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APA submission to draft Guideline

August 23, 2023

Pipeline Information Disclosure Guideline

Contents

1. Introduction

Key points

- The AER should establish a clear framework for asset valuation approaches to recognise the regulatory history of reporting pipelines, based on Part 9 for periods in which a pipeline was a scheme pipeline, and the RCM approach for periods in which a pipeline was a non-scheme pipeline.
- An explanatory note should be included at the top of each asset valuation page to briefly outline the key features of each reporting framework.
- Separate template pages should be provided for scheme and non-scheme pipelines to publish DBVM information, to highlight the differences in reporting frameworks;
- The Guideline requirements for publishing actual prices payable information for pipelines should be aligned to the requirements in the Rules.
- The AER's specification of WACC determination methodology and parameters should be removed to align with the publication requirements of the Rules.
- APA will provide further commentary on assurance requirements following engagement with its auditors.
- The Guideline requirements for publishing actual prices payable information for Part 18A facilities should be aligned to the requirements in the Rules.

APA welcomes the opportunity to comment on the AER's Draft Pipeline Information Disclosure Guideline (Guideline). We have 11 pipelines that will be subject to this disclosure Guideline, either as scheme or non-scheme pipelines. We are keenly interested in assisting in developing a Guideline that will be useful to customers seeking access to APA's pipelines, while making the information easily accessible for customers, and managing service providers' reporting burden.

APA is an Australian Securities Exchange (ASX) listed owner, operator, and developer of energy infrastructure assets across Australia. Through a diverse portfolio of assets, we provide energy to customers in every state and territory on mainland Australia. As well as an extensive network of natural gas pipelines, we own or have interests in gas storage and generation facilities, electricity transmission networks, and over 359 MW of renewable generation infrastructure with a further 88 MW under construction.

We understand that the AER needs to implement the legislative provisions of the revised NGL, and acknowledges that the requirements of the legislative provisions do impose some limits on the ability of the AER to deal with some of the practical issues that APA has articulated in its submissions. We have suggested a means of addressing these concerns and look forward to working constructively with the AER to this end.

2. Asset valuation

The draft Guideline creates three distinct financial reporting frameworks for asset valuation:

- An indexed asset value founded on a regulator-determined initial capital base and regulator-approved capital expenditure with straight-line depreciation, for scheme pipelines;

- A non-indexed asset value based on the Australian Accounting Standards, featuring allowances for acquisition costs and asset impairments, for non-scheme pipelines, and

- A non-indexed asset value based on original construction costs and "depreciation" based on a notional cash-flow based "return of capital" approach, for non-scheme pipelines.

The first two of these approaches are labelled with the same terminology, the Depreciated Book Value Method (**DBVM**), and are reported using the same template. This use of the same terminology could lead to confusion for stakeholders; we suggest adopting different names to differentiate the two frameworks.

2.1. Asset valuation and regulatory frameworks

APA considers that due to the 'patchwork' of regulatory arrangements that historically applied to the different pipelines that will be captured under this Guideline, there is an intrinsic challenge in developing reporting templates that use financial information that can be easily understood in the regulatory context.

We suggest the following approach as a means to aid understanding that aligns with the applicable regulatory frameworks and acknowledges previous regulatory determinations, namely:

- Where a pipeline is, or was, a *scheme pipeline*,[1] it should report using the methodology under Part 9 of the Rules for any year in which it is, or was, a scheme pipeline;
- Where a pipeline is a *non-scheme pipeline*, it should report under the Australian Accounting Standards, and report under the Recovered Capital Method, for any year in which it is a non-scheme pipeline.

In practice, this means that where a pipeline has become a non-scheme pipeline as a result of the 2 March 2023 legislative change:[2]

- it will calculate the value of its capital base under Part 9 for those years in which it was a scheme pipeline;
- the closing balance calculated using the methodology under Part 9 would form the opening balance for the RCM calculation; and
- as identified on p16 of the draft Guideline, the service provider may elect to use that asset value as the opening value for the DBVM.

1 For clarity, a "covered" pipeline under the National Gas Law as in effect prior to 2 March 2023.
2 For simplicity, APA recommends using 30 June 2023 or some other appropriate year-end accounting date to avoid the need to allocate revenues and expenses to part years before and after the 2 March 2023 legislative date.

