

Pipeline information disclosure guidelines and Price reporting guidelines for Part 18A facilities

Explanatory note

October 2023

© Commonwealth of Australia 2023

This work is copyright. In addition to any use permitted under the *Copyright Act 1968* all material contained within this work is provided under a Creative Commons Attribution 3.0 Australia licence with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication.

The details of the relevant licence conditions are available on the Creative Commons website as is the full legal code for the CC BY 3.0 AU licence.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

Email: AERInquiry@aer.gov.au

AER reference: 15751893

Amendment Record

Version	Date	Pages
1	27 October 2023	20

Contents

Shortened forms	iv
1 Introduction	1
1.1 About this document	1
1.2 Role of the Guidelines.....	1
1.3 Consultation process	2
1.4 Summary of Positions	3
1.5 Supporting templates	3
1.6 Recovered capital method	5
2 AER response to submissions to the draft Guidelines	7
Appendix A Further discussion of pipeline asset valuation principles	13

Shortened forms

Term	Definition
AER	Australian Energy Regulator
Guidelines	pipeline information disclosure guidelines and, where relevant, the price reporting guidelines
NGL	National Gas Law
NGR	National Gas Rules
prospective user	has the meaning given in the NGL or, for Part 18A facilities, a person who seeks or wishes to be provided with a facility service by means of a Part 18A facility
service provider	gas pipeline service provider
user	has the meaning given in Section 5(2) of the NGL or, for Part 18A facilities, has the meaning given in Part 18A of the NGR.
WACC	Weighted average cost of capital

1 Introduction

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. We are the economic regulator for electricity and gas networks in every state and territory in Australia except Western Australia. We regulate electricity networks under the National Electricity Law and National Electricity Rules (NER) and natural gas pipelines under the National Gas Law and the National Gas Rules (NGR).

1.1 About this document

This explanatory note accompanies the AER's pipeline information disclosure guidelines (Guidelines). These Guidelines are a requirement under Part 10 of the NGR and will help to improve transparency and bargaining power for current and prospective gas pipeline users (users). Broadly, the Guidelines:

- detail the financial and historical demand information gas pipeline service providers (service providers) must publish including information on the methods, principles and inputs used to calculate asset values, depreciation, allocation of costs and the return on capital
- specify the information that a service provider must report on as to the methodology used to calculate standing prices
- specify the level of detail of information required to enable users to negotiate on an informed basis with service providers
- specify where and how information a service provider is required to publish on their website.

Included in the Guidelines are the price reporting guidelines for service providers of a Part 18A facility. The price reporting guidelines:

- specify the information that a service provider must report on as to the methodology used to calculate standing prices
- specify the actual prices payable information that a service provider must report on
- specify where and how information a service provider is required to be published on their website.

This explanatory note summarises the issues raised by stakeholders in our consultation process on the draft Guidelines. We provide our responses to these issues, including noting where our position has changed from the draft Guidelines and providing an explanation where our position is different from those expressed by stakeholders.

1.2 Role of the Guidelines

On 31 March 2022, Energy Ministers agreed to the final package of changes to the legal and regulatory framework required to give effect to the reforms to the gas pipeline regulatory framework. These reforms were implemented to provide a simpler and more effective regulatory framework that will continue to support efficient use of and investment in gas pipelines.

The reforms introduced a prescribed transparency regime under Part 10 of the NGR. Similar reporting regimes previously applied to non-scheme pipelines under the former Part 23 of the NGR, and to light regulation pipelines under the former Part 7 of the NGR.

Part 10 of the NGR sets out information that service providers must publish on their websites. This includes details of the pipeline services offered, the historical demand for the services, actual prices payable, and costs and revenues associated with each pipeline service.

Information published by service providers under Part 10 will help users assess the reasonableness of offers. This information will reduce information asymmetry, which will facilitate more timely and effective negotiations between service providers and users.

1.3 Consultation process

To ensure a comprehensive and inclusive approach, the AER undertook the following consultation activities.

On 5 April 2023 we held an introductory forum on the gas pipeline reforms, including an overview of the work that the AER will progress over the coming months. The forum, attended by around 100 participants, served as an opportunity for stakeholders to engage and gain insights into the Guidelines. The interactive discussion facilitated a valuable exchange of perspectives and ideas among industry stakeholders.

We published an [issues paper](#) on 6 April 2023 and invited stakeholders to provide feedback on various questions related to the Guidelines. The issues paper discussed our preliminary views on a number of matters. Based on our review of the feedback, we incorporated valuable inputs and suggestions from the stakeholders, and published [draft gas pipeline information disclosure guidelines \(draft Guidelines\) and templates](#) on 26 July 2023. A public forum was held on 15 August 2023 to enable stakeholders to discuss the draft Guidelines and templates before close of submissions.

