



# **GOLDFIELDS GAS PIPELINE**

## **Access Arrangement Revision Proposal**

### **Response to ERA Draft Decision**

#### **Submission**

11 September 2019

## 1 Response to ERA Draft Decision

A Draft Decision on proposed revisions to the Access Arrangement for the Goldfields Gas Pipeline (**GGP**) was made by the Economic Regulation Authority (**ERA**) on 31 July 2019.

The Draft Decision set out thirteen amendments required to make the revision proposal acceptable to the ERA. Goldfields Gas Transmission Pty Limited (**GGT**) addresses each of these required amendments in this submission. GGT has accepted seven of the required amendments. In addressing two of the amendments, GGT has proposed changes to the opening capital base at 1 January 2020, to depreciation and to forecast operating expenditure. These changes flow through the remaining four amendments, which GGT has accepted “in principle”.

GGT has provided, with the submission, an amended proposed revised Access Arrangement, and amended Access Arrangement Information, incorporating changes to the GGP Access Arrangement revision proposal.

## 2 Required Amendment 1

***GGT must incorporate the proposed changes to section 2 (Pipeline Services) of the Access Arrangement as detailed in Appendix 4 of this Draft Decision.***

GGT accepts Required Amendment 1.

The proposed changes to section 2 (Pipeline Services) have been incorporated into section 2.1 of the amended proposed revised Access Arrangement.

## 3 Required Amendment 2

***GGT must amend the total revenue requirement for the fourth access arrangement period to reflect the values set out in Table 8 of the Draft Decision.***

GGT has amended the total revenue requirement for the fourth access arrangement period.

GGT's amended total revenue is shown in Table 1.

Table 1 shows total revenue at current prices – nominal total revenue – for the period 2020 to 2024. Wherever conversion from nominal to real values, or from real to nominal, has been required in amending the GGP Access Arrangement revision proposal to address matters raised in the Draft Decision, GGT has used the inflation forecast used in the Draft Decision tariff model. That forecast is shown in Table 2.

**Table 1: GGP (Covered Pipeline): amended proposed revised total revenue (nominal): 2020-2024**

		2020	2021	2022	2023	2024	Total
Return on capital base	\$m	18.765	18.622	18.307	17.960	17.589	<b>91.242</b>
Regulatory depreciation	\$m	6.147	7.305	7.578	7.840	6.994	<b>35.864</b>
Operating expenditure	\$m	18.685	18.897	19.399	19.197	19.833	<b>96.011</b>
Corporate income tax	\$m	4.707	4.938	4.947	5.076	5.143	<b>24.810</b>
Value of imputation credits	\$m	-2.353	-2.469	-2.473	-2.538	-2.572	<b>-12.405</b>
<b>Total revenue</b>	<b>\$m</b>	<b>45.949</b>	<b>47.292</b>	<b>47.757</b>	<b>47.535</b>	<b>46.988</b>	<b>235.522</b>

**Table 2: Inflation: actual (2018), and forecast**

	2018	2019	2020	2021	2022	2023	2024
<b>Inflation</b>	<b>1.46%</b>	<b>1.28%</b>	<b>1.28%</b>	<b>1.28%</b>	<b>1.28%</b>	<b>1.28%</b>	<b>1.28%</b>

The total revenue shown in Table 1 differs from the total revenue in Table 28 of the Draft Decision. The differences are consequences of the way in which GGT has addressed:

- (a) Required Amendment 3: GGT has amended the individually forecast items of operating expenditure
- (b) Required Amendment 5: GGT has amended the capital base during the period 2015 to 2019, and the amendments flow through to the projected capital base for the period 2020 to 2024, resulting in a different return on the capital base, and different regulatory depreciation.

The estimates of corporate income tax, and valuation of imputation credits, are different from those in Draft Decision Table 8 because GGT amended the total revenue for the period 2020 to 2024 (and not because GGT used methods and parameters different from those used by the ERA). This is noted in GGT's response to Required Amendment 9.

