ATTACHMENT 08.106A

BASE YEAR – CORPORATE COST REVIEW – RENNIE ADVISORY

DRAFT DECISION RESPONSE 2025-29

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AGA Corporate Cost Review – Report

ATCO Gas Australia (AGA)

June 2024

Expert Evidence Practice Note (GPN-EXPT)

Purpose

The purpose of this report is to address the Request for Quotation requirements set out by ATCO Gas Australia Pty Ltd and agreed to by Rennie Advisory on 6 May 2024, which is attached in Appendix D.

The expert

The expert is:

Matt Rennie

Rennie Advisory

Level 6, 145 Eagle Street

Brisbane Qld 4000

In accordance with section 5.2 of the *Expert Evidence Practice Note (GPN-EXPT)*, the expert:

(i) has read and complied with the requirements of the *Expert Evidence Practice Note (GPN-EXPT)* and agrees to be bound by them;

(ii) opinions are based wholly or substantially on specialised knowledge arising from the expert's training, study or experience; and

(iii) has signed the report and attached or exhibited copies of:

  a. documents that record any instructions given to the expert; and

  b. documents and other materials that the expert has been instructed to consider.

The expert's opinions and reasons

The expert's opinions are based wholly on the specialised knowledge set out in Appendix C to this report and the other information. The expert's recommendations can be found in the sections set out in the below Table i.

Table i – Where the expert's recommendations are located in the report.

	Section with expert's recommendations
Corporate – Other Corp Support (HR, President, Finance, Risk)	4.4
Short-Term Incentive Program	5.4
Corporate – ATCO Group Management Fees (Related Parties)	6.4
AA6 forecast base year	7.4

Warranties and disclaimer

The purpose of this report is to address the Request for Quotation requirements attached in Appendix D and it is not to be used for any other purpose without the permission of Rennie Advisory.

Accordingly, neither I nor Rennie Advisory accept responsibility in any way whatsoever for the use of this report for any purpose other than for which is has been prepared.

The analysis in this report is based on the information set out in this report. I reserve the right to amend any conclusions, if necessary, should any further information become available.

Signed

Matt Rennie

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Table of Contents

1 Executive summary

1.1 Scope of the report

ATCO Gas Australia (AGA) has engaged Rennie Advisory to conduct an analysis of the appropriateness of its operating expenditure forecast related to Corporate – Other Corporate Support (Other Corporate Support costs) and Corporate – ATCO Group Management Fees (Related Parties) (Canada head office charges). In relation to the above corporate cost categories we have been asked to:

- Evaluate and provide a comparison of Other Corporate Support costs and Canada head office charges approved as part of the Economic Regulation Authority's (ERA) fifth access arrangement period (AA5) Final Decision against actual expenditure for AA5 and the fourth access arrangement period (AA4);
- Undertake a detailed review of AGA's base year Other Corporate Support costs and Canada head office charges in comparison to accepted good industry practice and the AA4 average cost;
- Provide an assessment and opinion on whether AGA's Canada head office charges are efficient with reference to available benchmark costs; and
- Provide an assessment and opinion on whether AGA's Other Corporate Support costs and Canada head office charges for AA5, in comparison with AA4, are such as would be incurred by a prudent and efficient service provider.

The scope of our analysis is specific to ATCO's Corporate – ATCO Group Management Fees (Related Parties) and Corporate – Other Corp Support (HR, President, Finance, Risk) corporate cost line items, testing whether the costs are aligned to rule 91(1) of the National Gas Rules (NGR).

For reference, the 'ATCO Group Management Fees (Related Parties)' line item refers to the costs allocated to AGA for services provided from the Canada head office. Throughout the report, we will reference this line item as Canada head office charges.

1.2 Analysis of Corporate – Other Corp Support (HR, President, Finance, Risk)

ERA position

The ERA Draft Decision considered that the growth in Other Corporate Support costs from the AA4 average cost ($1.6 million) to the 2022 base year operating expenditure could not be approved due to a lack of incremental cost breakdown for costs related to COVID-19 and Canada head office costs, and compelling information of the value for money for the Canada head office services.

Our analysis

Our analysis and assessment of AGA's position with regard to the issues raised by the ERA in its Draft Decision is addressed below.

There appears to have been a misinterpretation of cost lines in the ERA's Draft Decision – The ERA determined in its Draft Decision that AGA's Other Corporate Support costs are not at an efficient level to be included in the base year costs, seemingly in part due to questions around Canada head office charges, and that forecast AA6 Other Corporate Support costs should be based on the AA4 average.[1] The ERA stated in the Draft Decision that:

> EMCa notes that ATCO has not provided a breakdown of the incremental costs attributable to the COVID-19 and Canada head office costs as part of the total Other Corporate Support costs. As a result, in the absence of better information, EMCa considered that the increase of $6.8 million over the AA4 average spend on Other Corporate Support has not been sufficiently justified as being reflective of an efficient cost.[2]

It also stated that:

> ATCO has raised an issue with EMCa's assumption on the increase in head office costs from Canada just prior to publication of this Draft Decision. Notwithstanding any potential misunderstanding on the potential drivers for the increase in costs, ATCO has not adequately explained the increase in Corporate Support costs. ATCO can provide further information in its response to the Draft Decision.[3]

The commentary above, which blurs the Other Corporate Support costs and Canada head office costs, appears to reflect a misinterpretation of the boundary between these two cost lines. For clarity, the Canada head office costs are attributable to the Corporate – ATCO Group Management Fees (Related Parties) cost line, rather than Other Corporate Support costs. Detailed analysis on the composition and allocation of the costs from the Canada head office can be found in Section 6.

A spreadsheet formula and linking issue led to incorrect calculations that led to skewed AA4 average costs – Revised data provided to us by AGA corrects for calculation and allocation errors that were present in data provided as part of AGA's access arrangement proposal, impacting the AA4 Other Corporate Support costs (and Canada head office charges). This revision changes the AA4 average calculations for both cost lines but does not affect the total AA4 corporate cost base. Further detail is provided in section 4.3.

[redacted] **cost incorrectly included in AA5 recurrent costs** – We concur with AGA that the [redacted], incurred in 2021, should be excluded from analysis of AA5 recurrent Other Corporate Support costs. Based on the data

[1] ERA Access Arrangement Draft Decision 2024, para 35.
[2] ERA Access Arrangement Draft Decision 2024, para 32. This aligns with EMCa's Review 2024, para 704.
[3] ERA Access Arrangement Draft Decision 2024, para 34.

provided by AGA, we also concur that this reduces the annual average AA5 recurrent Other Corporate Support costs from \$8.3 million to \$6.8 million. The adjustment can be seen in Figure 2 of this report.

Energy Safety levies have now been allocated to the Other Corporate Support cost line – Information provided by AGA confirms that an internal cost allocation change that occurred in 2022 has resulted in the allocation of Energy Safety levies to the Other Corporate Support costs line. This has resulted in an allocation of \$1.4 million (including accruals) from the Corporate – Regulatory costs to the Other Corporate Support costs line for the 2023 and 2024 years. Based on AGA advice noted above in section 4.2, we expect this will become a recurrent cost under this line item for future regulatory periods, unless amended by the issuing government authorities. Further detail is provided in section 4.3.

Exclusion of Short-Term Incentive Program (STIP) payments from AA4 and AA5 base – We agree with AGA's proposed approach to remove staff bonus payments under the STIP from the historical cost data only for the purpose of AA4 and AA5 Other Corporate Support costs expenditure analysis. We consider that this provides a consistent basis for analysis between years and periods, and aligns with the use of a benchmark-based forecast of the STIP for the development of AA6 forecast costs (explained further in sections 4.3 and 5).

Our recommendations / findings:

Topic	Recommendation / finding	Reference
Section 4 recommendations		
One-off [redacted]	We agree with AGA that the one-off cost incurred in 2021 as a result of the [redacted] was not excluded by EMCa from the line item as a non-recurrent cost for the purposes of an average cost comparison. This one-off cost should be removed from analysis of AA5 recurrent Other Corporate Support costs.	4.4 (i)
Inclusion of Energy Safety levies in the Other Corporate Support costs	We note that AGA has changed the allocation of Energy Safety levies, from 2023 onwards, from Corporate – Regulatory costs to Other Corporate Support costs. These changes are \$1.4 million into the Other Corporate Support costs line in both actual 2023 and forecast 2024 costs, contributing \$0.56 million to the AA5 annual average Other Corporate Support costs.	4.4 (ii)
Correction of calculation errors in AA4 Other Corporate Support costs	We note that AA4 cost data provided previously by AGA to the ERA included calculation errors and misallocated costs, as detailed in section 4, and that AGA intends to provide the ERA with corrected data as part of its revised access arrangement.	4.4 (iii)

Topic	Recommendation / finding	Reference
Exclusion of STIP from historical data for the purpose of equitable expenditure analysis	We agree with AGA that the exclusion of STIP costs from the historical cost data for the purpose of AA4 and AA5 Other Corporate Support cost expenditure analysis provides a consistent basis for analysis, given the year-to-year fluctuation of these costs and the fact that no STIP costs have yet been forecast for 2024.	4.4 (iv)
Inclusion of STIP in base year recurrent costs	We agree with AGA that a forecast of STIP costs should then be added to the base year recurrent costs, subject to adequate demonstration that these costs are at an efficient level (see section 5).	4.4 (v)
Using the revised AA4 and AA5 costs for the purposes of analysing average annual increase	We recommend that the revised average recurrent Other Corporate Support costs (excluding STIP costs) of $4.2 million for the AA4 period and $4.7 million for the AA5 period be adopted for the purposes of analysing the average annual increase between the respective periods. We note that the increase from AA4 to AA5 is fully accounted for by the change in allocation of the Energy Safety levies as noted in paragraph (ii) above.	4.4 (vi)

1.3 Specific response to the ERA's Draft Decision comments on the Short-Term Incentive Program

ERA position

The ERA determined in its Draft Decision that the $3.7 million related to the STIP does not form part of an efficient base year cost and should be removed from AGA's 2022 base year actual operating expenditure.[4]

Our analysis

Our analysis and assessment of AGA's position regarding the issue raised by the ERA in its Draft Decision is addressed below.

Given the industry AGA operates in, there are other, non-financial factors which form part of a reasonable assessment of how staff performance has contributed to ensuring overall business performance, network availability and customer satisfaction.

Employee incentive programs across organisations in regulated industries – Australian Energy Regulator (AER) regulated gas entities such as Evoenergy Gas[5] and Jemena[6] offer

[4] ERA Access Arrangement Draft Decision 2024, para 36-40 and 42-43.
[5] Evoenergy 2020, p.21.
[6] Desktop research, see reference list.

employee incentive programs, indicating that they form a prudent activity. Further detail is provided in section 5.3.

Safety – The primary metric used to assess safety within AGA, in alignment with industry best practice, is the Total Recordable Injury Frequency Rate (TRIFR). AGA's average TRIFR for the AA4 period was 2.25. AGA set an AA5 target of 1.2, and reported performance of 1.5, 1.2 and 0.6 reported in the years from 2020 to 2022. AGA has set a target TRIFR value of 1.0 for the AA6 period.[7]

We consider the reduction in AGA's TRIFR from the AA4 period to now shows a large reduction in safety incidents. Considering the above-average risk profile of AGA's business, we agree that reducing safety incidents should be considered as a key factor in awarding the STIP. Further detail is provided in section 5.3.

Network reliability – AGA uses three metrics to assess network reliability: Asset Health Index (AHI), System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI). Data provided by AGA has shown:

- Recent average AHI values have been higher than the target level of 100; and
- Recent SAIDI and SAIFI metrics targets have exceeded AA5 targets.

Considering the information above, including the establishment of targets that seek to deliver improving network reliability in the AA6 period, we consider that by maintaining a high level of service availability to its customers and maintaining good asset health, reliability should be considered as a key factor in determining the prudency of the STIP. Further detail is provided in section 5.3.

Customer service – With information provided to us by AGA[8], we were able to consider key metrics associated with customer service and customer satisfaction. The three metrics which we consider were:

- Domestic customer connections within 5 business days – AGA averaged an average of 99.1 per cent for this metric from 2014 to 2023;
- Attendance to broken mains and services within one hour – AGA reported an average of 99.9 per cent for this metric from 2014 to 2023; and
- Attendance to loss of gas supply within three hours – AGA reported an average of 99.9 per cent for this metric from 2014 to 2023.

We consider that prioritising customer safety and service by tracking and adhering to the metrics listed above incentivises AGA's employees to deliver a reliable service to its customers and in

[7] AGA HSE Performance 2019-2024YTD.pptx.
[8] ATCO Network Integrity and Customer Service – KPIs.

doing so, is a reasonable non-financial metric that should be considered when considering incentive programs for its employees. Further detail is provided in section 5.3.

Sustainability – As part of its sustainability goals and targets, AGA has advised that it assesses performance across three areas when considering bonuses for staff. Namely:

- AGA looks to the Mandatory Climate Disclosure requirements as part of its future reporting obligations, which align executive remuneration to sustainability metrics as disclosed in the Australian Sustainability Reporting Standards disclosure requirements;
- AGA includes sustainability metrics under the categories of environmental, social and governance performance when considering bonuses for staff; and
- AGA has committed to undertaking several sustainability activities within the ATCO Gas Australia Sustainability Strategy, which was developed on its own accord in partnership with external consultants.[9]

We consider it appropriate that sustainability measures are considered as a key non-financial metric in determining the STIP. Further detail is provided in section 5.3.