We received submissions on the draft Guidelines from the following stakeholders:

- APA Group
- Australian Pacific LNG
- Australian Pipelines and Gas Association
- Epic Energy (SA) Pty Ltd
- Jemena
- Lochard Energy.

A summary of the submissions received in response to the draft Guidelines, and our response, are detailed in Section 2 and summarised below.

Following the consultation process, we have prepared and published the final Guidelines, Part 10 financial reporting template, Part 18A actual prices payable template and related documents.

1.4 Summary of Positions

We consulted extensively on these Guidelines. We have held stakeholder forums and participated in stakeholder workshops, considered stakeholders' submissions to both our issues paper and draft Guidelines and met with stakeholders to better understand their views. In reaching our positions in the final Guidelines, we have sought to balance several factors including appropriate flexibility, cost of administration for pipelines and providing clear, consistent and accurate information to users.

Key issues

This summary outlines issues raised by stakeholders in their submissions to the draft Guidelines and the positions we have taken in the final Guidelines.

Table 1.1 Key issues raised by stakeholders and summary of AER position

	Issue	Position
1	Stakeholders raised concerns over the requirements for publishing details of terms that were not the same or substantially the same as the standing terms in the actual prices payable information for pipelines and Part 18A facilities. These concerns included the complexity and burden of fulfilling this requirement, and whether the NGR permit the AER to require this information to be disclosed.	The final Guidelines do not require service providers to publish details of terms and conditions in the actual prices payable information beyond what is required under the NGR.
2	Stakeholders raised concerns regarding the prescriptive approach to calculating the rate of return under the recovered capital method. Issues raised included the restrictive methodology, the validity of including imputation credits, whether the NGR permitted the AER to prescribe a rate of return methodology in the guidelines and that it may not align with a workably competitive market.	The final Guidelines require service providers to publish the return on capital using the methodology. While acknowledging the limitations of this approach, we consider that, overall, users will benefit from asset value information that is based on a well-accepted and consistent rate of return methodology. Please refer to Section 1.7 of this explanatory note for further explanation of our position.
3	Stakeholders recommended aligning assurance requirements with specific worksheets and tables in the financial template to avoid confusion and raised concerns over the increased cost burden of meeting the 'reasonable assurance' threshold.	The final Guidelines require service providers to use a similar methodology to that set out in the draft Guidelines. However, we have included further guidance and made improvements to the alignment with the Part 10 financial reporting template.

A more detailed discussion is given in Section 2.

1.5 Supporting templates

Feedback during the Government's consultation, *Improving gas pipeline regulation*, noted the need to make the information disclosed by service providers accessible and usable by the users of pipelines and Part 18A facilities.

The requirement for service providers to use standardised templates is one way that we have improved the usability of the information published under Part 10 and Part 18A of the NGR. These templates will allow users to compare different service providers across multiple metrics.

Part 10 financial reporting template

Gas pipeline service providers must use the Part 10 financial reporting template to publish pipeline information, financial information, asset values and historical demand information. The template will be familiar to service providers that have previously completed financial templates under the former Part 7 or Part 23 of the NGR. Key changes to these templates are:

- a greater requirement to allocate revenues, costs and assets to pipeline services
 - this approach will provide more meaningful financial information to users and facilitates the calculation of cost-based pricing benchmarks in the pricing template
- the removal of weighted average price information and the addition of historical demand information, as required under Part 10 of the NGR.

Pricing template

The AER is required to publish a pricing template under rule 103A of the NGR. We have integrated this template into the Part 10 financial reporting template to minimise any need by users or service providers to enter or manipulate the data.

The template provides for two benchmarks for each pipeline service. They are intended to reflect a range of reasonable prices based on a pipeline's costs, revenues and depreciated asset value. The benchmarks are calculated by deriving minimum and maximum values for fixed operating costs, return of capital and return on capital using different methodologies and asset valuation methods. The approach reflects that taken by Brattle Group in its report on information disclosed by gas pipeline service providers under Part 23 of the NGR.¹

Basis of preparation template

The pipeline information disclosure guidelines require service providers to complete a new standardised basis of preparation template. This template is formatted to align closely with, and complement, the Part 10 financial reporting template. The basis of preparation template will allow users to more easily access relevant information and assist the AER to monitor compliance with the Guidelines, while still giving service providers flexibility to provide details in accordance with their particular circumstances.