## **4 Required Amendment 3**

***GGT must amend the values for operating expenditure to reflect the values set out in Table 14 of this Draft Decision.***

The Draft Decision was to accept, for the forecasting of operating expenditure, GGT's proposed use of a base-step-trend method with base year 2017. However, changes were required to the following individually forecast expenditure items:

- (a) Major expenditure jobs
- (b) Regulatory costs
- (c) Corporate costs
- (d) Labour cost escalation.

GGT has amended the values for operating expenditure to those shown in Table 3.

**Table 3: GGP (Covered Pipeline): amended proposed revised operating expenditure forecast at constant (real, December 2018) prices: 2020-2024**

		2017	2018	2019	2020	2021	2022	2023	2024	Total
Inflation			1.87%							
Base year OPEX	\$m	15.985								
<i>Less: separate forecasts</i>										
Major expenditure jobs	\$m	0.322								
Regulatory costs	\$m	0.313								
Corporate costs	\$m	2.883								
	\$m	3.518								
OPEX less separate forecasts	\$m	12.467								
Base year OPEX (real, Dec-2018)	\$m	12.700			12.700	12.700	12.700	12.700	12.700	<b>63.500</b>
<i>Add: separate forecasts</i>										
Major expenditure jobs	\$m				0.560	0.480	0.670	0.200	0.500	<b>2.410</b>
Regulatory costs	\$m				0.676	0.676	0.676	0.676	0.676	<b>3.379</b>
Corporate costs	\$m				4.117	4.117	4.117	4.117	4.117	<b>20.585</b>
Baseline forecast OPEX	\$m				<b>18.052</b>	<b>17.972</b>	<b>18.162</b>	<b>17.692</b>	<b>17.992</b>	<b>89.872</b>
<i>Real labour cost increase</i>										
WA Treasury: increase in wage price index (Jul-Jun)				0.018	0.023	0.028	0.030	0.033	0.026	
WA Treasury: increase in CPI (Jul-Jun)				0.013	0.018	0.023	0.025	0.025	0.021	
Real labour cost escalation (Jan-Dec)				0.005	0.005	0.005	0.006	0.006	0.006	
Assumed real labour escalation rate			0.006	0.006	0.006	0.006	0.006	0.006	0.006	
Cumulative real labour cost increase		1.000	1.006	0.013	1.017	1.022	1.028	1.033	1.039	
Labour cost proportion of OPEX					0.544	0.544	0.544	0.544	0.544	
Labour cost (real, Dec-2018)	\$m				9.821	9.777	9.880	9.625	9.788	
Real labour costs increase	\$m				0.163	0.217	0.275	0.322	0.383	<b>1.360</b>
<b>Forecast operating expenditure</b>	<b>\$m</b>				<b>18.215</b>	<b>18.189</b>	<b>18.437</b>	<b>18.015</b>	<b>18.376</b>	<b>91.232</b>

In addressing the requirements of the Draft Decision, GGT has amended the individually forecast expenditure items in the ways explained in the following paragraphs.

**Major expenditure jobs**

GGT has reviewed its historical line of sight maintenance costs, and accepts, for the revised proposal, that the forecast can be reduced by \$0.400 million (real, \$ December 2018).

**Regulatory costs**

GGT accepts the ERA estimate of annual regulatory costs – \$0.676 million (real, \$ December 2018) – based on the averaging of actual regulatory costs over the last five years, with appropriate adjustment for inflation.

**Corporate costs**

Paragraph 223 of the Draft Decision advised that:

- (a) use of the KPMG estimate, as advanced by GGT in its access arrangement revision proposal, would overestimate the efficient amount of corporate costs for an entity with the characteristics of the gas transportation business based on the GGP
- (b) GGT's base year (2017) corporate cost estimate of \$2.937 million was the best estimate available to achieve the lowest sustainable cost of delivering pipeline services.

