Draft Decision

APA Victorian Transmission System (VTS)

Access Arrangement 2023 to 2027

(1 January 2023 to 31 December 2027)

Overview

June 2022

AUSTRALIAN ENERGY REGULATOR

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Invitation for submissions

In response to our draft decision, APA has the opportunity to submit a revised proposal for its upcoming 2023–27 access arrangement period by 10 August 2022.

Interested stakeholders are also invited to make submissions on both our draft decision and APA's revised proposal (once submitted) by 6 September 2022.

Submissions should be sent to: APAVTS2023@aer.gov.au

Alternatively, submissions can be sent to:

Sebastian Roberts
Special Advisor
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested.

Parties wishing to submit confidential information should:

(1) clearly identify the information that is the subject of the confidentiality claim
(2) provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website.[1]

[1] For further information regarding our use and disclosure of information provided to us, see the *ACCC/AER Information Policy* (June 2014), which is available on our website: https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information.

Note

This Overview 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

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Executive Summary

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia. The regulatory framework governing gas transmission and distribution networks is the National Gas Law and Rules (NGL and NGR). Our work is guided by the National Gas Objective (NGO).[2]

A regulated gas network business must periodically apply to us for a ruling on network charges, in the form of an access arrangement. APA[3] has submitted a proposal for the Victorian Transmission System (VTS), the primary transmission system for the delivery of gas throughout Victoria. APA's proposal would allow it to set gas transmission charges resulting in the recovery of an expected $644.1 million ($ nominal, smoothed) in revenues from consumers from 1 January 2023 to 31 December 2027. We have not accepted that proposal. This draft decision would currently allow APA to recover an estimated $611.5 million from consumers over the 2023–27 period: a reduction of $32.6 million (5.1%).

This draft decision marks the mid-point in our assessment of APA's proposal. Final decision outcomes may be significantly different:

- APA has not, in its proposal or in response to subsequent requests for further information, provided sufficient evidence for us to approve its proposal at this time. If further evidence is provided in its revised proposal, higher expected revenue may result.
- Components of forecast revenue will also change when we update our final decision for movements in market variables such as interest rates, bond rates and inflation. These movements are currently increasing revenue relative to APA's proposal.

For illustrative purposes only, we estimate the potential impact of APA's initial proposal at a system wide level would be a 36.7% increase to average transmission charges over the next five years. While final decision outcomes are likely to be somewhere in between, the modelled impact of lower revenue in this draft decision would be a smaller increase of around 25%.

In arriving at this draft decision and the differences between what APA has proposed and what we consider can be accepted at this time, we make the following observations.

Operating under uncertainty

Ongoing transformation in Australia's energy system and the explicit policy goals of reaching net zero emissions by 2050 create considerable uncertainties in future gas demand for the VTS. Since submission of APA's initial proposal, the Australian Energy Market Operator (AEMO) has published its 2022 Gas Statement of Opportunities (GSOO). The GSOO considers five potential demand scenarios (step change, progressive change, hydrogen superpower, strong electrification and low gas price) with greatest emphasis on:

[2] NGL, s. 23: "...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

[3] APA VTS Australia (Operations) Pty Ltd and APA VTS Australia (NSW) Pty Ltd.

- The step change scenario, which considers an accelerated transition towards a net zero economy with significant electrification occurring in the short to medium term, increasing renewable energy penetration and retiring coal generation.
- The progressive change scenario, which considers slower action towards the transition to a net zero economy, allowing time for technologies to develop with strong transformation efforts occurring in the long term to achieve net zero 2050.

AEMO has observed that stakeholders consider the step change scenario the most likely pathway for Australia's energy sector. However, it has also noted that 'urgent action would be needed to put south-eastern regions on the step change path by next winter'.

In presenting placeholder revenue and tariff outcomes for the purposes of this draft decision, we have used data from APA that is based on the progressive change scenario. We will further consider whether we should continue to use data based on the progressive change scenario where there is greater clarity in policy. In APA's revised proposal we expect to see consideration of the longer term outlook, and will require further evidence if APA maintains that the progressive change scenario, rather than the step change scenario, is the best forecast or estimate possible in the circumstances for the purposes of our decision on its 2023–27 access arrangement.

With an outlook of falling longer term demand across all scenarios, APA proposed accelerated depreciation of past and future investments to mitigate the risk of asset stranding. We recognise uncertainty around the future of gas, but consumers should not bear all the risk of uncertainty where it is not clear a business is also reconsidering how it invests. APA's proposal does not present a clear picture of the intended way forward for its business. In proposing a 30 year cap on all asset lives, and a considerable uplift in revenue as a result, APA has not made the case required of other businesses for whom we have endorsed this path. Nor has it addressed concerns with the potential disconnect between its implied expectations for the useful remaining life of the network and its forward expenditure and investment plans. APA's claim that accelerated depreciation was supported by stakeholders is not borne out in submissions to this review.

In our November 2021 information paper *'Regulating gas pipelines under uncertainty'*, we noted that uncertainty around future demand requires a balance between investing where necessary to provide safe and reliable gas services and protecting consumers from unnecessary cost burdens now and in the future. We expressed a preliminary view that some form of accelerated depreciation would be appropriate where there is sufficient evidence to demonstrate and quantify both the pricing risk and stranded asset risk arising from demand uncertainty. We also said maintaining the status quo is a default option if the risks are not adequately substantiated.

Where we have accepted accelerated depreciation in the context of stranding risk in previous decisions it has been based on stronger evidence and clearer outlooks than presented by APA for the VTS. In approving accelerated depreciation for Evoenergy's gas distribution network in the ACT, government policy was clearer, new capex was very limited and no new connections contemplated. Similarly, our recent decision for the APA-operated Roma to Brisbane Pipeline accepted accelerated depreciation in the context of significant reductions in proposed replacement and non-network capex, and no network expansion. We also accepted evidence that indicated the condition of a section of the pipeline warranted its

retirement. In contrast, key elements of Victorian government policy have yet to be settled and APA has proposed a 20% increase in capital investment in its network.

About 98% of existing VTS assets will have a remaining life of 34 years or less at the start of the 2023–27 period. While APA has proposed taking small steps towards accelerated depreciation in suggesting a cap of 30 years, it has not satisfied us that there is a case for taking action at this time, or that the difference between acting now and acting 5 years from now would materially change outcomes for consumers.

Our expenditure forecasts are lower than sought by APA

To approve proposed expenditure—and noting that APA is seeking material increases in expenditure—we must be satisfied that it is such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services.

More frequent gas supply gaps are evident in all future AEMO demand scenarios. Under 1-in-20 year demand conditions gas supply may fall short of peak demand during the 2023–27 period, and as soon as Winter 2023. APA's initial proposal, to address supply shortfalls by investing $90.9 million[4] ($2022) to expand its South West Pipeline with new compressors at Stonehaven and Pirron, would not have been completed in time for Winter 2023. AEMO's 2022 GSOO identified duplication of the Winchelsea compressor on the South West Pipeline as a more timely and lower cost solution to that initially proposed by APA. APA has since announced its intention to pursue that solution.[5] We are satisfied that some expansion of capacity on the South West Pipeline in time for Winter 2023 is an appropriate response to the short term risk of supply shortfalls, and also to the longer term need to ensure the VTS can adapt to changing sources of gas supply to Victoria. Our assessment of APA's proposed costs for the Winchelsea compressor is ongoing, but for the purposes of this draft decision we have included its suggested $60.1 million as an illustrative placeholder. Our draft decision also reconfirms our view that completion of the Western Outer Ring Main will deliver ongoing benefits to consumers in maintaining reliability and security of supply and includes both capital and operating expenditure for its completion and ongoing operation.

However, in other areas the quality of APA's proposal and the lack of supporting analysis and evidence—both in its December 2021 submission and after our subsequent requests for further substantiating analysis and information—has led to draft decision expenditure outcomes considerably below those sought by APA.

Our draft decision includes a total capex forecast of $186.3 million ($2022), a reduction of $165.7 million (47%) from APA's proposal. While we have approved key investments in the Western Outer Ring Main (WORM) and South West Pipeline, we have not accepted all of the capex APA has proposed to meet expected new Security of Critical Infrastructure obligations, to replace or upgrade information technology, or to increase its asset replacement and maintenance program. Nor have we accepted APA's proposed $37.9 million[6] hydrogen safety and integrity study. The Australian Energy Market Commission is reviewing the

4 Excluding overheads.

5 https://www.apa.com.au/news/media-statements/2022/apa-announces-additional-capacity-in-victoria-ahead-of-forecast-gas-shortfalls/

6 Excluding overheads.

potential to extend the regulatory framework for natural gas services to include hydrogen and renewable gases. We accept that all existing gas pipelines may not be fully hydrogen ready. However, APA has not provided sufficient evidence of its assessment of risk, how its proposed study would mitigate it, or that its proposed costs of completing this study are efficient. It is not clear that APA has considered alternative risk mitigation options to its proposed study, or whether some or all of this expenditure could be prudently deferred to or spread across future periods.