Labour shortages and COVID-19 for bonus considerations – AGA stated that the heightened risk and operational difficulty during the COVID-19 pandemic provided an additional factor in awarding STIP to employees during the AA5 period. We consider it reasonable that the operational difficulty, heightened risk and additional health and safety compliance, coupled with the labour shortages experienced during this time, could have placed higher than normal workload on employees and that bonuses provided additional remuneration for employees. Further detail is provided in section 5.3.

Reviewing market data showed a bonus allocation to ATCO is reasonable – We have found through research that several of the major gas distribution companies on the east coast do provide bonus payments as part of their remuneration and rewards packages, and that the Australian Energy Regulator (AER) does not appear to rule specifically on the suitability of the inclusion of bonus payments in its regulatory determinations for those gas distributors.

We also assessed benchmarking of bonus payments undertaken by AGA, utilising data from Mercer for Australian firms. This benchmarking sought to align job grades and descriptors, and applied the corresponding Mercer data on STIP targets and actual payouts. We consider this benchmarking approach to be reasonable. Further detail is provided in section 5.3.

[9] ATCO Gas Sustainability Strategy.

Our recommendations / findings

Topic	Recommendation / finding	Reference
Section 5 recommendations		
Financial and non-financial metrics for employee incentive programs	We consider that while financial metrics are important for employee incentive programs, in the case of AGA and similar businesses, non-financial metrics such as safety, network reliability, customer service and meaningful sustainability targets carry significant weight when determining overall staff and business performance and, as such, we consider that a STIP allowance can be approved.	5.4 (i)
STIP benchmarking analysis	We concur with AGA's benchmarking analysis into the level of STIP payments, in alignment with industry standards and Mercer's industry data, and recommend that a revised STIP allowance of $2.9 million per year should be approved, as determined from Mercer data on STIP per cent by staff level and STIP payout rates. We note that this is reduced from AGA's initially proposed amount of $3.7 million in the 2022 base year.	5.4 (ii)

1.4 Analysis of Corporate – ATCO Group Management Fees (Related Parties)

ERA position

The ERA noted, in paragraph 34 of its Draft Decision, that AGA would need to explain the increase in the allocation cost from the Canada head office, and explain and advise the key drivers behind the COVID-19 costs, to justify whether such costs can be considered prudent and efficient in line with the requirements of rule 91(1) of the NGR.

The ERA also stated that there was no compelling information or incremental cost breakdown regarding the increase in costs from the Canada head office from 2018A (AA5 Final Decision base year) to 2020A (AA5 year 1) in alignment with the Massachusetts formula, that would allow it to validate the growth in costs

Our analysis

Our analysis and assessment of AGA's position regarding the issues raised by the ERA in its Draft Decision is addressed below.

Prudency of the Canada head office services – We have reviewed the comprehensive summary of services document developed by ATCO's Canada head office that outlines the various services provided by the Canada head office to AGA. Through a careful examination of each service offering, we consider that these services are prudent for AGA's operation and business, for the reasons outlined in section 6.3.

Consistency of approach with rate of return assumptions – The ERA's 2022 final gas rate of return instrument states that the weighted average cost of capital (WACC) parameters are estimated for a 'benchmark efficient entity', which the ERA defined as "a pure-play network service provider operating within Australia without parental ownership, with a similar degree of risk as that which applies to the service provider in respect of the provision of gas network services".[10]

When evaluating the prudency and efficiency of AGA's operating costs, it may be inherently inconsistent to determine the rate of return based on an assumption of an Australian domiciled entity, while also expecting the delivery of efficiencies from an overseas head office relative to a hypothetical standalone Australian company. Further detail is provided in section 6.3.

Prudency of the Massachusetts formula – As part of an internal audit process, ATCO engaged independent third-party firm KPMG to provide an assessment on the methodology and services provided to Australia by ATCO's Canada head office. The assessment found that the allocation methodology and nature of services passed through is fair and reasonable with no recommendations to alter or change the methodology. Upon reviewing AGA-provided information[11] and the independent third-party reports, we consider that the Massachusetts formula methodology is a prudent approach for the allocation of head office costs between the Canada head office and AGA. Further detail is provided in section 6.3

Correction of error in allocation of costs under the Massachusetts formula – As one of its inputs, the Massachusetts formula looks at the labour cost for the ATCO Group and the labour cost for AGA.

Within the group and in Australia, it is common for employees to have their time allocated to non-BAU capitalised projects and, as such, the labour cost allocated to these projects is accounted for by the project. AGA then defines:

- 'gross labour' as the total labour cost before employees' time is allocated to capitalised projects; and
- 'net labour' as the total labour cost excluding the cost associated with employees' time that has been assigned to capitalised projects.

AGA has advised that net labour was incorrectly used as an input to the Massachusetts formula up to 2019, with the correct labour input, gross labour, being applied from 2020 onwards. AGA advised us that there are no historical considerations or implications that were recorded as a result of this change except for the already reported benefit of receiving lower cost allocations on the net labour

[10] ERA, Explanatory statement for the 2022 Final Gas Rate of Return Instrument, para 65.
[11] Memorandum – Current Corporate Cost Allocation, Common Groups - Summary of Services 2023, OOC allocation.

input. On this basis, we tend to the view that there is little justification to require a ‘value-for-money’ assessment of this incremental cost. See further detail in section 6.3.

Exclusion of the innovation, real estate, and corporate security costs from the Canada benchmarking exercise – We conducted a benchmarking exercise to test the reasonableness of the Canada head office charges and inform our opinion on whether they are efficient for the purpose of Rule 91(1). We excluded the following cost lines from this exercise on the basis that the costs were low and due to the lack of suitable benchmarks:

- *Innovation* – The services provided to AGA from the Canada head office under this allocation are from ATCO’s Spacelab, an enterprise-wide framework that provides collaborative support for staff. Given the bespoke nature of Spacelab, an equitable and good faith benchmarking exercise could not be completed.
- *Real estate* – Due to the variable nature of real estate costs and services, we are unable to develop a benchmark cost for these services and consider the materiality of this cost ($0.08 million) to be small in the context of this analysis. This would unjustifiably skew the overall benchmarking analysis.
- *Corporate security* – Based on a broader benchmarking exercise, we consider that a standalone corporate security function for a firm with AGA’s revenue would cost approximately $5.5 million[12] to operate on a yearly basis. We consider that the $0.2 million corporate security cost allocated from the Canada head office to AGA is aligned to rule 91(1) of the NGR.

Further detail is provided in section 6.3.

Standalone benchmarking exercise for Canada head office services – In selecting benchmark costs, we recognise that there are no directly comparable regulated gas businesses in Australia that are publicly listed and are utilising shared services from an overseas head office. The standalone cost build considered:

- The extent of services and their respective costs passed through from Canada, provided to us by AGA;
- Benchmark Australian costs for providing the same services, aligned with AGA’s industry as closely as possible, and consideration of international benchmark costs if Australian data is unavailable; and
- Scaling benchmarks utilising ‘a percent of revenue’ metric where possible, and where this is not possible, identification of metrics such as salary and organisation structures to calculate an operating cost for that specific function (e.g., executive function).

[12] What is corporate security? Report by the Security Executive Council 2024.

In 2023, the total allocated to AGA from Canada was $8.7 million. The excluded cost lines totalled $0.6 million, resulting in seeking to benchmark $8.1 million for the remaining services included within the Canada head office charges, while assessing the prudency of the non-benchmarked services.

Our benchmarking exercise showed that it would cost $7.8 million to provide the Canada head office functions on a standalone basis in Australia (not including the excluded cost lines). In considering this analysis, we note the benchmarking outcomes should be considered in total, as the boundaries between different cost categories may vary between organisations.

Further detail is provided in section 6.3 and Appendix B for our benchmarking methodology and assumptions.

Canada head office governance processes – Information provided by ATCO's Canada head office in relation to the governance processes for the charging of costs to AGA Australia identified the below processes:

- To ensure the services provided to AGA from Canada are aligned with the needs of the business, there is regular consultation that occurs between the two regions. This is evidenced by interviews with the Canada head office and supported by documentation that clearly outlines the consultation process between the regions;
- Each year, the head office updates an internal detailed corporate cost allocation memorandum[13] that outlines the importance, nature and methodology of the Massachusetts formula and the allocation of services to Australia; and
- As noted in section 6.3, the Canada head office sough third-party validation from KPMG for its cost allocation methodology, which KPMG accepted as a fair and reasonable methodology. It is also important to note that this methodology, along with those stated above, has also been validated and supported by the Canadian regulator, Alberta Utilities Commission (AUC).

Further detail is provided in section 6.3.

Our recommendations / findings:

Topic	Recommendation / finding	Reference
Section 6 recommendations		
Prudency of the Massachusetts formula	We consider the Massachusetts formula to be a fair and prudent methodology to determine cost allocation to AGA from the Canada head office.	6.4 (i)

[13] Memorandum – Current Corporate Cost Allocation, Common Groups - Summary of Services 2023, OOC allocation.

Topic	Recommendation / finding	Reference
Canada head office value-for-money	Note that the increase in the Canada head office charges resulting from a correction of previously incorrect inputs to the Massachusetts formula does not change the value-for-money position, and that AGA still benefits from the head office services.	6.4 (ii)
Exclusion of the innovation, real estate, and corporate security costs from the Canada benchmarking exercise	We consider that, in order to provide an equitable comparison between the Canada head office charges and the appropriately determined benchmark costs, it is prudent to exclude corporate security, real estate and innovation cost items due to their relatively small cost and the difficulty of benchmarking such costs.	6.4 (iii)
Standalone benchmarking exercise for Canada head office services	Consider that the Canada head office allocations are consistent with benchmark, based on our benchmarking analysis which estimates that a standalone capability based in Australia would cost $7.8 million per year to operate when compared to the current $8.1 million cost with corporate security, real estate, and innovation removed.	6.4 (iv)
Incurring one-off costs to establish a standalone capability	Note that AGA would likely incur one-off costs (not considered in our benchmarking analysis) if it was to establish a standalone capability to provide the services currently provided from the Canada head office.	6.4 (v)
Inconsistency in efficiencies from an overseas head office and a hypothetical Australian standalone entity	We note that, notwithstanding the benchmarking conclusion at (iv), there would be an inherent inconsistency in both expecting the delivery of efficiencies from an overseas head office relative to a hypothetical standalone Australian business, while at the same time determining the rate of return based on an assumption of an Australian domiciled entity.	6.4 (vi)
Canada head office governance processes	Agree that the governance processes, inclusive of the cost saving initiatives the Canada head office conducts, are reasonable to ensure that AGA is allocated services it requires.	6.4 (vii)

1.5 Analysis of AA6 forecast base year

Current state

AGA's initial access arrangement proposal was developed using AGA's 2022 actual year figures as the base year[14]. The ERA accepted the use of the 2022 base year as appropriate as it represented the most recent full year of actual costs and was outside the peak of the COVID-19 period, which would not be representative of forward costs for the AA6 period. This acceptance was subject to the removal of one-off and non-recurring costs in the base year. We also note that the ERA substituted specific cost line items in the 2022 base year, where it formed the view that the 2022 costs were not at an efficient level.

AGA now has 2023 actual costs available, which it did not at the time of preparing its original proposal.

Our analysis

Our analysis and assessment of AGA's position with regard to the choice of base year is addressed below.

2023 base year comparison to AA4 average (excluding bonuses) – Comparison of 2023A total corporate opex costs excluding STIP payments indicates that these compare favourably with AA4 average costs and the previously used 2022A base year. Additionally, information provided by AGA[15] indicates that 2023A costs of $19.2 million are less than the 2022A costs of $19.6 million and the AA4 average[16] of $19.5 million. Assessed on this basis, we consider that the use of 2023A total corporate opex costs (excluding bonuses) provides a realistic view of business performance. Further detail is provided In section 7.3.

Other Corporate Support and Canada head office costs (excluding bonuses) – Our analysis of these cost lines concluded that:

- 2023A Other Corporate Support costs of $4.0 million have decreased by $0.2 million over the AA4 average of $4.2 million. We analysed this cost allocation in section 4.
- 2023A Canada head office charges have increased by $3.6 million over the AA4 average, from $5.1 million to $8.7 million. We analysed this cost in section 6.

Based on the analysis contained in the report, we consider that the 2023A costs for Other Corporate Support and Canada head office charges provide a realistic view of AGA's recurrent costs, representing the most recent costs incurred and being further removed from the COVID-19 pandemic.

[14] ERA Access Arrangement Draft Decision 2024.
[15] EMCa 52 – Corrected (Offline copy).
[16] EMCa 52 – Corrected (Offline copy).

Short-Term Incentive Program – Based on recommendations in sections 4 and 5 of this report, the 2023A base year costs should be adjusted as follows to correct for year-to-year fluctuations in the cost associated with STIP payments:

- subtracting the actual STIP amount incurred in 2023A ($3.8 million) from total base year costs ($23.4 million); then
- adding a forecast for recurrent bonus costs, based on benchmarking data ($2.9 million).