To aid user understanding, it will be important to be clear which financial reporting framework is being used to calculate the asset value on any particular template page.

Further to our comments in the AER's public forum held on 15 August 2023, APA recommends:

- A separate tab be used to calculate the "Depreciated Book Value Method" for scheme and non-scheme pipelines. A scheme pipeline service provider would complete one of the tabs, and a non-scheme pipeline service provider would complete the other. The differences between the tabs would reflect the differences in the reporting frameworks – for example:
  - Disposals in the scheme pipeline tab would be recorded at proceeds, rather than cost;[3]
  - The scheme pipeline tab would not include scope to report impairments (there being no concept of impairment testing in the National Gas Rules); and
  - The non-scheme pipeline DBVM tab would include a line item for impairments – but these should be reported separately from depreciation.
- Each page reporting an asset value should include an explanatory note, with a link to the Guideline, outlining the main features of the financial reporting framework applied on that tab. APA would be pleased to assist the AER in drafting any explanatory text for this purpose. This would go a long way to assist in meeting the requirement in s2.5.9: "**Service providers** must qualitatively explain the difference in the total asset value using the **depreciated book value method** and the **recovered capital method**, or any **alternative asset valuation method** that the **service provider** publishes, in the basis of preparation."

2.2. Depreciated Book Value Method

The draft Guideline provides for two versions of a Depreciated Book Value Method (**DBVM**):

- one based on the provisions of Part 9 of the Rules, featuring an indexed regulator-determined capital base with straight line depreciation, and
- another, based on the Australian Accounting Standards, featuring recognition of acquisition costs and impairment testing.

The draft Guideline outlines the requirements for both these approaches in a single section (s 2.4).

It would be helpful, and aid user understanding, if the Guideline dealt with the two DBVM approaches in clearly divided sections.

Moreover, the Guideline includes some over-arching definitional items that apply differently to different frameworks. For example, s1.6.2 of the draft Guideline deals with inflation:

> **1.6.2 Inflation**
> **Service providers** must report all values (including **pipeline assets**) in the **Part 10 financial reporting template** for the current or previous years in nominal terms. Values are not to be adjusted or updated for inflation.

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[3] See AER, Final Decision – AusNet Services distribution determination 2016 to 2020, Attachment 2 – Regulatory Asset Base, May 2016, page 2-13 *et seq*.
APA also notes that the RCM approach, being a cash flow based approach, should also record disposals at proceeds rather than cost. The accounting standards based DBVM approach will record disposals at net book value, but may record a gain or loss on disposal.

This introduces scope for confusion, as the DBVM for scheme pipelines features indexation of the capital base (that is, the values are "adjusted or updated for inflation") whereas the accounting standards-based DBVM applicable to non-scheme pipelines does not include any recognition of inflation.

APA acknowledges the AER's provision (s2.4.1) to allow a former scheme pipeline to use the closing regulatory asset value from an applicable access arrangement as the opening value in the accounting-standards-based DBVM calculation. We are concerned that this approach still does not recognise any periods when the pipeline may have been a scheme pipeline, but subject to light regulation. As discussed above, we propose that current or former scheme pipelines should apply the Part 9 roll forward approach for the period in which it was a scheme pipeline.

However, such an approach may have implications for auditing, where opening asset values are based on a different financial reporting framework than that under which they are rolled forward. We are consulting with our auditors on this, and will report back to the AER in due course.

2.3. Recovered Capital Method

The Guideline proposes that all non-scheme pipelines should report the Recovered Capital Method (**RCM**) asset value, consistent with the requirements of rule 103(2)(a)(iii)(B). APA acknowledges that the RCM approach is the preferred methodology for reporting asset values for non-scheme pipelines – but we submit that any relevant measure of asset value must consider the regulatory history of the relevant asset.

The AER's *Financial Reporting Guideline for Non-scheme Pipelines* (the Part 23 Guideline) made an effort to recognise this, allowing the reporting service provider to start the RCM calculation at a previously determined opening capital base.[4] But this approach did not recognise the period during which the asset was subject to an access arrangement, or was otherwise a scheme pipeline. APA's proposed approach, discussed above, rectifies this issue.