Our draft decision on total forecast opex is $172.5 million ($2022): a reduction of $7.8 million (4.3%) to APA's proposed forecast opex. We have not accepted all of APA's proposed $27.6 million in opex step changes. We have allowed $4.1 million to cover established new requirements under Security of Critical Infrastructure legislation, and additional opex that will be incurred in completing and operation of the WORM. However, APA has not provided sufficient evidence to support the further $21.6 million in step changes it proposed for other elements of its Security of Critical Infrastructure response, its Transformation of Technology programs and potential increases in property tax. Nor is there evidence or stakeholder support for APA's proposal—absent any obligation on it to do so—to recover costs of acquiring carbon offset certificates from VTS users and consumers.

APA is responsible for providing the information needed to substantiate its proposals and demonstrate how they satisfy the requirements of the Rules. If, in its revised proposal, APA is able to provide further and better supporting material and analysis on these elements of its capex and opex forecasts, our final decision on its forecast expenditure may change.

Opportunity for improved consumer engagement

We recognise that the 14 months prior to submission of its proposal saw a step up in stakeholder engagement from APA relative to its previous proposals. From submissions we have received this appears to have provided participants with a good background and contextual information from which to comment on some of the key elements of APA's proposal.

While a step up from previous APA processes, these efforts nonetheless fall short of expectations in the Better Resets Handbook for consumer partnership. The impact of engagement with consumers on what has actually been proposed and the extent to which the proposal can be said to have been driven by or reflect consumer preferences is not evident. APA's efforts appear to have been successful in gathering and reflecting feedback on its preferred capex solutions from other declared wholesale market participants. It is less evident that it has addressed concerns with its overall proposal from the end users and consumers who will ultimately pay for its services.

Consumers should be partners in forming proposals rather than simply being asked for feedback on, or support for, the proposal a business thinks should be made. This increased level of control, challenge and collaboration delivers stronger and more considered proposals that better reflect the long term interests of consumers, as seen and valued by consumers.

Where revisions to APA's proposal are required in response to this draft decision, we expect APA to engage with consumers on how they think those changes should be addressed. We encourage APA to look for greater levels of engagement in co-designing what gets

discussed, and for opportunities for greater collaboration and partnership with consumers in developing, not just socialising and testing, the positions put forward in its revised proposal.

1 Our draft decision

A regulated gas network business must periodically apply to us for a ruling on network charges, in the form of an access arrangement that specifies the services it will provide, the tariffs for those services, and the other terms and conditions on which they will be provided.[7]

APA has submitted an access arrangement proposal for the Victorian Transmission System (VTS) that would allow it to set gas transmission charges resulting in the recovery of an expected $644.1 million ($ nominal, smoothed) in revenues from consumers from 1 January 2023 to 31 December 2027.

Our draft decision is not to accept that proposal.[8] The positions we have taken at this point would allow APA to recover an estimated $611.5 million from consumers over the 2023–27 period: a reduction of $32.6 million (5.1%) from APA's proposal.

1.1 Key differences between this draft decision and APA's proposal

Here and in the detailed attachments to this draft decision, we have set out the elements of APA's proposal that we have not accepted and the nature of the amendments that are required in order to make the proposal acceptable to the AER.[9] In some cases, these amendments are in the form of technical changes to be implemented by APA in its revised proposal. In others, they identify areas in which further evidence and analysis must be provided if APA is to satisfy us that its proposal should be approved.

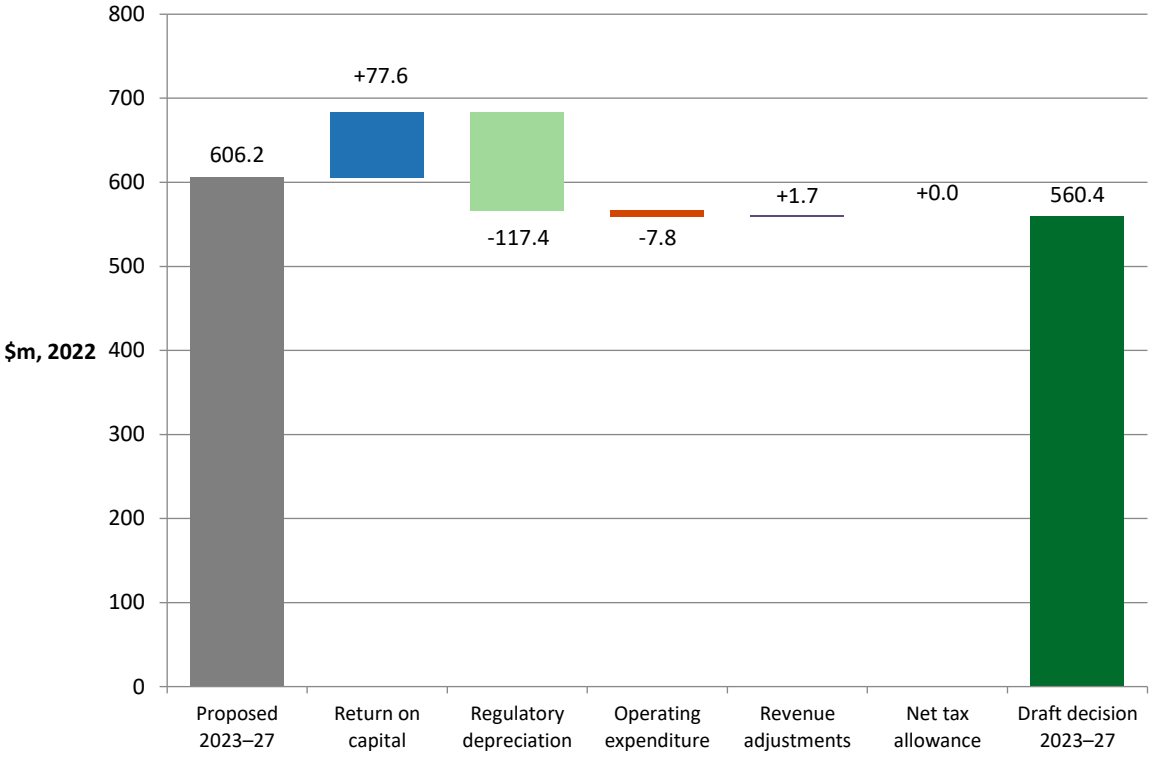
Figure 1 highlights areas in which our draft decision and APA's proposal currently differ, at a revenue component (or 'building block') level.

7 NGR, r. 48(1)

8 NGR, r. 41

9 NGR, r. 59(2)

Figure 1 Comparison of APA's proposal and our draft decision ($million, 2022)



Source: AER analysis.

We explain the reasons for these differences in section 3 of this Overview, and in detail in the attachments to this draft decision. At a high level:

- In this draft decision the allowed rate of return on APA's regulated capital base is lower than in the current period. However, as discussed in section 3.2, we have applied a higher rate of return than the placeholder in APA's proposal following recent movements in market variables. The rate of return will be updated again in our final decision. This has offset the impact that would otherwise result from the reduction this draft decision makes to APA's forecast capex for 2023–27, discussed in section 3.4.
- Lower forecast capex reduces the regulatory depreciation allowance relative to APA's proposal. In addition, we have not accepted APA's proposal to accelerate depreciation of its capital base. Independent of these decisions, the biggest contributor to the lower depreciation allowance in this draft decision is higher expected inflation. We expand on this in section 3.3.
- Our draft decision reduces APA's proposed forecast opex by 4.3%, from $180.3 million to $172.5 million. We expand on this in section 3.5. Our draft decision still allows for an increase in forecast opex of 13.7% from the current period, but not the increase of 18.8% sought by APA.
- Of smaller impact, our draft decision also reduces APA's proposed revenue adjustment under its opex efficiency carryover mechanism (resulting in a smaller revenue decrement under that mechanism or an increase to APA's proposal, all things being held constant). The corporate income tax allowance remains at zero, consistent with APA's proposal. These are summarised in sections 3.6 and 3.7, respectively.

This draft decision marks the mid-point in our consultation on APA's proposal, and final decision outcomes on most of these components are likely to differ.