Governance / methodology – AGA has utilised the Base Step Trend (BST) methodology to forecast its corporate cost requirements, which is explained in section 2. The BST methodology is a widely adopted process to forecast costs, aligned with industry best practice, and is adopted in the industry AGA operates in on the east coast and by similar companies nationally.

Our recommendations / findings

Topic	Recommendation / finding	Reference
Section 7 Recommendations		
The use of the 2023A as the base year for AA6 forecasting	We consider that, based on the information provided to us by AGA and for the reasons stated in sections 4 and 7 of this report, 2023 actual costs for Other Corporate Support costs and Canada head office charges should be adopted as the base year costs when forecasting for the AA6 period.	7.4

2 Introduction

AGA Gas Australia (AGA) owns and operates the Mid-West and South-West Gas Distribution Systems in Western Australia that serve Geraldton, Eneabba, Bunbury, Busselton, Harvey, Pinjarra, Kemerton, Capel and the Perth region. These systems comprise a regulated gas network, for which AGA is required to submit an access arrangement to the Economic Regulation Authority (ERA) to fund its monopoly distribution operation.

The National Gas Law (NGL) and National Gas Rules (NGR), as enacted by the *National Gas (South Australia) Act 2008* and adopted in Western Australia under the *National Gas Access (WA) Act 2009*, establish the legislative and regulatory framework for the independent regulation of certain gas pipelines in Australia. Under this framework, the ERA is responsible for assessing proposed access arrangements from AGA against the requirements set out in the NGL and NGR. The ERA published its AA6 Draft Decision and supporting materials on 24 April 2024, which included a report by Energy Market Consulting associates (EMCa) titled *Review of Technical Aspects of ATCO Revised Access Arrangement 2025-29* (referred to herein as the EMCa Report).

Forecasts for total opex over a regulatory period are developed using the 'base-step-trend' method combined with specific forecasts for unaccounted for gas and ancillary services. This is a top-down approach which consists of four steps:

1. Base – A business will select a recent year's opex expenditure (revealed opex) as the basis for the opex forecast.
2. Step – Costs are added or subtracted that are not compensated by base opex and the rate of change.
3. Trend – The base opex is trended forward by applying a forecast rate of change to account for growth in input prices, output and productivity.
4. Other – Category specific forecasts for unaccounted for gas and ancillary services.

AGA engaged Rennie Advisory to conduct an analysis of the appropriateness of AGA's operating expenditure forecast related to Corporate – Other Corporate Support (Other Corporate Support costs) and Corporate – ATCO Group Management Fees (Related Parties) (Canada head office charges). In relation to these corporate cost categories, Rennie was asked to:

- Evaluate and provide a comparison of Other Corporate Support costs and Canada head office charges approved as part of the ERA's AA5 Final Decision against actual expenditure for AA5 and AA4;
- Undertake a review of AGA's base year Other Corporate Support costs and Canada head office charges in comparison to accepted good industry practice and the AA4 average cost;
- Provide an assessment and opinion on whether AGA's Canada head office charges are efficient with reference to benchmarking to other networks; and

- Provide an assessment and opinion on whether AGA's Other Corporate Support costs and Canada head office charges for AA5, in comparison with AA4, are such as would be incurred by a prudent and efficient service provider.

All costs set out in the report are in real 2023 $.

The remainder of this report is structured as follows:

- Section 3 provides contextual analysis that has informed our approach;
- Section 4 assesses Corporate – Other Corp Support (HR, President, Finance, Risk) costs;
- Section 5 assesses the Short-Term Incentive Program costs;
- Section 6 assesses Corporate – ATCO Group Management Fees (Related Parties) costs as related to Canada head office;
- Section 7 assesses the nomination of 2023 as the base year for forecasting of AA6 costs; and
- Section 8 presents a summary of our recommendations.

Further, Appendix A and Appendix B include a supporting analysis, and a list of documentation and references.

3 Important context informing the approach to our analysis

The scope of our analysis is specific to ATCO's Corporate – ATCO Group Management Fees (Related Parties) and Corporate –Other Corporate Support (HR, President, Finance, Risk) corporate cost line items, testing whether the costs are aligned to rule 91(1) of the NGR. These cost lines form part of AGA's corporate operating expenditure.

For reference, the 'ATCO Group Management Fees (Related Parties)' line item refers to the costs allocated to AGA for services provided from the Canada head office. Throughout the report, we will reference this line item as Canada head office charges.

To inform our analysis, we have compared AGA's AA4 and AA5 corporate opex costs. Paragraph 28 of the ERA's Draft Decision reports that the projected AA5 corporate operating expenditure for AGA is $121.2 million, which was based on 2020-2022A (actual) and 2023F and 2024F (forecasts), and represented a $22.0 million dollar increase from the $99.2 million included in the AA5 Final Decision. While undertaking our analysis, AGA provided updated information which included 2020-2023A and 2024F. The updated documentation showed that the revised AA5 forecast was $118.4 million, which was due to lower actual costs being incurred in 2023.

This figure is further adjusted downward through the deduction of non-recurrent costs, as advised to us by AGA. These adjustments, which are shown in Figure 2, relate to [redacted] in IT ($7.7 million) and Legal ($1.8 million) categories, resulting in an AA5 revised recurrent corporate opex forecast of $108.9 million. Of these deductions, only the [redacted] relates to the cost lines in our scope (Other Corporate Support costs). This is discussed further in section 4.

It is important to note that not all of these adjustments, specifically the [redacted] costs, were in the scope of our analysis and, as such, we have not commented on these. As such, Rennie does not provide a view or analysis for the AA5 revised forecast as a total as it includes adjustments outside our remit.

In addition to the above, AGA provided us with additional information that lays out corrections to the AA4 costs submitted in its original access arrangement proposal, including the following changes that are explained in detail in section 4.2:

- the total AA4 corporate opex cost base has been revised to $115.1 million from the $99.2 million provided to the ERA previously;
- the Canada head office charges for the AA4 period are now $27.9 million instead of $35 million; and
- the Other Corporate Support costs are now $23.2 million, up from $9.6 million.

We have used these revised AA4 costs for the purposes of our analysis.

Please refer to Figure 1 and Figure 2 below for visual representations of the analysis above. Section 4 includes further analysis of the total AA4 and AA5 recurrent corporate opex costs excluding staff bonus expenses.

Figure 1 – AA4 and AA5 comparison, recurrent corporate cost opex real 2023 $

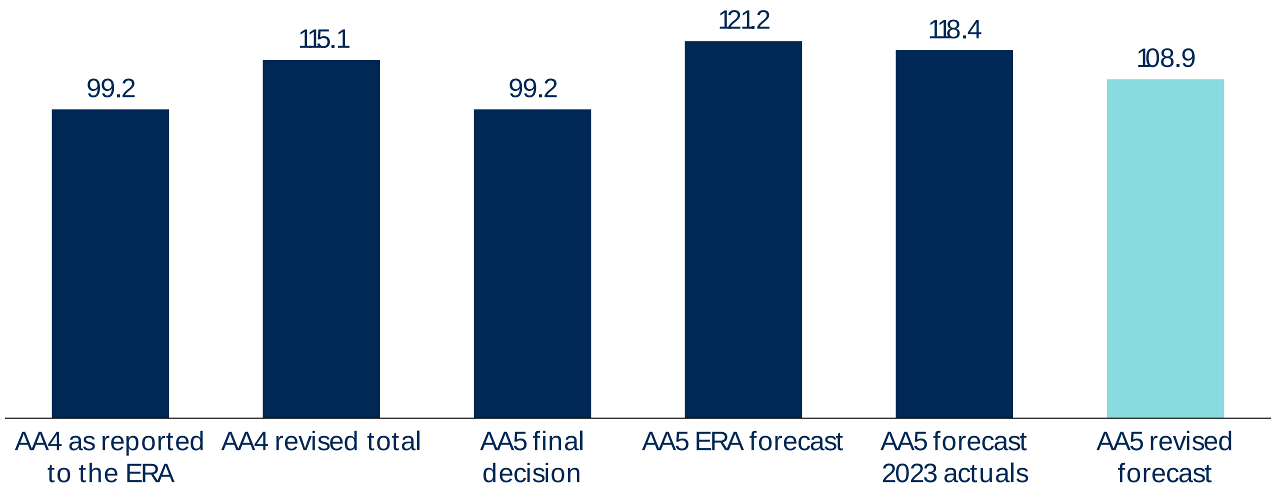

Figure 2 – AA5 revised forecast adjustments, recurrent corporate cost opex real 2023 $

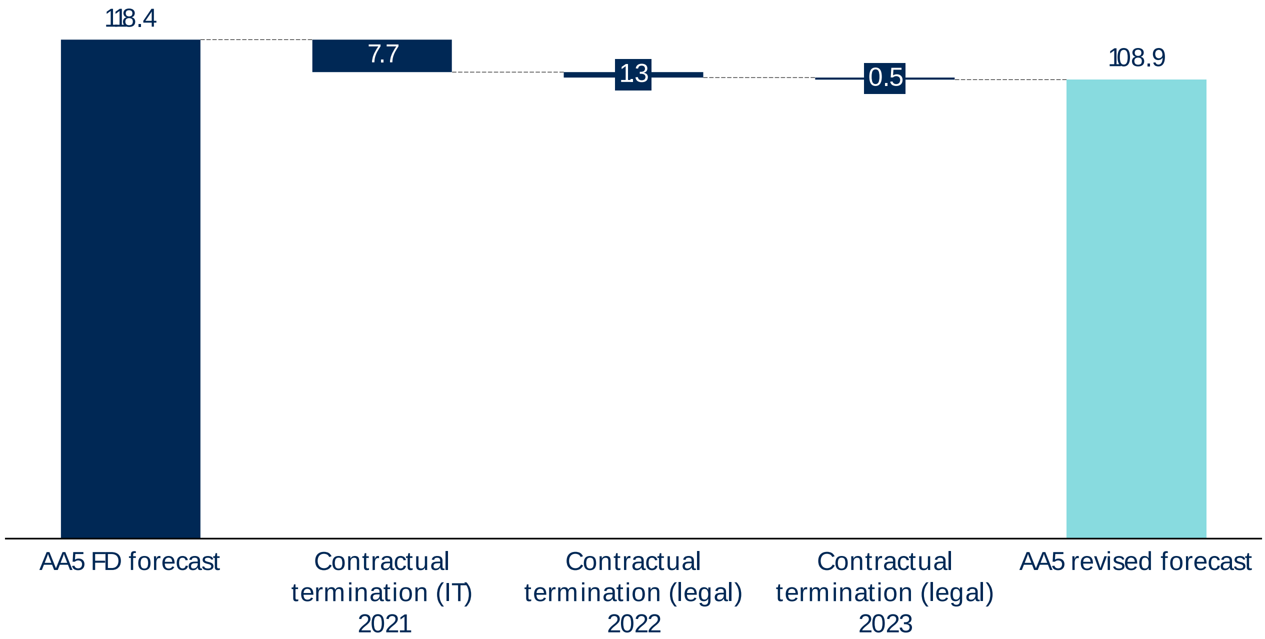

Table 1 shows that AGA has historically benchmarked well compared to other gas pipeline service providers in terms of total operating costs.

Table 1 – Benchmark operating costs for gas pipeline service providers, real 2023 $ [17]

	AGA (2022)	JGN (2021-22)	AusNet Gas Victoria (2021)	AGN SA (2021-22)	AGN Albury (2021)
Operating expenditure ($)	75,813,904	182,707,549	58,946,718	60,489,183	83,745,459
Customer numbers	765,680	1,483,981	792,537	471,641	739,621
Operating expenditure per customer ($)	99.02	123.12	74.38	128.25	113.23
Line length (km)	14,556	26,299	9,860		
Operating expenditure per km	5,208	6,947	5,978		

[17] Sourced from JGN 2021-22 Annual Reporting RIN, AusNet Services Gas Victoria, 2021 – Annual reporting RIN, AGN SA 2021-22 – Annual reporting RIN and AGN Albury, 2021 – Annual reporting RIN.

4 Corporate – Other Corp Support (HR, President, Finance, Risk)

4.1 ERA position

The ERA Draft Decision considered that the growth in Other Corporate Support costs from the AA4 average cost ($1.6 million) to the 2022 base year operating expenditure ($8.4 million) could not be approved. This decision was due to a lack of incremental cost breakdown for costs related to COVID-19 and Canada head office costs, and the lack of compelling information of the value for money for the Canada head office services. This reasoning is set out in paragraphs 32-35 of the ERA's Draft Decision and led the ERA to reduce the Other Corporate Support costs by $6.8 million from the 2022 base year operating expenditure.

It is important to note that the ERA has acknowledged in paragraph 34 of its Draft Decision that there may be some misunderstanding of the potential drivers for the increase in cost and the benefits of the Canada head office services. These misunderstandings are purportedly due to the lack of information provided by AGA to the ERA and its consultant, EMCa.

4.2 AGA position

Misallocated cost and calculation errors lead to skewed AA4 average costs

AGA shared updated cost data for the AA4 period with us, advising that this corrects for some incorrect allocation of costs and various calculation errors in the data previously submitted by AGA to the ERA. AGA has advised that it intends to provide the ERA with an updated version of its corrected model as part of its revised access arrangement.