2.3.1. Specifying WACC parameters for RCM calculation

The draft Guideline, section 2.5.3, specifies both the methodology to be used to calculate the return on capital, and most of the parameters to be used in that calculation.

This appears to go beyond the requirements of the Rules, which specify the scope of this Guideline.

In particular, Rule 103(2)(a)(ii)(E) provides that the Guideline must provide for the *publication* of the "the return on capital and the rate of return used in the calculation of the return on capital":

> **103 Pipeline information disclosure guidelines**
>
> (1) The AER must publish and maintain pipeline information disclosure guidelines.

[4] AER, *Financial Reporting Guideline for Non-Scheme Pipelines*, p21: "If a pipeline was previously regulated and a determination made on the asset value, the **service provider** may use this as the opening balance for the calculation under this method from the date the determination was made and to roll it forward using the method set out in the **Guideline**."

(2) The pipeline information disclosure guidelines must:

(a) provide for the publication of financial and historical demand information about each pipeline on a pipeline by pipeline basis and in respect of the financial year of the service provider for the pipeline, which must include: …

(ii) information on the methods, principles and inputs used to calculate: …

(E) the return on capital and the rate of return used in the calculation of the return on capital;

but does not provide for the AER to *specify* the approach or parameters to be used in calculating the rate of return.

We would like to understand the rationale for extending this obligation beyond that which is established in the Rules, and to request the AER to consult further with industry to better understand the balance between the risks of pursuing this extension with the perceived benefits. We are of the view that, in the absence of further consultation, the AER should amend the requirement in the Guideline to align with the Rules.

We understand the AER's intent in specifying the approach to calculating the WACC used in the RCM calculation, and the driver in specifying relevant parameters – to allow the business to specify the relevant beta value in the CAPM, thus expressing its views on the relative riskiness of the pipeline relative to the overall financial market.

However, we are concerned that overspecification of the WACC approach and parameters has the potential to lead to reporting metrics that do not accurately represent risk measures.

This will be particularly true in circumstances where the calculation of the RCM requires tracing back to the original construction costs in the hands of the original project proponent. In those circumstances, it is necessary to use a "whole of life" WACC measure – that is, the WACC required over the life of the project in order to be able to attract capital to the project from the date it was first constructed. Seeking to correlate this historical WACC with a regulated WACC through adjustment of the beta value alone risks creating incongruous beta metrics.

Specifying a methodology[5] and most of the parameters requires the business to artificially adjust the one remaining parameter (Beta) to derive a measure of the rate of return that was required to attract capital to the project.

This will force the business to adjust the Beta value to back-calculate the appropriate rate of return – the result will be incongruous Beta value, driven by the AER's locking down a methodology and other parameters – this will undermine the AER's objective of using the Beta value as a measure of the perceived risk of pipelines relative to each other.

Moreover, APA notes that the Part 23 Guideline, on which this Guideline is based, already requires the methodology, and parameters, used to determine the WACC used in RCM calculation to be disclosed in the Basis of Preparation (**BoP**). There are risks, but not ascertainable benefits, in specifying a WACC methodology and parameters in this Guideline.

[5] APA notes that it applies a CAPM methodology to determine the cost of equity in the RCM calculation. APA's concerns in this discussion focus on the *requirement* to apply a particular methodology, and the specification of input values to that methodology.

We also note in this regard that p23 of the draft Guideline requires the reporting service provider to draw "the market risk premium from the **AER's rate of return instrument** as were applied at the end of the **financial year** for which a historical market risk premium is required ". There does not appear to be a Rate of Return Instrument applicable to the period from 2009, and the AER's 2013 Rate of Return Guideline does not specify a market risk premium, stating rather that (p15) "The AER proposes to estimate a range for the MRP, and then select a point estimate from within that range."

2.3.2. Previously reported RCM values

The draft Guideline (p22) discusses "the historical market risk premium previously published by the **service provider** to calculate the return on capital". In light of the Guideline's requirement for the Part 10 RCM calculation to be based on original construction costs, the status of previously reported RCM values under Part 23 of the Rules is not clear.

APA is concerned about the scope for confusion if two sets of financial reports, both purporting to be reports under the same framework, co-exist on the same service provider web page. For example, APA (SWQP) Pty Ltd currently published Part 23 RCM information for 1995 through 2022; the Part 10 reporting will cover that same period, but with different information.