The quality of APA's proposal and the lack of supporting analysis and evidence—both in its December 2021 submission and after our subsequent requests for further substantiating analysis and information—has led to draft decision expenditure outcomes considerably below those sought by APA. In a number of cases we have currently allowed less, or none, of its proposed expenditure and allowances. To the extent APA is able to address our concerns in its revised proposal and satisfy us that a different outcome is in the long term interests of consumers, higher expected revenue will result.

Independent of this, components of forecast revenue will also change when we update our final decision for movements in market variables such as interest rates, bond rates and inflation. These movements are currently increasing revenue relative to APA's proposal.

However, the combined effect is that overall revenue is expected to increase relative to the current period.

1.2 APA's consumer engagement

Our framework for considering consumer engagement on network proposals is set out in the Better Resets Handbook. Genuine, high quality consumer engagement supports proposals that are driven by consumer preferences, support delivery of services that meet the needs of consumers, and do so at a price that is affordable and efficient. Used in conjunction with our technical analysis, the extent to which a proposal is driven by engagement and reflects consumer preferences assists in providing an overall perspective on a proposal. We've seen through experience that a regulatory proposal developed through genuine engagement with consumers is more likely to be largely or wholly accepted in our decisions.

The level of engagement we have seen on this proposal, while a step up for APA, falls short of the expectations in the Handbook for consumer partnership.

APA appears to have provided participants with a good background to equip them to comment on some elements of its proposal. It has been observed that stakeholders ability to communicate their needs, interests and concerns was constrained to some extent by APA's chosen engagement topics. While there are some examples of APA being responsive to suggestions on what should be covered in roundtable discussions (e.g. hydrogen, demand), in other cases (e.g. opex) requests for discussion were dismissed. Additional constraints included different levels of experience of the subject matter, the complexity of information and limited opportunity to absorb and consider it before discussion, and availability to respond.

While not all stakeholders were involved for the full period of engagement and some only joined in the months immediately preceding submission of the proposal, roundtable participants included large users, representatives of small and large consumers, retailers, gas producers, Victorian gas distributors, AEMO and Victorian and Commonwealth governments. This broad cross-section of interests brought with it different priorities, preferences and concerns, a lack of consensus that is somewhat overlooked in APA's proposal and its generalised statements of 'stakeholder' feedback or support.

As a result, the impact of APA's engagement with end users and consumers on what has actually been proposed and the extent to which the proposal has been driven by, or reflects, consumer preferences is not evident. APA's efforts appear to have been more successful in winning support from other declared wholesale market participants for elements of its capex proposal than in addressing concerns with the overall proposal from the end users and consumers who will ultimately pay for its services.

Consultation on a regulatory proposal should not end with the submission of that proposal. Where revisions to APA's proposal are required in response to this draft decision, we expect APA to engage with consumers on those changes. We encourage APA to look for greater levels of engagement in co-designing what gets discussed, and for opportunities for greater collaboration and partnership with consumers on the positions put forward in its revised proposal.

Outside this review, consumer engagement should be a continuous business-as-usual process. In the current, uncertain, environment that regular dialogue will be critical to ensuring that APA's decisions and actions are driven by consumer preferences. In turn, this genuine, ongoing engagement will increase confidence in, and the quality of, APA's decision making and its future regulatory proposals and processes. APA can then focus its resources on meeting the needs of its consumers, rather than extended engagement with the regulator.

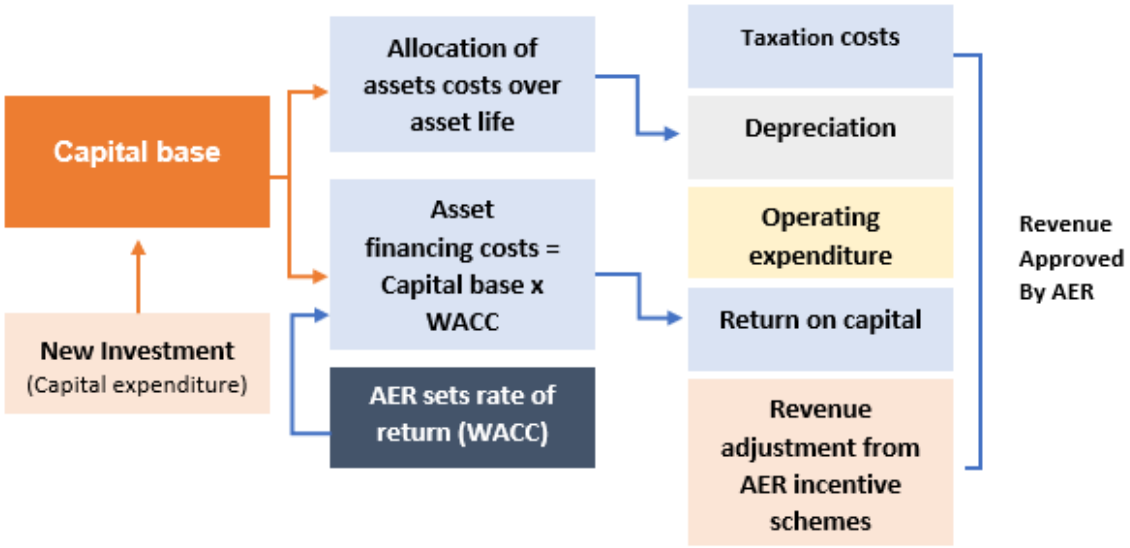
2 Total revenue requirement

The foundation of our regulatory approach is a benchmark incentive framework to setting revenues: once regulated revenues are set for the five year period, a network that keeps its actual costs below the regulatory forecast of costs retains part of the benefit. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed, and a lower cost benchmark is set in subsequent regulatory periods.

APA's proposed revenue requirement, and our assessment of it under the NGL and NGR, is based on six cost components or 'building blocks', illustrated in Figure 2:

- return on the capital base – to compensate investors for the opportunity cost of funds invested in this business
- depreciation of the capital base – or return of capital, to return the initial investment to investors over time
- capex – the capital costs and expenditure incurred in the provision of network services, which directly affects the size of the capital base and, therefore, the revenue generated from the return on capital and depreciation building blocks
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services
- revenue increments/decrements resulting from the application of incentive schemes, such as the opex efficiency carryover mechanism that applies to the VTS
- estimated cost of corporate income tax.

Figure 2 The building block approach to determining total revenue



Source: AER.

2.1 Draft decision on total revenue

The total revenue requirement is a forecast of the efficient cost of providing gas transmission services over the access arrangement period. We determine annual revenue, and the total revenue requirement, in nominal terms that take into account expected future inflation. We use five year inflation expectations to convert revenues to nominal values.

Our draft decision on APA's total revenue requirement for the VTS is $611.5 million ($nominal, smoothed). This is a reduction of $32.6 million (5.1%) from APA's proposal. We have made changes to each of APA's proposed revenue building blocks. We expand on these in section 3.

Table 1 sets out our draft decision on APA's total revenue requirement (by building block) for the VTS for each year of the 2023–27 period, the total revenue after equalisation (smoothing), and the X factors derived from APA's tariff model for use in the tariff variation mechanism.

Table 1 AER's draft decision on smoothed total revenue and X factors for the 2023-27 period ($ million, nominal)

Building block	2023	2024	2025	2026	2027	Total
Return on capital	63.6	68.7	70.2	70.8	71.1	344.4
Regulatory depreciation	11.9	17.4	20.7	18.3	13.3	81.6
Operating expenditure	35.4	36.5	37.6	38.7	39.7	188.0
Revenue adjustments	–2.4	–2.0	–2.1	0.0	3.3	–3.1
Net tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
Building block revenue – unsmoothed	108.6	120.7	126.4	127.7	127.5	610.9
Building block revenue – smoothed	**108.0**	**116.7**	**126.5**	**130.2**	**130.2**	**611.5**
X factors[a]	n/a	–8.00%	–4.50%	–1.00%	–1.00%	n/a

Source: AER analysis.
n/a: not applicable.
(a) Under the CPI–X form of control, a positive X factor is a decrease in price (and, therefore, in revenue). Our decision establishes 2023 tariffs directly, rather than referencing a change from 2022 tariffs.

2.2 Revenue smoothing and tariffs

The 'average revenue yield' form of control we apply to APA's tariffs for the VTS is unique to the APA VTS access arrangement. It shares characteristics with both a revenue and a price cap. Like a price cap, if actual demand is greater than forecast APA earns higher revenues than forecast, and vice versa if actual demand is less than forecast.