The base year corporate cost estimate noted in (b) above was an allocation of APA Group corporate costs. At the present time, the annual variation in Group level corporate costs seems to be small. APA Group's 2019 financial report noted that, after adjustment for "one-off" costs (retirement of a long-serving Managing Director, and response to a proposal for acquisition of the Group by another business), corporate costs had increased by only 3.4% from FY2017 to FY 2019. This increase was mostly due to inflation over the period.

The allocation of Group level corporate costs to the GGP and, from the GGP, to the Covered Pipeline, has, however changed over the period FY2017 to FY2019 as a result of a relatively permanent change in the values of the allocation factors used. The allocations are based on revenues earned, and revenue earned from gas transportation in the GGP has risen as new contracts for transportation of gas to users located on the Eastern Goldfields Pipeline have come into operation during 2018. In consequence, the allocation of corporate costs to the GGP, and to the Covered Pipeline, has increased. The ERA's corporate cost estimate of \$2.937 million was based on a 2017 allocation of \$2.882 million to the Covered Pipeline. The allocation for 2018, based on the same methods but recognising higher GGP revenue, is \$4.117 million.

GGT accepts the ERA's view that an allocation of APA Group corporate costs can provide the best estimate available to achieve the lowest sustainable cost of delivering

pipeline services. However, the best estimate now available reflects the 2018 revenue conditions. These changed conditions which are expected to continue over the period 2020 to 2024 because the GGP is expected to be "fully contracted" during that period.

For its revised proposal, GGT has used an estimate of corporate costs of \$4.117 million (real, \$ December 2018), as the best estimate available to achieve the lowest sustainable cost of delivering pipeline services. This estimate of corporate costs is the allocation of APA Group level corporate costs set out in the Schedule of Operating Expenditures for the Covered Pipeline for 2018 (the current equivalent of the Schedule for 2017 from which the allocation of \$2.882 million was obtained by the ERA). The 2018 Schedule is currently being reviewed by GGT's auditors, Deloitte Touche Tohmatsu, and will be provided to the ERA as soon as the audit review report is available.

***Labour cost escalation***

The ERA used, for the Draft Decision, Western Australian Treasury forecasts of price and labour cost inflation more recent than the forecasts available to GGT late in 2018, to revised downwards, by \$1.5 million, GGT's proposed allowance for labour cost escalation.

For its revised proposal, GGT has accepted the method, and forecasts of price and labour cost inflation, used in the Draft Decision estimation of labour cost escalation, but has applied these to the different cost base implied by the higher estimate of corporate costs noted above. In consequence, the estimate of labour cost escalation in GGT's revised proposal is \$0.089 million (real, \$ December 2018) higher than the estimate in Table 14 of the Draft Decision.

**5 Required Amendment 4**

***GGT must amend the opening capital base at 1 January 2020 to reflect the values set out in Table 28 of this Draft Decision.***

GGT has amended the opening capital base at 1 January 2020. The amendments are summarized in Table 4 below.

**Table 4: GGP (Covered Pipeline): amended proposed revised opening capital base at 1 January 2020 (real, December 2018)**

		2015	2016	2017	2018	2019
<b>Opening capital base</b>	<b>\$m</b>	<b>413.664</b>	<b>409.656</b>	<b>399.612</b>	<b>389.542</b>	<b>378.804</b>
Plus: capital expenditure	\$m	3.391	1.393	1.395	0.711	1.589
Less: depreciation	\$m	7.399	11.437	11.466	11.449	11.321
Less: asset disposals	\$m	0.000	0.000	0.000	0.000	0.000
<b>Closing asset value</b>	<b>\$m</b>	<b>409.656</b>	<b>399.612</b>	<b>389.542</b>	<b>378.804</b>	<b>369.072</b>

GGT accepts the Draft Decision capital expenditure, recognising that the expenditures for 2018 and 2019 are both estimates. In consequence, the opening capital base at 1 January 2020 may need to be adjusted in accordance with rule 77(2)(a) when setting the opening capital base for the access arrangement period expected to commence on 1 January 2025.

