cost leads to an annual find rate of 30 non-compliant units and an average rectification cost $10,220 per unit.

166. Thus, the three year and 5-year results vary significantly. As a form of cross-check, we asked ATCO to provide its 2024 year-to-date non-compliant meter 'find rate' and the cost of rectification. The response is that 76 non-compliant meter locations had been identified through to July 2024 and as of August 2024, 68 had been rectified at a cost of $300,000, or an average unit cost of $4,412.[65] These results are closer to the historical 5-year averages that ATCO has used for its forward estimate. We therefore consider ATCO's forecasting method to be reasonable based on available information.

167. ATCO also reports that it has identified 61 hazardous areas and proposes to rectify them over the AA6 period at the average unit rate derived from the cost of rectifying 33 areas in 2023 (the only year in which it has rectified hazardous areas). We consider this to be a reasonable cost forecasting approach.

168. We therefore consider that ATCO's forecast cost for the program is reasonable.

Summary of assessment

169. We propose no adjustment to ATCO's new Facility Upgrade – Meter Compliance program.

3.3.6 Summary of adjustments to ATCO's revised AA6 Network Sustainability program

170. In aggregate we propose an aggregate adjustment of -$2.3 million to ATCO's revised Network Sustainability program which is derived from:

- Asset Replacement
  - Mechanical Fittings (-$0.3 million)
  - Carry over works (-$0.3 million)
  - HPR (-$1.1 million)
- Asset Performance and Safety
  - Gate Station Meter (-$0.6 million).

---

[64] ATCO response to IR113

[65] ATCO response to IR113

3.4 Our assessment of the unit rates applied to the revised AA6 Growth program

3.4.1 Background

Scope of our assessment

171. The ERA asked us to consider the revised unit costs for B2 and B3 greenfield and brownfield connections used by ATCO in its Revised Plan as inputs to its revised AA6 growth capex.

Overview of B2 and B3 greenfield and brownfield connections unit costs

172. *Table* 3.6 shows ATCO's initial and revised unit cost assumptions for B2 and B3 greenfield and brownfield connections. We include the capex components for information only.

173. ATCO advises that in its Initial Plan it used a 3-year average unit rate (2020-2022) to forecast the B2 and B3 cost per connection and it has simply changed the three-year averaging period to 2021-2023 using revealed costs.[66]

Table 3.6: ATCO's revised AA6 connection unit costs - $m, Dec 2023

	B2 greenfield	B2 brownfield	B3 greenfield	B3 brownfield
Mains capex	0.6	0.0	41.7	0.0
Meter and Service capex	4.1	2.5	80.3	5.5
Feeders capex	0.0	0.0	9.7	0.3
Revised cost / connection	[redacted]	[redacted]	[redacted]	[redacted]
Initial Plan cost/connection[67]	[redacted]	[redacted]	[redacted]	[redacted]

Source: 7.26ATCO Revised Plan, Table 7.26

3.4.2 Our assessment of new or updated information

Forecast customer connection unit costs are subject to service provider-led cost increases

174. New connections in Greenfield and Brownfield areas are subject to the same service provider contracts and therefore the same source of cost uplifts through recent competitive tender results, as discussed in section 3.3.3:

- Mains and services contract – mains extensions and installations of new services, which are relevant to Brownfields and Greenfields connections, and
- Common trench contracts – for Greenfield connections.

175. For the same rationale we provided in section 3.3.3, we consider the unit cost uplifts applied to the average unit costs derived from historical costs (which are the starting points for forecast unit costs) to be reasonably based.

Derivation of 'starting point' unit costs from a 3-year average of revealed costs is a reasonable approach

176. The average unit cost is derived from the most recent three years' revealed costs, without overheads. We refer to this as the 'starting point' unit cost. ATCO advises that it then adds overheads and labour escalation, with overheads derived from the Base Step Trend

66 ATCO Revised Plan, Table 7.25

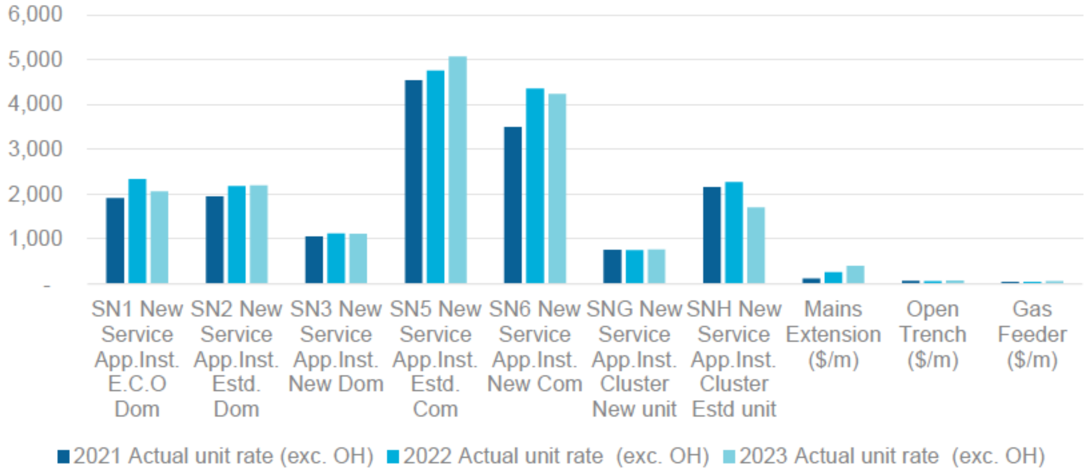
67 The amount is converted from $2022 using ATCO escalator in ATCO AA6 c

methodology. ATCO advises that *'consequently, this approach results in variations in the unit rates from one year to another.'*[68] This is a reasonable conclusion.

177. *Figure* 3.1 is based on information provided in ATCO's response to our information request for more detail on the derivation of the revised unit costs in *Table* 3.6.[69] The response also included the historical annual volumes of connections over the three years. *Figure* 3.1 shows that overall, taking the most recent 3-year average of each connection activity as the basis for the forecast AA6 expenditure is reasonable because the average is a fair representation of the fluctuations experienced.

178. SN3 (B3 New domestic connections) represent 51% of the forecast AA6 connections cost, with the unit cost shown in *Figure* 3.1 to be relatively flat. We note that volume has increased steadily every year from 2020 (7,618 connections) to 2023 (12,189 connections). We consider that no adjustments of the 'starting point' unit costs presented by ATCO in its response are required.

Figure 3.1: ATCO's revealed costs for B2 and B3 connections ($, real 2023) – no overheads



Source: EMCa analysis from EMCa112 – Unit Rates – Table 7.26 2025-29 Revised Plan

179. Furthermore, ATCO advises that Brownfield connection[70] unit costs vary significantly depending on the physical characteristics of the connection, which is a reasonable conclusion.[71] Smoothing out these variations with a 3-year historical average is a reasonable approach in our view.

180. We note the steady increase in SN5 unit costs from 2021-2023 in *Figure* 3.1 which seems to contradict the variability of Brownfield connection costs referred to by ATCO. We consequently examined the volume fluctuation in each of the three years from 2021-2023. There is no pattern to suggest that the volume of work is a material factor in the annual cost trend.[72] SN5 work constitutes 1.7% of the projected $144.7 million connections expenditure, so the relative impact of the cost increases is minor.

181. Greenfield connections[73] leverage off the common trench approach (extending the mains and setting up pre-installed services). As ATCO reasonably states:

> *Pre-laid services play a pivotal role in achieving the most economically viable cost for connecting a new customer. These pre-laid services constitute most of the service installation process and capitalise on the cost advantages of the common trench method.*

68 ATCO Attachment 7.131, page 15

69 ATCO response to IR112 – Unit Rate – Table 7.26 2025-29 Revised Plan.xls

70 Brownfield connections are SN1 (B3 tariff), SN2 (B3 tariff), SN5 (B2 tariff), and SNH (B3 tariff)

71 For example, it will vary depending on which side of the road the property is relative to the main and the location of the meter on the premises (ATCO attachment 7.131, page16)

72 SN5 volumes for 2021-2023: 64, 96, 70 connections p.a.

73 Greenfields connections are SN3 (B3 tariff), SN6 (B2 tariff), and SNG (B3 tariff)

This approach minimises the length of the service and consequently reduces the unit rate.[74]

182. The average SN6 unit cost reduced in 2023, coinciding with a significantly higher volume of connections compared to 2021 and 2022. This is likely to have had a beneficial effect on the unit cost. The three year 'starting point' unit cost average of [redacted] is 7% lower than the high in 2022. SN6 work constitutes 2.8% of the projected $144.7 million AA6 connections expenditure, so the relative impact of the cost changes is minor.

Summary of assessment

183. We propose no adjustments to ATCO's proposed 'starting point' unit rates.

3.5 Our assessment of the revised AA6 Information Technology capex

3.5.1 Background

Scope of our assessment

184. The ERA has requested that we review the new and updated information provided by ATCO pertaining to its Information Technology program to assess compliance of the proposed revised capex with the NGR.

185. We discuss opex step changes related to the revised IT program in section 4.4.

Overview of revised Information Technology program

The revised AA6 IT program is based on multiple inputs that were not available at the time that ATCO prepared its Initial Plan

186. ATCO advises that its revised AA6 IT program has been developed to address the outcomes of the following developments and assessments that were not available at the time that it developed its Initial Plan.[75] These have led ATCO to significantly reassess its IT needs and to present a significantly different proposal in its Revised Plan. Relevant documents and assessments that inform ATCO's reassessment include:

- IT Current state analysis (conducted Q4 2023).
- Incident Root Cause Analysis Q2 2024 – following incidents occurring in Q1 2024.
- Technology Risk Assessment – completed March 2024.
- ERA / EMCA Draft Decision.
- CHIPS reports (February and May 2024) and Red Team penetration testing – April 2024.
- Regulatory and Compliance Obligations.
- CyberCX Independent Cyber Security Review.
- KPMG Independent Program Review.

The revised AA6 IT program is $40.7 million higher than the ERA's Draft Decision

187. As shown in *Table* 3.7, ATCO has in its Revised Plan increased its proposed capex from $41.2 million to $64.1 million for AA6, which is a significant increase on the ERA's Draft

[74] ATCO Attachment 7.131, page 15

[75] ATCO, 07.09.004 2025-29 IT Strategic Plan, page 49

Decision of $23.3 million.[76] The major sources of increase are the revised costs for the ERP Replacement project and the new Technology Lifecycle and Data Enablement projects.

188. In accordance with the ERA's requirement to capitalise SaaS opex, ATCO has capitalised its revised SaaS-related expenditure in its Revised Plan as shown in *Table* 3.7 and this is now included in capex for relevant IT systems.

189. We review the revised and new projects highlighted in *Table* 3.7 in sections 3.5.2 to 3.5.8. We do not assess the following projects/programs:

- The IT Sustainability Program, Continuous Improvement Program, Digital Program and Data and Analytics Program because ATCO has withdrawn them from its Revised Plan.
- The GIS and webMethods projects because the ERA accepted the expenditure for these projects in its Draft Decision.

Table 3.7: Summary of ATCO's revised AA6 Information Technology capex - $m, real 2023

Key driver	Scope	ATCO Initial Plan	ERA Draft Decision (incl SaaS)	ATCO Revised Plan (incl SaaS)
Maintaining service levels	Technology lifecycle	n/a	n/a	11.9
	ERP Replacement[77]	4.2	20.1	39.3
	HR/Payroll	0.2	0.0	0.5
	GIS	2.0	2.0	2.0
	webMethods	1.1	1.1	1.1
Compliance	IT Sustainability Program	2.5	0.0	0.0
	ESG Reporting[78]	n/a**	n/a	0.5
	Continuous Compliance[79]	n/a**	n/a	0.4
IT business capability improvements	Cyber Security Program	0.0	0.0	2.1
	Continuous Improvement	0.6	0.0	0.0
	Digital Program	1.5	0.0	0.0
	Data & Analytics Program	0.8	0.0	0.0
	Data Enablement	n/a	n/a	6.3
Total IT capex		13.0	23.3	64.0
SaaS adjustment (proposed as opex)		*28.2*	*n/a*	*n/a*
TOTAL CAPEX		**41.2**	**23.3**	**64.0**

Source: Revised Plan, Table 7:30; - Regulatory Resubmission for IT Expenditure - KPMG Report, page 12

76 The ERA reclassified SaaS opex to capex in its Draft Decision.

77 The ERA's Draft Decision included SaaS costs classified as capex whereas ATCO's Initial Plan included the SaaS costs as opex.

78 ESG Reporting was a project within the IT Sustainability Program in ATCO's Initial Proposal and it is a standalone project in its Revised Plan.

79 Continuous Compliance was a project within the Continuous Improvement Program and is now a standalone project.

3.5.2 Technology lifecycle Program

Overview

190. ATCO has proposed the Technology lifecycle program as a new program in its Revised Plan at a total cost of $14.6 million ($11.9 million capex and $2.7 million opex step change[80]).

Our assessment of new or updated information

ATCO's recent incidents are indicative of sub-optimal IT management and a more general need to address technology risk

191. ATCO reports in its business case that for various reasons, important aspects of its ICT infrastructure had not been upgraded or refreshed, noting that '*Over the past two regulatory periods, AA4 and AA5, ATCO's IT function has undergone significant change and disruption.*'[81] In response to a follow-up information request, ATCO added:

> *The Technology Lifecycle Program of works was not included in the Initial Plan due to timing. The critical need for ATCO to modernise our ICT infrastructure and enhance our recovery capability was identified late in 2023 (after ATCO's initial submission) through an external assessment of the IT Current State. The assessment highlighted numerous* [redacted]*, it was necessary for ATCO to respond to address* [redacted] *through the Technology Lifecycle Program submitted.* [82]

192. ATCO is undertaking significant expenditure in the current regulatory period to upgrade software and its end use computing fleet. ATCO will uplift its Disaster Recovery (DR) capability, and complete remediation of (i) its legacy field mobility applications, and (ii) a coding platform that is at end-of-life, with a strategy to '*leverage the benefits of cloud services above the infrastructure layer.*'[83]

193. It is indicative of sub-optimal IT management that this program or a version of it was not included in the AA6 Initial Plan. Nonetheless, it is apparent from the information now provided[84] that there is a material technology risk to address through some form of refresh/upgrade of infrastructure at the end of their technical life in the next regulatory period.