Our decision on APA's access arrangement proposal includes a determination of APA's total building block revenue (unsmoothed revenue), and a smoothed revenue profile across the 2023–27 access arrangement period.

This annual weighted average tariff change ('X factor') must ensure that the sum of the smoothed revenues across the period equals the unsmoothed building block revenue (in NPV terms). The X factors represent the weighted average *real* change in tariffs. As part of

the annual reference tariff variation process applying from 2024, we combine the X factors we have determined in our decision with actual inflation to create *nominal* reference tariffs for the coming year. This means that the prices paid by consumers, and therefore the revenues received, change with actual inflation, plus the annual X factor rate.

By smoothing revenue we also aim to minimise price volatility between and within access arrangement periods by keeping the difference between smoothed and unsmoothed revenue in the final year of each period as close as possible, and to provide price signals across tariffs that reflect APA's underlying, efficient costs of providing services. Smoothing for the purposes of this access arrangement is completed in APA's tariff model.

The lower revenue we have arrived at in this draft decision, and updates to the demand forecasts in APA's proposal following release of the 2022 GSOO, mean that revenue smoothing has also changed. As a result, the average annual tariffs over the 2023–27 period have also changed as summarised in Table 2 below.

These are not necessarily indicative of final decision tariffs, which will change again with our final decisions on revenue and forecast demand.

Table 2 AER's draft decision - average annual tariffs for the 2023-27 period ($/GJ, nominal)

	2023 [a]	2024	2025	2026	2027
AER's draft decision ($, million)	**108.0**	**116.7**	**126.5**	**130.2**	**130.2**
Forecast volume (PJ)	204.5	198.7	203.1	201.7	195.1
Nominal price ($/GJ)	0.53	0.59	0.62	0.65	0.67
Nominal price change	–1.2%	11.2%	6.1%	3.7%	3.4%
APA's proposal ($, million)	**116.3**	**122.1**	**128.6**	**134.2**	**142.9**
Forecast volume (PJ)	207.0	204.3	201.5	196.9	198.2
Nominal price ($/GJ)	0.56	0.60	0.64	0.68	0.72
Nominal price change	4.3%	6.4%	6.7%	6.8%	5.8%

Source: AER analysis.
n/a: not applicable.
(a) Nominal price change for 2023 is calculated based on the percentage change between 2022 average tariff and 2023 average tariff. Our draft decision 2022 average tariff is calculated based on AEMO's 2022 volume forecast, while APA's proposal 2022 average tariff is calculated based on volume forecast provided in its initial proposal.

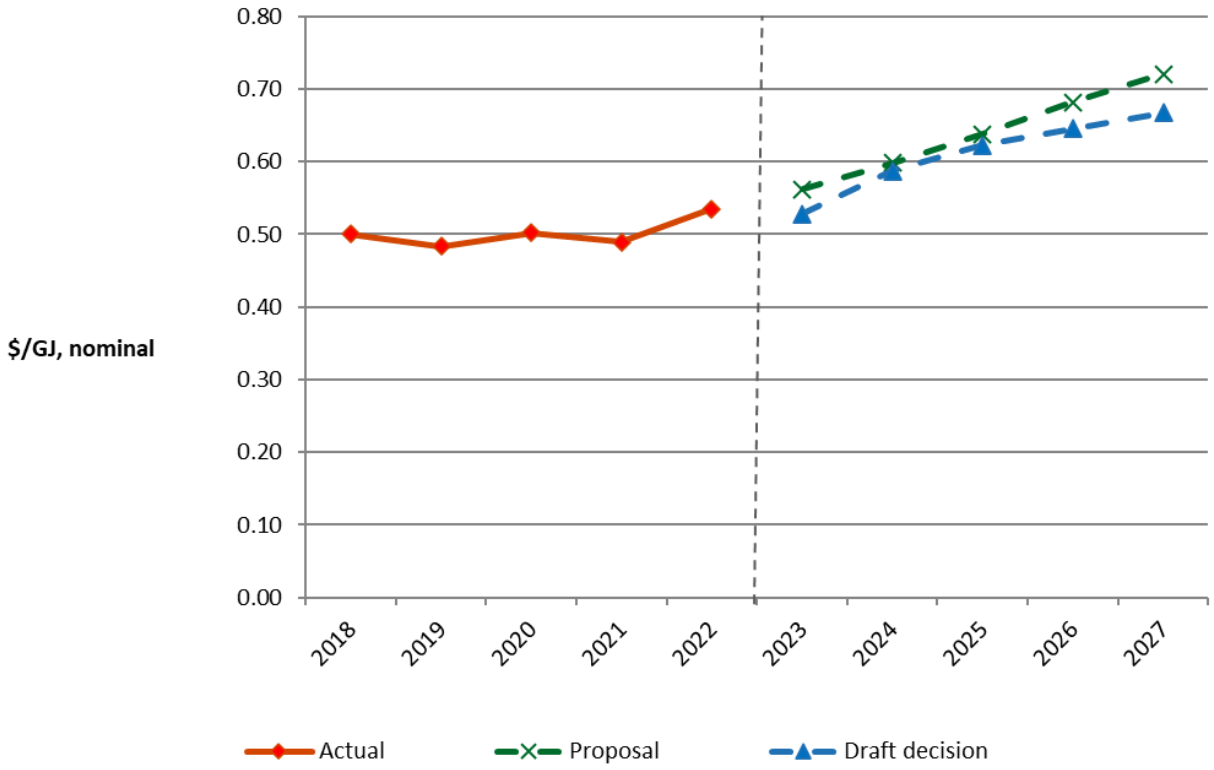
For illustrative purposes, the difference in impact on tariffs between the lower total revenue allowance in this draft decision and APA's proposal is that, at a system wide level, estimated average charges for the transmission service over the next five years would increase by 36.7% ($0.19) were we to accept APA's initial proposal. The two are compared in Figure 3. The modelled impact of this draft decision is an estimated increase of around 25% ($0.13). These are simple estimates only, calculated based on an aggregate level (total revenue divided by total volume) rather than individual zone level tariffs. Final decision outcomes will be different again:

- APA has not, in its proposal or in response to subsequent requests for further information, provided sufficient evidence for us to approve its proposal at this time. If further evidence is provided in its revised proposal, higher expected revenue may result.

- Components of forecast revenue will also change when we update our final decision for movements in market variables such as interest rates, bond rates and inflation. These movements are currently increasing revenue relative to APA's proposal.

Within the access arrangement, the magnitude of changes to individual injection and withdrawal tariffs across the different tariff zones in the VTS will also vary depending on cost allocation under APA's tariff model.

Figure 3 Indicative average reference tariffs from 2018 to 2027 ($nominal)



Source: AER analysis.

3 Key elements of our draft decision on revenue

The components of our draft decision include the building blocks we use to determine the total revenue requirement. The following sections summarise our revenue decision by building block. The attachments to this decision provide a more detailed explanation of our analysis and findings.