We consider that it would be helpful for the Guideline to be clear on the status of previously reported Part 23 RCM information, and any relationship between the previous Part 23 information and the future Part 10 information. It would be also helpful if a note to this effect could be included on the RCM page of the reporting template.

2.3.3. Tax

APA supports the AER's proposed approach to allow a reporting business to calculate a benchmark tax payable amount. This will ease the reporting burden significantly, with no significant loss of accuracy or relevance.

However, we would again encourage the AER to review and reconsider its position on the value of imputation credits (Gamma) in the RCM calculation. As we have previously noted, and again emphasise, the RCM calculation is clearly a cash flow based approach, and the treatment of Gamma must recognise the incidence of these cash flows. In particular, any cash flow relating to imputation credits accrues wholly to end shareholders – there is no cash flow to the reporting entity. The appropriate treatment of Gamma would be to disregard it (or alternately set it to zero) for the purposes of the RCM framework.

3. Actual prices payable

Rule 101E is clear on what actual price information is required to be published. For the purposes of this submission, APA wishes to specifically note clause 101E(1)(h):

> **101E Actual prices payable information**
>
> (1) A service provider must publish the following information for each pipeline service that a user has procured under an *access contract* with the service provider:

(h) whether the pipeline service is provided on the same or substantially the same non-price terms as those set out in the standing terms published for the pipeline under rule 101C(1)(a); …

Section 4 of the draft Guideline (p31), however, does not require the service provider to note whether the service is provided on the same or substantially the same terms, but purports to extend this requirement beyond the provision of a 'yes/no' response, to require the service provider to enumerate and disclose the detail of the terms:

> If a **pipeline service** procured under an **access contract** is provided on non-price terms that are not the same or substantially the same as the **standing terms**, the **service provider** must specify those non-price terms.

APA is concerned that there are considerable practical, governance and confidentiality concerns associated with this proposed extension to the obligation:

- From a practical perspective, APA is concerned that the draft Guideline does not appreciate the bespoke nature of gas pipeline contracts. A requirement to publish the entire suite of terms and conditions which differ from the standing terms would be an onerous task, in many cases requiring publication of the entire contract.

- From a commercial confidentiality perspective, APA is concerned that the disclosure of the specific terms for one shipper may disclose commercially sensitive information to its competitors. It is not obvious to APA that protection from prosecution under Rule 137(3) would be provided when confidential information is disclosed in accordance with a *Guideline* (rather than the NGL as contemplated in r137(3)(c)(i)), particularly where the Guideline over-steps the Rules.

- From a governance perspective, APA would seek to understand the rationale for extending this obligation beyond that which is established in the Rules, and to request the AER to consult further with industry to better understand the balance between the risks of pursuing this extension with the perceived benefits. We are of the view that in the absence of further consultation, the AER should amend the requirement in the Guideline to align with the Rules.

For all these reasons, APA asks the AER to align the requirement of the Guidelines with that established in the Rules.

3.1. Reporting template

APA notes that the draft Guideline did not include a draft template for reporting actual prices under Rule 101E.

As a preliminary matter, we question the need for the AER to produce a template to report actual prices under Rule 101E. Rule 101E includes a comprehensive list of the services for which actual prices must be published; it is not clear that a template would increase the quality of the information provided.

As discussed at the industry workshop on 18 August 2023, APA, like many other businesses, employs a comprehensive Enterprise Management System to run its business. Generally, these are highly complex systems, a key feature of which is the complexity associated with change management, and significant costs associated with making changes to such systems.

Owing to the comprehensive nature and complexity of the actual price payable reporting requirements, APA has had to commence system modifications to be able to report actual prices payable by the 22 December 2023 deadline. This has required a significant redeployment of internal resources and the engagement of external consultants, at considerable cost.

Notwithstanding the *costs* of complying with the actual price payable reporting requirements, we are concerned about the *time* required to modify its systems to produce this information. Should the AER produce a Rule 101E reporting template as part of the final Guideline in October 2023, APA is concerned that it may not be able to (re-)modify its systems to provide the required information in the form required by that template in time to provide the information by the 22 December 2023 reporting deadline. Moreover, the significant costs associated with APA's current system modifications to comply with Rule 101E would be sadly wasted.

