



# **FINAL DECISION**

## **APA VTS Australia**

### **Gas access arrangement**

#### **2018 to 2022**

## **Attachment 2 – Capital base**

November 2017

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## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
APA	APA VTS Australia (Operations) Pty Ltd and APA VTS Australia (NSW) Pty Ltd
capex	capital expenditure
NGL	National Gas Law
NGR	National Gas Rules
PTRM	Post tax revenue model
RFM	Roll forward model

## 2 Capital base

The capital base roll forward accounts for the value of APA's regulated assets over the access arrangement period. The opening capital base value for a regulatory year within the access arrangement period is rolled forward by indexing it for inflation, adding any conforming capex, and subtracting depreciation and other possible factors (for example, disposals or customer contributions).<sup>1</sup> Following this process, we arrive at a closing value of the capital base at the end of each year of the access arrangement period. The opening value of the capital base is used to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

### 2.1 Final decision

We do not approve APA's revised proposed opening capital base as at 1 January 2018.<sup>2</sup> Our final decision approves an opening capital base of \$971.1 million (\$ nominal) as at 1 January 2018 for APA. This amount is \$26.5 million lower than the \$997.6 million in APA's revised proposal. This is because:

- we do not accept APA's revised proposal to use forecast inflation as an input to roll forward the capital base over the 2013–17 access arrangement period
- we have made several amendments to other inputs for the roll forward model (RFM)
- we have substituted our latest version of the RFM to correct a number of errors in APA's revised proposal RFM.

In the draft decision, we did not accept APA's proposed opening capital base as at 1 January 2018. We identified changes to several inputs and formulae in the RFM, in particular:

- Completing the capital base roll forward using actual conforming capex that is recognised on an as-commissioned basis (not just as-incurred basis) to establish the opening capital base at 1 January 2018. APA's revised proposal did not adopt this amendment nor provide a response to the draft decision. For the reasons set out in our draft decision, our final decision is to use actual conforming capex on as-commissioned basis (not just as-incurred basis) and we have made the necessary revisions to the access arrangement to reflect this final decision.<sup>3</sup>
- The treatment of inflation in the capital base roll forward process. APA's revised proposal did not adopt our draft decision and maintained its proposal to change the treatment of inflation for both the historical roll forward of the capital base (in the

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<sup>1</sup> The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

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

<sup>3</sup> AER, *Draft decision, attachment 2*, 6 July 2017, pp. 16–17.

2013–17 RFM) and the projected roll forward of the capital base (in the 2018–22 post tax revenue model (PTRM)).<sup>4</sup> We have considered APA's revised proposal and confirm our draft decision to not accept either of the proposed changes to inflation treatment in the regulatory models.<sup>5</sup> For this final decision, we have applied the AER's standard approach—use of actual inflation for the roll forward of the capital base in the 2013–17 RFM and use of expected inflation for the projected roll forward of the capital base in the 2018–22 PTRM. Further detail on our final decision in relation to this issue is set out in attachment 14.

Our draft decision also identified required changes to APA's proposed conforming capital expenditure (capex) for the 2013–17 access arrangement period. We noted that the proposed capex for 2016 and 2017 were estimates, and that APA would provide actual capex for 2016 in its revised proposal and may provide a revised 2017 capex estimate based on more up to date information.

APA's revised proposal submitted conforming capex of \$412.2million (\$2017), which included an update of the capex estimate for 2017 but not for 2016.<sup>6</sup> Following an information request from us, APA provided the actual capex for 2016 and further updates to the capex estimate for 2017.<sup>7</sup> As discussed in attachment 6 we accept APA's (amended) revised proposed capex as conforming capex during the 2013–17 access arrangement period. Therefore, we consider that actual conforming capex has been properly accounted for in the revised proposed capital base roll forward, consistent with the requirements of the NGR.

Table 2-1 summarises our final decision on the roll forward of APA's capital base during the 2013–17 access arrangement period.

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<sup>4</sup> APA VTS - Access Arrangement revision proposal submission - 20170814 – Public, pp. 52–58.

<sup>5</sup> The details of our reasons are set out in attachment 14 of this final decision.

<sup>6</sup> APA VTS - Access Arrangement revision proposal submission - 20170814 – Public, p. 60.

<sup>7</sup> APA, Email response to AER information request # 13, [AER]–[APA VTS]–[IR #13]–[Information request in relation to APA VTS revised proposed RFM [20170914], 12 October 2017.