3.1 Capital base

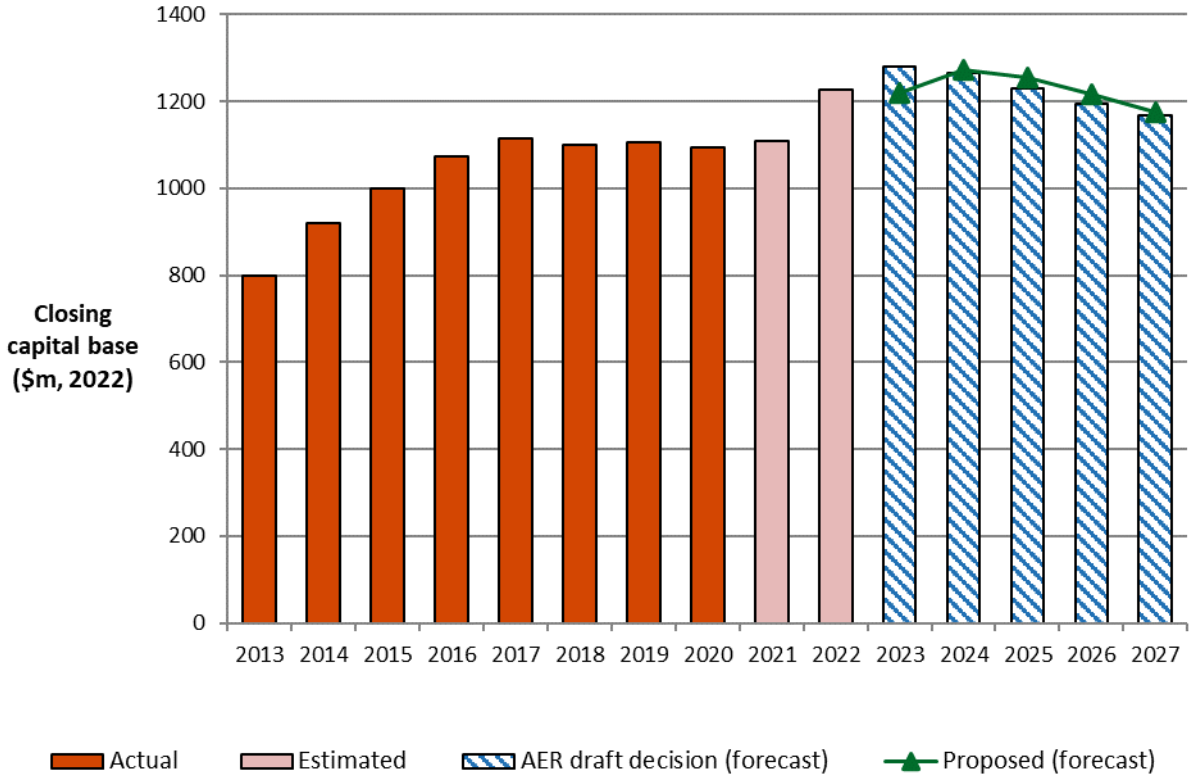
The capital base accounts for the value of regulated assets over time. To set revenue for a new access arrangement period, we take the opening value of the capital base from the end of the last period and roll it forward year by year by indexing it for inflation, adding new capex and subtracting depreciation and other possible factors (such as disposals). This gives us a closing value for the capital base at the end of each year of the access arrangement period. The value of the capital base is used to determine the return on capital and depreciation building blocks.

For this draft decision, we have determined an opening capital base value of $1226.2 million ($ nominal) as at 1 January 2023. This value is $93.9 million (8.3%) higher than APA's proposed opening capital base of $1132.3 million as at 1 January 2023. While we largely accept the proposed method for calculating the opening capital base, we made a number of input corrections to APA's proposed roll forward model (RFM). We have also updated inputs to the RFM as newer information has become available since APA submitted its proposal. These are not areas of disagreement between us and APA. Where our approach does depart from APA's is in the removal of its proposed, dedicated asset class for the WORM project, which we discuss further in section 3.3.

We have determined a projected closing capital base of $1344.2 million ($ nominal) as at 31 December 2027, which is $45.7 million (3.5%) higher than APA's proposed $1298.5 million. Our draft decision on the forecast closing capital base value reflects our draft decisions on the expected inflation rate, forecast depreciation and forecast capex, again discussed further in the sections below.

In real terms ($2022), the combined effect of these is that our draft decision projects a reduction of $60 million (4.9%) to the capital base by the end of the 2023–27 period relative to the opening capital base at 1 January 2023, compared to a reduction of $99 million (8.1%) that would result from APA's December proposal. While a number of things may change this between our draft and final decisions, the difference in potential outcomes between APA's proposal and this final decision is illustrated in Figure 4.

Figure 4 Value of APA VTS closing capital base over time ($ million, 2022)



Source: AER analysis.

3.2 Rate of return and value of implementation credits

The return each business is to receive on its capital base (the 'return on capital') is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the capital base.

We estimate the rate of return by combining the returns of two sources of funds for investment – equity and debt. The allowed rate of return provides the business with a return on capital to service the interest rate on its loans and give a return on equity to investors. We have applied our 2018 Instrument to estimate the rate of return for this draft decision.[10] This leads to a placeholder rate of return of 5.19% (nominal vanilla).

Updates to risk-free rate and the return on debt have resulted in an increase of 0.92 percentage points from the placeholder estimate of 4.27% in APA's proposal.

Our estimate of expected inflation for the purposes of this draft decision is 2.87% per annum. It is an estimate of the average annual rate of inflation expected over a five year period based on the approach adopted in our 2020 Inflation Review[11] and the forecast from the Reserve Bank of Australia's May 2022 Statement on Monetary Policy. This is a higher estimate of inflation than used in APA's proposal (2.00%).

10 AER, *Rate of return Instrument*, December 2018. See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline-2018/final-decision.

11 AER, *Final position – Regulatory treatment of inflation*, December 2020.

These variables will be updated again in APA's revised proposal and in our final decision, which is part of our standard process.

Both APA's proposal and our draft decision apply a value of imputation credits (gamma) of 0.585 as set out in the 2018 Instrument.[12]

3.3 Regulatory depreciation (return of capital)

Depreciation is a method used in our decision to allocate the cost of an asset over its useful life. It is the amount provided so capital investors recover their investment over the economic life of the asset (otherwise referred to as 'return of capital'). When determining the total revenue for the VTS, we include an amount for the depreciation of the projected capital base.[13]

Our draft decision is not to accept APA's proposed regulatory depreciation amount of $205.3 million ($nominal). We have included a lower amount of $81.6 million, a reduction of $123.7 million (60.2%) from APA's proposal.

One of the key reasons for the reduction from APA's proposal is our higher expected inflation rate for the 2023–27 period, which increases the adjustment for indexation of the capital base that is offset against straight-line depreciation in determining regulatory depreciation.

Other factors leading to lower depreciation are:

- our draft decision includes a lower capex forecast than APA has proposed, as we discuss in section 3.4.
- our draft decision not to accept APA's proposal to accelerate depreciation by applying a 30 year cap on asset lives.

Forecasts of expected inflation will be updated again in APA's revised proposal and our final decision. Our final decision may also accept a different (higher) forecast of capex if APA's revised proposal addresses the concerns we have with its projected expenditure.

For the reasons set out in Attachment 4 to this draft decision, we have also rejected APA's proposal for accelerated depreciation. In anticipation of falling demand, APA has proposed accelerated depreciation of its past and future investments to mitigate the risk of asset stranding. The impact of APA's proposed approach would have been a $30.8 million (5.0%) increase to total revenues over the 2023–27 period.[14]

In our November 2021 information paper *'Regulating gas pipelines under uncertainty'*, we expressed a preliminary view that some form of accelerated depreciation would be appropriate where there is sufficient evidence to demonstrate and quantify both the pricing risk and stranded asset risk arising from demand uncertainty. We also said maintaining the status quo is a default option if the risks have not been adequately substantiated.

12 AER, *Rate of return Instrument, Explanatory Statement*, December 2018, pp. 307–382.

13 NGR, r. 76(b).

14 The assets that would have been primarily affected by the cap were the 'Pipelines' and 'General buildings' asset classes.

APA has not provided sufficient justification to satisfy us that accelerated depreciation of the VTS is warranted at this time. We have accepted accelerated depreciation in the context of stranding risk in previous decisions. However, those decisions were made with the benefit of stronger evidence, and clearer outlooks, than provided by APA for the VTS.

The case presented by APA for accelerated depreciation was limited. APA only submitted information at a high level. It suggested small steps in accelerating depreciation to guard against possible adverse impacts of a network winding down.[15] It provided limited modelling of future impacts on its own network.[16] We stated in our information paper we expected businesses to provide compelling evidence to justify the proposed changes to asset lives.[17] We also expected that to demonstrate stranded asset risk, regulated businesses would have to provide plausible future energy scenarios that covers a spectrum of outlooks from the most pessimistic to the most optimistic for their networks, and to estimate the likelihood (probability) of each scenario.[18] APA has not met our expectations.[19]

In approving accelerated depreciation for Evoenergy's gas distribution network in the ACT, government policy was clearer, new capex was very limited and no new connections contemplated. Similarly, our recent decision for the APA-operated Roma to Brisbane Pipeline accepted accelerated depreciation in the context of significant reductions in proposed replacement and non-network capex, and no network expansion. We also accepted evidence that indicated the condition of a section of the pipeline warranted its retirement. In contrast, key elements of Victorian government policy remain unclear and APA has proposed a 20% increase in capital investment in its network.

APA's claim that accelerated depreciation was supported by stakeholders is not borne out in submissions to us as part of this review. Stakeholder views on APA's accelerated depreciation proposal were mixed, noting a lack of clarity in APA's plans for the future and questioning the interrelationship between accelerated depreciation and other parts of APA's proposal, in particular its growing capex forecast. CCP28, Victorian Community Organisations, and Darebin Climate Action Now were against the proposal and saw no benefits to consumers from accelerating depreciation.[20] The EUAA supported APA's proposal on intergenerational equity grounds,[21] while Red Energy stated the AER could use

15 APA discussed analysis by Crew and Kleindorfer which it considered had relevance to the situation for the VTS. The key idea of this analysis was that there is a window of opportunity to increase prices through accelerated depreciation while there are still enough customers on the network for the asset costs to be fully recovered before the network winds down. APA stated that this would reduce risks both for APA and those customers who may find it difficult to switch to alternative energy consumption. Crew, M and Kleindorfer, P, *Economic Depreciation and the Regulated Firm under Competition and Technological Change*, Journal of Regulatory Economics, 4(1), 1992.