ATCO considered three options for addressing technology risk and has selected the prudent approach

194. The three options considered in the business case are:[85]

- Option 1: do nothing – no investment in reducing technical debt, at a cost of $9.5 million (opex)
- Option 2: address the technical risks to mission and business critical IT services at a total cost of $14.6 million (capex and opex) (preferred)

---

80 Step changes associated with the IT program are assessed in Section 4.4

81 07.118.00 - Technology Lifecycle - Business Case, page 1

82 ATCO response to IR116

83 07.118.00 - Technology Lifecycle - Business Case, page 2

84 Including by its consultant in 07.121 - Regulatory Resubmission for IT Expenditure - KPMG Report, pages 31, 32

85 07.118.00 - Technology Lifecycle - Business Case, page 9

- Option 3: accelerated reduction in technical risk at a total cost of $20.4 million (capex and opex).

195. In assessing these options, ATCO advises that it recently introduced a service criticality framework, from which it identified '*many key IT Services requiring replacement, upgrade, or modernisation to meet current and future operational business needs*.' [86] Our understanding is that where there are architecture gaps or where the underlying infrastructure is at end-of-life, they have been included in Option 2.

196. We are satisfied that Option 1, which would result in an increasing level of technology debt[87] and business risk is not what a prudent operator would adopt. We are also satisfied by ATCO's rationale for dismissing Option 3 in favour of Option 2 because the latter option is based on bearing the minimum acceptable technology and business risk through to the AA7 period and is therefore significantly less expensive than Option 3.

197. We therefore focussed our assessment on the scope and cost of Option 2 to discern the prudency and efficiency of the proposed work.

The scope of Option 2 is reasonably derived

198. We are satisfied with the proposed scope of work for Option 2 because:

- It has been reasonably derived from application of ATCO's criticality framework – the focus on the following components make sense in the context of the identified need:[88]
  - DR upgrades for mission and business critical applications
  - Targeted remediation of legacy applications
  - Focus on move to the cloud to minimise the need for data centre hardware upgrades, and
  - Completion of the transition to a leasing model for its end user computing (EUC) and audio visual (AV) systems.
- ATCO identifies the 14 initiatives and timing across the next regulatory period, each of which seem to align to the stated selection criteria.
- It is prudent for ATCO to reduce its technology debt whilst balancing the renewal of on-premises hardware prior to transitioning systems and applications to the cloud.
- The recurrent capex in the AA6 period for managing technical debt is substantially less than in the AA5 period.

199. Nonetheless, it appears to us that some of the initiatives listed in section 3.4 of the business case for Option 2 are upgrades which will establish new or expanded capability rather than maintaining service levels. For example, the following appear to be in the former category:

[redacted]

- Outsystems – business applications,
- G-Suite, and
- EIM Platform upgrades.

200. We asked ATCO to confirm the primary driver of these initiatives (i.e. to establish new or expanded capability or to maintain service levels), noting that if they are to establish new or expanded capability, a positive NPV is required to justify the expenditure as being beneficial for customers.

---

86 07.118.00 - Technology Lifecycle - Business Case, page vii

87 This is the implied cost of maintaining dated technology (e.g. higher support costs) and of restoring contemporary levels of functionality and other features inherent in platforms, systems, and applications (such as cyber security defences)

88 07.118.00 - Technology Lifecycle - Business Case, page 21

201. ATCO responded stating that none of the initiatives is to establish new or expanded capability.[89] We are satisfied that the two initiatives driven by redundancy and disaster recovery are to help ATCO maintain service levels. We identified a further initiative to improve incident resolution ('Monitoring Tools'), which we are also satisfied is primarily for the purposes of maintaining current service levels.

The cost of Option 2 includes a contingency allowance but is otherwise reasonable

202. ATCO provided a cost estimate spreadsheet for the project which included largely hard-coded costs that were not aligned directly to the 14 initiatives referred to above. Little meaningful information was provided by ATCO to give confidence in the quality of the cost estimate, nor were we able to discern the quantum of the contingency allowance referred to in the business case. We therefore asked for further information.

203. We received a supplementary spreadsheet[90] from ATCO which provided the build-up of the hard-coded costs, structured by initiative, and which we consider provides sufficient credibility for the forecast costs with the exception of the 15% contingency allowance that ATCO has included.

Summary of adjustment

204. We propose removal of the contingency allowance of $1.55 million for reasons stated in our Initial Technical Report to the ERA, leading to an adjusted capex amount of $10.35 million.

3.5.3 ERP Replacement Project

Overview

205. In its Initial Plan, ATCO proposed expenditure of $28.2 million ($4.2 million capex and $24.0 million opex) to replace its SAP ECC6 Enterprise Resource Planning (ERP) system by 2027 due to technical obsolescence. The ERA's Draft Decision was that $20.1 million capex was likely to conform with the NGR (including classification of SaaS as capex, rather than opex as ATCO had proposed).

206. Important aspects of the ERA's Draft Decision are:

- The ERA accepted the need for the project
- The ERA considered that replacing the existing ERP in the AA6 period was a necessary step
- ATCO had not adequately demonstrated that its selected option for replacing the ERP was prudent, and ERA's Draft Decision was instead based on an upgrade to [redacted] (which was one of ATCO's options in its original business case) which was 30% less expensive than ATCO's preferred solution (based on ATCO's cost estimates).

207. In its Revised Plan, ATCO proposes $39.3 million capex (allocated to ATCO covered services and including SaaS costs as capex) to upgrade its ERP to [redacted] together with a [redacted]. This represents an increase of $19.2 million, or nearly double the allowance included in the Draft Decision.

Our assessment of new and updated information

ATCO has increased its cost substantially from its Initial Plan primarily through a revised bottom-up build

208. Whilst ATCO has accepted the ERA's position that it should base the replacement on [redacted] the revised estimate is almost double the estimate in its Initial Plan and which the ERA relied upon in its Draft Decision. The scope of work has increased considerably in the revised version, because (i) ATCO apparently left out many project implementation tasks

89 ATCO response to IR116

90 ATCO Detailed Project Costing Tech Lifecycle – EMCA 116.xlsx

and costs from its initial estimate, and (ii) as seen from the options analysis that follows, it has added a [redacted] to its preferred option.

ATCO considered three options in its Revised Plan

209. In the Draft Decision, the ERA included replacing the ERP with an upgrade to [redacted]. Whilst an option in ATCO's original business case, it was not ATCO's preferred option.

210. ATCO has provided a revised business case which considers three options:[91]

- Option 1: retain current SAP ECC6 system
- Option 2: upgrade to [redacted]
- Option 3: (**recommended**) upgrade to [redacted]

211. ATCO also considered an Oracle Replacement option but this was not analysed in any detail in the revised business case.

212. ATCO has selected Option 3 which, like [redacted], which was the ERA's position in the Draft Decision. We therefore do not revisit this choice. However, ATCO proposes purchasing a [redacted] which we do consider.

213. We therefore focus on two aspects of ATCO's proposal:

- The prudency of selection of a separate EAM solution, and
- The reasonableness of the (increased) cost.

Selection of the [redacted] is reasonable

214. Option 2 in the business case is to replace SAP ECC6 [redacted] with integrated functions, including [redacted]. We note that ATCO has, or will have, implemented [redacted].[92] This option is 4% cheaper than Option 3.[93] Similarly, the NPV for Option 2 is $1.7 million higher (i.e. less negative) than for Option 3.

215. ATCO's justification for the [redacted] is that [redacted] does not offer the full level of capabilities required *'and additional investment would be required,'* while other dedicated solutions [redacted], provide the required capabilities 'out of the box'.[94] ATCO does not proffer a cost estimate for the additional investment that would be required to [redacted], but in our experience:

- It is not uncommon for a [redacted] to be implemented in infrastructure-intensive businesses, and
- The cost difference between Options 2 and 3 would be immaterial to achieve a [redacted] (which ATCO has not fully costed for its Option 2 estimate).

216. ATCO should have included the cost of achieving its desired [redacted] in Option 2 to provide a more equitable comparative cost with Option 3. Nonetheless, we consider that Option 3 is likely to be the prudent choice.

The proposed cost of the preferred [redacted] is well supported

217. ATCO did not initially provide sufficient compelling information in support of the new cost estimate in its Revised Plan given that the revised estimate is almost double the estimate from six months earlier (i.e. as provided in the Initial Plan). Whilst ATCO did provide a cost estimate spreadsheet and advice from its consultant, the spreadsheet primarily included

91 07.10.052.00 - IT - ERP Replacement - Revised Business Case

92 HCM and Payroll, EHSM, and BI/BW

93 From Tables 2.6, 2.7, 2.10, and 2.11 and using the 97.6% allocation to ATCO

94 07.10.052.00 - IT - ERP Replacement - Revised Business Case, pages 22-23

hard-coded costs and the consultant's report referred to detailed cost analysis which we were not provided with.

218. We therefore asked ATCO to provide supporting information to confirm the reasonableness of the revised cost estimate (capex and opex). In its response,[95] ATCO provided:

- A detailed cost estimate,[96] which among other things provides a link between the cost estimate provided with ATCO's Initial Plan and the detailed cost build-up for the options presented
- A copy of a letter from its consultant which essentially describes its approach to developing the view regarding the ERP Replacement project in the report provided with ATCO's Initial Plan (and repeating its view that ATCO's 15% contingency provision is excessive)[97]
- A description of ATCO's attempts at benchmarking its project and project costing '*through engagement of industry experts and Industry Advisory organisations, such as Gartner, KPMG, IBM, Rimini Street*'. Its conclusion was that benchmarking was not feasible because of the '*differences in IT estates (complexities, integrations, legacy systems), inability to assess comparative program scopes, prevailing market conditions at the time and the scale of risk to an organisation in undertaking an ERP Replacement.*'
- An explanation of the drivers for the cost increase, which we summarise as:
  - A more detailed examination of the resources and time required for implementation, including extra project management, migration (training and change management), backfilling of internal resources, and governance
  - 'Intense' competition for the specialist resources required given that the same resource pool will be sought globally given Gartner's advice that '*approximately 64% of companies globally* [redacted].

219. *Table* 3.8 summarises the cost differences between the preferred Option 4 in ATCO's Initial Plan and its preferred Option 3 in its Revised Plan, which confirms that the major source of cost increase is labour (internal and contractor).

Table 3.8: ATCO's comparison between ERP Replacement capex (Initial and Revised Plan) - $m, real 2023

	Initial cost estimate (Option 4)	Revised cost estimate (Option 3)	*Variance*
Labour/vendor	[redacted]	[redacted]	[redacted]
Material (License)	[redacted]	[redacted]	[redacted]
Contingency	[redacted]	[redacted]	[redacted]
Total project cost	[redacted]	[redacted]	[redacted]
Allocation to AGA	[redacted]	[redacted]	[redacted]
Allocation to ATCO[98]	[redacted]	[redacted]	[redacted]

Source: ATCO response to IR117

220. The additional information is sufficient for us to conclude that:

- The cost estimate provided with the Initial Plan that was used as the basis for the assessment included with the Draft Decision was not likely to reflect the total cost of successfully implementing a project of the complexity and scale required. This reflects

95 ATCO response to IR117

96 ATCO Detailed Project Costing ERP EMCA 117

97 KPMG Response to EMCa Assessment

98 In accordance with ATCO's Cost Allocation Methodology (of approximately 82% to AGA and 97.6% of this to ATCO's covered network)

- a poorly developed initial estimate that omitted or under-estimated significant aspects of scope, and
- The revised cost estimate is, with the exception of the inclusion of contingency, reasonably derived.

Summary of adjustment

221. We propose removal of the contingency allowance of $5.13 million (being the proportionate allocation to ATCO), for reasons stated in our Initial Technical Report to the ERA, leading to an adjusted amount of $34.17 million.

3.5.4 HR/Payroll

Overview

222. In its Initial Plan, ATCO proposed $0.2 million capex for Phase 2 of a project to upgrade its Payroll system, stating that it intended to provide a business case for Phase 2 during the AA6 review process. Stage 1 will be completed in the AA5 period. The ERA's Draft Decision did not include any expenditure for Phase 2 pending provision of justification for the work.

223. In its Revised Plan, ATCO proposes $0.5 million capex (and $0.1 million annual opex step change) to complete implementation of the project, which is essentially advancing the upgrade of the payroll component of the Human Capital Management (HCM) platform which will be a part of the proposed ERP Replacement Program.[99]

Our assessment of new and updated information

ATCO's risk analysis indicates that advancing replacement of the Payroll component of the upcoming HCM platform replacement is prudent

224. ATCO's Project Brief describes the need for advancement of the upgrade of the HCM platform as primarily based on the risk of regulatory non-compliance from having an

> *'…outdated, highly customised HR/Payroll system* [redacted]

225. ATCO describes the project as consolidating disparate Time & Attendance and Payroll systems enabling alignment to regulatory requirements and that the current reliance on multiple disconnected systems has resulted in multiple material enterprise risks.[101]

226. We concur with ATCO's rationale that delivery of the Payroll solution in parallel to the ERP replacement program is prudent.

ATCO's Project Brief includes sufficient information to support the revised cost estimate

227. ATCO's Initial Plan included an estimate of $0.2 million capex for the upgrade in the AA6 period. The derivation of the revised capex estimate of $0.5 million is not provided in or with the Revised Plan, however we note that ATCO had initiated a competitive tender for the work.[102] Given that the price is ATCO's estimation of the cost from a competitive tender process which is underway, we accept that the estimate is reasonably derived.