AGA has advised that the updated data corrects for an erroneous misallocation of some costs between cost lines for 2019. Data previously submitted to the ERA indicated Canada head office costs of $10.3 million and Other Corporate Support costs of $0.2 million, with both numbers being outliers in comparison to surrounding years.

AGA has also explained to us that there were calculation errors in the data submitted to the ERA and used by EMCa for its analysis. These errors in data calculation were due to:

- a spreadsheet linking error, where a detailed breakdown for corporate expenditure was linking from a separate spreadsheet in a number of corporate sub-categories. The formula was referencing one year beyond the intended value, i.e., the formula was referencing 2016 when it should have been referencing 2015. This continued to occur in the model for the remaining years in the regulatory period; and

- the Corporate – Other Corporate Support (HR, President, Finance etc) row was being used as a balancing cost for total corporate costs[18] but contained formula errors, including an incorrect deduction of real 2023 $ quantities from a real 2019 $ base, resulting in significantly lower values than the correct cost.[19] This led to incorrectly low costs in the data originally provided.

AGA has advised that the correction of these errors does not change the total AA4 cost base, however has the effect of increasing the AA4 average Other Corporate Support costs above the value of $1.6 million that was reported in the Draft Decision[20], as shown in Table 2. (This has the additional effect of decreasing the Canada head office charges for the AA4 period.) AGA also noted that the ERA calculations of annual average costs for the AA4 period appeared to average costs over 6 years, but that the AA4 period had in fact been for 5.5 years.

Table 2 – AA4 Other Corporate Support costs in ERA Draft Decision ($m, 2023 $)

2014 Jul-Dec	2015 Jan-Dec	2016 Jan-Dec	2017 Jan-Dec	2018 Jan-Dec	2019 Jan-Dec	Average
2.6	2.6	0.0	2.2	1.9	0.2	1.6[21]

When the adjustments are made by correcting the allocation of costs and the AA4 values are escalated to real 2023 $ (including 2017A , 2018F and 2019F), the average rises to $5.7 million as shown in Table 3.

Table 3 – Corrected AA4 Other Corporate Support costs ($m, 2023 $)

2014 Jul-Dec	2015 Jan-Dec	2016 Jan-Dec	2017 Jan-Dec	2018 Jan-Dec	2019 Jan-Dec	Average[22]
2.3	5.9	3.0	4.8	6.3	8.8	5.7

[18] For clarity, Corporate – Other Corp Support (HR, President, Finance, Risk) costs was used by AGA to balance total corporate costs, which additionally consists of Marketing and BD, Licence Fees, Regulatory, Legal (Combined with Reg for AA3), ATCO Group Management Fees (Related Parties), Interco labour recharge, reclassified to cost centres and IT (reclassified to the separate IT line from 2017). The balancing row is used to balance back the Corporate total after removing all the components stated explicitly. This ensures the total of Corporate costs equals the total contained in the summary report.
[19] AGA explained to us that the intention of the formula was to take the total corporate costs in real 2019 $ (from a separate spreadsheet), escalate to real 2023 $ and then deduct corporate costs in the rows above (which are in real 2023 $). However, the formula first deducted the real 2023 $ corporate costs above this row from the real 2019 $ total Corporate Costs, and then escalation was applied.
[20] ERA Access Arrangement Draft Decision 2024, Para 28.
[21] Average appears to be calculated over 6 years.
[22] Average is calculated over 5.5 years.

[redacted] *incorrectly included in AA5 recurrent costs*

AGA advised that in 2021 it incurred a one-off [redacted] of $7.7 million related to the [redacted] This resulted in a [redacted] which were not included in the forecasts submitted for AA5.

AGA advised that this one-off cost was identified in data provided to the ERA prior to the Draft Decision, but that it appears it was not removed from the analysis of AA5 recurrent corporate opex costs. This had the effect of amplifying the apparent difference between AA4 and AA5 costs.

The removal of these costs reduces the 2021 recurrent Other Corporate Support costs from $12.4 million to $4.7 million. Additionally, with the previous 2023 forecast data updated to actuals, and updates to the 2024 forecast to reflect 2023A costs, this reduces the annual average AA5 recurrent Other Corporate Support costs from $8.3 million to $6.8 million.

Energy Safety levies have now been allocated to the Other Corporate Support cost line

AGA advised that due to an internal cost allocation change, costs of $1.4 million (including accruals) associated with Energy Safety levies are now allocated to the Other Corporate Support cost line item. These costs were previously allocated to the Corporate – Regulatory cost line. This does not represent an additional cost to the AA5 base but increases the Other Corporate Support cost line item from 2023 onwards. AGA has advised us that the Energy Safety levies will remain as recurrent costs in future years within the Other Corporate Support cost line item, including a forecast of $1.4 million in 2024F.

Exclusion of Short-Term Incentive Program from AA4 and AA5 base

AGA pays staff bonuses under its Short-Term Incentive Program (STIP), which are accounted for in the Other Corporate Support cost line. AGA observed that the ERA Draft Decision[23] has appeared to deduct costs associated with STIP twice:

- through the deduction of the full cost of the STIP in the AA6 forecast base year (2022), being $3.7 million; and
- within the deduction of $6.8 million for Other Corporate Support costs, for which the ERA determined to revert to annual average AA4 costs.

AGA advised that it has reflected on the complexity of considering STIP costs in the AA4 and AA5 analysis, given the potential for confusion as to where bonus costs have been allocated, the year-to-year fluctuation of bonus costs in the AA4 and AA5 periods, and the absence of a 2024 forecast of STIP costs, per AGA policy.

[23] ERA Access Arrangement Draft Decision 2024, Table 5.3.

Consequently, we understand that AGA now proposes to:

- exclude the STIP from the Other Corporate Support cost line for the purposes of analysing the real average cost increase in Other Corporate Support costs in AA4 versus AA5; and
- add back bonus costs (an upward step) to the base year recurrent costs, as further explained in section 5 of this report.

We understand that AGA has reflected this approach in updated analysis provided to the ERA.

4.3 Our analysis

There appears to have been a misinterpretation of cost lines in the ERA's Draft Decision

In conducting our analysis of AGA's Other Corporate Support costs, it is important to firstly address related commentary in the ERA's Draft Decision and how Other Corporate Support costs relate to Canada head office charges. The ERA stated:

> EMCa notes that ATCO has not provided a breakdown of the incremental costs attributable to the COVID-19 and Canada head office costs as part of the total Other Corporate Support costs. As a result, in the absence of better information, EMCa considered that the increase of $6.8 million over the AA4 average spend on Other Corporate Support has not been sufficiently justified as being reflective of an efficient cost.[24]

It also stated that:

> ATCO has raised an issue with EMCa's assumption on the increase in head office costs from Canada just prior to publication of this Draft Decision. Notwithstanding any potential misunderstanding on the potential drivers for the increase in costs, ATCO has not adequately explained the increase in Corporate Support costs. ATCO can provide further information in its response to the Draft Decision.[25]

The ERA then determined in its Draft Decision that AGA's Other Corporate Support costs are not at an efficient level to be included in the base year costs, seemingly in part due to questions around Canada head office charges, and that costs for Other Corporate Support costs should be based on the AA4 average.[26]

The commentary above, which blurs the Other Corporate Support costs and Canada head office costs, appears to reflect a misinterpretation of the boundary between these two cost lines. For clarity, the Canada head office costs are attributable to the Corporate – ATCO Group Management Fees (Related Parties) cost line, rather than Other Corporate Support costs. Detailed analysis on the composition and allocation of the costs from the Canada head office can be found in Section 6.

[24] ERA Access Arrangement Draft Decision 2024, para 32. This aligns with EMCa's Review 2024, para 704.
[25] ERA Access Arrangement Draft Decision 2024, para 34.
[26] ERA Access Arrangement Draft Decision 2024, para 35.

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A spreadsheet formula and linking issue led to incorrect calculation which led to skewed AA4 average costs

Revised data provided to us by AGA corrects the reported calculation and allocation errors that were present in data provided as part of AGA's access arrangement proposal, impacting the AA4 Other Corporate Support costs (and Canada head office charges). This revision changes the AA4 average calculations for both cost lines but does not affect the total AA4 corporate cost base.

We confirm that calculation errors had occurred during the development of the AA4 cost base and were reflected in data submitted as part of the access arrangement proposal. Specifically, we note that:

- spreadsheet linking errors occurred between spreadsheets, referencing values one year ahead of where it should have been referencing; and
- an escalation error had occurred related to the Corporate – Other Corporate Support (HR, President, Finance etc) row being used as a balancing cost for total Corporate Costs. Specifically, real 2023 $ were deducted from a real 2019 $ base, incorrectly resulting in a value significantly lower than the true cost.

AGA has provided us with updated data that incorporates the corrections above, which changes the AA4 Other Corporate Support costs average to $5.7 million from the $1.6 million reported in the Draft Decision.

We have validated the errors and inconsistencies with AGA's data as stated above by reviewing the model via an AGA walkthrough session and assessing the model ourselves. We do note that we were unable to view linked documents the model was referencing due to the documents sitting in AGA's technology environment. To address this, AGA provided a document that stepped through the errors and inconsistencies, as well as informing us that it had a walkthrough session with the ERA to demonstrate where the errors had occurred[27].

[redacted] *should be excluded from analysis of recurrent costs*

We reviewed the model submitted to the ERA previously and validated that the [redacted] was included in the model. Based on our analysis of AA5 forecast total corporate opex cost data provided by AGA, it appears the ERA has retained this cost in the 2021A Other Corporate Support costs line when analysing AA5 costs to inform its Draft Decision, specifically when referencing a projected AA5 corporate operating expenditure of $121.2 million[28].

We concur with AGA that the [redacted] $7.7 million, incurred in 2021, should be excluded from analysis of AA5 recurrent Other Corporate Support costs. Based on the

[27]ATCO Explanation of EMCa 52 errors and progression to normalised costs in AA5 28052024 – Updated 05062025.

[28] ERA Access Arrangement Draft Decision 2024, para 28.

data provided by AGA, we also concur that this reduces the annual average AA5 recurrent Other Corporate Support costs from \$8.3 million to \$6.8 million.

The adjustment can be seen in Figure 2 of this report.

Energy Safety levies have now been allocated to the Other Corporate Support cost line

Information provided by AGA confirms that an internal cost allocation change that occurred in 2022 has resulted in the allocation of Energy Safety levies to the Other Corporate Support costs line. This has resulted in an allocation of \$1.4 million (including accruals) from the Corporate – Regulatory costs to the Other Corporate Support costs line.

We confirm this has not affected the AA5 base but has increased the Other Corporate Support costs line item in 2023. Based on AGA advice noted above in section 4.2, we expect this will become a recurrent cost under this line item for future regulatory periods, unless amended by the issuing government authorities.

Exclusion of Short-Term Incentive Program (STIP) payments from AA4 and AA5 base

We acknowledge AGA's position that the year-to-year fluctuation of the STIP does not lend itself to robust trend analysis across the AA4 and AA5 period. Further, we note that per AGA policy, the 2024F year does not include any STIP amount, which indicates a full AA5 average is not yet available.

We also acknowledge that some bonus costs appear to have been deducted twice in the adjustments to the 2022 base year opex in the Draft Decision.[29]

Furthermore, we agree with AGA's proposed approach to remove the bonuses from the historical cost data only for the purpose of AA4 and AA5 Other Corporate Support costs expenditure analysis. We consider that this provides a consistent basis for analysis between years and periods, and aligns with the use of a benchmark-based forecast of the STIP for the development of AA6 forecast costs (explained further in section 5). By doing so, the calculated total corporate opex costs, excluding staff bonuses, are:

- \$107.2 million for AA4 (reduced from \$115.1 million), or \$19.5 million per year; and
- forecast to be \$98.3 million for AA5 (reduced from \$108.9 million), or \$19.7 million per year.

With bonus payments being accounted for under the Other Corporate Support cost line item, the removal of these from the AA4 and AA5 recurrent opex cost analysis results in Other Corporate Support costs of:

- \$23.2 million in total for AA4 (reduced from \$31.1 million), or \$4.2 million per year; and

[29] ERA Access Arrangement Draft Decision 2024, Table 5.3.

- (forecast) $23.7 million for AA5 (reduced from $34.1 million), or $4.7 million per year.

We note that the reallocation of Energy Safety levies into the Other Corporate Support cost line fully accounts for this increase in costs from AA4 to AA5. These costs total $2.8 million in the AA5 period ($1.4 million in each of 2023A and 2024F), which contribute $0.56 million to the AA5 annual average Other Corporate Support costs.

Finally, we also agree with the inclusion of an amount of bonuses in the base year recurrent costs, subject to adequate demonstration that these costs are at an efficient level, as explained in section 5 of this report.

