Draft Decision

APA Victorian Transmission System (VTS)

Access Arrangement 2023 to 2027

(1 January 2023 to 31 December 2027)

Attachment 9
Reference tariff setting

June 2022

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to APA's Victorian Transmission System (VTS) for the 2023–27 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Operating expenditure incentive mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

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9 Reference tariff setting

This attachment outlines our assessment of the reference tariffs proposed by APA for the Victorian Transmission System (VTS) against the requirements of the National Gas Rules (NGR). Our assessment focuses on the structure of reference tariffs and takes into account the revenue and pricing principles.[1]

We assessed APA's proposed reference tariffs against the provisions of the NGR[2] and the National Gas Law (NGL).[3]

This attachment describes our assessment of the VTS reference tariffs proposed by APA and sets out the revisions required by this decision. The AER's assessment focuses on the design and structure of tariffs and the allocation of costs to services.

9.1 Draft decision

We accept APA's proposed structure of reference tariffs for the 2023–27 access arrangement period (2023–27 period) for the VTS and the three proposed prudent discounts. We are satisfied that they meet rule 96 of the NGR. We are satisfied the proposed structure of the reference tariffs complies with the requirements of the NGR.

We accept the fundamental features of APA's proposed reference tariffs for the VTS, including tariff design, the zonal structure, the basis for charging users and the general approach to allocating costs.

Nevertheless, the quantum of the proposed reference tariffs must be amended to reflect our assessment of the building block proposal set out in this draft decision.

9.2 APA's proposal

APA proposed a single reference service, which is the tariffed transmission service. All costs allocated to the VTS are allocated to this service (in the form of reference tariffs). APA did not propose any changes to its methodology for allocating costs to its reference tariffs. The methodology proposed is the same as that which applied in the 2018–22 access arrangement period.[4]

9.2.1 Injection and withdrawal tariffs

In the VTS (under the Declared Wholesale Gas Market) market participants can operate as:

- Injecting parties (suppliers), or as
- Withdrawing parties (buyers).

The Declared Wholesale Gas Market (DWGM) is a mandatory market that assumes that all gas is injected to the system and delivered to a central "market" where it is traded and then delivered from the central "market" to a specified withdrawal point. The VTS tariff model is

1 NGL, ss. 24(2)–(7).

2 NGR, rr. 93, 95 and 96.

3 NGL, ss. 23 and 24.

4 APA, *VTS Proposal*, Overview, December 2021, p. 54.

therefore structured to produce injection tariffs and withdrawal tariffs. The current tariff structures (and the tariff model) have been in place for over 20 years.

The VTS model calculates injection and withdrawal tariffs on a granular zonal basis. Zonal tariffs reflect the cost of the assets used to serve each of the zones and are therefore cost reflective.

9.2.1.1 Injection tariffs

The injection tariff applies to suppliers and recovers the costs of "injection" pipelines. There are five injection points on the VTS:

- Longford
- Port Campbell
- Pakenham
- Dandenong
- Culcairn.

To signal peak use to market participants (which drives expansion costs), the injection charge is levied on the ten peak injection days over the winter at each injection zone.

If a supplier injects on a top-ten peak day, it pays the injection charge. If a supplier injects on a non-top-ten peak day, it does not attract an injection charge. The top-ten peak days are not known in advance.

A smoother payment schedule is provided to users whereby injection charges are forecast annually for each injector and levied monthly on a sculpted profile. An injection charge 'wash-up' is performed after September each year when the actual peak days are known.

9.2.1.2 Withdrawal tariffs

The withdrawal tariff applies to buyers who procure their gas from the DWGM via the VTS. The withdrawal tariff recovers the cost of transmission from the DWGM "market" to the user. The system is divided into 25 withdrawal zones, and tariffs levied on the withdrawing user. Within each withdrawal zone there are up to three tariff classes. These tariff classes are:

- Tariff-D (Demand)
- Tariff-V (Volume)
- Cross-system tariff (supplements other tariffs in some circumstances).