---

99 2025-29 Revised Plan, pages 110-111

100 07.122 - Payroll Upgrade - Project Brief, Table 2.3

101 2025-29 Revised Plan, page 111 and response to EMCaIR120

102 07.122 - Payroll Upgrade - Project Brief

Summary of adjustment

228. We consider that the revised estimate of $0.5 million capex is a reasonable estimate and accordingly we propose no adjustment.

3.5.5 ESG Reporting Project

Overview

229. ATCO proposes implementing a new environmental, social, and governance (ESG) IT-based reporting system at a cost of $0.5 million capex and $0.5 million recurrent opex step change) over the AA6 period. This project was originally included within its IT Sustainability Program in ATCO's Initial Plan, which is no longer proposed.

230. ATCO identifies two sources of 'High' risk that the proposed ESG reporting project will address:

- Non-compliance with mandatory sustainability disclosure requirements – mainly due to potential data inaccuracy from the current manual processes, and
- Limited financing for the AGA network from relevant financial institutions – due primarily to being '*unable to provide adequate means of reporting on ESG metrics and goal progression*'.[103]

231. In its Draft Decision, the ERA considered that ATCO did not provide compelling justification for the additional requirements to meet its claimed ESG reporting obligations as a basis for the IT Sustainability Program and did not allow the requested expenditure.

Our assessment of new or updated information

ATCO has now provided information that allows consideration as to whether there might be preferred alternatives to its current manual processes for ESG reporting

232. In its Revised Plan, ATCO outlines the current and likely expanded reporting requirements of regulators and other stakeholders (such as financial institutions) in more detail, noting the anticipated step up in obligations from 2027.[104] We are satisfied that ATCO is likely to incur new or enhanced ESG reporting obligations as part of the ATCO Group and as an operating entity in Australia.[105]

233. ATCO has provided a reasonably detailed gap analysis between its current manual ESG reporting system and what it considers to be required as part of its new and likely ESG obligations and its corporate financing risk. We consider that its risk assessment of 'High' if no further resources are allocated to support the reporting obligations is reasonable.

ATCO's proposed capex investment is likely to be prudent

234. ATCO presents four options in its business case, ranging from 'doing nothing new' to a custom built ESG system.

- Option 1 requires continuing with the current situation of manual data entry, reporting and qualitative analysis and assumes no further additional resources are added to meet the increasing regulatory reporting obligations.
- ATCO's preferred Option 2 is implementation of an integrated ESG system '*to manage data inputs and data outputs, including collection, automation, measuring, analysis, target setting and production of relevant reports or visual representations. The system has the ability to perform risk and opportunity analysis against climate related scenarios.'*[106]

---

103 07.103.00 - ESG Reporting System - Business Case, Appendix D

104 07.103.00 - ESG Reporting System - Business Case, page 2 and Table 1.1

105 07.103.00 - ESG Reporting System - Business Case, pages 3-15

106 07.103.00 - ESG Reporting System - Business Case, page 19

- Option 3 is implementation of an ESG system without integration with other AGA systems. ATCO's assessment is that it provides little benefit over the manual-based Excel spreadsheet system currently deployed.
- Option 4 is a fully implemented and integrated custom-built database and reporting software with minimal continuous support. Whilst it would achieve ATCO's objectives, ATCO concludes that there would be a higher degree of difficulty for ATCO to apply this option, support for the sustainability component is not available, and it would cost more than the preferred option.

235. We are satisfied that Options 3 and 4 are not likely to be superior to Option 2. Option 1 as proposed by ATCO is likely to fail to meet regulatory requirements beyond 2027 and is therefore not a prudent choice.

236. However, for comparison purposes, ATCO should have presented an 'Option 1a' which would include the cost of additional resources to meet the more stringent regulatory requirements, particularly after 2026/27, noting that: [107]

> *Option 1 involves a high level of manual entry and time commitment from a number of dedicated business stakeholders that decreases productivity of those individuals involved.*
>
> *Manual data entry and simple reporting maintains the bare minimum up to approximately 2026/2027 due to the limited assurance requirements appended to mandatory disclosures. Beyond this point, the challenge to meet internal and external expectations and the compliance failure risk will not be as Low as reasonably practicable…it is likely that more people are required to maintain the level of disclosure reporting and assurance required over the dataset and the outputs.*

237. Option 1a would have provided a more reasonable counterfactual to Option 2 for determining the net benefit of Option 2, by quantifying the cost of the additional people that ATCO refers to. However, ATCO does not provide any indication of the current cost of maintaining the manual reporting system nor of the estimated cost of the extra resources that would be required.

238. ATCO quotes an NPV of -$1.1 million for Option 2 in the business case, however it does not quantify any benefits (e.g. the avoided costs associated with manual processing). Therefore what is presented as the 'NPV' is simply the net present cost over a 5-year study period (accounting for capex and opex). It therefore provides no quantified added value for options comparison.

239. ATCO describes qualitative benefits from Option 2 including role-specific efficiencies, the ability to 'easily produce data and reporting' to comply with the disclosure requirements through automated and robust data input and data extraction.[108] We consider that these benefits are realistic and would tend to favour Option 2. We also consider that, although ATCO has not quantified the avoided additional manual processing costs from a compliant version of Option 1 (i.e. an 'Option 1a'), these benefits too are realistic and would further validate selection of Option 2.

240. We also consider that the cost estimate for Option 2 is reasonably derived, despite being a preliminary estimate, because (i) considerable thought regarding the approach and the scope is evidenced in the business case, and (ii) the estimate itself was derived from vendor advice.

241. We discuss the proposed opex step change associated with the project in section 4.4.

Summary of adjustment

242. We propose no adjustment to ATCO's proposed $0.5 million capex.

---

[107] 07.103.00 – ESG Reporting System – Business Case, page 20

[108] 07.103.00 – ESG Reporting System – Business Case, page 25

3.5.6 Continuous Compliance Program

Overview

243. In its Initial Plan, ATCO proposed $2.0 million for an IT Continuous Improvement Program which the ERA rejected in its Draft Decision. ATCO has discontinued the IT Continuous Improvement Program and instead proposes $0.4 million capex to focus '*on small scale initiatives that enable us to continue to meet regulatory compliance, license obligations and comply with the requirements of the Safety Case*.[109]

Assessment of new information

244. In its Revised Plan, ATCO states that its proposal is based on various potential sources of changes to regulatory requirements, aiding incident resolution, and trends analysis, and managing the recurrence of controlled document reviews.[110]

245. In our view, the proposed capex is not justified because:

- The regulatory changes are not able to be identified and given the relatively small quantum of capex (0.6% of ATCO's proposed revised IT program) should reasonably be able to be absorbed within its current portfolio of projects
- If any new, material obligations arise during the course of the AA6 period requiring additional expenditure, there is a mechanism for ATCO to recover the reasonably incurred costs
- No evidence is provided to support the need for incremental provision to support the speculative service delivery initiatives nominated by ATCO as examples.

Summary of adjustment

246. We propose an adjustment to remove the full amount of $0.4 million.

3.5.7 Cyber Security Program

Overview

247. The ERA's Draft Decision did not include additional expenditure in AA6 for ATCO's cyber security program. This decision was based on assessment of ATCO's proposal to achieve Security Profile 3 (SP-3) under version 1 of the Australian Energy Sector Cyber Security Framework (AESCSF V1) without a regulatory obligation to do so, and given ATCO's projected cyber security maturity level at the commencement of the AA6 period, which was [redacted] obligations.

248. ATCO has provided a revised business case and supporting documentation in support of its revised AA6 cyber security program, requiring $2.1 million capex and a $6.6 million opex step change. This is an increase on the $4.5 million opex step change included in ATCO's Initial Plan (i.e. no capex was proposed).

249. The basis of ATCO's revised business case is to meet its minimum compliance obligations *and* to address escalating cyber security risks to its critical infrastructure from an increasingly onerous threat landscape. It is [redacted] and has updated its scope of work and costs.

109 ATCO 2025-29 Revised Plan, page 112

110 ATCO 2025-29 Revised Plan, page 112

Assessment of new information

ATCO has provided compelling justification of its proposed expenditure

250. ATCO has accepted that it does not need to achieve SP-3 to meet its cyber security-related regulatory obligations and sought consulting advice to help develop a risk-based approach to its cyber security program for the AA6 period.

251. We consider the consulting advice[111] to be comprehensive and compelling in support of ATCO's revised position of meeting its regulatory obligations and implementing additional controls in response to the risks posed by the worsening cyber threat landscape. The report presents:

- Analysis of ATCO's regulatory obligations under the SOCI Act pertaining to critical infrastructure and under the Privacy Act.
- Analysis of the escalating threat and risk landscape, leading to the reasonable conclusion that currently [redacted].'
- A current state assessment, mapped to the AESCSF V1: [redacted] of SP-1 practices achieved, [redacted] of SP-2 practices achieved and [redacted] of SP-3 practices achieved (in mid-2024).
- A target risk level of [redacted]' by the end of the AA6 period and consideration of three dimensions: compliance, risk, and threats, with the targets described as follows:
  – when mapped to the AESCSF V1, the 'indicative' targets are [redacted] of SP-1 and [redacted] of SP-2 practices, with [redacted]
  – cyber capabilities are also mapped against the NIST cyber security framework.
- A comprehensive risk register and gap analysis (i.e. between current cyber capabilities and what is required to achieve an [redacted]' risk rating) mapped to 16 recommended initiatives.
- A good description of the 16 recommended initiatives.
- A roadmap and deliverability assessment.

252. In contrast to the approach taken by ATCO in its Initial Plan, it has now taken a risk-based approach and has identified controls to achieve an Intermediate risk level and to meet its compliance obligations. We consider this target state for cyber security at the end of AA6 to be reasonable and the initiatives identified in the cyber security program to be a prudent means of achieving it.

An important aspect of the revised program is a new strategy of reducing reliance on ATCO Canada for cyber security controls

253. ATCO currently relies upon ATCO Canada as managed service provider (MSP) for threat monitoring and detection and an Australian MSP for remediation. ATCO notes that:[112]

> *These complex relationships and processes, although cost efficient have been found to be* [redacted]

254. ATCO considered two options in its business case (in addition to Option 1, 'do nothing more', which was reasonably rejected by ATCO) and which vary in the staffing level of a proposed cyber security operations centre. The Australian-based cyber security operations centre will establish direct control over the cyber security function and cyber posture. This is a new initiative recommended by ATCO's consultant.

---

111 07.123 - Cyber Security Program & Roadmap

112 08.09.013.00 - IT - Cyber Security - Revised Business Case, page 24

255. Option 2 is based on a hybrid[113] cyber security operations centre (SOC) comprising four new roles to supplement the existing [redacted], with three existing industry partners (for ad-hoc services), an existing SecOps MSP, and an existing Incident Response MSP (on a retainer). The [redacted] in-house personnel will be supported by two FTEs (change manager and project manager to support the program). ATCO proposes this option.

256. Option 3 is based on Option 2 with a further three FTEs in the cyber SOC for a total of [redacted] in the SOC plus the change manager, project manager (FTEs) plus the external service provider as with Option 2.

257. Establishment of a hybrid, on-shore security operation centre is aligned with good industry practice and ASD requirements, the number of staff is not excessive, and the new roles are also logical, being spread over the following functions:[114]

- Governance and risk compliance (GRC) – lead analyst, who would be responsible for (i) defining ATCO's cyber risk and integrating it into its enterprise framework, (ii) development and provision of cyber security metrics and reporting, and (iii) assessing the current state of controls, setting, implementing, and monitoring the application of security policies across ATCO's environment.
- SecOps and Incident response – manager, analyst, and security engineer who would collectively engage with ATCO's security partners in monitoring and triaging security events and declaring incidents, as well as ensuring ATCO has sufficient planning, playbooks, and procedures in place to respond to an incident effectively.
- Security Architecture – combined cyber and IT architect who would be responsible for (i) overseeing the design and implementation of technical requirements to maintain security, (ii) managing the privileges of users accessing ATCO's environment and reduce the potential for a malicious actor to move across its information technology environment, and (iii) oversee the management of vulnerabilities across ATCO's technology suite.

258. Each of the new SOC roles are allocated to opex and are assumed to build up over the period from 2025 to 2026. We discuss the proposed opex step change in section 4.4.

259. The change manager and project manager are also logical temporary positions and are allocated to capex over the period 2025-2026.[115] Their combined role is to oversee the establishment of the new Australian SOC, including the transition from the Canadian SOC, and ensuring it can operate effectively on an ongoing basis. We are satisfied that the complexity and organisational impact of the change from a Canadian-centric SOC model to an Australian SOC is sufficient to warrant positions to manage the transition for the first two years of the AA6 period.

260. We therefore consider Option 2 to represent the prudent path. The enhanced [redacted] strong SOC team with additional support as proposed will be responsible for implementing the 16 proposed strategic initiatives.

ATCO's capex estimate is reasonable except for the inclusion of contingency

261. ATCO provided a cost estimate spreadsheet which includes a bottom up build of the capex but which (i) is not aligned to the 16 initiatives, and (ii) includes 15% contingency allowance.[116]

262. We asked for further information from ATCO to confirm the reasonableness of the cost estimate (including by understanding the capex and opex attributed to each initiative). ATCO's response included a more detailed cost estimate spreadsheet, which provides the cost build-up for each initiative. Whilst the line items within each initiative are clearly

113 A combination of in-house and external expertise

114 08.09.013.00 - IT - Cyber Security - Revised Business Case, pages 31-32

115 08.09.013.00 - IT - Cyber Security - Revised Business Case, page 32; Cyber Roadmap Cost Estimates v6 Option 2 to 3

116 08.09.013.01 - IT - Cyber Security - Cost Estimate - Option 2

approximate and many are hard-coded numbers, based on our experience, the assumed 'unit costs' are reasonable. Most of the capex for Option 2 is incurred in 2025 and 2026.