GGT's roll forward of the opening capital base from 1 January 2015 differs from the roll forward in Table 28 of the Draft Decision for the following reasons.

***Opening capital base at 1 January 2015 incorrectly escalated***

Table 28 of the Draft Decision shows the roll forward of the GGP capital base from 1 January 2015. All values in the Table are real, at constant December 2018 prices.

The opening capital base at 1 January 2015 has, GGT believes, been incorrectly converted from a nominal value at 31 December 2014 to a real (December 2018) value at 1 January 2015. Cell AV24 of the *Assets* worksheet in the Draft Decision tariff model shows a closing asset value of \$390.326 million (nominal) at the end of 2014. That closing asset value is then converted to a real 31 December 2018 value, \$407.674 million, which is the opening capital base at 1 January 2015 (cell AW19), and the opening capital base at 1 January 2015 shown in Table 28 of the Draft Decision. The conversion uses the inflation factor in cell AW15 of the Draft Decision tariff model. That factor is 1.0444, which is  $CPI_{Dec-2018}/CPI_{Dec-2015}$ . That is, inflation over three years, from December 2015 to December 2018 is applied to the closing value at the end of 2014 to obtain a December 2018 equivalent value. The inflation which should have been applied is inflation over four years, from December 2014 to December 2018, which, as shown in the tariff model, is measured using an inflation factor of 1.0597, which is  $CPI_{Dec-2018}/CPI_{Dec-2014}$ .

GGT has corrected the error in its roll forward of the capital base for the amended proposed revised Access Arrangement. The corrected opening capital base, \$413.664 million, is shown in Table 4.

***Prior CAPEX and depreciation require minor amendments***

Table 3 also includes the following amendments to Table 28 of the Draft Decision:

- (a) the *Assets* worksheet of the Draft Decision tariff model rolls forward real (December 2013) values of 2014 capital expenditures (cells AV173 to AV 183) when it should roll forward the nominal values of those expenditures; the difference is small (the total capital expenditure should be \$2.136 million, and not \$2.100 million)
- (b) row 163 of the *Inputs* work sheet in the tariff model shows depreciation of Quarter 4 2000 Compression capital expenditure (asset life 30 years) changing from \$0.0242 million in 2015 to \$0.0672 million in 2016: depreciation should not change during the life of the asset in question; there is a minor input error which requires correction

- (c) row 164 of the *Inputs* work sheet in the tariff model shows depreciation of Quarter 4 2000 Receipt and Delivery Point facilities expenditure (asset life 30 years) changing from \$0.0013 million in 2015 to \$0.0008 million in 2016: depreciation should not change during the life of the asset in question; there is a minor input error which requires correction.

## 6 Required Amendment 5

**GGT must amend the projected capital base to reflect the values set out in Table 43 of this Draft Decision.**

GGT has amended the projected capital base for the period 2020 to 2024, and its amended proposed revised projection is shown in Table 5.

**Table 5: GGP (Covered Pipeline): amended proposed revised projected capital base for 2020-2024 (nominal)**

		2020	2021	2022	2023	2024
<b>Opening capital base</b>	<b>\$m</b>	<b>373.796</b>	<b>370.952</b>	<b>364.677</b>	<b>357.765</b>	<b>350.382</b>
Inflation adjustment	\$m	4.785	4.748	4.668	4.579	4.485
	\$m	378.580	375.700	369.345	362.345	354.867
Plus: capital expenditure	\$m	3.303	1.030	0.665	0.457	0.850
Less: indexed straight line depreciation	\$m	10.931	12.053	12.246	12.420	11.479
Less: asset disposals	\$m	0.000	0.000	0.000	0.000	0.000
<b>Closing asset value</b>	<b>\$m</b>	<b>370.952</b>	<b>364.677</b>	<b>357.765</b>	<b>350.382</b>	<b>344.238</b>

The increase in the 1 January 2015 opening capital base, resulting from the corrections noted in GGT's response to Required Amendment 4, flows through to the opening capital base at 1 January 2020.