The cost of transmission through the withdrawal zones is based on a forecast of physical flows. That is, they recover the costs of withdrawal pipelines on an "any day" per GJ throughput, rather than capacity, basis.

The withdrawal tariffs are subject to a flow analysis model with the aim of allocating costs to each user in proportion to that user's use of system assets. A user who uses a short section of the system will generally pay a lower charge than a user who uses a longer section of the system.

"Tariff V" (Volume) and "Tariff D" (Demand) withdrawal tariffs distinguish between customers based on the volume of gas used per annum. Tariff D customers use more than 10TJ per annum while Tariff V customers are all other customers. The withdrawal charge is levied on the actual flows each month (an 'anytime' charge).[5]

9.2.2 Prudent Discount Tariffs

APA also proposed tariffs for three prudent discounts to minimise the threat of bypass. APA has three prudent discounts in the current access arrangement period, which APA proposed to continue:

- Maryvale zone discount
- Western zone discount
- Dandenong bypass tariff.[6]

9.3 Assessment approach

In an access arrangement a service provider is required to specify, for each reference service, the reference tariff and proposed approach to setting the reference tariff.[7] This is done by:

- explaining how revenues and costs are allocated, including the relationship between costs and tariffs[8]
- explaining how the tariffs have been designed to generate the portion of referable total revenue from each reference service and from each user, or class of users[9]
- explaining and describing any pricing principles it employed.[10]

We assessed APA's proposed reference tariffs for the VTS against the provisions of the NGR and the NGL, in particular, rules 93, 95 and 96 of the NGR. We have also taken into account the revenue and pricing principles[11] and the requirement for consistency with the National Gas Objective.[12]

Rules 93 and 95 of the NGR require that reference tariffs for reference services be designed to reflect the current and expected future demand, and the allocation of costs between reference and non-reference services. Where we do not accept the proposed reference tariffs, we must determine the initial reference tariffs to apply for each reference service.

5 APA, *VTS Proposal*, Overview, December 2021, pp. 58-60.

6 APA, *VTS Proposal*, Tariff derivation approach, December 2021, pp. 20-22.

7 NGR, rr. 48(1)(d)(i) and 72(1)(j).

8 NGR, rr. 72(1)(j)(i), 93(1)–(2).

9 NGR, r. 95(1).

10 NGR, r. 72(1)(j)(ii).

11 NGL, s. 28(2); s. 24.

12 NGR, r. 100(a); NGL, s. 23.

In our assessment of the proposed reference tariffs, we reviewed the VTS 2023–27 access arrangement information and proposal. We also had regard to submissions received in the course of our consultation on APA's proposed VTS access arrangement.[13]

9.3.1 Identifying the reference service

The NGR require service providers to specify a reference tariff for each reference service.[14] When undertaking our review, we first consider what is (or are) the reference service(s) for the purpose of the NGR. Our decision on what constitutes the reference service was published in May 2021 and is referenced in Attachment 1 – Services covered by the access arrangement.[15]

9.3.2 Interrelationships

The reference tariffs have interrelationships across other key parts of our draft decision. For example, it interrelates with the total revenue that can be earned by APA, the services it provides to its VTS customers to recover those revenues, the tariffs it charges for the use of those services, and the demand forecast volumes used to calculate tariffs.

Our VTS draft decision on:

- the total revenue requirement for APA is set out in the Overview of this draft decision
- the services offered to customers over the 2023–27 period are set out in Attachment 1 – Services covered by the access arrangement
- the annual tariff variation mechanisms are set out in Attachment 10 – Reference tariff variation mechanism
- the demand forecast volumes are set out in Attachment 12 – Demand.

9.4 Reasons for the draft decision

APA proposed the continuation of the current reference tariff structures during the 2023–27 access arrangement period, which we have accepted subject to updates required to give effect to other parts of this draft decision.

Stakeholders have noted the complexity of the VTS tariff structure, which establishes locational tariffs based on the physical flow of gas across the VTS network. An issues paper on tariff structures was contemplated as part of APA's early (pre lodgement to the AER) stakeholder engagement, but it did not allow sufficient time for this. For future access arrangement periods, APA is considering moving away from the existing VTS tariff model and tariff structure towards something more straightforward.