263. We are satisfied that with the exception of the contingency provision the capex estimate for Option 2 is reasonable.

ATCO has quantified the risk-cost cost of Option 1 which is the defacto counterfactual for Option 2

264. ATCO determined a risk-cost for Option 1 of $10.0 million based on a cyber security incident occurring once per year every year of the AA6 period with a duration of 4 days of impact on ATCO. It was not apparent from the information provided with its Revised Plan how ATCO derived the $2.0 million annual cost estimate. In response to an information request,[117] ATCO provided the cost build up, with the salient assumptions being:

- Productivity loss and regulatory fines as the major sources of direct cost to ATCO, and
- ATCO would require support from cyber resources, ATCO leadership, and crisis management resources to help guide the recovery effort.

265. ATCO states that its analysis is 'conservative' (i.e. understates the full probabilistic cost impact of cyber events) and cites IBM's 2024 Cost of a Data Breach Report and the ACSC's Cyber Incident Response Plan Guidance as supporting information in this context.[118]

266. Based on our experience, ATCO's analysis is quite simplistic. Whilst we consider that ATCO's assumed frequency of successful attacks is high, it likely understates the recovery time and effort from a successful Priority 1 IT system or operational technology attack. Further, ATCO's analysis does not appear to countenance the impact of data loss from cyber-attack, which depending on the scale, could attract a significant fine under the Privacy Act (up to $50 million) and high recovery costs. Overall, we consider ATCO's Option 1 cost, which is essentially the counterfactual for ATCO's Option 2, to be on the low side and this would reinforce ATCO's preference of Option 2.

ATCO's preferred Option 2 is likely to have a positive NPV

267. ATCO's cost estimate for Option 1 can be treated as a benefit for Option 2 but ATCO has not done so in its NPV analysis (i.e. it has derived only a present value of the Option 2 cost).[119]

268. Given that (i) ATCO's opex for Option 2 stabilises at a recurrent $2.2 million p.a. from 2027 (ongoing licence fees and the recurrent incremental cost of the Cyber Security Operations Centre), and (ii) we consider that ATCO's derivation of $2.0 million recurrent avoided cost (i.e. from Option 1) is understated, it is reasonable to assume that the NPV of its proposed investment would be positive over 5 or 10 year study periods.

Summary of adjustment

269. We propose an adjustment of $0.3 million to remove contingency from ATCO's estimate, resulting in adjusted amount of $1.8 million capex. We consider the proposed opex step change in section 4.4

3.5.8 Data Enablement Project

Overview

270. ATCO proposes expenditure of $6.3 million capex and a $0.9 million opex step change during the AA6 period for improving its data standards and governance. This new project has been submitted by ATCO after removing its initially-proposed Digital Program and its Data and Analytics Project from its Revised Plan.

---

117 ATCO response to IR118

118 ATCO response to IR118

119 08.09.013.03 - IT - Cyber Security - NPV Assessment - Option 2

Assessment of new information

ATCO's case for change is based on avoiding manual intervention to achieve adequate reporting quality

271. Our understanding of ATCO's need for the project is, in summary:[120]

- Its data records have gaps, integrity, and accuracy issues ('data issues'), due to inadequate data governance and master data management impacting the safety of staff, the reliability of its gas network and putting at risk its compliance with regulatory obligations, including its ability to meet licence conditions.
- The data issues manifest themselves in operational data sets, decision systems as well as operational and regulatory reports which will manifest as significant issues during the ERP Replacement Program.
- The data issues are currently overcome through manually cleansing and collating of data for reporting and insight purposes across the gas operational workforce, creating significant drag on operations.

ATCO considers three options in its business case and has selected Option 2

272. The three options covered in the business case are:[121]

- Option 1: Continue with the current situation - largely manual intervention at an escalating cost (i.e. adding FTEs), but with a residual risk of 'High' from expected regulatory and licence condition breaches.[122]
- Option 2: Data standards and governance (**recommended**) – this involves five activities:
  – Create an enterprise data model (EDM) for an integrated view of data
  – Establish an effective data governance framework
  – Implement a master data management (MDM) capability to automate how business-critical data is governed, managed, and shared throughout applications used by the business
  – Refactor existing reports as source systems change, and
  – Change process and data structures to reflect the broader capabilities of the ERP and EAM replacement.
- Option 3: Data enrichment – in addition to Option 2, expand data sources to receive more data from ATCO applications, IoT devices, and third parties.

273. ATCO has not provided compelling evidence that the residual risk of Option 1 would be High, although it states that it believes *'that business inefficiencies will continue to grow*[123] because resources will need to be increasingly devoted to the manual processing.

274. ATCO states that Option 2 will '*remove the burden of time and effort involved in manually cleansing and collating data for reporting and insights purposes… [uplift] data security and privacy capabilities…enable better operations modelling and business planning, good policy development and error-free compliance actions.'*[124]

275. From the information provided, Option 3 is not the prudent solution – whilst it addresses the identified risks ATCO concludes that it is unlikely to be efficiently and prudently delivered in the AA6 period. The cost is also significantly higher than for Option 2.

---

[120] 07.113.00 - Data Enablement - Business Case, page 1

[121] 07.113.00 - Data Enablement - Business Case, Table 2.1

[122] 07.113.00 - Data Enablement - Business Case, Table 2.3

[123] 07.113.00 - Data Enablement - Business Case, Table 2.3, Regulatory and Licence Condition Breaches, Mitigation

[124] 07.113.00 - Data Enablement - Business Case, section 2.2.5

276. As positioned by ATCO, Option 2 appears to have a wider scope than the 'title' would suggest:

- The first three denoted activities are directly related to data standards and governance and ATCO's needs demonstrate it to be a more cost-effective option than Option 1
- The remaining two activities relate to likely requirements when the ERP Replacement project is implemented. In its cost estimate for this project,[125] ATCO combines the two activities, referring to them as 'Catalogue and Categorise.'

ATCO's analysis is rudimentary but replacement of manual interventions through the data standards and governance activities is likely to be the prudent choice

277. Strategically, it is prudent to overcome data issues by implementing the proposed activities and capabilities incorporated in Option 2 rather than to continue to invest in manual data cleansing and validation and to do this before (i) introducing the replacement ERP as proposed in 2027, and (ii) extending the businesses' data analytics capability.

278. The cost estimate spreadsheet provided by ATCO for Option 2 includes hard-coded data and no cost estimate spreadsheet was provided for Option 1. We therefore asked ATCO for supplementary information. From the response,[126] we were able to discern that:

- For Option 1:[127]
  - the cost estimate of $6.2 million totex (all opex) for the AA6 period[128] is derived from a reasonable bottom-up build of the extra manual resources likely to be required for data cleansing, data validation, etc.
  - the NPV of -$11.9 million is derived from growing data cleansing/validation labour costs over a 10-year study period.
- For Option 2: [129]
  - the cost estimate of $7.2 million ($6.2 million capex, $1.0 million opex) is derived from a bottom-up build of the cost of each of the four components (Data governance, EDM, Catalogue and Categorise, and MDM)[130]
  - the NPV of -$7.6 million is derived from a 10-year study period in which the opex cost for running the enablement program is included through to December 2034; however, no allowance is made for upgrades/refreshes of the hardware; we asked ATCO for an explanation of this apparent omission and it advised that the intention is that there should be no significant additional capex costs for Option 2 in the 10-year period post the initial two years by establishing the requisite technology capabilities on an evergreen, cloud-based platform.[131]

279. ATCO's cost estimate includes a 15% contingency allowance ($0.8 million capex[132]) which if removed for reasons we discuss in or Initial Technical Report, would lead us to conclude that the NPV for Option 2 is likely to be positive if the avoided cost of Option 1 is used as the benefit counterfactual of Option 2. Taking into account the other non-quantified benefits of Option 2, this is likely to be the prudent and efficient path.

---

125 ATCO Detailed Project Costing template Data Enablement - EMCA 115

126 Covering email and three spreadsheets provided in response to EMCa115, noting that this does not align with the $5.9 million referred to in Table 2.2 of 07.113.00 - Data Enablement - Business Case

127 AGA-FIN-PR17 Financial Evaluation Data Enablement Option 1 EMCa115 and 07.113.01 - Data Enablement - Cost Estimate - Option 1

128 All of ATCO, per ATCO Detailed Project Costing template Data Enablement - EMCA 115 with our correction of an error by ATCO in extending the cost incurred for Option 1 through to June 2030

129 AGA-FIN-PR17 Financial Evaluation Data Enablement Option 2 EMCa115 and ATCO Detailed Project Costing template Data Enablement - EMCA 115

130 The cost estimate is slightly lower than the $7.3 million totex quoted in Tables 2.4 and 2.5 of 07.113.00 - Data Enablement - Business Case; ATCO's capex model identifies $6.30 million capex 07.102 – AA6 Capex Model (clean)

131 ATCO response to IR129

132 ATCO response to EMCa115, allowing for 97.6% allocation to ATCO

Summary of adjustment

280. We propose an adjustment of $0.82 million to remove the contingency allowance, resulting in a project capex of $5.48 million for the Data Enablement project. The opex step change for this program is assessed in section 4.4.

3.5.9 Summary of IT adjustments

281. As shown in *Table* 3.7, in its Revised Plan ATCO has proposed IT capex of $64.1 million. ATCO accepted ERA's Draft Determination for six projects but has proposed seven projects that are new, or for which it has proposed a higher allowance. For the seven additional or changed projects we propose an aggregate adjustment for the AA6 period of -$8.17 million capex, comprising:

- Removal of contingency amounts:
  - ERP Replacement (-$5.13 million)
  - IT Cyber Security (-$0.27 million)
  - IT Data Enablement (-$0.82 million)
  - Technology lifecycle (-$1.55 million)
- 100% adjustment to ATCO's proposed IT Continuous Compliance project (-$0.40 million).

3.6 Our assessment of the revised STEQ program

3.6.1 Background

Scope of our assessment

282. We have reviewed new and updated information provided by ATCO in its Revised Plan to justify changes to the ERA's Draft Decision.

Overview of revised STEQ

283. The STEQ category incorporates Fleet, Property and Plant, and Equipment. In its Draft Decision, the ERA substituted $23.7 million as conforming capex in place of ATCO's proposed $23.9 million. The adjustment was to remove a 'timesheeting' line item in the cost estimate in the depot minor capital works program which was understood to be a contingency allowance.[133]

284. ATCO does not accept the ERA's Draft Decision to disallow $0.2 million 'timesheet loading' which was part of its $2.3 million proposed Depot Minor Works Program on the basis that it does not equate to a contingency allowance (as assumed by the ERA), stating that it *'covers the expected labour costs of the Facilities Project Management team (Facilities) who will oversee the depot minor capex works program. This cost was expressed as "timesheeting" to reflect the number of hours expected to be spent by this team on the depot minor works program.'*[134]

3.6.2 Our Assessment

285. The clarification by ATCO is sufficient to confirm that the timesheeting line item was not a contingency allowance and we consider the revised capex amount of $2.3 million for the Depot Minor Works Program is reasonable.

---

133 ERA ATCO GDS AA6 Draft Decision, para 369, 370

134 ATCO 2025-29 Revised Plan, pages 116-117

3.7 Summary of findings and implications

3.7.1 Summary of findings

286. We have reviewed the new and updated information provided by ATCO to support aspects of its revised AA6 capex forecast that are within our scope.

287. ATCO has included two new Network Sustaining Programs and two new IT programs and has changed the scope on multiple programs in its Revised Plan. Whilst it has removed contingency allowances in a number of projects in the Network Sustaining project it has typically replaced the allowances with increased materials and/or contractor costs.

288. ATCO's Initial Plan forecast for its IT requirements for the AA6 period was deficient – it omitted important programs and underestimated the cost of its largest investment (ERP Replacement) by almost $20 million (100%) based on its revised estimate. ATCO now appears to have provided a more well-constructed IT program of work but with a much higher level of expenditure than in its Initial Plan.

289. The largest sources of change from the ERA's Draft Decision (within our scope) are:

- $40 million increase in the estimated cost of the ERP Replacement project following a ground-up revision to the cost supported by external advisers
- $23 million increase from the combined impact of four new projects and programs (i.e. not included in the Initial Plan)
- Net reductions from changes in scope and removal of contingency amounts.

290. The information provided in the Revised Plan supplemented by questions from us to seek clarification and/or more evidence to confirm ATCO's statements has now enabled us to form the view that, despite ATCO's substantial increase relative to its Initial Plan, the majority of the AA6 forecast capex is likely to satisfy the NGR. The exceptions are where ATCO has included contingency amounts, which we have removed for reasons discussed in our Initial Technical Report, together with a small number of projects for which we consider the scope or proposed option is not justified.

3.7.2 Implications

291. Table 3.9 summarises the proposed adjustments for the items within the scope of our review. If these are the only adjustments to be made, then it would result in an aggregate adjustment of -$10.44 million (2%) of ATCO's proposed AA6 capex in its Revised Plan.