The change in the opening capital base at 1 January 2020, and the changes noted in the two paragraphs which follow, flow through the projected capital base, and change the inflation adjustment from the adjustment shown in Table 43 of the Draft Decision.

The forecast capital expenditure shown in Table 5 is the forecast of the Draft Decision.

The differences between the indexed straight line depreciation shown in Table 5 and the corresponding depreciation in Table 43 are, in part, due to the changes in capital expenditure and depreciation for the period 2015 to 2019 noted above, in GGT's response to Required Amendment 4.



## 7 Required Amendment 6

***GGT must incorporate a speculative capital expenditure account into the access arrangement. The speculative capital expenditure account for AA3 will reflect the closing balance shown in Table 45.***

GGT has incorporated a speculative capital expenditure account into a new section 3.6 the GGP Access Arrangement.

The speculative capital expenditure account reflects the closing balance shown in Table 45 of the Draft Decision.

## 8 Required Amendment 7

***Subject to the nomination of a final averaging period, GGT must amend its rate of return estimate to be 5.02 per cent (vanilla, nominal after-tax).***

GGT accepts Required Amendment 7.

GGT's nominated averaging period, which is confidential, is set out in the letter attached to this submission.

The nominated averaging period:

- (a) has a duration of 20 consecutive trading days
- (b) is as close as possible to the expected access arrangement final decision for the next regulatory period
- (c) has been nominated prior to any of its dates taking place.

## 9 Required Amendment 8

***GGT must amend the forecast of depreciation for the fourth access arrangement period to reflect the values set out in Table 51 of this Draft Decision.***

GGT has amended the forecast of (indexed straight line) depreciation, but the amended forecast differs from the forecast shown in Table 51 of the Draft Decision. The reasons for the difference are those set out in GGT's response to Required Amendment 4.

GGT's amended proposed revised depreciation is shown in Table 6.

**Table 6: GGP (Covered Pipeline): amended proposed revised indexed straight line depreciation for the period 2020-2024 (real, December 2018)**

		2020	2021	2022	2023	2024	Total
Pipeline and laterals	\$m	7.256	7.259	7.259	7.259	7.259	<b>36.291</b>
Main line valve and scraper stations	\$m	0.190	0.222	0.222	0.222	0.222	<b>1.077</b>
Compressor stations	\$m	2.687	2.918	2.923	2.937	2.039	<b>13.505</b>
Receipt and delivery points	\$m	-0.294	0.158	0.178	0.180	0.147	<b>0.369</b>
SCADA, comm. and electronic equipment	\$m	0.482	0.503	0.512	0.514	0.517	<b>2.527</b>
Cathodic protection	\$m	0.086	0.130	0.129	0.126	0.084	<b>0.555</b>
Maintenance bases and depots	\$m	0.220	0.262	0.265	0.265	0.265	<b>1.278</b>
Other depreciable assets	\$m	0.030	0.151	0.151	0.151	0.102	<b>0.584</b>
<b>Forecast depreciation</b>	<b>\$m</b>	<b>10.657</b>	<b>11.602</b>	<b>11.638</b>	<b>11.655</b>	<b>10.636</b>	<b>56.187</b>

## 10 Required Amendment 9

**GGT must amend its calculation of income tax and tax depreciation methods as follows:**

- **Amend the depreciation method to the diminishing value method for new assets from 1 January 2020**
- **Amend the estimated cost of corporate income tax in accordance with Table 58 of this Draft Decision.**

GGT accepts the first part of Required Amendment 9: the diminishing value method has been used to calculate, for tax purposes, depreciation on new assets from 1 January 2020.