16 CCP28 made similar observations. CCP28, *APA: Victorian Gas Transmission System Access Arrangement 2023–27, CCP28 Advice to the AER,* 18 February 2022, pp. 63-64,.68-69.

17 AER, *Regulating gas pipelines under uncertainty information paper*, November 2021, p. 46.

18 AER, *Regulating gas pipelines under uncertainty information paper*, November 2021, p. 45.

19 Darebin Climate Action Now also stated that whichever form of depreciation is adopted, the AER is correct to ask for compelling evidence in support of the business proposal, as well as treating each one on a case-by-case basis. Darebin Climate Action Now, *Submission to the Australian Energy Regulator re APA Access Arrangement 2023-2027*, 21 February 2022, p. 8.

20 CCP28, *APA: Victorian Gas Transmission System Access Arrangement 2023–27, CCP28 Advice to the AER,* 18 February 2022, pp. 59-70. VCO, *Victorian community organisations' submission to the Australian Energy Regulator (AER) 'Regulating Gas Pipelines Under Uncertainty' Information Paper,* 14 February 2022, pp. 7-18. Darebin Climate Action Now Darebin Climate Action Now, *Submission to the Australian Energy Regulator re APA Access Arrangement 2023-2027*, 21 February 2022, pp. 6-9.

21 EUAA, *Submission, APA Gas Transmission Access Arrangement*, 18 February 2022, pp. 2, 9.

depreciation to ensure a fair allocation of asset stranding risk between current and future gas consumers, although it was concerned with new investments.[22] Based on our observations, we consider APA's engagement on depreciation was undertaken at too high a level, with a number of participants in its engagement finding it difficult to understand how the proposal would benefit consumers and the price impacts over subsequent access arrangement periods.

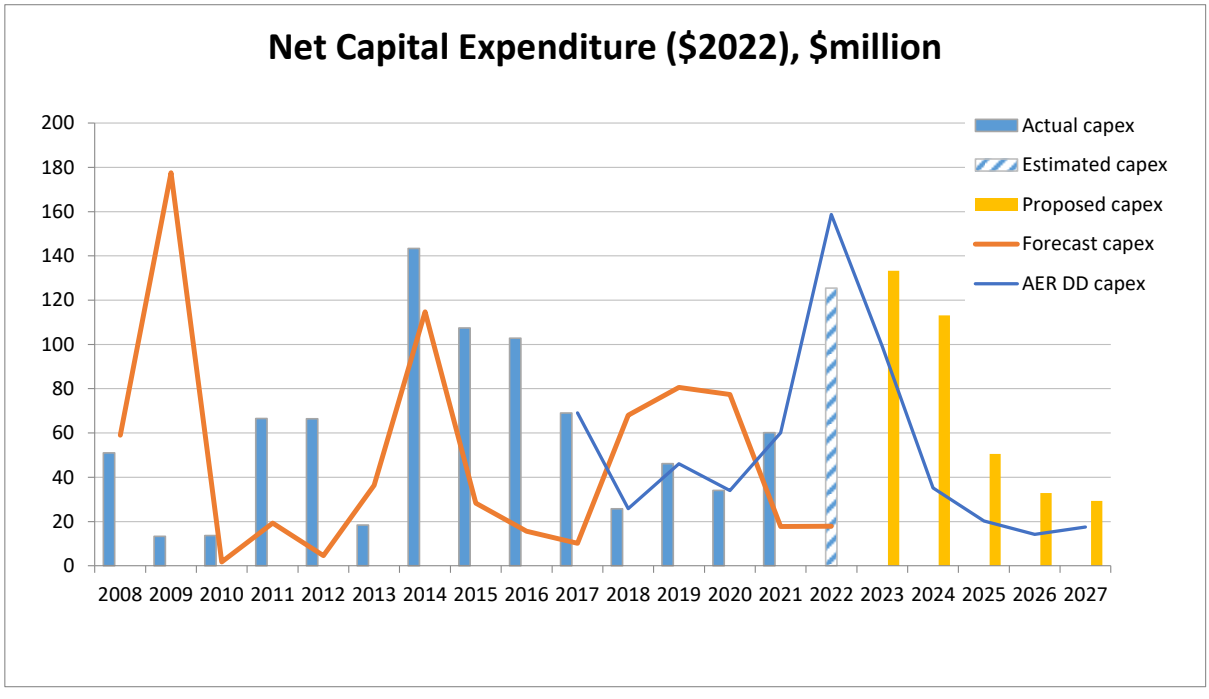
While APA has proposed taking small steps towards accelerated depreciation in suggesting a cap of 30 years, it has not satisfied us that there is a case for taking action at this time. About 98% of existing VTS assets will have a remaining life of 34 years or less at the start of the 2023–27 period. It is not clear to us that the difference between acting now and acting 5 years from now would materially change outcomes for consumers.

3.4 Capital expenditure

Capital expenditure (capex)—the capital costs and expenditure incurred in the provision of network services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. Forecast capex directly affects the size of the capital base and the revenue generated from the return on capital and depreciation building blocks.

Our draft decision is not to accept APA's proposed capex forecast of $352 million ($2022) for the 2023-27 period.[23] Our draft decision includes a lower forecast of $186.3 million, a reduction of $165.7 million (47%) from APA's proposal. Figure 5 compares our draft decision to APA's proposal and its forecast and actual capex in the current and previous periods.

Figure 5 Historical and forecast capex ($million, 2022)



Source: AER analysis

22 Red Energy. Letter, *Re: APA Victorian Transmission System - Access Arrangement 2023–27*, 18 February 2022, p. 2.

23 APA, *VTS-Forecast Opex model -Dec 2021-Public*

We have approved key investments in the WORM and South West Pipeline. Our draft decision reconfirms our view that completion of the Western Outer Ring Main will deliver ongoing benefits to consumers in maintaining reliability and security of supply and includes both capital and operating expenditure for its completion and ongoing operation. The WORM contributes $49.0 million to APA's forecast capex for 2023, and $144.8 million of capex in the final two years of the current period.

We are also satisfied that some expansion of capacity on the South West Pipeline is an appropriate response to the short term risk of supply shortfalls in Winter 2023, and also to the longer term need to ensure the VTS can adapt to changing sources of gas supply to Victoria. Installation of a second compressor at Winchelsea provides a more timely solution than put forward in APA's initial proposal, and at a lower cost of $60.1 million compared to $90.9 million. APA has now publicly committed to this project. This makes up a significant part of the difference in forecast capex between our draft decision and APA's initial proposal: instead of the $90.9 million in forecast capex proposed by APA, installation of the Winchelsea compressor is a smaller project, and is divided between the current and forecast period ($37.2 million to be incurred in 2022 and $22.8 million in 2023) whereas APA's initial solution would have been undertaken in the forecast period only. Our assessment of these costs is ongoing, but for the purposes of this draft decision we have included them as an illustrative placeholder.

However, in other areas of its capex forecast APA has not provided sufficient evidence to satisfy us that its proposed capex would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services. We discuss each of these areas of difference in attachment 5 to this draft decision. Examples include:

- We have not accepted APA's proposed $37.9 million hydrogen safety and integrity study. The Australian Energy Market Commission is reviewing the potential to extend the regulatory framework for natural gas services to include hydrogen and renewable gases. We accept that all existing gas pipelines may not be fully hydrogen ready. However, APA has not provided sufficient evidence of its assessment of risk, how its proposed study would mitigate it, or that its proposed costs of completing this study are efficient. It is not clear that APA has considered alternative risk mitigation options to its proposed study, or whether some or all of this expenditure could be prudently deferred to or spread across future periods. Nor has it identified committed projects to carry hydrogen on either the VTS or Victorian distribution networks.
- We have not accepted all of APA's proposed $123.3 million for replacement capex, and have included a lower forecast of $96.3 million. We have not approved a number of projects associated with upgrading the Brooklyn Compressor Station. We consider that with the completion of the Western Outer Ring Main expected in May 2023, the criticality of the Brooklyn Compressor Station will reduce, with some units no longer being required to operate and the remaining being used mostly for winter demand or high peak demand days.