Table 3.9: Adjustment summary for items within scope of our review – Revised AA6 capex ($m, 2023)

Capex by driver	2025	2026	2027	2028	2029	Total
NETWORK SUSTAINING						
Asset replacement						
ATCO revised	**44.94**	**41.98**	**43.61**	**42.04**	**41.20**	**213.78**
less EMCa project/program adjustments	*-0.33*	*-0.07*	*-0.07*	*-0.60*	*-0.61*	***-1.68***
Subtotal with EMCa adjustments	**44.61**	**41.91**	**43.54**	**41.43**	**40.60**	**212.10**
Asset Performance and Safety						
ATCO revised	**4.18**	**7.30**	**9.11**	**8.86**	**8.84**	**38.29**
Less not in scope	*-0.80*	*-1.33*	*-1.94*	*-3.09*	*-2.48*	***-9.64***
ATCO revised (in-scope)	3.39	5.96	7.17	5.77	6.36	**28.65**
less EMCa project/program adjustments	*-0.34*	*-0.25*	*0.00*	*0.00*	*0.00*	***-0.59***
Subtotal with EMCa adjustments	**3.84**	**7.05**	**9.11**	**8.86**	**8.84**	**37.70**
GROWTH						
ATCO revised (not in scope)	**25.38**	**29.23**	**31.02**	**32.34**	**33.05**	**151.02**
INFORMATION TECHNOLOGY						
ATCO revised	**19.33**	**28.49**	**9.41**	**4.71**	**2.09**	**64.03**
Less not in scope	*-1.02*	*-0.51*	*0.00*	*-1.63*	*0.00*	*-3.16*
ATCO revised (in scope)	18.32	27.98	9.41	3.08	2.09	**60.87**
less EMCa project/program adjustments	*-2.26*	*-3.65*	*-1.23*	*-0.57*	*-0.44*	***-8.15***
Subtotal with EMCa adjustments	**17.07**	**24.84**	**8.19**	**4.14**	**1.64**	**55.88**
STEQ						
ATCO revised	**6.05**	**6.70**	**2.80**	**3.78**	**4.23**	**23.57**
Less not in scope	*-5.48*	*-6.31*	*-2.34*	*-3.34*	*-3.76*	***-21.24***
ATCO revised (in scope)	0.58	0.39	0.46	0.44	0.47	**2.34**
less EMCa project/program adjustments	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	***0.00***
Subtotal with EMCa adjustments	**6.05**	**6.70**	**2.80**	**3.78**	**4.23**	**23.57**
ATCO Revised Plan AA6 capex	**99.90**	**113.70**	**95.96**	**91.73**	**89.40**	**490.69**
Less EMCa adjustments	*-2.93*	*-3.98*	*-1.29*	*-1.18*	*-1.05*	***-10.44***
TOTAL with EMCa adjustments	**96.97**	**109.72**	**94.66**	**90.55**	**88.35**	**480.25**

Source: EMCa table derived from ATCO att. 07.102.-AA6 Capex model

Table 3.10: Adjustment summary for items within scope of our review – Revised AA6 capex ($m, 2023)

Capex by Asset Category	2025	2026	2027	2028	2029	Total AA6
High Pressure Mains - Steel						
EMCa project/program adjustments	-0.07	0.00	0.00	0.00	0.00	-0.07
Medium/Low Pressure Mains						
EMCa project/program adjustments	-0.17	-0.07	-0.07	-0.07	-0.07	-0.44
Regulators						
EMCa project/program adjustments	0.00	0.00	0.00	-0.54	-0.54	-1.07
Meter and Service Pipes						
EMCa project/program adjustments	-0.10	0.00	0.00	0.00	0.00	-0.10
Equipment & Vehicles						
EMCa project/program adjustments	0.00	0.00	0.00	0.00	0.00	0.00
Information Technology						
EMCa project/program adjustments	-2.26	-3.65	-1.23	-0.57	-0.44	-8.15
Telemetry and Monitoring						
EMCa project/program adjustments	-0.34	-0.25	0.00	0.00	0.00	-0.59
Structures & Equipment						
EMCa project/program adjustments	0.00	0.00	0.00	0.00	0.00	0.00
Total EMCa project/program adjustments	***-2.93***	***-3.98***	***-1.29***	***-1.18***	***-1.05***	***-10.44***

Source: EMCa table derived from ATCO att. 07.102.-AA6 Capex model

4 ASSESSMENT OF NEW INFORMATION ON SELECTED ASPECTS OF AA6 OPEX

We have assessed ATCO's proposed base opex (other than for UAFG and Ancillary Services) and the proposed step changes that are within our scope (and which comprises all except three of those that ATCO has proposed).

ATCO has clarified and corrected a number of matters that led ERA to make significant negative adjustments to its base year opex allowance, in its Draft Determination. For the most part, we consider that ATCO's proposed adjusted base opex allowance is reasonable, but we consider that there are two elements of this allowance that do not reasonably reflect prudent and efficient requirements. Further to the base year adjustments that ATCO has made, we therefore propose two additional adjustments to address these matters.

ATCO has proposed a total of 20 step changes in its Revised Plan, totalling $38.7 million. Compared with the eleven step changes proposed in its Initial Plan, the Revised Plan includes a large number of new and relatively small opex step changes in addition to revising step changes originally included. Of the 13 proposed step changes within our scope, totalling $26.1 million, we find justification for four step changes though for two of these (Cyber Security and Technology Lifecycle) we consider that a lower amount is justified. We consider that the remaining nine step changes are not justified.

For the items within our scope, we consider that a reasonable opex allowance would require:

- Deduction of $1.1 million from the base opex that ATCO has proposed, and
- Step changes that, in aggregate over the five years, are $12.4 million less than ATCO has proposed.

4.1 Introduction

292. We have been asked to review and provide advice to ERA on selected aspect of the opex allowance that ATCO has proposed in its Revised Plan. These are:

- ATCO's proposed 'base opex' allowance. Specific aspects of this include:
  - its update to base this on its 2023 actual opex (whereas its Initial Plan was based on its 2022 actual opex)
  - the base year adjustments that it has proposed applying to its 2023 opex, and
  - its response to the ERA for instances where it has rejected making adjustments that ERA had required in its Draft Determination
- Those step changes that are directly related to capex investments that we were asked to review (and which are reviewed in section 3 or which are technical in nature).

293. We have not been asked to review ATCO's allowances for UAFG or for Ancillary Services, nor any other aspect of its proposed opex allowance including, for example, its proposed trend parameters.

294. We first provide an overview comparison between ATCO's Initial Plan, ERA's Draft Decision and ATCO's Revised Plan. We then provide two subsections where we assess and provide our findings on:

- ATCO's base year opex (section 4.3), and
- ATCO's proposed step changes (section 4.4).

4.2 ERA Draft Decision and relevant aspects of ATCO's Revised Plan

295. In its Draft Decision, the ERA approved total opex of $337.4 million of the $455.9 million proposed by ATCO in its Initial Plan (a 26% reduction).

296. The majority of the reduction was to ATCO's opex base year (adjusted by $59.1 million), with a further reduction of $48.4 million to ATCO's proposed opex step changes.

297. ATCO does not accept ERA Draft Decision and in response, ATCO proposes $441.6 million total opex, which is 3% less than its original proposal but 31% more than ERA's Draft Decision, as shown in the *Table* 4.1 below.

Table 4.1: Opex ATCO original proposal with ERA Draft Decision and ATCO Revised - $m, real 2023

Opex Category	ATCO Original Proposal	ERA Draft Decision	ATCO Revised Proposal[135]
Base year	312.6	253.5	332.2
Step changes	62.8	14.4	38.6
Output growth escalation	10.4	14.0	9.3
Input cost escalation	12.4	4.1	9.6
Sub-total network, corporate & IT	**398.1**	**286.0**	**389.8**
UAFG	30.8	31.8	29.6
Ancillary services	27.1	19.6	22.2
TOTAL	**455.9**	**337.4**	**441.6**

Source: Table 8.49 of ATCO 2025-29 Revised Plan

4.3 Assessment of proposed allowance for efficient base year opex

4.3.1 Update from 2022 base year to 2023 base year

ATCO now proposes 2023 as the base year for opex

298. The ERA accepted ATCO's proposal to use the 2022 actual as the base year, as this was the most recent year of actual expenditure at the time of ATCO's original submission.

299. In its Revised Plan, ATCO proposes to adopt 2023 as the base year because it is now the most recent full year of actual expenditure.

300. The 2023 actual expenditure is $4.5 million higher than the 2022 actual expenditure, primarily driven by network opex while the movement of other opex categories somewhat have cancelled out each other, as shown in *Table* 4.2. [redacted] costs are as shown,

135 The matters within the scope of our review are contained within the highlighted shape

however ATCO excludes these from its base opex as part of its base year adjustments (as shown in *Table* 4.3.

Table 4.2: Comparison between 2022 and 2023 opex - $million, real 2023

Opex Category	2022	2023	Movements
Network	36.1	40.5	4.4
Corporate	24.5	23.5	-1.1
Information Technology	4.7	5.6	0.9
UAFG	3.3	3.0	-0.2
Ancillary services	0.9	2.0	1.1
Total Base Year opex	**69.5**	**74.6**	**5.0**
[redacted]	[redacted]	[redacted]	[redacted]
TOTAL OPEX	**74.4**	**78.9**	**4.5**

Source: Table 8.4 of ATCO 2025-29 Revised Plan

ATCO's proposed adjustments for non-recurrent expenditures in 2023 base year actual

301. In *Table* 4.3 we summarise the base year and adjustments that ATCO initially proposed, those from the ERA's Draft Decision and ATCO's Revised Plan. In its Revised Plan, ATCO has retained the adjustments that it initially made to achieve an efficient base year total opex, but it has updated the amounts. It has also accepted in principle the CEIH and Blending adjustments that ERA applied in its Draft Decision, though with lower amounts, and has accepted the need for some adjustment of its originally proposed STIP.

302. ATCO has not accepted the Other Corporate Support cost and Stakeholder Engagement cost adjustments that ERA applied in its Draft Decision.

303. For the first five items in the Revised Plan column in *Table* 4.3, the adjustment items that ATCO has re-proposed are the same as originally proposed and as accepted in the ERA's Draft Decision. The different amounts reflect the updated base year (i.e. the quantum, of these amounts in 2023 rather than 2022). Consistent with our scope, we have not re-assessed these items and we maintain the position from our Initial Report that these adjustments are reasonable.

304. Of the items below this, we have not been asked to further review the CEIH and Blending projects adjustment. However, we note that ATCO has accepted ERA's adjustment for this in principle and, as with the items above, the different amounts appear to solely reflect the updated base year value.

305. In the following subsections, we have reviewed the remaining items, being:

- ATCO's considerably lower negative adjustment for STIP than the ERA's Draft Decision
- ATCO's rejection of a negative adjustment for Other Corporate costs, and
- ATCO's rejection of a negative adjustment for Stakeholder Engagement.

Table 4.3: Summary of base year adjustments - $m, real 2023

	Initial Plan (2022 base year)		ERA Draft Decision		Revised Plan (2023 base year)	
Base year actual		**74.68**		**74.68**		**78.86**
Adjustments						
[redacted]	[redacted]				[redacted]	
AA6 submission expenditure	-1.23				-1.73	
[redacted]	[redacted]				- [redacted]	
One-off Corporate restructure cost	-0.80				-0.12	
Inline pipeline inspection	-0.60				-0.28	
Subtotal	**-7.97**	**-7.97**	**-7.97**	**-7.97**	**-6.43**	
Short Term Incentive Payment (STIP)			-3.70		-0.89	
CEIH & Blending projects			-0.30		-0.10	
Other Corporate Support			-6.80		0.00	
Stakeholder engagement			-1.00		0.00	
Subtotal			**-11.80**	**-11.80**	**-0.99**	**-7.43**
UAFG	-3.27		-3.27		-3.03	
Ancillary Services	-0.92		-0.92		-1.96	
Subtotal	**-4.19**	**-4.19**	**-4.19**	**-4.19**	**-5.00**	**-5.00**
Total efficient base year OPEX		**62.52**		**50.72**		**66.44**

Source: ATCO initial AA 09.020 Base step trend opex forecast model, ERA Draft Decision table 5.3 and ATCO RAA 08.101 AA6 Opex model. (Note some values differ between sources due to rounding)

4.3.2 Adjustment for STIP

Background

306. In its initial Plan, ATCO's proposed base year opex included $3.7 million for staff bonuses (STIP).[137] In its Draft Decision, the ERA excluded the full amount.

307. In our Initial Technical Report to the ERA on ATCO's Initial Plan, we recommended a negative adjustment of $1.7 million, to reduce the base year STIP to $2.0 million. This figure was the average STIP for the five years to 2022 and was intended to account for the 2022 STIP being significantly above trend.

308. In its Revised Plan, ATCO provides information that its STIP payments totalled $3.8 million in 2023. ATCO has proposed a negative adjustment of $0.9 million, to reduce the adjusted base year amount to $2.9 million.[138] ATCO asserts that this is reasonable because:

- It is an essential element of its Total Compensation package to qualifying staff
- Funding STIP only through financial outperformance is inconsistent with market practice
- Previous Regulatory Approvals and consultant recommendations support and recognise STIP as an efficient cost
- ATCO's STIP structure is consistent with market practice, and

136 [redacted]

137 ATCO refers to these as Short Term Incentive Payments, or STIP.

138 RAA, page 134

- The consequence of removing STIP would be significantly harmful to ATCO's needs to be able to recruit and retain a highly skilled workforce.[139]

309. In its Revised Plan, ATCO has provided a considerable amount of information on these points and has also provided expert reports from Mercer and from Rennie Advisory.[140]

Our assessment

310. Consistent with our advice on its Initial Plan and for the reasons that ATCO and its advisors propose, we consider that a level of incentive-based remuneration is a reasonable cost, and that an expectation of a reasonable level of incentive-based remuneration is a relevant factor in attracting and retaining staff of the necessary calibre. As we show in *Table* 4.4, an incentive-based component of remuneration has been included in ATCO's opex for many years,

311. As ATCO has acknowledged, its STIP payments in 2022 were above trend, as too are its payments in 2023. In its Revised Plan ATCO has proposed an amount of $2.9 million, which is less than its actual expenditure in 2023 and has been derived from benchmarking information provided by Mercer, however this amount too is nevertheless still well above the trend level. As shown in *Table* 4.4, average payouts that ATCO has made over successive five-year periods commencing in AA4 have never exceeded $2.0 million until now (i.e. with the inclusion of 2023 actual).[141] While annual variation in incentive payments is to be expected, since they are dependent on performance, allowing for $2.9 million per year for the five years of AA6 would effectively entrench this high water mark for the next five years.