In summary, APA asks the AER not to specify a reporting template for Rule 101E reporting requirements.

3.2. Receipt and delivery points

APA notes that Rule 101E(1)(g)(ii)(A) calls for the reporting of receipt and delivery points that pertain to a service.

We request the AER consider clarifying this requirement to include *key* receipt and delivery points only. The reason for this is that many of APA's pipeline services can have 20-30 receipt and delivery points. It is impractical to display this number of receipt and delivery points in a useful manner, and further, there are only a handful of receipt and delivery points that are operative in terms of setting the price for a service.[6] Accordingly, what is useful for users is the key receipt and delivery points that are relevant to the setting of the price for the service. Reporting all receipt and delivery reports introduces scope to detract from the usability of the information and create 'noise' in interpretation.

4. Historical demand information

4.1. Nameplate capacity

The Guideline's templates require the service provider to identify the nameplate capacity of the relevant pipeline. While this is a relevant piece of information (which is currently published as part of the service information), the Guideline template then performs some capacity utilisation and availability metrics, for which a static capacity figure is not appropriate.

In particular, many pipelines reduce pressure as part of routine summer maintenance cycles, and these pressure reductions impact the capacity of the pipeline during the periods the pressure reductions are in place.

Also, where a pipeline expansion is brought into service part way through a year, the current structure of the Historical demand template would not allow this increase in capacity to be reflected.

[6] For example, a pipeline with a postage stamp tariff could include any or all available receipt and delivery points.

Where the template currently provides for the same nameplate capacity to be identified for every day, we suggest that this column of the template (Column F) be open to input so that temporary or seasonal capacity changes can be properly reflected.

4.2. Coordination with AEMO

As discussed in its submission to the Issues paper and in the AER's public forum, APA is always concerned about duplication of effort in manual processes, and the scope for errors to creep into manual reporting processes. To this end, APA is always keen to use a single source of the truth for information, rather than copying it to another location.

At the industry workshop on 17 August 2023, the AER and industry representatives discussed engaging with AEMO to prepare consistent, and accessible reports as part of the Gas Bulletin Board. The AER has undertaken to open this engagement with AEMO, and we look forward to working constructively with AEMO and the AER to develop these reports.

5. Pricing template

APA has commenced, but not completed, a review of the logic and mathematics included in the proposed pricing template. Early investigations have identified some items that require further follow-up, and we proposes to work collaboratively with the AER in a workshop environment to conclude these matters.

One area of concern is the pricing template's specification of regulated rates of return,[7] particularly for non-regulated pipelines. As an alternative, we propose that the WACC used in the RCM calculation might be more relevant for a non-scheme pipeline pricing template.

We remain concerned about the pricing template's foundational reliance on an arbitrary allocation of costs to services. We would value the opportunity to work collaboratively with the AER to so-design a workable pricing template that can provide useful and relevant information to Users.

6. Other matters

6.1. Basis of preparation template

As discussed in the AER's *Part 10 financial reporting template handbook and Basis of preparation template* document, the basis of preparation template, in tabular form, appears to be duplicative.

S1.2 of that document indicates that

> **Service providers** must publish a Basis of Preparation document, which should follow a logical structure and align with the information in the **Part 10 financial reporting template**. The purpose of the Basis of Preparation is to help **users** understand and assess the assumptions, formulas and procedures underpinning the prescribed transparency information published by **service providers**.

[7] Reference '6. Pricing template'!E21:E25

We accept the requirement to publish a Basis of Preparation (**BoP**) document as an integral part of the reporting framework, and an important element to assist Users in understanding the published information. The Part 10 reporting templates usefully include a place for the BoP reference – the part of the BoP where information related to that particular line item can be found.

But the *Part 10 financial reporting template handbook and Basis of preparation template* document also requires:

> **Service providers** are required to demonstrate the following information with respect to the **Part 10 financial reporting template** in the **Basis of Preparation template**:
>
> - Explanation of sources from which the service provider obtained the information provided.
> - Methodology applied to provide the required information and any assumptions made.
> - Where **service providers** have had to provide estimates.
> - The rationale for not being able to provide actual information and the steps taken to try and obtain actual information.
> - In absence of actual information, the basis (approach, assumptions, justification) for the estimates provided.
> - Explanation if accounting policies adopted by **service providers** have materially changed during any regulatory year including the nature and impact of the change.