13 NGR, r. 59.

14 NGR, r. 48(1)(d)(i).

15 AER - APA Victorian Transmission System reference service decision 2023-27 - Final decision, May 2021

9.4.1 Reference tariff structure and cost allocation

We accept APA's proposed reference tariff structure for the VTS because we are satisfied that it complies with the NGR requirements.[16] The tariff structure is consistent with that applied in the current access arrangement.

However, the quantum of the proposed initial reference tariff must be amended to reflect the draft decision on APA's building block proposal for the VTS.

9.4.2 Prudent discounts

We accept APA's proposed prudent discounts for the VTS for the 2023–27 period. On the basis of the information provided, the three prudent discounts meet rule 96 of the NGR. We are satisfied that:

- the discounts are necessary to maintain efficient use of the pipeline (rule 96(2)(a)(ii))
- provision of the discounts is likely to lead to reference or equivalent tariffs that are lower than they would otherwise have been (rule 96(2)(b)).

These prudent discounts are an existing part of the current access arrangement and APA has not proposed any changes to these prudent discounts, other than an adjustment for inflation. In considering APA's proposal to continue these prudent discounts we have revisited the initial assessments of them and engaged with APA on the ongoing need for them.

The prudent discounts proposed to be continued are discussed below.

9.4.2.1 Maryvale zone discount

APA described the Maryvale Zone prudent discount as relevant to the Paperlinx plant which has the only offtake in the Maryvale zone.[17] APA further described the Maryvale prudent discount as being driven by concerns about a potential bypass pipeline. However, the prudent discount approved for the Maryvale zone in the 2008–12 access arrangement was not based on the risk of pipeline bypass, as stated by APA, but on the risk of a change in production processes at the Maryvale plant, leading to a reduction in gas demand.

Having noted the actual rationale for the original approval of the Maryvale prudent discount, and separately confirming this with APA in preparing this draft decision, we have considered the ongoing need for this prudent discount. We note that Maryvale zone customers are, under the prudent discount arrangement, contributing to APA's recovery of indirect costs which benefits all other VTS users. With that in mind we consider the discount remains relevant to prevent Maryvale zone customers from defecting from the VTS and therefore benefits all VTS customers.

9.4.2.2 Western zone discount

APA stated it had previously designed and costed a bypass pipeline from the SEA Gas Pipeline which parallels the VTS between the towns of Warrnambool and Koroit. It proposed

16 NGR, rr. 93 and 95.

17 APA, VTS Proposal, Tariff derivation approach, December 2021, p. 21.

discounted tariffs at both Warrnambool and Koroit because it stated they were required to offset the risk of connection of those systems to the SEA Gas pipeline.[18]

We consider the discount remains appropriate to prevent Warrnambool and Koroit customers from defecting from the VTS.

9.4.2.3 Dandenong bypass tariff

APA previously provided evidence that a bypass risk existed between the Dandenong offtake of the VTS and Pakenham, where gas was to be injected into the VTS from the Bass Gas production facility. The bypass tariff was proposed in the second access arrangement period and was implemented as an Injection Tariff at Pakenham and a discounted Withdrawal Tariff in the Metro south east zone. The risk being that a bypass could be constructed which would displace gas supply from Longford through the VTS.[19]

We consider the discount remains appropriate to prevent Dandenong and Pakenham customers from defecting from the VTS.

9.5 Revisions

We require APA to amend the quantum of the proposed initial reference tariffs to reflect the draft decision on APA's building block proposal for the VTS.

[18] APA, VTS Proposal, Tariff derivation approach, December 2021, p. 21.

[19] APA, VTS Proposal, Tariff derivation approach, December 2021, p. 22.

A Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
APA / APA VTS	APA VTS Australia (Operations) Pty Ltd and APA VTS Australia (NSW) Pty Ltd
DWGM	Declared Wholesale Gas Market
GJ	Giga joule
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
TJ	Tera joule
VTS	Victorian Transmission System