Table 4.4: Historical STIP payments - $m, real 2023

<table>
<tr><th></th><th>2016</th><th>2017</th><th>2018</th><th>2019</th><th>2020</th><th>2021</th><th>2022</th><th>2023</th><th>5-year average</th></tr>
<tr><td>STIP</td><td>2.15</td><td>2.49</td><td>1.94</td><td>1.11</td><td>1.12</td><td>2.09</td><td>3.63</td><td>3.79</td><td>2.35</td></tr>
<tr><td rowspan="4">Rolling 5-year averages:</td><td colspan="5">1.76</td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td colspan="5">1.75</td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td colspan="5">1.98</td><td></td><td></td></tr>
<tr><td></td><td></td><td></td><td colspan="5">2.35</td><td></td></tr>
</table>

Source: EMCa, derived from information provided by ATCO in workbook 08.103 – EMCa 052 (corrected)

312. Consistent with the approach that we adopted in our advice on ATCO's Initial Plan, we consider that a reasonable approach in the circumstances is to allow an amount that represents (in real terms) the average such payment over the past five years. We consider that averaging such costs provides a reasonable measure of revealed cost and mitigates against the possibility that a decision to award STIP at a particular level in a 'base year' becomes self-perpetuating as a regulatory cost. By now including 2023 actual STIP in the average, the allowance could be considered to reflect a pathway towards levels of STIP that might in future reflect the benchmarks that Mercer has provided, though ATCO's inherent cost efficiency incentives will reveal over time if this is the case.

313. As shown in *Table* 4.4, this 5-year average cost is $2.35 million.

314. We would also suggest that, while STIP may not be wholly related to financial outperformance, allowing $2.35 million as a regulatory cost does not prevent ATCO from topping this up to the levels indicated by the Mercer benchmark, for example if it achieves outperformance in a particular year.

315. We further note that an average in AA4 for the three years for which non-zero data was provided to us, is $2.2 million, meaning that the amount that we propose for AA6 is broadly

139 RAA, page 135

140 Letter dated 28 May 2024 from Mercer and report Attachment 8.106: Base Year – Corporate Cost Review – Rennie Advisory (issued 10/06/2024)

141 The amount would be lower still if we were to include the year 2015, for which ATCO has reported zero STIP.

in line with the amounts that were implicit in the regulatory determination for the previous period, and therefore represent a level of regulatory consistency for a base level value.

Conclusion

316. We recommend inclusion of a STIP allowance of $2.35 million. This requires a base year adjustment of negative $1.44 million.[142]

4.3.3 Adjustment for Other Corporate Support costs

Background

317. ATCO does not accept the ERA Draft Decision to remove $6.8 million from ATCO Other Corporate Support costs (HR, Finance and Risk).

318. ATCO acknowledges that there were errors in the data submitted in response to IR EMCa52 which resulted in a distortion of the costs incurred and expected within each category of such expenditure historically. This contributed to our calculation of an average historical cost of $1.6 million per year for the Other Corporate Support category, and this then led ERA to determine the negative base year adjustment of $6.8 million.

319. In its attachment 08.106, which is a report by Rennie Advisory,[143] ATCO also provides further information on the components of Corporate Cost line items and which clarify aspects that were not clear in the information that ATCO provided to support its Initial Plan.

Assessment

320. As a result of ATCO correcting EMCa52 historical information, the relevant average for Other Corporate Costs in AA4 is now $5.7 million instead of $1.6 million. The average for AA5 to date (i.e. including 2023 actual) is $8.5 million, however, these figures include STIP and (in 2023) the transfer of EnergySafety charges to this line item (from 'Corporate – Regulatory'). After removing STIP (given that it is separately accounted for), we can now produce averages for what could be considered underlying 'Corporate – Other' costs, in order to compare these with the 2023 base year value. These are shown in *Table* 4.5.

Table 4.5: ATCO Opex – Other Corporate Support Costs after deducting STIP - $m, real 2023[144]

Corporate - Other Corp Support (HR, President, Finance, Risk)	Amount
Average AA4	4.23
Average AA5 actual to date (2020-2023)	3.89
2023 Actual	**3.99**

Source: EMCa analysis derived from ATCO Corrected EMCa52

321. The new information indicates that ATCO's 2023 base year Corporate – Other opex of $3.99 million is less than its average expenditure over AA4 and only slightly more than its average for AA5 to date.

Conclusion

322. Taking account of clarifications that ATCO has provided, we consider that the figure now advised for Corporate – Other expenditure is reasonable and that no adjustment for this line item is warranted.

142 To two decimal places, 2023 STIP is $3.79 million (ATCO RAA 08.103). For the avoidance of doubt, the negative adjustment replaces (and is not additional to) the adjustment of negative $0.893 million that ATCO has proposed.

143 Attachment 08.106, Base Year – Corporate Cost Review, Rennie Advisory, 10/06/24

144 Amounts exclude STIP and Termination costs, both of which are the subject of separate adjustments

4.3.4 Adjustment for stakeholder engagement

Background

323. In its Draft Decision, ERA noted that $2.8 million in ATCO's base year opex was described as 'Corporate – Stakeholder Engagement'. In information that it provided, ATCO further described this as Business Improvement costs.[145] Referring to our assessment advice, ERA applied a negative adjustment of $1.0 million on the basis that business improvement costs should be offset by cost reductions that the team achieves and should not form part of an efficient base year cost.

324. ATCO disputes ERA's assessment, on the basis that Business Improvement forms part of an efficient and prudent costs base. ATCO also provides information that the Business Improvement function within this category was $0.67 million in 2023,[146] out of a total cost of $2.9 million in that year.

Assessment

Stakeholder Engagement is now presented as Marketing and BD expenditure

325. In presenting its update to the EMCa052 information, ATCO has provided a sheet in which it has renamed this line item as 'Corporate – Marketing and BD'.[147] In ATCO's corrected version of EMCa052, it has also presented different historical annual data for this line item from that previously provided.[148] While this adds further confusion, the aggregate cost difference for AA4 is relatively small and, after accounting for what is presumably a rounding difference, the updated 2022 cost of $3.0 million is essentially the same as was previously advised ($3.1 million) and is close to the 2023 cost of $2.9 million that we now assess.

Business improvement expenditure

326. In its response, ATCO has solely addressed the justification for not excluding Business Improvement costs from the base year. ATCO provides information that the Business Improvement component of the cost in 2023 was $0.67 million, not $1.0 million that was deducted in the ERA Draft Decision. ATCO explains the role of its Business Improvement Team, and which includes improving several customer interaction processes. With this further information and the information that it represents a smaller amount, it is now reasonable to accept that this component provides value to customers.

327. However, this still leaves approximately $2.2 million (i.e. $2.9 - $0.67) that is being incurred for BD and Marketing costs other than for the Business Improvement team and for which there remains minimal explanation.

Previous regulatory consideration of BD and Marketing expenditure

328. In previously reviewing ATCO's proposed AA4 opex (in 2014) and its proposed AA5 opex (in 2019) we have consistently formed the view that ATCO had not justified inclusion of the levels of BD and Marketing expenditure that it had proposed. As part of our review of ATCO's proposed AA5 expenditure, we reviewed ATCO's Business Development and Marketing Strategy (dated June 2018).[149] In summary, ATCO's strategy was to increase Marketing and BD expenditure with the objective of arresting declining gas consumption. We formed the view that ATCO had not demonstrated that this expenditure would benefit existing customers.

---

145 ATCO response to EMCa052, workbook sheet EMCa52 (D,E)

146 ATCO Revised Plan, page 133.

147 This is reasonably inferred from the fact that the AA4 cost data in the sheet labelled 'EMCa 52 (Submission)' has identical annual data to that originally labelled as Corporate – Stakeholder Engagement in EMCa052.

148 For example, in originally provided information the costs in JUL-DEC 2014 and JAN-DEC 2016 were $0.7 million and $4.5 million respectively; in the updated data these are $1.9 million and $2.8 million.

149 Review of Technical Aspects of the Proposed Access Arrangement (for ATCO Gas), EMCa report to ERA, March 2019. Paragraphs 481 to 487

329. Information that ATCO provided at that time did, however, justify a component of BD and Marketing expenditure to the extent that it provides assistance to its existing and prospective customers. In our summary paragraph we stated the following:

> *For the purpose of the current decision, we consider that it would be reasonable to allow the same level of BD and marketing opex in real terms for AA5 as ERA allowed for AA4. For future determinations we consider that the ERA should continue to seek information from ATCO to evidence the outcomes achieved from its BD and marketing spend. This evidence is necessary to determine the extent to which it is acceptable for such expenditure to be included in ATCO's future revenue allowances based on benefits to existing consumers.*[150]

330. ATCO provided further information on this line item following the ERA's Draft Decision, however in our October 2019 report to ERA we reaffirmed our view that:

> *'(d)espite the additional information on what ATCO's BD and Marketing activities comprise, we consider that ….it is not reasonable to include expenditure at the level that ATCO has proposed, as part of its opex allowance.'*[151]

331. Despite ERA applying negative adjustments to ATCO's proposed expenditure in its two previous determinations, and the opportunity that we provided for ATCO to evidence the outcomes from such, ATCO has not done so either in its Initial Plan or in its Revised Plan.

332. Moreover what appears to have been a temporary relabelling of the expenditure as 'Stakeholder Engagement' and including ATCO's description (in its response to EMCa52 parts D and E) that this was focused on Business Improvement, appears to be inconsistent with the nature of the majority of what is again referred to as Marketing and BD expenditure. This is further reinforced in ATCO's Revised Plan where the explanation under the heading of 'Stakeholder Engagement' is entirely on the Business Improvement function. While this is perhaps in response to the rationale provided in ERA's AA6 Draft Decision (and our Initial report to ERA), ATCO did not take the opportunity to 'correct the record' on the nature of this overall Marketing and BD expenditure or its justification in terms of the NGR requirements.

Assessment of further information

333. To resolve our assessment as to whether the issues that had led ERA to disallow portions of proposed Marketing and BD expenditure in its determinations for the previous two Regulatory Periods, persist in ATCO's AA6 proposal, we sought more granular information from ATCO on its opex, based on a cost centre listing that ATCO had provided in response to EMCa52. ATCO's response (IR114) provided disaggregated information on 'Corporate - Marketing and BD' costs as shown in *Table* 4.6.

Table 4.6: Corporate - Marketing and BD opex - $m, real 2023

Cost centre	2023 opex
Business Development / Customer Engagement	0.92
Marketing / Corporate affairs	0.84
Blue Flame Kitchen	0.09
Business Improvement and change	0.67
Customer Relations	0.35
Advertising, marketing and promotions	-
Total: Marketing and BD	**2.87**

150 As above, paragraph 487

151 Review of aspects of ATCO's 2020-24 Revised Plan, EMCa report to ERA, October 2019. Paragraph 255.

Source: EMCa table, from information provided in ATCO IR114

334. In ERA's previous determinations (for AA4 and for AA5), expenditure for the 'blue flame kitchen' has not been accepted as regulatory expenditure.

335. Similarly, in our 2019 report to the ERA, which we refer to above, we were concerned with the validity of charging existing customers for ATCO's marketing. In its IR114 response, ATCO shows that it has further separated 'Customer Relations' from 'Marketing/Corporate Affairs'. However, its Marketing/Corporate Affairs expenditure remained the same despite the transfer, showing that marketing expenditure (other than customer relations) increased at that time. It has remained broadly at the same level in 2023 (i.e. around $0.8 million per year).[152]

336. In summary, ATCO's information demonstrates that expenditure for the Blue Flame Kitchen and for its marketing, remains as part of its 'Corporate - Marketing and BD' cost category and both of these components contribute to an overstatement of prudent and efficient expenditures that are allowable for regulatory purposes.

Adjustment

337. After considering the constitution and quantum of ATCO's BD and Marketing expenditure in its Final Determination for AA5, ERA determined that a prudent and efficient allowance for that period was $1.96 million (in $2019). Having determined this as an efficient allowance for AA5, and absent information that could result in justification of a different amount, we consider that this continues to represent a reasonable allowance for AA6.

338. In current dollar terms ($2023), the AA5 allowance was $2.31 million per year, which is $0.56 million less than ATCO's 2023 disclosed expenditure on this line item. We therefore propose a negative adjustment of $0.56 million in ATCO's adjusted base year opex to account for this difference.

339. By comparison with ATCO's disclosed bottom-up expenditure, this adjustment could be considered as disallowing Blue Flame Kitchen expenditure and a portion of Marketing/Corporate Affairs expenditure.

4.3.5 Consideration of 2023 base year amount

340. In recommending in favour of accepting ATCO's 2023 opex as its revealed cost, we have further considered variance between the 2022 actual opex that we assessed in our review of ATCO's Initial Plan, and its actual 2023 expenditure.

Base year 2023 - Network opex

341. Network opex has increased by $4.5 million to $40.5 million in 2023. ATCO states that the increase was driven by the factors shown in *Table* 4.7:

Table 4.7: 2022-2023 Difference: Network costs - $m, real 2023

Network cost variances	2022	2023	*Variance*
IT Managed Services			*2.4*
Vacancies / constrained labour market			*1.6*
Meter reads			*0.3*
Insurance			*0.1*
Total	**36.1**	**40.5**	***4.4***

152 Information is from ATCO response to IR114, including associated notes. (In ATCO's Note C in IR114, it refers to Customer Relations being transferred from cost centre '152401 – Marketing'. We note that this cost centre number is the Blue Flame Kitchen, and we assume that the number is in error, but that the labelling of the transfer as being from 'Marketing' is correct)

Source: ATCO Revised Plan, table 8.5 (page 126)

342. We assess each of the increases in the subsections below.

IT managed services costs

343. In its 2025-29 Revised Plan, ATCO states that the increase in costs from 2022 to 2023 is due to two factors:

- Increased cyber security expenditure, to meet its obligations under the SOCI Act, and
- Migrating to off-premises hosted infrastructure provision, as an alternative to incurring capex to replace existing hardware that had reached the end of its life in its on-premises Data centre.