**Table 2-1 AER final decision on APA's capital base roll forward for the 2013–17 access arrangement period (\$ million, nominal)**

	2013	2014	2015	2016	2017
Opening capital base	634.0	649.8	762.5	842.7	918.0
Net capex	15.9	127.9	97.4	94.5	64.5
Indexation of capital base	12.3	11.2	12.9	12.4	18.4
<i>Less:</i> straight-line depreciation	12.4	26.4	30.2	31.6	29.8
Closing capital base	649.8	762.5	842.7	918.0	971.1
<b>Opening capital base as at 1 January 2018</b>					<b>971.1<sup>a</sup></b>

Source: AER analysis.

- (a) The adjustment to account for any difference between actual and estimated capex in the final 'year' of the previous access arrangement period (in this case, 1 January 2012 to 31 December 2012 and the additional six months from 1 January 2013 to 30 June 2013) is not required for APA because actual capex was included in APA's 2013 approved opening capital base. This occurred as part of the amendments to the 2013–17 access arrangement that followed a decision by the Australian Competition Tribunal.

We approve a forecast closing capital base value of \$1143.5 million (\$ nominal) at 31 December 2022. This is \$35.7 million (or 3.0 per cent) lower than the \$1179.2 million (\$nominal) in APA's revised proposal. Our final decision on the projected closing capital base reflects our changes to the opening capital base as at 1 January 2018, and our final decisions on forecast capex (attachment 6), expected inflation (attachment 3) and forecast depreciation (attachment 5). We also do not accept APA's revised proposal to use lagged actual inflation (annually updated) in the roll forward of its projected capital base (attachment 14). Therefore, we do not approve APA's revised proposed forecast capital base as at 31 December 2022.<sup>8</sup>

Table 2-2 sets out our final decision on the projected roll forward of the capital base during the 2018–22 access arrangement period.

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<sup>8</sup> NGR, r. 78.

**Table 2-2 AER's final decision on APA's projected capital base roll forward for the 2018–22 access arrangement period (\$ million, nominal)**

	2018	2019	2020	2021	2022
Opening capital base	971.1	1022.8	1085.6	1145.1	1141.9
Net capex	64.6	78.5	77.2	18.2	18.7
Indexation of capital base	23.8	25.1	26.6	28.1	28.0
<i>Less:</i> straight-line depreciation	36.7	40.8	44.4	49.5	45.0
<b>Closing capital base</b>	<b>1022.8</b>	<b>1085.6</b>	<b>1145.1</b>	<b>1141.9</b>	<b>1143.5</b>

Source: AER analysis.

For this final decision and consistent with our draft decision, we determine that the forecast depreciation approach is to be used to establish the opening capital base at the commencement of the 2023–27 access arrangement period for APA.<sup>9</sup>

APA's revised proposal adopted the forecast depreciation approach to establishing the capital base. However, it raised concerns with our draft decision in relation to the use of forecast depreciation at the asset class level rather than in total. APA submitted that our approach to applying forecast depreciation at the asset class level would preclude any adjustment reflecting changes in the expected economic life of a particular asset or class of assets under r. 89(1)(c) of the NGR.<sup>10</sup>

We do not agree with APA's submission. Our decision on the opening capital base at 1 January 2018 approves the asset classes and associated standard asset lives and remaining asset lives to be applied in calculating the depreciation allowance for the 2018–22 access arrangement period. At the next access arrangement review the roll forward of the capital base using forecast depreciation ensures the value of straight-line depreciation used to form the regulatory depreciation allowance is removed from the capital base at the asset class level. This reflects the proportion of return of capital embedded in the reference tariff and ultimately recovered from customers. We avoid any retrospective change to the economic life of an asset or class of assets that potentially results in tariff variation or windfall gains or losses to the service provider. We consider our approach will provide for a forecast of depreciation over the 2018–22 access arrangement period that provides for continuity and consistency in determining depreciation from one access arrangement period to the next.<sup>11</sup>

In the event that circumstances arose requiring a service provider to propose adjustments to the economic life of an asset or class of assets to calculating depreciation in future access arrangements we would assess the merits of such a

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<sup>9</sup> NGR, r. 90(2).

<sup>10</sup> APA VTS - Access Arrangement revision proposal submission - 20170814 – Public, p. 64.

<sup>11</sup> NGL, s. 24(4) and s. 28(2)(a)(i).

proposal at that time. Acceptance of a proposal to adjust the economic life of an asset would be considered to take effect from the commencement of the access arrangement period under review. As discussed in our draft decision, our approach is consistent with the depreciation criteria under the NGR because each asset class is depreciated over its economic life.<sup>12</sup> Therefore, we revised APA's access arrangement to reflect this decision to establish the capital base as at 1 January 2023 using the approved depreciation schedules (straight-line) based on forecast capex at the asset class level.<sup>13</sup>

## 2.2 Assessment approach

Our approach to the capital base is set out in section 2.3 of our draft decision. We have not changed that approach in this final decision.

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<sup>12</sup> NGR, r. 89(1)(b).

<sup>13</sup> NGR, r. 90.