4.4 Recommendation

Based on the analysis above we:

(i) Agree with AGA that the one-off cost incurred in 2021 as a result of the [redacted] should be excluded from analysis of AA5 recurrent Other Corporate Support costs;

(ii) Note that AGA has changed the allocation of Energy Safety levies from 2023 onwards, from Corporate – Regulatory costs to Other Corporate Support costs, and note AGA's intention to continue with this allocation. These charges are $1.4 million in the Other Corporate Support costs line in 2023A and 2024F, contributing $0.56 million to the AA5 annual average Other Corporate Support costs;

(iii) Note the correction of cost allocation and calculation errors in previous AA4 data provided by AGA Other Corporate Support costs to the Canada head office charges, and that AGA intends to provide corrected data to the ERA as part of its revised access arrangement;

(iv) Agree with AGA that the exclusion of STIP costs from the historical cost data for the purpose of AA4 and AA5 Other Corporate Support cost expenditure analysis provides a consistent basis for analysis, given the year-to-year fluctuation of these costs and the fact that no STIP costs have yet been forecast for 2024;

(v) Agree with AGA that a forecast of STIP costs should then be added to the base year recurrent costs, subject to adequate demonstration that these costs are at an efficient level (see section 5); and

(vi) Recommend that the revised average recurrent Other Corporate Support costs (excluding STIP costs) of $4.2 million for the AA4 period and $4.7 million for the AA5 period be adopted for the purposes of analysing the average annual increase between the respective periods. We note that the increase from AA4 to AA5 is fully accounted for by the change in allocation of the Energy Safety levies as noted in paragraph (ii) above.

5 Short-Term Incentive Program

5.1 ERA position

In reference to paragraphs 36-40 and 42-43 of the Draft Decision, the ERA determined that the $3.7 million cost relating to AGA's Short-Term Incentive Program (STIP) does not form part of an efficient base year cost and should be removed from AGA's 2022 base year actual operating expenditure.

The ERA noted that STIP payments have increased significantly in 2021 and 2022 from the previous five years and expressed the view that bonus payments should only be awarded when productivity growth is achieved, in which case bonuses should be paid from savings against expenditure targets.

While the ERA did not award any amount for the STIP, EMCa had stated that a $2 million allowance for the STIP was prudent.[30]

5.2 AGA position

AGA is of the position that the STIP is a material component of AGA's past, present, and future remuneration and rewards package. AGA considers that this program is a key factor of consideration when employees are evaluating their employment options and, as such, is a key value offering the business has in retaining and attracting the best talent available in the market.

AGA notes that the ERA determination to exclude STIP payments reflects the view that bonuses should be awarded based on financial metrics only.

Beyond financial metrics, such as exceeding expenditure targets or finding efficiencies, AGA emphasises the importance of non-financial based performance metrics as key drivers for the STIP. Examples of these key drivers include:

- Safety – For an organisation such as AGA's to provide efficient services for its customers, it must ensure that staff are safe in the workplace, including when operating in higher-risk, outdoor environments. Therefore, ensuring staff are properly adhering to safety protocols is important to ensure the safety of staff, customers, and the gas distribution network. AGA advises that it conducts regular and comprehensive training for its staff to ensure safety protocols are abided by and that those protocols remain up to standard[31];
- Network reliability – AGA aims to provide customers with a service they can rely on and advised us that it has provided a 99.99998% service availability for the 2022-2023 period; and

[30] EMCa Review 2024, para 710.
[31] ATCO health, safety and environment policy 2023.

- Sustainability – AGA has undertaken several initiatives, such as procuring third-party advice to develop a sustainability framework, to align with sustainability goals and the Mandatory Climate Disclosure requirements.

In addition to the metrics above, in the AA5 period, AGA advised that it considered other non-financial factors when awarding STIP payments:

- COVID-19 – This anomalous event significantly hampered employee movements due to government restrictions, an increase in illness and absenteeism, and adapting the workplace quickly and safely to cater to government and best practice requirements;
- Labour shortages – During the COVID-19 pandemic, and in the period that followed, companies across most industries experienced high levels of staff turnover, as large as 22 per cent, which placed additional workload on remaining employees, a focus on recruitment, and a focus on training existing employees to fill existing roles or capabilities; and
- Total Recordable Injury Frequency Rate (TRIFR) – due to the anomalous COVID-19 pandemic, additional workplace health and safety protocols were implemented which resulted in lower injuries through increased training, education, and process improvement.

In addition, AGA advises that bonuses have been awarded in line with market benchmarks in AA4 and AA5 and in line with business growth. AGA indicated that it had engaged Mercer to conduct an independent review[32] of its short-term incentive structure, which supports AGA's view that its incentive program is aligned to market practice and that non-financial metrics such as safety are widely adopted and utilised in its industry and more broadly. AGA considers that the advice from Mercer supports its position to have the STIP included in the AA6 forecast.

5.3 Our analysis

Given the industry AGA operates in, there are other, non-financial factors which form part of a reasonable assessment of how staff performance has contributed to ensuring overall business performance, network availability and customer satisfaction. We have sought information regarding the non-financial metrics that AGA has considered as part of the STIP, as explained below. In addition, we undertook a high-level comparison exercise to further understand how staff incentive programs were treated by regulators across regulated entities on the east coast of Australia.

Employee incentive programs across organisations in regulated industries

Gas distribution businesses operate critical infrastructure that requires a focus on safety and network reliability. Incentive programs that are well designed can be prudent measures to drive performance in these key areas.

[32] 20240528 ATCO_STI Mkt Practice Report_FINAL.pdf.

In addition to safety, incentive programs can promote network availability and uptime and improved customer satisfaction. With incentives tied to metrics such as gas availability, restoration after outages and maintenance, gas utilities can enhance their network resiliency and, in turn, drive customer satisfaction.

Furthermore, the gas utility sector faces competition for skilled labour required to construct, operate and maintain networks. Attractive incentive programs are often necessary for recruiting and retaining top technical and operational talent.

Without well-designed incentives, it is plausible that gas utilities may struggle to build a capable workforce, jeopardising safety standards and network dependability.

We note that other regulated gas entities such as Evoenergy Gas[33] and Jemena[34] offer employee incentive programs and are regulated by the Australian Energy Regulator (AER). We note that the AER makes no provision to report bonuses in its Regulatory Information Notice templates, nor has it made mention of employee incentive programs in recent gas distribution determinations[35], indicating that incentive programs have been considered within a prudent cost base.

With the information listed above, if a new market participant was to enter the gas distribution business, it is likely that an employee incentive program would form a prudent part of its cost base and business structure due to the potential implications of not attracting talent.

Safety

We requested information from AGA evidencing safety being a driving factor in awarding the STIP to its employees.

The primary metric used to assess safety within AGA, in alignment with industry best practice, is the Total Recordable Injury Frequency Rate (TRIFR). The TRIFR refers to the frequency of recordable work-related injuries or illness for each 200,000 hours worked. The TRIFR captures work-related injuries or illnesses where the outcome has resulted in medical treatment or medical aid, restricted work, lost time, or a fatal incident.

AGA's average TRIFR for the AA4 period was 2.25. AGA set an AA5 target of 1.2, and reported performance of 1.5, 1.2 and 0.6 reported in the years from 2020 to 2022. AGA has set a target TRIFR value of 1.0 for the AA6 period.[36]

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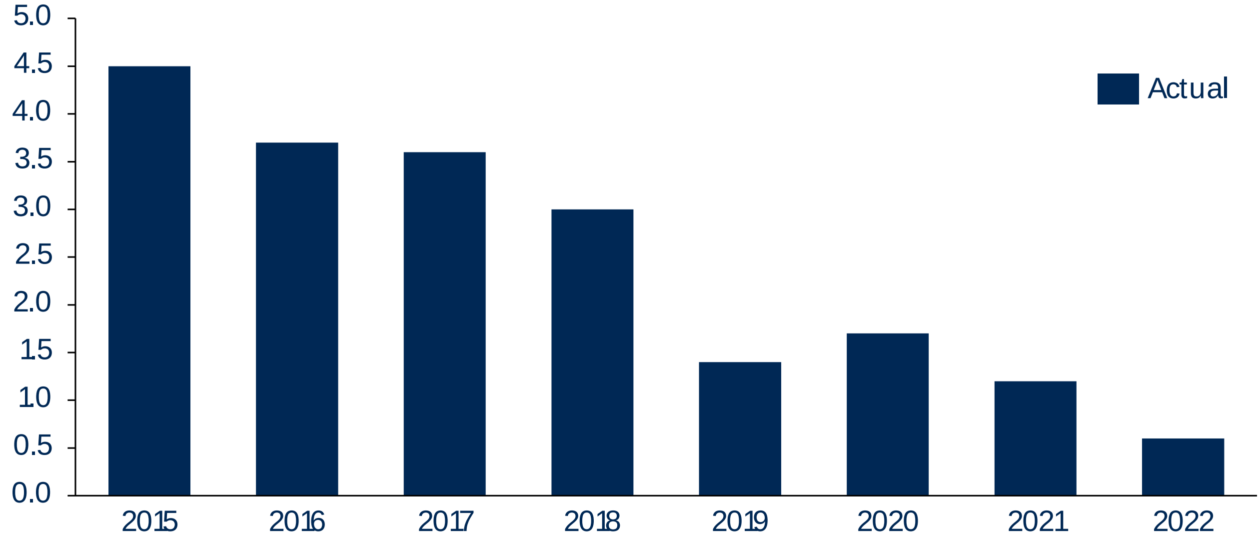
[33] Evoenergy 2020, p.21.
[34] Desktop research, see reference list.
[35] For example, in AER draft and final decision access arrangements for AusNet Services Gas 2018-2022, Australian Gas Networks (Victoria and Albury) 2018-2022, Muiltinet Gas Networks 2023-2028 and Jemena Gas Networks (NSW) 2020-2025.
[36] AGA HSE Performance 2019-2024YTD.pptx.

Figure 3 – AGA TRIFR 2015 – 2022



With the information provided by AGA, Rennie considers the reduction in AGA's TRIFR from the AA4 period to now shows a large reduction in safety incidents. Considering the above-average risk profile of AGA's business, Rennie agrees that reducing safety incidents should be considered as a key factor in awarding the STIP.

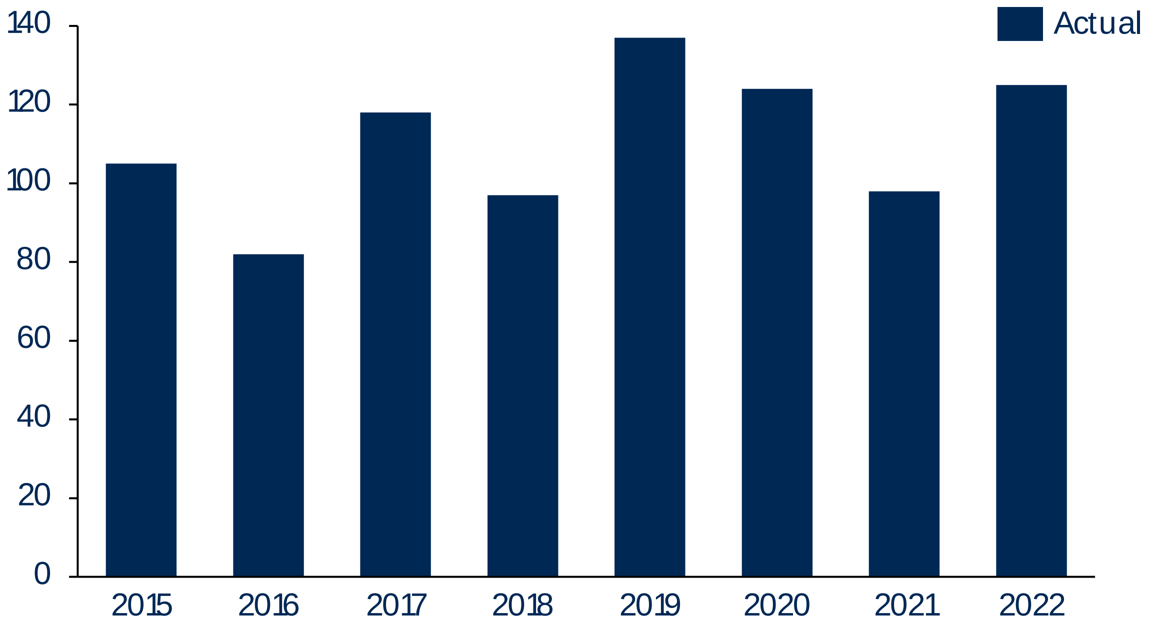
Network reliability

We referred to AGA's *ATCO Gas 2025-29 Plan* in relation to network reliability metrics. This plan proposes three metrics: Asset Health Index (AHI), System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI).

AGA reports that the AHI metric is used to measure the overall health of AGA's assets, considering factors such asset age, condition, performance, and the likelihood of failure. The metric is also used to inform maintenance requirements to support reliability and reduce safety risks. AGA has indicated that it will maintain a performance target AHI of 100 for the AA6 period.

Please see below for a visual representation of *AGA's AHI to the last reported year, 2022*.

Figure 4 – AGA AHI 2015 – 2022



SAIDI and SAIFI are common industry measures for reliability, based on the frequency and duration of service interruptions that a customer would experience in a year. AGA's recent reliability performance on these metrics has exceeded its AA5 targets[37], and its proposed targets for the AA6 period represent improvements of 20 per cent and 15 per cent relative to the AA5 targets, in line with recent performance. The figures below provide a visual representation of AGA's SAIDI and SAIFI from 2015 to the last reportable year 2022.

[37] For the SAIDI and SAIFI metrics, a lower number represents a greater level of reliability. AGA's SAIDI and SAIFI values from 2020 to 2022 are lower than the AA5 targets, on average, reflecting reliability above the targets.