344. Both causes for increased opex are consistent with what we observe across all gas and electricity network businesses.

Vacancies / constrained labour market

345. We similarly consider that ATCO's explanation of the constrained labour market and, in particular, the high level of vacancies in 2022 that it had filled by 2023, as reasonable explanations and similarly accord with our observations from other gas and electricity networks across Australia.

Meter reads

346. ATCO explains that due to labour shortages in 2022, it needed to estimate a larger than normal number of reads and therefore had a below-trend meter reading cost in that year. ATCO explains that by 2023 it had managed to return to its normal level of actual reads.

Insurance

347. ATCO explains its increase in insurance costs as being due to general Australian market premium increases and also the increase in its underlying asset value. Again, these are factors that we observe across almost all gas and electricity network businesses and, in this instance, at $0.1 million this is only a modest increase.

Conclusion on 2023 Network cost increases relative to 2022

348. We consider that the increases in Network costs from 2022 to 2023 are reasonable, while noting that ATCO has made some negative adjustments to this base year amount, as shown in *Table* 4.3.

Base year 2023 – Corporate costs

2023 Corporate costs

349. The 2023 actual corporate cost is $1.1 million lower than 2022 actual, from $24.5 million to $23.5 million. This is primarily due to a reduction in legal costs. ATCO states that it considers this to be a reasonable reflection of its ongoing requirements, and we agree that this value is reasonable.

Base year 2023 – IT costs

350. The 2023 IT cost is $0.9 million higher than 2022, from $4.7 million to $5.6 million. As with its Network costs, ATCO explains that it had a high level of vacancies in 2022 which it has filled in 2023. Continuing cloud migration, cyber security enhancements and the data centre migration to off-premises also result in an increased opex.

351. We invariably observe increases in IT opex in other such businesses, for similar reasons. The amount of increase is not inconsistent with our observations elsewhere, and we consider that the 2023 value is reasonable.

4.3.6 Summary of proposed adjusted base opex allowances

352. Further to the base year adjustment amount that ATCO has proposed, and which we have listed in *Table* 4.3, we consider that two further adjustments are required. These are as shown in *Table* 4.8, and are as follows[153]:

- An STIP adjustment of $1.44 million, replacing the $0.89 million adjustment that ATCO has proposed, and
- A BD and Marketing adjustment of $0.56 million, whereas ATCO proposed that no adjustment is warranted for this item.

353. We have not been asked to advise on the UAFG or Ancillary Services amounts in the Base year, therefore these amounts are listed for completeness only.

Table 4.8: Summary of proposed base year adjustments - $m, real 2023

	ATCO RAA		EMCa RAA		
2023 actual opex		**78.86**			**78.86**
less adjustments for which EMCa proposes different values:					
Short Term Incentive Payment (STIP)	-0.89		-1.44		
BD and Marketing (Stakeholder engagement)	0.00		-0.56		
Subtotal	**-0.89**		**-2.00**	-1.11	
Sum of ATCO RAA proposed adjustments (excl UAFG and AS)	-7.43			-7.43	
Aggregate base year adjustments		-7.43		**-8.53**	-8.53
Adjusted base year (for items in scope)		**71.44**			**70.33**
less items not in scope					
UAFG	-3.03				
Ancillary services costs	-1.96				
Subtotal	-5.00	-5.00			-5.00
Adjusted base year		**66.44**			**65.33**
Base opex for AA6 (5 years)		**332.18**			**326.65**

Source: EMCa, from information in ATCO 08.101 – AA6 Opex model, and adjustments as referred to in the preceding sections of our report

4.4 Assessment of certain proposed step changes

4.4.1 Scope

354. *Table* 4.9 summarises the step changes that the ERA has asked us to assess. This comprises ATCO's updated and new 'technical'[154] and Information Technology-related recurrent and non-recurrent step changes. For completeness we also show the step changes proposed by ATCO that are not within our scope.

355. There are two aspects to our assessment: (i) is the quantum of the proposed step change reasonable, and (ii) is the entire cost incremental to what is already in ATCO's base opex?

153 All adjustments referred to here are negative

154 Excluding the 'Enabling renewable gases' step change and 'Pipeline inline inspections' (lower cost than in the ERA's Draft Decision)

Table 4.9: ATCO's revised recurrent step changes, $m, Dec 2023

		Step changes	ATCO Initial Proposal	ERA Draft Decision	ATCO Revised Plan
Not in scope	Recurrent step changes	Enabling renewable gases	7.3	0.0	1.7
		Superannuation Guarantee rate increase	2.6	2.6	1.9
		Gas Inspection team	1.0	1.0	1.0
		PPE threshold increase	0.9	0.9	0.9
		Regulatory Changes	2.0	0.0	1.0
	Sub-total: Recurrent / not in scope		**13.8**	**4.5**	**6.6**
In scope	Updated recurrent step changes	Cyber security program	4.5	0.0	6.6
		ERP Replacement	4.1	0.6	4.1
	New recurrent step Changes	Critical Infrastructure Act	-	-	1.4
		Security of Supply – Pipeline Patrol	-	-	0.8
		Control Room Fatigue Management	-	-	1.6
		Picarro Leak Survey Technology	-	-	0.5
		Payroll Upgrade Project	-	-	0.5
		Technology Lifecycle	-	-	2.7
		Data Enablement	-	-	0.9
		Technology leasing	-	-	1.5
		ESG reporting system	-	-	0.5
	Sub-total: Recurrent / in scope		**8.6**	**0.6**	**21.1**
Total proposed recurrent step changes			**22.4**	**5.1**	**27.6**
Not in scope	Non-recurrent step changes	AA7 Regulatory Preparation	6.2	4.2	6.0
		SaaS arrangements	27.3	0.0*	0.0*
	Sub-total: Non-recurrent / not in scope		**33.5**	**4.2***	**6.0***
In scope	Updated non-recurrent step changes	Pipeline Inline Inspection	6.3	4.2	4.5
		Managed IT services tender renewal	0.5	0.0	0.5
	Sub-total: Non-recurrent / in scope		**6.8**	**4.2**	**5.0**
Total proposed non-recurrent step changes			**40.3**	**8.4**	**11.0**
Total proposed step changes			**62.7**	**13.5**	**38.7**

Source: ATCO 2025-29 Revised Plan, Table 8.36; ATCO 9.020 – Base Step Trend Opex Forecast Model
** Not including SaaS arrangements, which the ERA subsequently classified as capex and which is a classification that ATCO has adopted in its Revised Plan*

4.4.2 Assessment - Cyber security Program step change

Overview

356. We provide an overview of the revised cyber security program and our assessment of the revised capex in section 3.5.6. We are supportive of the program and so the focus here is

the justification of the incremental cost of the 'Licence and ongoing support' which ATCO has claimed as a step change.

Our assessment of new and updated information

357. The Revised Plan categorises the costs as comprising 'Labour' ($3.6 million) and 'Subscription fee' ($3.0 million). The labour component is to increase ATCO's head count to establish an Australian-based Security Operations Centre (SOC) and the Subscription fee is for 'cyber-specific tools' (expected to be cloud-based on SaaS agreements).

358. The cost estimate spreadsheet provided with the Revised Plan includes only hard coded annual costs, which was not sufficient to form a view about the reasonableness of the cost. As described in our capex assessment we are supportive of Option 2 which includes four additional cyber security personnel to build its on-shore SOC (giving a total of five FTEs).[155]

359. We asked ATCO to provide the cost estimate in more detail, expecting to see the deductions for the MSP costs from Canada for cyber-security services, a reconciliation to the Base Year and otherwise how ATCO derived the quantum for the two sources of cost.

360. ATCO's response[156] provided sufficient information for us to conclude that the build-up of costs for Option 2 was reasonable, however the absence of any offsetting reduction in costs from the Canadian head office for what it currently charges for cyber security services to ATCO was not what we expected.

361. We therefore asked a follow-up information request, to which ATCO advised that it valued the displaced cyber security service from the Canadian equivalent of the SOC as [redacted]. [redacted].[157] The explanation is '*that the Canadian head office will continue to provide enterprise-wide cyber security services:*

- *Strategy and governance,*
- *Policies, standards and controls,*
- *Incident response (global oversight) and,*
- *Phishing campaigns.'*

362. The response also indicated that [redacted] was included in the base year as a Canada head office fee for Cyber security (for cyber security assurance and cyber security risk services) from the Canadian SOC and attributed to AGA.

363. We do not consider the [redacted] offset to be a credible response and further we consider that there should be some reduction in the Canada head office fee for cyber security, given ATCO's (appropriate) adoption of a country-specific approach. The Australian SOC as proposed will be established with [redacted] in-house cyber security professionals supported by vendors/service providers for Governance, Risk and Compliance, Testing and Assurance, Security Operations, and Incident response, as shown in *Figure* 4.1.

---

155 The proposed change manager and project manager to help with the implementation of the proposed cyber security maturity uplift initiatives are allocated to capex

156 ATCO response to IR118

157 ATCO response to information request EMCa130

Figure 4.1: Cyber security operation model as proposed by ATCO

[redacted]

364. Whilst there may be some value to the Australian SOC from Canada head office for cyber security governance etc as described by ATCO, we consider that the unchanged fee proposed by ATCO following establishment of the Australian SOC is not reasonable.

365. We propose a 50% reduction to the $0.28 million annual fee as an offsetting adjustment (i.e. -$0.7 million in total over the AA6 period) to the $6.6 million opex proposed, leading to an adjusted step change amount of $5.9 million.

4.4.3 Assessment - ERP Replacement step change

Overview

366. ATCO proposes $4.1 million opex step change (incurred from 2028-2029), for annual licensing fees (cloud-based solution).

367. ATCO's project is described in section 3.5.3 and we support the intent and scope of the project.

Assessment of new and updated information

368. ATCO did not quantify what appear to be significant benefits from replacing SAP ECC6:

- ATCO identifies 15 benefits associated with Option 3, many of which are described as delivering financial benefits to ATCO, but which ATCO did not quantify nor recognise as offsets to the opex step change nor disclose any other means of passing the tangible financial benefit back to customers
- ATCO instead advises that it will quantify the benefits in line with the '*Commercial RFP process for platform selection.*'[158]

369. In the absence of an offsetting benefit provided by ATCO or recognition of the ERP opex replacing opex for the system(s) that this will replace, we consider that a reasonable view is that a step change is not required.

4.4.4 Assessment - Critical Infrastructure Act step change

Overview

370. ATCO notes that with changes to the SOCI Act, it has enhanced obligations regarding personnel, supply chain, and physical security of its critical assets (collectively, the four hazard vectors). ATCO proposes two additional FTEs at a cost over the AA6 period of $1.4

158 07.10.052.00 - IT - ERP Replacement - Revised Business Case, page 24

million to manage the CIRMP and associated functions – one SoCI Compliance Lead and one SoCI Physical Security and Controls Lead.[159]

Assessment of new and updated information

371. Based on the information provided, we do not foresee the role requiring additional FTEs over the AA6 period, noting that the main work is establishing the CIRMP and processes to support it is within the AA5 period.

372. In our view, once established, the ongoing effort within the three non-cyber security vectors is unlikely to be demanding with respect to changing or monitoring procurement, recruitment, and the Safety Case processes. We also note that additional cyber security Identity Access Management (IAM) provisions included in the cyber security program (and allowed for in the step change described in section 4.4.2) will help with personnel security. Once new or modified processes are established (i.e. in the current period) we consider that the ATCO workforce, which is of the order of 400 personnel, will absorb these into their routine work processes, assisted by the additional personnel allowed for under the cyber security program and the associated security-related capital investments it is making.

373. We consider that ATCO has not justified the need for its proposed step change of $1.4 million.

4.4.5 Assessment - Security of Supply – Pipeline Patrol step change

374. Overview

375. ATCO has recently completed an assessment which identified three more high pressure pipelines that should be patrolled daily at a cost of $0.8 million for 1.5 extra FTEs. This is in addition to the 1.0 FTE currently responsible for daily patrols of pipelines in Caversham, Two Rocks and Bunbury to reduce the risk of third party damage that would result in the need to isolate the pipeline.

376. Assessment of new and updated information

377. ATCO advises that the pipelines are located in the North and South Metropolitan regions, and we accept that it is feasible for 1.0 FTE to patrol the pipelines by car on a daily basis. However:

- We do not see in the information provided by ATCO that an extra 0.5 FTE for redundancy is required,
- Regardless, we do not consider that a step change is required for a notional 0.25% FTE increase in staff. Rather, we consider that this can be covered by other offsetting efficiencies throughout the business that are referred to throughout the Revised Plan and accompanying business cases. Moreover, since it arises from growth in customer numbers on these pipelines, a counter to ATCO's proposal is that the small amount of additional cost is implicitly covered by the customer growth trend factor in its BST derivation.

378. We consider that ATCO has not justified the need for its proposed step change of $0.8 million.

4.4.6 Assessment - Control Room Fatigue Management step change

379. Overview

380. DEMIRS issued a WorkSafe Improvement Notice to ATCO in 2024 to review and assess fatigue management within the 24-hour Control Room.

381. ATCO's current estimate is that it requires four additional FTE to provide for two control room operators for night and weekend shifts but notes that (i) it is still undertaking its own review, and (ii) had yet to receive from DEMIRS the detailed grounds for the Notice.

[159] ATCO 2025-29 Revised Plan, section 8.6.2

382. Assessment of new and updated information

383. We asked ATCO to confirm the grounds of the Notice and the requirement to add four personnel via an information request. ATCO has responded, advising that following discussions with DEMIRS, it no longer requires the step change.[160]

4.4.7 Assessment - Picarro Leak Survey Technology step change

384. Overview

385. ATCO's project is summarised in section 3.3.3. ATCO proposes adoption of Picarro's leak rate measurement technology to enhance its Leak Survey Program at a total cost of $0.5 million to cover the operation and maintenance of the Picarro technology. ATCO anticipates that it will realise cost savings and states that the technology aligns to good industry practice to replace the traditional walking of the mains to detect leaks.