Considering that every item in the BoP template list is required to be provided in the BoP, the detail to be provided in the BoP, and the inclusion of BoP references in the financial reporting templates, we consider the tabular form of the BoP template to be duplicative – it provides no additional information than that already included in the BoP document as referenced in the financial reporting templates.

Given the wide range of regulatory histories that this template will need to accommodate, we suggest the AER provide more general document "outline" of a BoP, targeted more at the "logical structure and align with the information in the Part 10 financial reporting template". Moreover, APA considers that, while the requirements for the BoP are mandatory as outlined in the Rules, any BoP template should be optional, to provide sufficient flexibility for the service provider to include the breadth of information needed to assist Users in understanding the information provided.

As stated previously, we support the role of a BoP document to help users and prospective users understand where judgement has been applied in the preparation of the reported financial and other information. This is particularly important where the reporting templates are locked down and do not provide scope for supporting explanatory information.

It is the important role of judgement in this framework that requires the basis of preparation document to be as flexible as possible. In this regard, APA does not support development of a rigid BoP template. We undertake to work collaboratively with the AER to develop a more suitable flexible outline, model Table of Contents, or flexible template.

6.2. Assurance Requirements

As outlined in its response to the Issues Paper, we accept the need for some form of audit assurance to provide confidence to users of the financial information.

In order to streamline the scope of the audit and review requirements to reduce costs, we ask the AER to provide specific guidance regarding which pages of the reporting template are required to be subject to what form of assurance. This will allow us to engage with our auditors on scope and procedures, and will also provide consistency of audit reports across reporting entities.

As discussed above, APA is liaising with its auditors on the scope to use historical regulatory asset values as the opening balance in the accounting standards-based DBVM information, and will revert in a supplementary submission on this matter in due course.

7. Part 18A disclosure requirements

7.1. Definitional consistency

The definition of "User" in the Guideline is inconsistent with that in Part 18A of the Rules.

Section 1.5 of the Guideline defines "user" as follows:

> **user** means a person that seeks or wishes to be provided with a service by a **Part 18A facility**. To avoid doubt, a **user** may be an existing **user** or a prospective **user** of a **Part 18A facility**.

Whereas Part 18A Rule 198A(1) defines "user" as follows:

> **user** means a person who is a party to a contract with a service provider under which the service provider provides, or intends to provide, a compression or storage service to that person by means of a Part 18A facility

The use of inconsistent definitions between the Guideline and the Rules under which it requires reporting introduces scope for confusion in reporting. We suggest that the definition of "user" for the Part 18A reporting requirements be aligned to the Rules definition.

We appreciate that, in some cases, the definition of "user" is dependent on the context. For example, the draft Guideline includes references to "user" meaning the user of a facility, whereas in other areas a contextual reading of "user" indicates a user of the financial information pertaining to the facility. We suggest that a review of the text should be undertaken to distinguish "user" as a defined term (in bold text) vs a "user" of information (not in bold text).

APA requests the AER to undertake a review of the Guideline to ensure that all definitions are consistent with the Rules under which the Guideline specifies reporting requirements.

7.2. Pricing template

Consistent with our views relating to the requirement to publish actual prices for pipeline services, we consider that a pricing template for storage and compression services is not required, and would not provide additional information value relative to the published Rules.

7.3. Alignment of requirements with Rules

As with the discussion above regarding disclosure of actual prices payable under Rule 101E, we note a similar concern relating to the requirements to report actual prices payable under Part 18A.

Part 18A of the Rules (Rule 198G(1)(g)) requires:

198G Actual prices payable information

(1) A service provider for a Part 18A facility must publish the following information for each service that a user has procured under a contract with the service provider:

(g) whether the service is provided on the same or substantially the same nonprice terms as those set out in the standing terms published by the service provider under rule 198F(1)(a);

Whereas the draft Guideline requires (s9.5, p44):

A Part 18A service provider must also:

- specify the non-price terms of the contract and identify whether or not the contract is provided on non-price terms that are the same or substantially the same as the standing terms

For similar reasons to those outlined above for pipeline actual prices payable information, APA asks the AER to align the requirement of the Guidelines with that established in the Rules.