For its revised proposal, GGT has amended its estimate of the cost of corporate income tax. GGT has used the methods of estimation which the ERA has used to estimate the cost of corporate income tax shown in the Table 58 of the Draft Decision, but has applied those methods using:

- different tariff revenue (smoothed) resulting from a different total revenue (see response to Required Amendment 2)
- different operating expenditure (see response to Required Amendment 3)
- different debt costs resulting from a different projected capital base (see response to Required Amendment 5).

GGT's amended estimate of the cost of corporate income tax is summarized in Table 7.

**Table 7: GGP (Covered Pipeline): amended proposed revised estimate of corporate income tax at current prices (nominal): 2020-2024**

		2020	2021	2022	2023	2024
<b>Revenue</b>						
Tariff revenue (smoothed)	\$m	47.158	47.029	47.029	47.029	47.158
<b>Expenses</b>						
Operating expenditure	\$m	18.685	18.897	19.399	19.197	19.833
Debt servicing costs	\$m	9.025	8.957	8.805	8.638	8.460
Tax depreciation	\$m	2.628	2.717	2.335	2.275	1.721
	\$m	30.338	30.571	30.539	30.110	30.013
<b>Tax</b>						
Net income	\$m	16.820	16.458	16.490	16.919	17.144
Tax loss brought forward	\$m	1.132				
Taxable income	\$m	15.689	16.458	16.490	16.919	17.144
Income tax expense	\$m	4.707	4.938	4.947	5.076	5.143
Value of imputation credits	\$m	-2.353	-2.469	-2.473	-2.538	-2.572
<b>Cost of tax net of imputation credits</b>	<b>\$m</b>	<b>2.353</b>	<b>2.469</b>	<b>2.473</b>	<b>2.538</b>	<b>2.572</b>

## 11 Required Amendment 10

**GGT must amend Schedule A of the Access Arrangement with the reference service tariffs in Table 61 of this Draft Decision.**

GGT has included an amended proposed revised reference tariff in Schedule A of the GGP Access Arrangement. The amended tariff is shown in Table 8.

**Table 8: GGP (Covered Pipeline): amended proposed revised reference tariff: 2020-2024**

Tariff component		Tariff
Toll	\$/GJ MDQ	<b>0.132024</b>
Capacity reservation	\$/GJ MDQ km	<b>0.000800</b>
Throughput	\$/GJ km	<b>0.000219</b>

The tariff in Table 8 has been determined from the total revenue shown in Table 1 of this submission. It differs from the tariff shown in Table 61 of the Draft Decision only because the total revenue in Table 1 differs from the Draft Decision total revenue for the period 2020 to 2024.

## 12 Required Amendment 11

***GGT must amend the tariff variation formulas in Schedule A of the Access Arrangement (pages 40 and 41) to update the definition of inflation (“Z”) to reflect the value of inflation used in this Draft Decision. The ‘limit on movement of the weighted average tariff basket’ formula must delete the definition of “Y” because this component is not used in that formula. The X factor parameter must be revised to use the present value of the tariff revenue and tariffs that are calculated by the tariff model.***

GGT accepts Required Amendment 11.

GGT has amended the tariff variation formulas in Schedule A of the GGP Access Arrangement in accordance with Required Amendment 11.

## 13 Required Amendment 12

***GGT must incorporate the proposed changes to section 5 (Queuing) of the Access Arrangement as detailed in Appendix 5 of this Draft Decision.***

GGT accepts Required Amendment 12.

The proposed changes to section 5 (Queuing) have been incorporated into the amended proposed revised Access Arrangement.

## 14 Required Amendment 13

***GGT must incorporate the proposed changes to section 7 (Extension and expansion) of the Access Arrangement as detailed in Appendix 6 of this Draft Decision.***

GGT accepts Required Amendment 13.

The proposed changes to section 7 (Extension and expansion) have been incorporated into the amended proposed revised Access Arrangement.

## **Attachments**

***Amended proposed revised Access Arrangement***

***Amended Access Arrangement Information***

***Confidential letter: averaging periods for rate of return calculations***