Figure 5 – AGA SAIDI 2015 – 2022

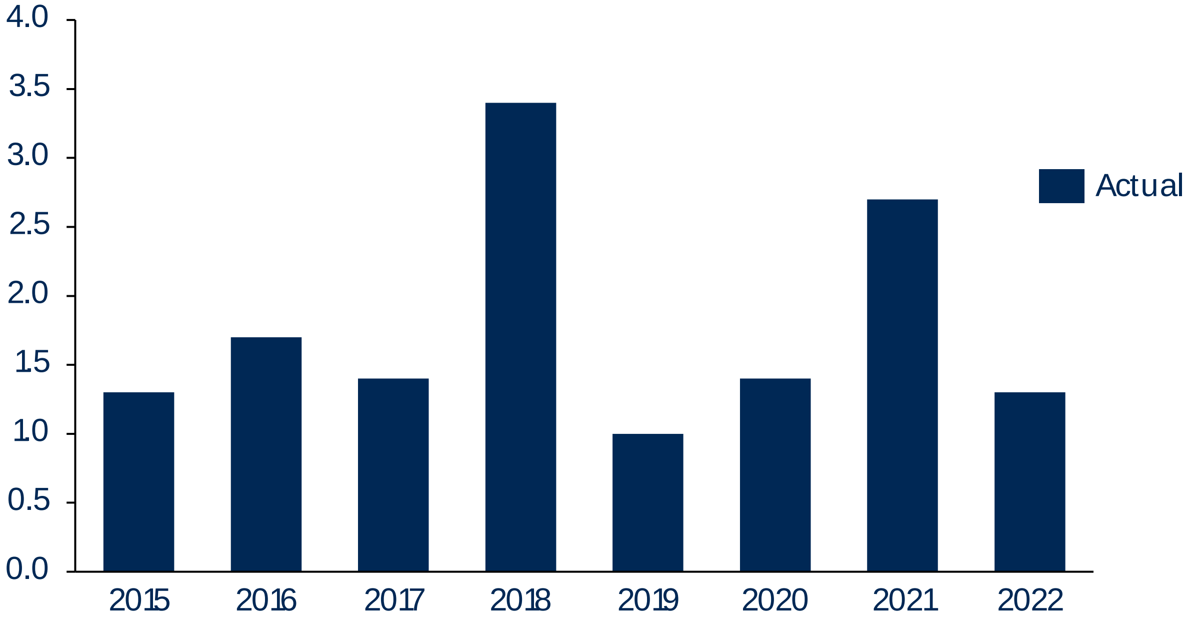
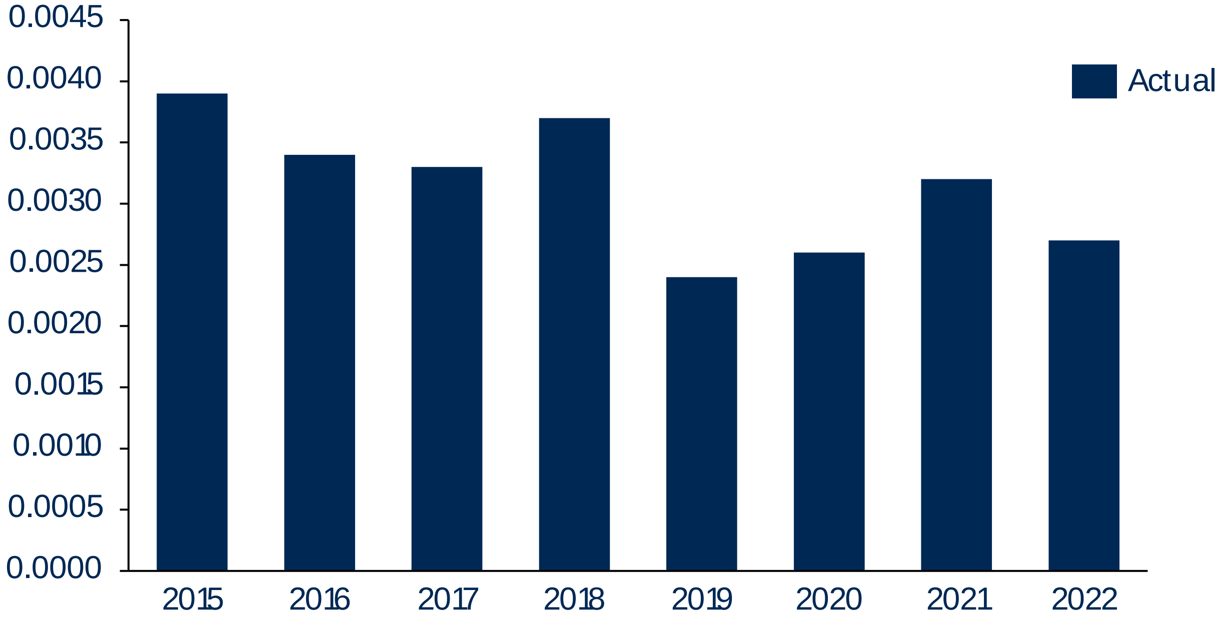


Figure 6 – AGA SAIFI 2015 – 2022



In addition to the AHI, a key metric used to test network reliability is the average percentage of time that gas has been supplied to customer premises during the reporting year. From 2014 to 2023, AGA has maintained an average percentage of time of gas supply to customer premises of 99.999%[38], further demonstrating its high level of network uptime and service reliability.

Considering the information above, including the establishment of targets that seek to deliver improving network reliability in the AA6 period, we consider that by maintaining a high level of service availability to its customers and maintaining good asset health, reliability should be considered as a key factor in determining the prudency of the STIP.

Customer service

With additional information provided to us by AGA[39], we were able to consider key metrics associated with customer service and customer satisfaction. The three metrics which we considered were:

- Domestic customer connections within 5 business days
- Attendance to broken mains and services within one hour; and
- Attendance to loss of gas supply within three hours.

Domestic customer connections within 5 business days is an important metric as it ensures efficient service, minimises disruptions for households, and demonstrates AGA's commitment to prompt and reliable gas access for its residential customers. We consider this metric incentivises operational excellence when considering residential connections. AGA achieved an average of 99.1% for this metric from 2014 to 2023.

Attending to broken gas mains and services within one hour is crucial for AGA's customers. The rapid response time aims to mitigate safety risks, prevents prolonged outages, and maintains customer confidence in the reliability of the gas network. Prioritising this metric demonstrates a strong commitment to public safety and uninterrupted service delivery. AGA reported an average of 99.9% for this metric from 2014 to 2023.

Similar to attending to broken gas mains and services, AGA considers that attending to customer reports of loss of gas supply within three hours is an essential metric for its business. The three-hour response window seeks to minimise public safety risks and disruption to households and businesses, preventing extended inconveniences and productivity losses. AGA considers that this metric reflects its dedication to maintaining a highly dependable gas network and delivering a reliable service to its customers. AGA reported an average of 100% for this metric from 2014 to 2023.

[38] ATCO Network Integrity and Customer Service – KPIs.
[39] ATCO Network Integrity and Customer Service – KPIs.

Rennie considers that prioritising customer safety and service by tracking and adhering to the metrics listed above incentivises AGA's employees to deliver a reliable service to its customers and in doing so, is a reasonable non-financial metric that should be considered when considering incentive programs for its employees.

Sustainability

As part of its sustainability goals and targets, AGA has advised that it assesses performance across three areas when considering bonuses for staff.

Firstly, AGA looks to the Mandatory Climate Disclosure requirements as part of its future reporting obligations, which align executive remuneration to sustainability metrics as disclosed in the Australian Sustainability Reporting Standards disclosure requirements. AGA has advised that it is implementing the required processes to ensure alignment with its future obligations.

Secondly, AGA includes sustainability in performance metrics as per the following examples:

- Environmental
    - No reportable incidents to the Department of Water and Environmental Regulation;
    - No operational environmental spills[40];
    - Ensure full compliance to the National Greenhouse and Energy Reporting Scheme;
    - Continue to contribute to AGA's Global Decarbonisation Project; and
    - Contribute to growth activities to ensure progress toward its 2030 ESG targets[41].
- Social
    - Improved people engagement and culture to ensure progress towards its 2030 ESG targets[42];
    - Improved & sustained safety culture;
    - Enhanced indigenous relations through strategic partnerships and collaboration;
    - Community engagement activities; and
    - Increased diversity, equity, and inclusion.
- Governance
    - Maintaining regulatory compliance.

Lastly, AGA has committed to undertaking several sustainability activities within the ATCO Gas Australia Sustainability Strategy, which was developed on its own accord in partnership with external consultants.[43]

[40] Department of Water and Environmental Regulation Environmental Spills.
[41] ATCO Sustainability Report 2023.
[42] ATCO Social and Governance Targets for 2030.
[43] ATCO Gas Sustainability Strategy.

We consider it appropriate that sustainability measures are considered as a key non-financial metric in determining the STIP.

Labour shortages and COVID-19 for bonus considerations

AGA stated that the heightened risk and operational difficulty during the COVID-19 pandemic provided an additional factor in awarding STIP to employees during the AA5 period. We consider it reasonable that the operational difficulty, heightened risk and additional health and safety compliance, coupled with the labour shortages experienced during this time, could have placed higher than normal workload on employees and that bonuses provided additional remuneration for employees. However, due to the COVID-19 pandemic no longer posing significant operational difficulties we do not consider this demonstrates a driving factor in awarding the STIP in future.

However, given the nature of AGA's business, the specialist requirements and safety considerations for field roles, we recognise that the skilled labour pool is likely more limited than other general industries. Bonuses can help retain and attract staff that might otherwise look elsewhere. We consider that bonuses can assist labour shortages and labour requirements in general and, in the context of the requirements of AGA's industry, are an effective measure in retaining and attracting key personnel.

Reviewing market data showed a bonus allocation to ATCO is reasonable

We have found through research that several of the major gas distribution companies on the east coast do provide bonus payments as part of their remuneration and rewards packages, and that the Australian Energy Regulator (AER) does not appear to rule specifically on the suitability of the inclusion of bonus payments in its regulatory determinations for those gas distributors. While the reasoning for the AER's position is unclear, it seems as though the presence of bonus payments does not form a material consideration when assessing the operating expenditure of east coast gas distributors.

It is noted that while the ERA did not award any amount for the STIP in the Draft Decision, EMCa had proposed that a $2.0 million allowance for the STIP was likely to be representative of the recurrent bonus payments through the AA6 period, aligning with the five-year historical average for those payments.

AGA undertook additional benchmarking[44], provided to us, using Mercer data for Australian firms to determine whether its STIP allocation was aligned with industry benchmarks. This exercise compared against and aligned to the below factors to develop an appropriate benchmark level:

- AGA's STIP target and the Mercer STIP targets;
- AGA job grades and Mercer job grades; and

[44] ATCO response to ERA Draft Decision Mercer Short Term Incentive Data.

- AGA job descriptors and Mercer job descriptors.

Mercer provides the average STIP target and average actual STIP payout by job grade.

AGA advised that:

- its STIP targets at each job grade were consistent with Mercer data for Australian organisations;
- it had calculated a benchmark bonus quantity of $2.9 million by using the Mercer actual bonus payment ratios for each corresponding job grade for Australian firms, and using the most conservative actual bonus payment ratio for roles where Mercer provided no data for a comparable job grade. This is $0.8 million less than the amount of $3.7 million initially proposed by AGA for the 2022 base year recurrent corporate opex costs.

We consider that the benchmarking approach utilised by AGA is reasonable as it directly compares AGA's job descriptors and STIP targets to reputable and industry relevant market benchmarks developed by Mercer and coupled with Mercer's independent review[45] of AGA's short-term incentive program, the $2.9 million STIP amount is reasonable and aligned to market practice.

5.4 Recommendation

Based on the analysis above we:

(i) Consider that while financial metrics are important for employee incentive programs, in the case of AGA and similar businesses, non-financial metrics such as safety, network reliability, customer service and meaningful sustainability targets carry significant weight when determining overall staff and business performance and, as such, we consider that a STIP allowance can be approved; and

(ii) Concur with AGA's benchmarking analysis into the level of STIP payments, in alignment with industry standards and Mercer's industry data, and recommend that a revised STIP allowance of $2.9 million per year should be approved, as determined from Mercer data on STIP per cent by staff level and STIP payout rates. We note that this is reduced from AGA's initially proposed amount of $3.7 million.

We consider that a bonus allocation of $2.9 million based on the benchmarking analysis completed by AGA and upon review of the independent report conducted by Mercer into AGA's STIP program, is consistent with accepted good industry practice and aligned with rule 91(1) of the NGR.

[45] 20240528 ATCO_STI Mkt Practice Report_FINAL.pdf.

6 Corporate – ATCO Group Management Fees (Related Parties)

6.1 ERA position

The ERA noted, in paragraph 34 of its Draft Decision, that AGA would need to explain the increase in the allocation cost from the Canada head office, and explain and advise the key drivers behind the COVID-19 costs, to justify whether such costs can be considered prudent and efficient in line with the requirements of rule 91(1) of the NGR.

The ERA also stated that there was no compelling information or incremental cost breakdown regarding the increase in costs from the Canada head office from 2018A (AA5 Final Decision base year) to 2020A (AA5 year 1) in alignment with the Massachusetts formula, that would allow it to validate the growth in costs.

