FINAL DECISION
Roma to Brisbane Gas Pipeline Access Arrangement 2017–22

Attachment 2 – Capital base

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AUSTRALIAN ENERGY REGULATOR

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Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CESS	Capital Expenditure Sharing Scheme
CPI	consumer price index
DRP	debt risk premium
ECM	(Opex) Efficiency Carryover Mechanism
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	Value of Imputation Credits
MRP	market risk premium
NGL	National Gas Law
NGO	national gas objective
NGR	National Gas Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STTM	Short Term Trading Market
TAB	Tax asset base
UAFG	Unaccounted for gas
WACC	weighted average cost of capital
WPI	Wage Price Index

2 Capital base

The capital base roll forward accounts for the value of APTPPL's Roma to Brisbane Pipeline (RBP) 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).[1] Following this process, we arrive at a closing value of the capital base at the end of the relevant year. 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

Our final decision approves an opening capital base of $452.1 million ($nominal) as at 1 July 2017 for APTPPL. This amount is $0.1 million lower than the $452.2 million in APTPPL's revised proposal. This is because we amended APTPPL's revised proposed roll forward model (RFM) to correct an input error with the value of capital contributions for 2013–14 to be deducted from the capital base. Therefore, we do not approve APTPPL's revised proposed opening capital base as at 1 July 2017.[2]

In the draft decision, we did not accept APTPPL's proposed opening capital base as at 1 July 2017 and identified changes to several inputs to the RFM:

- Adjustments for difference between actual and estimated capex in 2011–12. These included:
    - adjusting the estimated capex to recognise the length of the 2011–12 regulatory year as 14 months
    - adjusting the regulatory depreciation, inflation and WACC inputs for 2011–12 to recognise the length of the 2011–12 regulatory year as 14 months
    - adjusting the allocation of the RBP8 estimated and actual capex in 2011–12 to reflect the asset classes that comprised the project
    - updating the actual as–commissioned capex values for 2011–12
- Allocation of forecast depreciation values across asset classes to be subtracted from the capital base in the 2012–17 access arrangement period.

APTPPL's revised proposal adopted these amendments to the RFM in full.[3]

[1] The term "rolled forward" means the process of carrying over the value of the capital base form one regulatory year to the next.

[2] NGR, r. 77(2).

[3] APTPPL, *RBP Revised access arrangement submission*, August 2017, pp.33–37.

Our draft decision also identified required changes to APTPPL's proposed conforming capex for the 2012–17 access arrangement period. We noted that the proposed capex for 2016–17 was an estimate, and that APTPPL may provide a revised 2016–17 capex estimate based on more up to date information in its revised proposal.

APTPPL's revised proposal submitted conforming capex of $127.0 million ($ 2016–17), including an update of capex for 2016–17 to reflect actual capex.[4] APTPPL did not adopt our draft decision to remove conforming capex to address flood and land slip damage repairs over the 2012–17 access arrangement period.[5] As discussed in attachment 6 we now accept APTPPL's revised proposed actual capex as conforming capex during the 2012–17 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 APTPPL's capital base over the 2012–17 access arrangement period.

Table 2-1 AER's final decision on APTPPL's capital base for the 2012–17 access arrangement period

	2012–13	2013–14	2014–15	2015–16	2016–17
Opening capital base	417.1	420.8	427.4	438.8	437.0
Capital expenditure	5.9	10.8	23.6	10.2	18.8
Inflation indexation on opening capital base	10.4	12.3	5.7	5.7	9.3
Less: straight-line depreciation	12.7	16.5	17.9	17.6	16.8
Closing capital base	420.8	427.4	438.8	437.0	448.4
Difference between estimated and actual capex (1 July 2011 to 31 August 2012)					2.7
Return on difference for 2011–12 capex					1.0
Opening capital base as at 1 July 2017					**452.1**

Source: AER analysis.

(a) As-incurred, net of disposals and adjusted for CPI.

(b) Forecast depreciation adjusted for actual CPI.

We approve a forecast closing capital base value of $502.5 million ($nominal) at 30 June 2022. This is $1.4 million lower than the $503.9 million ($nominal) in APTPPL's revised proposal. Our final decision on the projected closing capital base reflects our changes to the opening capital base as at 1 July 2017, and our final decisions on

4 APTPPL, *RBP Revised Access Arrangement Submission – RFM*, August 2017. The conforming capex quoted includes an amount for the 2011–12 regulatory year.

5 APTPPL, *RBP Revised Access Arrangement Submission*, August 2017, p. 39.

forecast capex (attachment 6), expected inflation (attachment 3) and forecast depreciation (attachment 5). We also do not accept APTPPL'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 APTPPL's revised proposed forecast capital base as at 30 June 2022.[6]

Table 2-2 sets out our final decision on the projected roll forward of the capital base for APTPPL over the 2017–22 access arrangement period.

Table 2-2 AER's final decision on APTPPL's projected capital base for the 2017–22 access arrangement period ($million, nominal)

	2017–18	2018–19	2019–20	2020–21	2021–22
Opening capital base	452.1	473.3	483.7	484.0	492.2
Capital expenditure[a]	27.0	17.0	7.5	9.4	9.5
Inflation indexation on the opening capital base	11.0	11.5	11.7	11.7	11.9
Less: straight-line depreciation	16.7	18.1	18.8	13.0	11.1
Closing capital base	473.3	483.7	484.0	492.2	502.5

Source: AER analysis.

(a) In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half year WACC allowance to compensate for the six month period before capex is added to the capital base when determining revenue.

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 2022–27 access arrangement period for APTPPL.[7]

APTPPL'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. APTPPL 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.[8]

We do not agree with APTPPL's submission. Our decision on the opening capital base at 1 July 2017 approves the asset classes and associated standard asset lives and remaining asset lives to be applied in calculating the depreciation allowance for the 2017–22 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

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6 NGR, r. 78.

7 NGR, r. 90(2).

8 APTPPL,

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 2017–22 access arrangement period that provides for continuity and consistency in determining depreciation from one access arrangement period to the next.[9]

In the event that circumstances arise 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 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.[10] Therefore, we revised APTPPL's access arrangement to reflect this decision to establish the capital base as at 1 July 2022 using the approved depreciation schedules (straight-line) based on forecast capex at the asset class level.[11]

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.

[9] NGL, s. 24(4) and s. 28(2)(a)(i).

[10] NGR, r. 89(1)(b).

[11] NGR, r. 90.