If, in its revised proposal, APA is able to provide further and better supporting material and analysis on these elements of its capex forecast, our final decision may change.

At the same time as its access arrangement proposal, APA also submitted applications under rule 80 of the NGR for pre-approval of additional expansion capex on the South West Pipeline (via three possible projects) if required over the 2023–27 period. The effect of pre-approval under rule 80 would be to confirm now that these investments would be considered conforming capex and rolled into the capital base from the commencement of the next (2028–32) period. This decision would otherwise be made as part of our next review. APA has not provided sufficient evidence to demonstrate the potential $230.6 million in capex contemplated in its rule 80 applications meets the criteria for conforming capex. We have not approved its proposed $215.8 million for augmentation of the South West Pipeline to accommodate Lochard Energy's Iona gas storage expansion. APA has not set out forecast shortfalls that show capex will be needed to meet demand at the time the expenditure is incurred. AEMO's 2022 GSOO has highlighted a number of likely supply projects across southern gas markets. Due to the uncertainty surrounding market developments, along with supply and demand uncertainty, we have also rejected APA's applications for pre-approval of further augmentation to accommodate proposed gas import terminals by either Viva Energy or Vopak.

3.5 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses incurred in the provision of pipeline services.

Our draft decision is not to accept APA's proposed opex forecast of $180.3 million ($2022) for the 2023-27 access arrangement period.[24] Our draft decision includes a lower forecast of $172.5 million, a reduction of $7.8 million (4.3%) from APA's proposal.

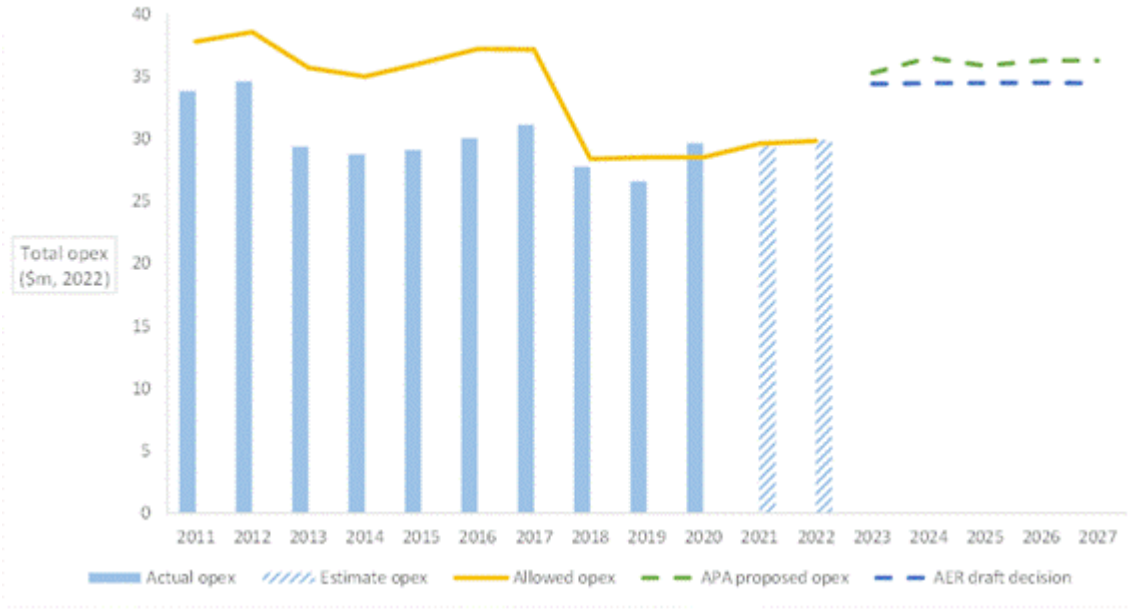
The key area of difference between our draft decision and APA's proposal is that we have only included $6.0 million of the $27.6 million in step changes proposed by APA.

- We have not accepted APA's $9.4 million Transformation of Technology step change. APA has not provided sufficient evidence to substantiate the drivers (end-of-life and/or service improvements) or to assess the efficiency of the proposed costs.
- We have included $4.1 million ($2022) for the Security of Critical Infrastructure (SoCI) step change in our alternative estimate. This is less than the $6.6 million ($2022) proposed by APA.
- We have not included APA's proposed $3.9 million for opex related to operating and maintaining the augmented South West Pipeline. This is because the capex approved in this draft decision for the South West Pipeline expansion relates to a different project than contemplated in APA's opex proposal. At the time of this draft decision, we do not have sufficient information to determine what opex that would be required to operate and maintain the new Winchelsea compressor. These costs may be relatively minor as the asset will be new and used relatively minimally for peak demands. We will consider this further with the benefit of further information from APA in its revised proposal. We have included the step change for ongoing opex related to the WORM, which we consider prudent and efficient.

[24] APA, *VTS-Forecast Opex model -Dec 2021-Public*

Figure 6 compares our draft decision, APA's proposal, and APA's forecast and actual opex in the current and previous periods.

Figure 6 Historical and forecast opex ($million, 2022)



Source: AER analysis.
Note: Includes debt raising costs.

If, in its revised proposal, APA is able to provide further and better supporting material and analysis on these elements of its opex forecast, our final decision may change.

These reductions have been partially offset by our use of a higher opex base year that has been updated with the benefit of the Reserve Bank of Australia's May 2022 Statement on Monetary Policy, and addition of a final year increment to the base year to ensure consistency between opex and the operating expenditure incentive mechanism.

3.6 Revenue adjustments

Our calculation of total revenue for the VTS includes an adjustment under the operating expenditure incentive mechanism in its access arrangement. This mechanism provides a continuous incentive for APA to pursue efficiency improvements in opex, and provides for a fair sharing of these between APA and VTS users.

Our draft decision is to approve carryover amounts totalling –$3.2 million ($2022) from the application of the incentive mechanism in the current period. This adjustment is smaller than APA's proposed –$5 million, because we have:

- Reflected actual opex in 2021, which has become available after APA submitted its initial proposal
- Accounted for the movement in provisions, and removed category specific forecasts from the opex used to determine carryover amounts for the 2018–22 period, consistent with the intended application of the scheme.
- Updated inflation values for 2021 and 2022 with the benefit of more recent information available at the time of this draft decision.

We have also approved APA's proposal that the operating expenditure incentive mechanism continue to apply during the 2023–27 access arrangement period.

3.7 Corporate income tax

Our determination of the total revenue requirement includes the estimated cost of corporate income tax for 2023–27 period. Under the post-tax framework, this amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM).

Our draft decision is to determine an estimated cost of corporate income tax of zero over the 2023–27 period. This is consistent with APA's proposal. We expect APA to incur a forecast tax loss over the 2023–27 period, because its forecast tax expenses are expected to exceed its revenue for tax assessment purposes over the 2023–27 period. This is largely driven by the implementation of our findings from the 2018 *Review of the regulatory tax approach*, involving the introduction of immediate expensing of capex and diminishing value method of tax depreciation, which resulted in an increase to forecast tax depreciation. Consequently, we determine $79.3 million ($ nominal) in tax losses as at 30 December 2027 will be carried forward to the 2028–32 period where it can be used to offset future tax liabilities.

4 Forecast demand

Forecast demand plays an important part in APA's access arrangement:

- The 'average revenue yield' form of control we apply to APA's tariffs is similar to a price cap. In very simple terms, tariffs are determined by cost (the revenue allowance discussed in section 2) divided by total demand. In this draft decision, declining forecast demand has the effect of increasing tariffs.
- Forecast demand is also a driver of opex and capex for network growth or expansion.

The demand forecasts in APA's initial proposal were informed by the 2021 GSOO, and by work it commissioned from Oakley Greenwood to explore key issues affecting supply and demand in Victoria considering the changes in the market after it was released, including potential implications for the VTS.[25] Feedback from stakeholders was that it would be important to this decision to consider more recent forecasts informed by the 2022 GSOO, which was released in March.