6.2 AGA position

AGA is of the position that:

- The increase in costs from AA4 to AA5 is due in part to an increase in the cost allocation from the Canada head office as a result of correct application of the Massachusetts formula, referred to in paragraph 704 of the EMCa Report, and is not representative of any change in allocation methodology from Canada;
- The services provided from the Canada head office deliver benefits in the form of economies of scale when negotiating contracts for licenses and maintenance, centralised knowledge and the global shared services capability; and

The commentary in paragraph 704 of the EMCa report and paragraph 29-35 of the ERA Draft Decision mixes two cost categories, being the Other Corporate Support cost category and the ATCO Group Management Fees (Related Parties) category. Canada head office charges are included in the latter category. AGA identified three significant influences that have driven changes in the business: in recent years:

- Inflation: AGA notes the inflationary cost pressures caused by the conflicts in Ukraine and the Middle East, and global supply chain issues which are still feeling the effects of COVID-19;
- Government, Regulatory and Investor Engagement: Stakeholders, regulatory bodies and governments are demanding greater amounts of information at quicker paces; and
- Social awareness: New functions have been added in the business such as Diversity, Equity, and Inclusion (DEI) and the expansion of the ESG team within ATCO's business.

With these influences in mind, representatives from the ATCO Canada head office have advised that it has, in consultation with AGA, undertaken the following initiatives to improve its business to address the influences stated above:

- Finance and accounting (F&A)
    - Continual assessment of the finance and accounting function to ensure correct functions reside centrally;
    - Prioritisation and execution of process improvement projects led by the F&A technology strategy team to eliminate manual processes and drive efficiency; and
    - Upgrade of financial consolidation system in 2023 to realise additional savings due to lower licensing and support costs.

- Common services passed through to AGA
    - Continual assessment of the need for services passed through to AGA to ensure no costs are passed through that are not required; and
    - Enhancing in-house legal and governance capabilities, which allow for a more risk-based approach and reducing third-party costs.

- Technology
    - Restructuring of the corporate information technology function.

- Executive
    - Reducing costs by leveraging in-house counsel and lowering travel costs where possible.

Other considerations when assessing the value-for-money of the Canada head office

The additional benefits derived from services provided from the Canada head office include:

- Economies of scale – AGA benefits from economies of scale when negotiating contracts related to technology, supply chain, maintenance and other services such as project management;
- Buying power – Similar to economies of scale, AGA benefits from an increase in buying power being a part of ATCO. For example, the Canadian Digital team is charged with managing the Salesforce platform for the entire business, which ATCO (and subsequently AGA) uses Salesforce as its primary customer relationship management (CRM) tool. There are 17 business units within ATCO that use Salesforce and as such, ATCO is able to use its buying power to negotiate discounted prices. Due to the commercially sensitive nature of the costs ATCO, has and due to contractual limitations with Salesforce, we cannot disclose the cost for the contract, however, we have been advised that ATCO benefited from a 20% reduction in total licensing costs in 2022A; and
- Centralised and shared knowledge – Similar to economies of scale, by being a part of a larger group, AGA benefits from a centralised information sharing platform, subject to ringfencing obligations, to share information between regions.

6.3 Our analysis

Prudency of the Canada head office services as they relate to AGA

We have reviewed the comprehensive summary of services document developed by ATCO's Canada head office[46] that outlines the various services provided by the Canada head office to AGA. Through a careful examination of each service offering, we consider that these services are prudent for AGA's operation and business, for the reasons outlined below.

The range of services includes (but is not limited to) human resources, information technology, financial services, specialist expertise and stakeholder engagement. We consider these services are valuable in ensuring AGA remains in alignment with its goals and objectives and in alignment with Rule 91(1) of the NGR. As detailed further in this section, it is evident the Canada head office has an understanding of AGA's industry trends and alignment to best practices, which has facilitated a consistent and prudent approach across the business units.

Consistency of approach with rate of return assumptions

The ERA's 2022 final gas rate of return instrument states that the weighted average cost of capital (WACC) parameters are estimated for a 'benchmark efficient entity', which the ERA defined as "a pure-play network service provider operating within Australia without parental ownership, with a similar degree of risk as that which applies to the service provider in respect of the provision of gas network services".[47]

Within the WACC formula, the gamma parameter reflects the value of Australian imputation credits for investors. The gamma value of 0.5 as determined by the ERA[48] means that investors are assumed to value each $1 of imputation credits as being worth 50 cents. However, these imputation credits have a lower value for foreign investors who cannot utilise them to offset tax liabilities in their home countries, in this case Canada. A lower gamma value would translate to a higher required rate of return on equity and a higher overall rate of return. This higher allowed rate of return would result in greater potential revenue from regulated gas distribution services and activities.

When evaluating the prudency and efficiency of AGA's operating costs, it may be inherently inconsistent to determine the rate of return based on an assumption of an Australian domiciled entity, while also expecting the delivery of efficiencies from an overseas head office relative to a hypothetical standalone Australian company.

With the above considered, we have undertaken a benchmarking exercise in this section with the view of building a benchmark that is representative of a standalone Australian domiciled entity, as it

[46] Canada summary of services 2023.docx.
[47] ERA, Explanatory statement for the 2022 Final Gas Rate of Return Instrument, para 65.
[48] ERA 2022 Final Gas Rate of Return Instrument para 136.

would not be possible to effectively benchmark against a comparative foreign-owned company due to the highly bespoke nature of the makeup of head office services established within companies.

Massachusetts formula

The costs allocated from ATCO's Canada head office are done so using the 'Massachusetts formula'. This formula considers three equally-weighted factors of the AGA and Canada business – operating revenue, payroll and asset values – to ensure services required by AGA are appropriately allocated from the Canada head office.

ATCO and ATCO Pipelines (AP) engaged independent third-party firm KPMG, as part of an internal audit process, to provide an assessment on the cost allocation methodology and suitability of services provided to Australia by Canada. The KPMG Shared Service Allocation Review report[49] supports ATCO and AP's position that the allocation methodology and nature of services passed through to Australia are fair and reasonable, with no recommendations to alter or change the methodology.

Upon reviewing AGA-provided information[50] and the independent third-party reports, we consider that the Massachusetts formula methodology is a prudent approach for the allocation of head office costs between the Canada head office and AGA. The Canadian regulator that oversees ATCO and AP, the Alberta Utilities Commission (AUC), has also agreed that this methodology is fair and reasonable and has approved it for use.[51]

Correction of error in allocation of costs under the Massachusetts formula

As one of its inputs, the Massachusetts formula looks at the labour cost for the ATCO Group and the labour cost for AGA.

Within the group and in Australia, it is common for employees to have their time allocated to non-BAU capitalised projects and, as such, the labour cost allocated to these projects is accounted for by the project. AGA then defines:

- 'gross labour' as the total labour cost before employees' time is allocated to capitalised projects; and
- 'net labour' as the total labour cost excluding the cost associated with employees' time that has been assigned to capitalised projects.

[49] KPMG Shared Service Allocation Review report.
[50] Memorandum – Current Corporate Cost Allocation, Common Groups - Summary of Services 2023, OOC allocation.
[51] 2013-03-21 Decision 2013-111 AU Corporate Costs ID 1920.

AGA previously explained the correction of the labour input in the Massachusetts formula in its Regulatory Information Notice for the 2022 regulatory year[52]:

> As noted in the 2020 variance analysis previously submitted, there is an increase in the support costs of approximately $2.3 million following a correction made to the ATCO group allocation methodology under the Massachusetts formula.
>
> Between 2011 and 2019 corporate support costs had been allocated based on net labour costs (following capitalisation to projects), whereas they should have been allocated based on gross labour costs, this error resulted in ATCO Gas Australia receiving a lower allocation of corporate costs than it should have.
>
> Therefore, as a result consumers have benefited from this under allocation of corporate support costs to ATCO Gas Australia, as this error resulted in lower Opex and therefore lower tariff charges across AA4 and AA5.

The correct labour input, gross labour, was applied from 2020 onwards. AGA advised us that there are no historical considerations or implications that were recorded as a result of this change except for the already reported benefit of receiving lower cost allocations on the net labour input.

On this basis, we tend to the view that there is little justification to require a 'value-for-money' assessment of this incremental cost. For this reason, we consider that the increase from the AA4 year 2018A compared to the AA5 year 2020A that results from correcting the input into the Massachusetts formula is consistent with rule 91(1) of the NGR.

Benchmarking

Rennie conducted a benchmarking exercise to test the reasonableness of the Canada head office charges and inform our opinion on whether they are efficient for the purpose of Rule 91(1). In selecting benchmark costs, we recognise that there are no directly comparable regulated gas businesses in Australia that are publicly listed and are utilising shared services from an overseas head office.

The standalone cost build considered:

- The extent of services and their respective costs passed through from Canada, provided to us by AGA;
- Benchmark Australian costs for providing the same services, aligned with AGA's industry as closely as possible, and consideration of international benchmark costs if Australian data is unavailable; and

52 ATCO, Attachment 3 – Variance Analysis, Regulatory Information Notice (April 2022), Gas Division.

- Scaling benchmarks utilising ‘a percent of revenue’ metric where possible, and where this is not possible, identification of metrics such as salary and organisation structures to calculate an operating cost for that specific function (e.g., executive function).

Our analysis was based on actual Canada head office service and cost data for 2023, provided to us by AGA. In 2023, the total allocated to AGA from Canada was $8.7 million.

We initially excluded three smaller cost lines from the benchmarking exercise (corporate security, real estate, and innovation. The costs associated with the excluded cost lines were low ($0.6 million) and we were unable to complete an equitable benchmarking exercise for these services due to lack of suitable benchmarks. Instead, we assessed the suitability of the services being provided and whether AGA still realises a benefit from them. Consequently, we sought to benchmark the cost of $8.1 million for the remaining services included within the Canada head office charges, while assessing the prudency of the non-benchmarked services.

Our benchmarking exercise estimated that it would cost $7.8 million to provide the benchmarked Canada head office functions on a standalone basis in Australia (not including the excluded cost lines), which is within 4 per cent of the benchmarked component of 2023A Canada head office charges. Please see Appendix B for our benchmarking methodology and assumptions.

In considering this analysis, we note the benchmarking outcomes should be considered in total, as the boundaries between different cost categories may vary between organisations.

It is also important to note that the commentary in this benchmarking section has only considered the efficiency of operating expenditure and does not consider the capital expenditure that would be required for AGA to establish a standalone capability to provide these services. An example of one-off costs required to establish standalone capabilities would be likely to include:

- Technology costs, including setting up cloud environments and end user compute;
- Procuring audit, tax and other financial services;
- Procuring project management and supply chain services; and
- Recruitment activities for all required functions.

The services for which we were unable to provide benchmarks are explained in further detail below.

Corporate security ($0.2m)

The services provided to AGA from the Canada head office under this allocation include, but are not limited to:

- Executive security:
  - Managing executive vehicle leases;
  - Security for AGMs; and

- Executive protection.

- Corporate assets security:
  - Domestic and global security of human resources and corporate assets;
  - Infrastructure protection;
  - Development of threat mitigation plans and critical infrastructure;
  - Information risk management;
  - Business continuity crisis management & response;
  - Employee risk awareness;
  - Background & due diligence investigations;
  - Risk assessment, evaluation, security reviews;
  - Threat response from ATCO call centre; and
  - Monitor suppression of terrorism.

- International security:
  - International travel program;
  - Security clearances; and
  - Country risk assessment.

It is evident that there is a large suite of services which are provided in the $0.2 million cost line for corporate security, though it is estimated that these are representative of approximately 20 per cent of a full function[53].

As AGA is part of the publicly listed entity ATCO, it is reasonable that AGA is allocated costs that may relate specifically to the publicly listed entity. We also consider it reasonable that AGA contributes to the cost of maintaining operational continuity in the event of a crisis, including business continuity crisis management and response services, terrorism monitoring, risk management, country risk assessment and infrastructure protection.

Based on limited publicly available reference data, it can be estimated that a standalone corporate security function for a firm with AGA's revenue would cost approximately $5.5 million[54] to operate on a yearly basis. We scale this down to reflect the approximately 20 per cent of a full corporate security function that is provided from Canada head office, resulting in a reduced benchmark figure of $1.1 million This is significantly higher than the cost passed through from Canada.

Based on the above, we have decided not to include the corporate security cost of $0.2 million in our benchmarking analysis and the Canada head office charges total, for the purposes of our benchmarking analysis.

[53] What is corporate security? Report by the Security Executive Council 2024.
[54] What is corporate security? Report by the Security Executive Council 2024.

We consider that the $0.2 million corporate security cost allocated from the Canada head office to AGA is aligned to rule 91(1) of the NGR and, in comparison to the benchmark provided, is a prudent and efficient cost incurred by AGA.

Real Estate ($0.08m)

The services provided to AGA from the Canada head office under this allocation are:

- Acquisitions and dispositions;
- Development;
- Leasing and asset management; and
- Lease administration and operations.

Due to the variable nature of real estate costs and services, we are unable to develop a benchmark cost for these services. The reasoning for this is that real estate services such as rent, development, maintenance, leasing and administration are highly variable between regions, businesses and industries, and cannot be effectively benchmarked due to these factors.