386. Assessment of new and updated information

387. ATCO has provided a business case which provides compelling information about the benefit of adopting the technology,[161] including from completion of the trial of the technology over 390 km of pipeline since the Initial Plan was submitted. The cost is based on '*vendor quotes and does not include contingency*.'[162] However it does not offer an estimate of the quantitative benefit, which would offset the ongoing cost.

388. We therefore asked ATCO for an estimate of the cost savings from deploying the technology, extrapolated to the whole network and over the course of the AA6 period. In its response,[163] ATCO identified annual avoided opex of $1.0 million from 2026 inclusive (i.e. avoided cost of $3.5 million when the opex increase is included).

389. We therefore consider that no step change is required and that the balance of any further efficiency gain can be used to offset other step changes that we recommend should be adjusted to zero in the balance of this section.

4.4.8 Assessment - Payroll Upgrade Project step change

390. Overview

391. ATCO's project is summarised in section 3.5.4. We are generally supportive of the intent, scope and timing of the project. ATCO proposes an upgrade to its Payroll system. ATCO has allowed for $0.5 million opex ($0.1 million opex p.a.) for the upgraded Payroll system from 2025 onwards as the incremental licencing costs.

392. Assessment of new and updated information

393. ATCO has not attempted to quantify the benefits that will accrue to it after implementing the Payroll Upgrade project noting that in the Project Brief, multiple benefits are claimed, such as reduced administrative burden.[164] Although ATCO has not provided an estimate of the value of these benefits, we consider it more than likely from ATCO's description that they would exceed the $0.1 million p.a. that it is seeking as a step change, or that the $0.1 million p.a. it is proposing would not be additional to operational costs for its exiting payroll system.

394. We consider that an opex step-change for the project is not justified.

160 ATCO response to IR121

161 07.107.00 - Asset Performance - Picarro - Business Case

162 07.107.00 - Asset Performance - Picarro - Business Case, page v

163 ATCO response to EMCa121

164 07.122 - Payroll Upgrade - Project Brief, page 5

4.4.9 Assessment - Technology Lifecycle

Overview

395. ATCO's Technology Lifecycle program was introduced in the Revised Plan and is summarised in section 3.5.2. ATCO proposes a $2.7 million opex step change for 'licensing and support fees' associated with technology assets requiring change or uplift (refresh, update, upgrade), typically due to technical obsolescence.

Assessment of new and updated information

396. The information provided with the Revised Plan only included hard-coded costs for the annual expenditure and scant details about the basis for the opex estimates. We therefore asked for more information to enable our assessment.

397. In its response,[165] ATCO provided a list of the drivers and opex for 25 proposed initiatives and the associated projects required to deliver each initiative. The cost estimates are clearly approximations in most cases; however this is not unreasonable at this stage of the project lifecycle. The majority of the proposed $2.7 million opex allocated to ATCO is for maintenance and support.

398. There is a relatively small amount of opex driven by 'Redundancy and Disaster Recovery', which is strictly increasing capability, and 'Security of critical infrastructure' which strictly should be incorporated into the Cyber security business case. However, the periodic update/refresh of the systems, tools, and applications is consistent with the intent of recurrent technology lifecycle management, and it is normal for a 'refresh' to provide some additional functionality.

399. It was not clear from the information presented whether there are any offsetting savings from licensing and support fees from systems that are being replaced and whether they had been deducted from the base year. In response to our information request, ATCO advised that there would be savings from reduced licensing and support fees of $0.9 million over the AA6 period.[166] There is no indication in the response, nor in ATCO's Revised Plan or its Business Case that this amount has been accounted for in its proposed step change.

400. On this basis we consider that the step change should be adjusted by -$0.9 million to $1.8 million.

4.4.10 Assessment - Data Enablement step change

Overview

401. ATCO's new Data Enablement project is summarised in section 3.5.8. ATCO proposes $0.9 million over the AA6 period for annual licensing and support fees for the technologies to deliver and maintain these activities.[167]

Assessment of new and updated information

402. We consider ATCO's proposed project is prudent. ATCO estimates $0.1m opex for licensing and support fees from 2025, with the balance of $0.8 million for a new data architect (i.e. 1.0 FTE) from 2027 onwards.

403. The need for the proposed data architect was not clear from the business case. We asked ATCO for clarification of the purpose of the role and whether the need was likely to be enduring (i.e. beyond December 2029). In ATCO's response in which it describes the role and responsibilities of the data architect,[168] it states that:

165 ATCO response to EMCa116

166 ATCO response to Information Request EMCa131

167 2025-29 Revised Plan, page 173

168 ATCO response to EMCa122

If there were none or limited Data Architecture capabilities allocated to the Data Enablement business case, ATCO would have significant difficulties in delivering the initiative with the benefits unlikely to be achieved. Furthermore, it would seriously impinge on ATCO's ability to successfully deliver an ERP Replacement program within the budget and timeframes defined.

404. Given the information included in the response we consider that input to this project from a Data Architect resource is justified. However as with many other business cases, ATCO does not recognise the productivity improvement that it claims will accrue from this project by reducing the current burden of manual data cleansing and validation. Based on ATCO's analysis of the 'do nothing different' option, which we discuss in section 3.5.8, and which reveals an estimated $6.2 million savings over five years from avoided manual interventions, we consider that the additional cost of the data architect will be more than offset by productivity improvement.

405. We therefore consider that a step change is not warranted for this project.

4.4.11 Assessment - Technology Leasing step change

Overview

406. ATCO proposes changing from a purchase model to a leasing model for 317 devices commencing in 2025. ATCO proposes a $1.5 million step change for this.

Assessment of new and updated information

407. ATCO has provided an NPV analysis which demonstrates over 5 years that the opex versus capex outlay over the AA6 period is 17% ($0.3m) less in favour of leasing.[169]

408. With the assumed unit costs, this is a legitimate and cost effective opex-capex trade-off and we are satisfied that the step change is warranted.

4.4.12 Assessment - ESG Reporting System step change

409. ATCO's project is summarised in section 3.5.5. It proposes a $0.5 million step change for this.

410. ATCO's Option 2 will replace a cumbersome manual system with a digital platform 'offering speed, efficiency, and scalability.' In section 3.5.5, we propose accepting ATCO's proposed capex on the basis of these claimed benefits. As we state in that section, ATCO does not attempt to quantify the efficiency benefits that it refers to and which we consider would be (i) material, (ii) an offset to the proposed step change, and (iii) are part of the rationale for accepting the proposed capex.

411. Consistent with accepting the proposed capex-based solution and its associated benefits, we therefore consider that the proposed opex step change is not justified.

4.4.13 Assessment – Pipeline inline inspections (ILI)

412. As discussed in section 3.3.3, ATCO has changed its inspection technique for the three Bunbury pipelines in its Revised Plan from ILI to direct assessment. This reduces the cost of inspecting the Bunbury pipelines from an estimated $2.1 million to $0.3 million opex over the AA6 period. ATCO has retained the $4.2 million opex estimate to undertake ILI of the other pipelines that are due for inspection in the AA6 period. ATCO's revised estimate of $4.5 million for its AA6 pipeline inspection program is $0.3 million more than the ERA's Draft Decision of $4.2 million (but which did not allow for any inspection of the Bunbury pipelines in the AA6 period). We consider that the step change is justified.

[169] 08.110 - OPEX Forecasting Leasing 2

4.4.14 Assessment - IT Managed services step change

Overview

413. ATCO proposes a $0.5 million opex step change to renew the tender for IT managed services before the expiry of the current contract in 2026. The ERA rejected this step change on the grounds that it was a routine operational expense and not reflective of an additional cost that is imposed by the introduction of a new regulatory obligation or an efficient capex / opex trade-off.

Assessment of new and updated information

414. In its Revised Plan, ATCO argues that this is not a routine activity despite also stating that the contract is periodically reviewed. It states that '*given the highly complex nature of IT services delivery, ATCO requires specialist external expertise to ensure that the tender for the upcoming renewal achieves the required outcomes from the contract negotiation process.*' *The contract consists of 70 discrete IT services.*[170]

415. We are satisfied with the new information that confirms that specialist expertise (including legal and commercial advice) is reasonably required to support ATCO in selecting the appropriate services, balancing cost and risk, among other factors. However, this is not a new requirement and for an organisation of ATCO's size, we do not see the justification for a perpetual step change which is a small amount in an operating budget of more than $400 million over the AA6 period.

4.5 Findings and Implications

4.5.1 Findings

416. ATCO has proposed a large number of new and relatively small opex step changes. ATCO has not acknowledged that it will accrue offsetting tangible opex benefits in submitting opex step changes, either at the project level or when submitting relatively minor increases for one or two extra staff in a workforce of over 400 FTEs and with a proposed operating budget in excess of $80 million per annum.

417. With the exception of step changes associated with four of the projects/programs within our scope, we consider that no step changes are justified. The four projects for which we consider a step change is justified are:

- Revised cyber security program, which the ERA did not allow in its Draft Decision, but which ATCO has resubmitted after significant analysis and reconfiguration. We consider that the establishment of the onshore SOC and the opex fees associated with the increased cyber capabilities is largely warranted, with the exception being offsetting Canadian MSP charges which ATCO did not recognise.
- New Technology Lifecycle program which is unlikely to generate tangible opex reductions given the scope and intent of the projects and which we consider will reasonably incur incremental opex costs. However, ATCO has advised that there are offsetting savings from licensing and support fees from systems that are being replaced, which we have deducted.
- Technology leasing which we consider to be a reasonable capex to opex swap
- Pipeline inline inspections for which we consider the estimates to be reasonable and required as part of prudent asset management practice.

[170] 2025-29 Revised Plan, page 179

4.5.2 Implications

418. *Table* 4.10 summarises our proposed adjustments to the step changes included in ATCOs' Revised Plan and which are within our scope. The aggregate adjustment is -$12.4 million for these items.

Table 4.10: Summary of step changes, with EMCa adjustments - $m, real 2023

Step changes		ATCO Initial Plan	ERA Draft Decision	ATCO Revised Plan	Step changes after EMCa adjustments	EMCa adjustment
Recurrent step changes not in scope		**13.8**	**4.5**	**6.6**	**6.6**	**n/a**
Updated recurrent step changes	Cyber security program	4.5	0.0	6.6	5.9	-0.7
	ERP Replacement	4.1	0.6	4.1	0.0	-4.1
New recurrent step Changes	Critical Infrastructure Act	-	-	1.4	0.0	-1.4
	Security of Supply – Pipeline Patrol	-	-	0.8	0.0	-0.8
	Control Room Fatigue Management	-	-	1.6	0.0	-1.6
	Picarro Leak Survey Technology	-	-	0.5	0.0	-0.5
	Payroll Upgrade Project	-	-	0.5	0.0	-0.5
	Technology Lifecycle	-	-	2.7	1.8	-0.9
	Data Enablement	-	-	0.9	0.0	-0.9
	Technology leasing	-	-	1.5	1.5	0.0
	ESG reporting system	-	-	0.5	0.0	-0.5
Sub total updated and new recurrent step changes (in scope)		**8.6**	**0.6**	**21.1**	**9.2**	**-11.8**
Non-recurrent step changes not in scope		**33.5**	**4.2***	**6.0***	**6.0***	**n/a**
Updated non-recurrent step change	Pipeline Inline inspections	6.3	4.2	4.5	4.5	0.0
	Managed IT services tender renewal	0.5	0.0	0.5	0.0	-0.5
Sub-total non-recurrent step changes (in scope)		**6.8**	**4.2**	**5.0**	**4.5**	**-0.5**
TOTAL step changes		**62.7**	**13.5**	**38.7**	**26.3**	**-12.4**

Source: ATCO 2025-29 Revised Plan, Table 8.36; ATCO 9.020 – Base Step Trend Opex Forecast Model
** Not including SaaS arrangements, which the ERA subsequently classified as capex and a classification that ATCO has adopted in its Revised Plan*

419. *Table* 4.11 shows the annual proposed step change adjustments for the AA6 period.

Table 4.11: EMCA step change adjustments (step changes within scope) – $m, real 2023

Step change adjustments	2025	2026	2027	2028	2029	Total
Recurrent step changes						
Cyber security program	-0.14	-0.14	-0.14	-0.14	-0.14	**-0.70**
ERP Replacement	0.00	0.00	0.00	-2.07	-2.07	**-4.14**
Critical Infrastructure Act	-0.29	-0.29	-0.29	-0.29	-0.29	**-1.44**
Security of Supply – Pipeline Patrol	-0.16	-0.16	-0.16	-0.16	-0.16	**-0.79**
Control Room Fatigue Management	-0.32	-0.32	-0.32	-0.32	-0.32	**-1.60**
Picarro Leak Survey Technology	-0.09	-0.09	-0.09	-0.09	-0.09	**-0.45**
Payroll Upgrade Project	-0.09	-0.09	-0.09	-0.09	-0.09	**-0.46**
Technology Lifecycle	-0.18	-0.18	-0.18	-0.18	-0.18	**-0.90**
Data Enablement	-0.01	-0.01	-0.29	-0.29	-0.29	**-0.90**
Technology leasing	0.00	0.00	0.00	0.00	0.00	**0.00**
ESG reporting system	0.00	-0.12	-0.12	-0.12	-0.12	**-0.47**
Non-recurrent step changes						
Pipeline Inline Inspection	0.00	0.00	0.00	0.00	0.00	**0.00**
Managed IT services tender renewal	-0.26	-0.26	0.00	0.00	0.00	**-0.52**
TOTAL	**-1.54**	**-1.66**	**-1.68**	**-3.74**	**-3.74**	**-12.37**

Source: EMCa analysis from 08.101 – AA6 Opex Model – Spreadsheet - Clean