Unlike previous versions the 2022 GSOO does not pick one central demand scenario. The GSOO and Victorian Gas Planning Report (VGPR) update focus on two scenarios, both assuming net zero emissions by 2050:

- Step Change represents a future with rapid transformation of the energy sector and a coordinated economy-wide approach that efficiently and effectively tackles the challenge of rapidly lowering emissions (including electrification of gas heating load), driven by consumer-led change with a focus on energy efficiency, digitalisation and step increases in global emissions policy above what is already committed. Under this scenario, AEMO is forecasting a reduction of 16.8% in annual gas consumption in the outlook period, and peak day system demands are forecast to reduce by approximately 18%.[26]
- Progressive Change reflects slower action across the economy, allowing time for technologies to develop and relying on very strong transformation efforts later to get to net zero by 2050. Action towards net zero emissions is delivered through technology advancements and based on current state and federal government environmental and energy policies. Under this scenario, AEMO is forecasting a 1.9% decrease in Victoria's annual total gas consumption over the next five years with peak system demand remaining near current levels. Key drivers include energy efficiency savings due to the Victorian Energy Upgrades scheme and a continuing increase in the number of new connections during the outlook period.[27]

During consultation on the 2022 Integrated System Plan (ISP), stakeholders identified Step Change as the scenario they considered to be the most likely pathway.[28] However, as AEMO has noted, the pace of change so far has been relatively slow and urgent action would be

[25] APA VTS - Access Arrangement 2023-27 - A Look at plans for VTS - Proposal Overview - December 2021, p.16.

[26] AEMO – 2022 Gas Statement of Opportunities – March 2022, p. 15; AEMO – Victorian Gas Planning Report Update – March 2022, p. 4

[27] AEMO – 2022 Gas Statement of Opportunities – March 2022, p. 15; AEMO – Victorian Gas Planning Report Update – March 2022, p. 4-5

[28] AEMO – 2022 Gas Statement of Opportunities – March 2022, p. 11

needed to put south-eastern regions on the Step Change path by next winter.[29] In the absence of significant additional policy commencing, AEMO has identified a material risk that in the near term gas use will not reduce in line with the Step Change scenario from 2023-26.[30]

For the purposes of its VGPR update, AEMO has assessed supply adequacy using the both the Step Change and Progressive Change scenarios in forecasts of consumption and peak demand for the outlook period.[31] A similar approach is open to us in respect of judgment to be exercised in assessing APA's capex and opex forecasts (to the extent that these are demand-driven). Our draft decision to approve expenditure for key investments in the South West Pipeline and Western Outer Ring Main recognises that gas adequacy is tight in both scenarios in the early years of the 2023–27 period, and particularly in 2023.[32]

For the purposes of our final decision on APA's access arrangement, however, we will need to arrive at one demand forecast, arrived at on a reasonable basis and representing the best forecast or estimate possible in the circumstances, for the purposes of setting tariffs for the 2023–27 access arrangement period. This will require consideration of whether the clarity in policy AEMO has noted is required to drive step change behaviour has emerged.

We have included updated load and demand forecasts from APA based on the Progressive Change scenario as a placeholder for the purposes of this draft decision. This does not necessarily represent our final view on the this issue, and further consideration of expected natural gas policy direction will follow. APA's revised proposal will need to take this into account. We will consult on and consider the merits of these forecasts as part of our final decision.

29 AEMO – 2022 Gas Statement of Opportunities – March 2022, p. 11

30 AEMO – Victorian Gas Planning Report Update – March 2022, p. 5

31 AEMO – Victorian Gas Planning Report Update – March 2022, p. 5

32 AEMO – Victorian Gas Planning Report Update – March 2022, p. 9; AEMO – 2022 Gas Statement of Opportunities – March 2022, p. 11

5 Reference services and tariffs

APA's access arrangement for the VTS specifies the reference service it will provide, the tariffs for that service, and the other terms and conditions on which it will be provided.[33]

5.1 Services covered by the access arrangement

The VTS operates under market carriage model, which provides for open access to the VTS and uses the outcomes from the operation of Victoria's Declared Wholesale Gas Market to schedule injections and withdrawals from the VTS. As the system operator of the VTS, the Australian Energy Market Operator (AEMO) is responsible for scheduling injections and withdrawals and the day-to-day operation of the pipeline.

The single reference service in APA's access arrangement proposal is its Tariffed Transmission Service. APA makes the Tariffed Transmission Service for the VTS available to AEMO under a Service Envelope Agreement, in accordance with the NGL.[34] Shippers access that reference service through AEMO. They then pay transmission tariffs directly to APA as owner of the VTS.

APA submitted its reference service proposal for the Tariffed Transmission Service in December 2020.[35] We published our decision to approve that proposal in May 2021.[36] Absent any material change in circumstances since then, this draft decision confirms our approval of APA's proposed reference service.

Our draft decision also approves the non-tariff components of the proposed access arrangement, which are consistent with those approved in our decision for the current 2018-22 period. We remain satisfied that these elements of the APA VTS access arrangement are appropriate to the in the unique circumstances of the VTS.

5.2 Reference tariff setting and variation mechanism

Our draft decision is that the same tariff setting and tariff variation mechanisms that have applied in the current period should continue to apply to the VTS in 2023–27.

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 engagement, but it did not allow sufficient time for this. In future access arrangement periods, APA intends to move away from the existing VTS tariff model and tariff structure towards something more straightforward. We look forward to its engagement on this reform.

33 NGR, r. 48(1)

34 NGL, s. 91BE.

35 APA VTS - Victorian Transmission System reference service proposal - December 2020

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

APA proposed a number of changes to other parts of its tariff setting and tariff variation mechanisms, which we have not accepted:

- APA proposed the reintroduction of a revenue and tariff adjustment mechanism to manage the risk that actual volumes in a given regulatory year fall either higher or lower than 5.5% of forecasts. In simple terms, if actual volumes are more than 5.5% lower than forecasts revenue and tariffs would be increased. If they are more than 5.5% lower revenue and tariffs would be decreased. This arrangement was removed from APA's access arrangement, at its request, from the commencement of the 2013–17 access arrangement period. APA has suggested its reintroduction will contribute to tariff stability, but has provided little justification for its proposed reintroduction of this mechanism at this time. No discernible detriment to consumers has been demonstrated from its absence in the last two access arrangement periods. Nor has it provided analysis or evidence in support of its proposed 5.5% threshold.
- APA proposed an extension of time for its submission of annual tariff variations to the AER (from 50 business days to 30 business days), and a reduction to the time allowed for the AER's verification of proposed tariffs (from 20 business days to 10 business days). These changes go to the current tariff approval process for the VTS, which given APA's preferred inputs to the tariff calculation requires it to submit its initial proposal 50 business days from the commencement of the new pricing period, and then later submit updated data. The current, 20 business day period for the AER's assessment is already shorter than allowed under other access arrangements (typically 30 business days). The later submission and shorter assessment period proposed would add pressure to our approval of tariffs under a uniquely complex model rather than addressing the underlying input preferences from APA that drive the need for post-submission updates.

Our draft decision is that the cost pass through events available to APA in the current period will continue to apply in the 2023–27 period, but with some minor amendments to provide greater drafting consistency between APA and other network service providers.

Our draft decision does not accept APA's proposed new 'pre-approved capex' cost pass through event, which would allow APA to reopen its revenue allowance to recover a return on additional forecast capex during the access arrangement period. The proposed event was directly linked to applications made by APA under rule 80 of the NGR for pre-approval of additional expansion capex on the South West Pipeline if required over the 2023–27 period. The effect of pre-approval under rule 80 would otherwise be limited to confirming that investment would be considered conforming capex and rolled into the capital base from the commencement of the next (2028–32) period. APA submits that the proposed cost pass through would provide APA and project proponents comfort within the next access arrangement period if decisions are made about the investments required to manage the supply/demand balance in Victoria. We have not accepted APA's applications under rule 80, rendering the proposed pass through event redundant for that purpose.

A Shortened forms

Shortened form	Extended form
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
APA / APA VTS	APA VTS Australia (Operations) Pty Ltd and APA VTS Australia (NSW) Pty Ltd
Capex	Capital expenditure
CCP/CCP28	Consumer Challenge Panel, sub-panel 28
GSOO	Gas Statement of Opportunities
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Opex	Operating expenditure
PTRM	Post tax revenue model
RFM	Roll forward model
VGPR	Victorian Gas Planning Report
VTS	Victorian Transmission System
WORM	Western Outer Ring Main

B List of submissions on APA's proposal

Australian Energy Market Operator	18 February 2022
AGL	18 February 2022
Consumer Challenge Panel (CCP28)	18 February 2022
Consortium of East Coast gas market participants	18 February 2022
Darebin Climate Action Now	18 February 2022
Energy Users Association Australia	18 February 2022
Lochard Energy	18 February 2022
Red Lumo	18 February 2022
Victorian Community Organisations	18 February 2022
Viva Energy	18 February 2022

Note: All submissions are available on the AER's website: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/apa-victorian-transmission-system-access-arrangement-2023%E2%80%9327/proposal#step-79753