Additionally, we consider the materiality of this cost to be small in the context of this analysis, and that any benchmark cost would likely be significantly higher than $0.08 million. This would unjustifiably skew the overall benchmarking analysis.

Based on the above, we consider the $0.08 million allocated from Canada to AGA is aligned to rule 91(1) of the NGR.

Innovation ($0.3m)

The services provided to AGA from the Canada head office under this allocation are from ATCO's Spacelab.

The ATCO Spacelab[55] is an enterprise-wide framework that provides collaborative support for ATCO's people and provides a source of funding and expertise for any ATCO employee with a desire to pursue sustainable new value for the company.

Given the bespoke nature of Spacelab and the fact that is it not a traditional in-house research and development (R&D) function, an equitable and good faith benchmarking exercise could not be completed.

Based on the above, we have chosen to exclude this cost from our benchmarking analysis and Canada head office total. While we have chosen to exclude these costs from our benchmarking analysis, based on the services which are passed through to Australia, we believe the services and subsequent costs are prudent.

[55] ATCO Spacelab.

Canada head office governance

We conducted interviews with staff from AGA and the ATCO Canada head office and sought additional information on governance processes in relation to the charging of Canada head office costs to AGA. The below processes were identified:

- To ensure the services provided to AGA from Canada are aligned with the needs of the business, there is regular, annual consultation that occurs between the two regions to understand what services should be appropriately allocated to Australia. For example, if there are HR services conducted in Australia that Canada also conducts, there will be no pass-through of costs for the same service from Canada. This is evidenced by interviews with the Canada head office and supported by documentation that clearly outlines the consultation process between the regions.
- Each year, the head office updates an internal detailed corporate cost allocation memorandum[56] that outlines the importance, nature and methodology of the Massachusetts formula and the allocation of services to Australia. This memorandum provides a detailed insight into how the head office manages this process and emphasises the importance of doing so transparently.
- As noted above, the Canada head office sought third-party validation from KPMG for its cost allocation methodology, which KPMG accepted as a fair and reasonable methodology. It is also important to note that this process, along with those stated above have also been validated and supported by the Canadian regulator, AUC.

We also note the information provided to us by AGA and the ATCO Canada head office regarding cost saving initiatives implemented in respect of the services provided from the head office[57].

Based on the information provided to us by AGA, while not easily quantifiable, we consider that the ATCO Canada head office is actively and regularly identifying measures to save costs and drive efficiencies within the business at a group level.

6.4 Recommendation

Based on the analysis provided above, we:

(i) Consider the Massachusetts formula to be a prudent methodology to determine cost allocation to AGA from the Canada head office;

[56] ATCO – Memorandum Current Corporate Cost Allocation.
[57] 2023 Cost savings initiatives.

(ii) Note that the increase in the Canada head office charges resulting from a correction of previously incorrect inputs to the Massachusetts formula does not change the value-for-money position, and that AGA still benefits from the head office services;

(iii) Consider that, in order to provide an equitable comparison between the Canada head office charges and the appropriately determined benchmark costs, it is prudent to exclude corporate security, real estate and innovation cost items due to their relatively small cost and the difficulty of benchmarking such costs;

(iv) Consider that the Canada head office allocations provide value to AGA and the network it services, based on our benchmarking analysis which estimates that a standalone capability based in Australia would cost $7.8 million per year to operate when compared to the current $8.1 million cost with corporate security, real estate, and innovation removed;

(v) Note that AGA would likely incur one-off costs (not considered in our benchmarking analysis) if it was to establish a standalone capability to provide the services currently provided from the Canada head office;

(vi) Note that, notwithstanding the benchmarking conclusion at (iv), there would be an inherent inconsistency in both expecting the delivery of efficiencies from an overseas head office relative to a hypothetical standalone Australian business, while at the same time determining the rate of return based on an assumption of an Australian domiciled entity; and

(vii) Agree that the governance processes, inclusive of the cost saving initiatives the Canada head office conducts, are reasonable to ensure that AGA is allocated services it requires.

Based on our analysis, we consider that the services and subsequent costs as at 2023 provided to AGA by the Canada head office are aligned with rule 91(1) of the NGR, and recommend that the $8.7 million Canada head office charges should remain in the 2023A base year costs.

7 AA6 forecast base year

7.1 Current state

AGA's initial proposal was developed using AGA's 2022 actual year figures as the base year for the base-step-trend approach[58]. The ERA accepted the use of the 2022 base year as appropriate as it represented the most recent full year of actual costs and was outside the peak of the COVID-19 period, which would not be representative of forward costs for the AA6 period. This acceptance was subject to the removal of one-off and non-recurring costs in the base year.

We also note that the ERA substituted specific cost line items in the 2022 base year, where it formed the view that the 2022 costs were not at an efficient level. For example, the ERA substituted 2022A costs with the AA4 average for Other Corp Support costs.

AGA now has actual 2023 costs (2023A) available, which it did not at the time of preparing its original proposal.

7.2 AGA position

AGA contends that the use of 2023A costs as the base year should provide a more representative view of the forward operating costs of the business, based on the reasoning set out in the ERA's Draft Decision, given that it now represents the most recent full year of actual costs and is further removed from the peak of the COVID-19 period.

AGA's 2023A corporate opex costs totalled $23.4 million including bonus payments, and $19.2 million when STIP payments are excluded. AGA proposes that the 2023A costs excluding STIP payments, $19.2 million, should be used for developing the AA6 forecast of total corporate opex costs.

7.3 Our analysis

2023 base year comparison to AA4 average (excluding bonuses)

Comparison of 2023A total corporate opex costs excluding bonuses with previous years indicates that 2023A costs compare favourably with AA4 average costs and the previously used 2022A base year. Information provided to Rennie by AGA[59] indicates that 2023A costs of $19.2 million are less than the 2022A costs of $19.6 million and the AA4 average[60] of $19.5 million.

Assessed on this basis, we consider that the use of 2023A total corporate opex costs (excluding bonuses) provides a realistic view of business performance, representing the most recent costs

[58] ERA Access Arrangement Draft Decision 2024.
[59] EMCa 52 – Corrected (Offline copy).
[60] EMCa 52 – Corrected (Offline copy).

incurred while being consistent with past costs. In addition, we note that 2023 is further removed from the COVID-19 pandemic than the previously nominated base year of 2022.

Other Corporate Support and Canada head office costs (excluding bonuses)

Focusing on the cost lines that are the focus of this report:

- 2023A Other Corporate Support costs (excluding STIP payments) of $4.0 million were $0.2 million lower than the AA4 average of $4.2 million per year. We analysed this cost allocation in section 4.

- 2023A Canada head office charges have increased by $3.6 million over the AA4 average, from $5.1 million to $8.7 million. We analysed and benchmarked this cost in section 6.

Based on the analysis in previous sections, we consider that the 2023A costs for Other Corporate Support and Canada head office charges provide a realistic view of AGA's recurrent costs, representing the most recent costs incurred and being further removed from the COVID-19 pandemic.

Short-Term Incentive Program

Based on our previous recommendations in sections 4 and 5 of this report, the 2023A base year costs should be adjusted as follows to correct for year-to-year fluctuations in the cost associated with staff bonuses:

- subtracting the actual STIP amount incurred in 2023A ($3.8 million) from total base year costs ($23.4 million); then
- adding a forecast for recurrent bonus costs, based on benchmarking data ($2.9 million).

This results in an updated total corporate opex cost for the 2023A base year of $22.5 million.

Governance / methodology

AGA has utilised the Base Step Trend (BST) methodology to forecast its corporate cost requirements, which is explained in section 2. The BST methodology is a widely adopted process to forecast costs, aligned with industry best practice, and is adopted in the industry AGA operates in on the east coast and by similar companies nationally.

7.4 Recommendation

We consider that, based on the information provided to us by AGA and for the reasons stated above and in section 4 of this report, 2023 actual costs for Other Corporate Support costs and Canada head office charges should be adopted as the base year costs when forecasting for the AA6 period.

This results in 2023 base year costs of:

- $4.0 million for Other Corporate Support costs (excluding STIP payments);
- $2.9 million for STIP payments; and
- $8.7 million for Canada head office charges.

We consider that these base year forecasts for the AA6 period are aligned with rule 91(1) of the NGR.

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8 Summary of recommendations

Topic	Recommendation / finding	Reference
Section 4 recommendations		
[redacted]	We agree with AGA that the one-off cost incurred in 2021 as a result of the [redacted] was not excluded by EMCa from the line item as a non-recurrent cost for the purposes of an average cost comparison. This one-off cost should be removed from analysis of AA5 recurrent Other Corporate Support costs.	4.4 (i)
Inclusion of Energy Safety levies in the Other Corporate Support costs	We note that AGA has changed the allocation of Energy Safety levies, from 2023 onwards, from Corporate – Regulatory costs to Other Corporate Support costs. These changes are $1.4 million into the Other Corporate Support costs line in both actual 2023 and forecast 2024 costs, contributing $0.56 million to the AA5 annual average Other Corporate Support costs.	4.4 (ii)
Correction of calculation errors in AA4 Other Corporate Support costs	We note that AA4 cost data provided previously by AGA to the ERA included calculation errors and misallocated costs, as detailed in section 4, and that AGA intends to provide the ERA with corrected data as part of its revised access arrangement.	4.4 (iii)
Exclusion of STIP from historical data for the purpose of equitable expenditure analysis	We agree with AGA that the exclusion of STIP costs from the historical cost data for the purpose of AA4 and AA5 Other Corporate Support cost expenditure analysis provides a consistent basis for analysis, given the year-to-year fluctuation of these costs and the fact that no STIP costs have yet been forecast for 2024.	4.4 (iv)
Inclusion of STIP in base year recurrent costs	We agree with AGA that a forecast of STIP costs should then be added to the base year recurrent costs, subject to adequate demonstration that these costs are at an efficient level (see section 5).	4.4 (v)
Using the revised AA4 and AA5 costs for the purposes of analysing average annual increase	We recommend that the revised average recurrent Other Corporate Support costs (excluding STIP costs) of $4.2 million for the AA4 period and $4.7 million for the AA5 period be adopted for the purposes of analysing the average annual increase between the respective periods. We note that the increase from AA4 to AA5 is fully accounted for by the change in allocation of the Energy Safety levies as noted in paragraph (ii) above.	4.4 (vi)

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Topic	Recommendation / finding	Reference
Section 5 recommendations		
Financial and non-financial metrics for employee incentive programs	We consider that while financial metrics are important for employee incentive programs, in the case of AGA and similar businesses, non-financial metrics such as safety, network reliability, customer service and meaningful sustainability targets carry significant weight when determining overall staff and business performance and, as such, we consider that a STIP allowance can be approved.	5.4 (i)
STIP benchmarking analysis	We concur with AGA's benchmarking analysis into the level of STIP payments, in alignment with industry standards and Mercer's industry data, and recommend that a revised STIP allowance of $2.9 million per year should be approved, as determined from Mercer data on STIP per cent by staff level and STIP payout rates. We note that this is reduced from AGA's initially proposed amount of $3.7 million.	5.4 (ii)
Section 6 recommendations		
Prudency of the Massachusetts formula	We consider the Massachusetts formula to be a fair and prudent methodology to determine cost allocation to AGA from the Canada head office.	6.4 (i)
Canada head office value-for-money	Note that the increase in the Canada head office charges resulting from a correction of previously incorrect inputs to the Massachusetts formula does not change the value-for-money position, and that AGA still benefits from the head office services.	6.4 (ii)
Exclusion of the innovation, real estate, and corporate security costs from the Canada benchmarking exercise	We consider that, in order to provide an equitable comparison between the Canada head office charges and the appropriately determined benchmark costs, it is prudent to exclude corporate security, real estate and innovation cost items due to their relatively small cost and the difficulty of benchmarking such costs.	6.4 (iii)
Standalone benchmarking exercise for Canada head office services	We consider that the Canada head office allocations provide value to AGA and the network it services, based on our benchmarking analysis demonstrating that a standalone capability based in Australia would cost $7.8 million per year to operate (exclusive of any one-off costs to establish the capability) when compared to the current $8.1 million cost with corporate security, real estate, and innovation removed.	6.4 (iv)

Topic	Recommendation / finding	Reference
Inconsistency in efficiencies from an overseas head office and a hypothetical Australian standalone entity	We note that, notwithstanding the benchmarking conclusion at (iv), there would be an inherent inconsistency in both expecting the delivery of efficiencies from an overseas head office relative to a hypothetical standalone Australian business, while at the same time determining the rate of return based on an assumption of an Australian domiciled entity.	6.4 (v)
Canada head office governance processes	We agree that the governance processes, inclusive of the cost saving initiatives the Canada head office conducts, are reasonable to ensure that AGA is allocated a fair and efficient cost for services from which it derives value.	6.5 (vi)
Section 7 Recommendations		
The use of the 2023A as the base year for AA6 forecasting	We consider that, based on the information provided to us by AGA and for the reasons stated in sections 4 and 7 of this report, 2023 actual costs for Other Corporate Support costs and Canada head office charges should be adopted as the base year costs when forecasting for the AA6 period.	7.4

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Appendix A: References

Please note that the reference numbers in this Appendix A correspond to the footnote numbering contained within the body of the report.

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