Actual prices payable template

Service providers of a Part 18A facility must use the actual prices payable template to publish information required under rule 198G of the NGR. The use of a template for actual prices payable information will allow users to quickly compute and compare the total price that would be payable under similar terms offered to other users and by other Part 18A service providers.

¹ The Brattle Group, *Financial Information Disclosed by Gas Pipelines in Australia under Part 23 of the National Gas Rules*, October 2019.

1.6 Recovered capital method

The recovered capital method is intended to reveal the residual value of the pipeline asset, through showing the total value that has been recovered from users since the pipeline was constructed. In the final Guidelines, we have specified a methodology that:

- conforms with the methodology set out in Rule 113Z(5) of the NGR
- promotes consistency between service providers and pipelines
- reduces the risk of service providers overstating asset values, which would result in recovered capital values increasing over time.

Workable Competition

Rule 113Z(5)(a) of the NGR states:

the value of any assets used in the provision of the pipeline service must be determined using asset valuation techniques consistent with the objective of facilitating access to pipeline services provided by means of non-scheme pipelines on reasonable terms, which is taken to mean at prices and on other terms and conditions that, so far as practicable, reflect the outcomes of a workably competitive market.

We discuss the concept of workable competition in the context of gas pipelines in Appendix A.

The rate of return under the recovered capital method

The recovered capital method is highly sensitive to the inputs and assumptions used. While some stakeholders have called for greater flexibility in calculating the rate of return, a previous review of recovered capital values under Part 23 of the NGR found evidence of overstated recovered capital values, in several instances due to the rate of return calculations and assumptions used.²

As such, we do not consider that giving service providers greater discretion to set the rate of return would further the objectives of the guidelines. We have therefore maintained our position that the rate of return to be published under the return on capital component of the recovered capital method must follow the Sharpe-Lintner capital asset pricing model and follow a similar approach to that set out in the AER's rate of return instrument.

As noted in the explanatory note to the draft Guidelines, this approach promotes greater consistency when calculating the return on capital between different pipelines. This transparency is in keeping with the objectives of the Guidelines, and better enables users to negotiate with pipelines on a more informed basis.³

We discuss the rate of return in the context of the recovered capital method in greater detail in Appendix A.

² ACCC, July 2019 Gas Inquiry 2017-2020 Interim Report, July 2019.

³ AER, Explanatory Note - Draft Pipeline Information Disclosure Guidelines and Price Reporting Guidelines, July 2023, p. 8.

Recovered capital method and alternative asset valuation methods

In some circumstances, the recovered capital method may produce values that are inconsistent with the asset valuation objective.

We consider that valuation methodologies based on actual historical costs are most suitable and most likely to produce outcomes consistent with workably competitive markets. We generally do not support the use of replacement cost methodologies, as they share a similar limitation to the recovered capital method in that they are highly sensitive to the inputs and assumptions used in their calculation. We also generally do not support valuations based on revenue (such as net present value) which can raise the problem of circularity: as the valuation is dependent on pipeline cashflows, and which in turn is dependent on the valuation of the pipeline.

We discuss alternative asset valuation methods in greater detail in Appendix A.

2 AER response to submissions to the draft Guidelines

Our consideration of issues raised by stakeholders in submissions to the draft Guidelines are set out in the table below.

	Issue	Submission	Comment	AER response
1	Assurance	APLNG	Audit requirement benefits may not outweigh the costs.	We consider that the required level of assurance is appropriate and ensures that users can access genuine information when negotiating access to pipeline service with service providers.
2	Assurance	Jemena APGA APA	Auditing Standards (ASA) applicability.	The AER acknowledges the comment and would like to affirm that reasonable assurance must be provided under the relevant auditing standard per the Guidelines. ASA 805 being a relevant standard under which an assurance practitioner may provide an opinion of reasonable assurance. Service providers are not required to provide reasonable assurance under both auditing standards.
3	Assurance	Jemena	Request to provide explicit guidance on which tabs necessitate specific assurance.	Please refer to Appendix D in the Guidelines for the assurance required per tab of the Part 10 financial reporting template.
4	Depreciation	Jemena	The Guidelines do not acknowledge that life to date depreciation is reversed on disposal of assets and therefore the current year depreciation in Table 3.3.1 will not always reconcile with the depreciation expense in Table 2.1.1.	While, from an accounting entry perspective, asset disposal will reverse the accumulated depreciation amount (including current year depreciation), the current year depreciation should still be captured within the depreciation schedule and should tie through to the depreciation expense within the statement of profit and loss.
5	Depreciation	Jemena	To promote consistency with AASB 116, the Guidelines should remove reference to easements: where land or easements are owned by the service provider, these assets must be recorded at historical cost and not depreciated.	We consider that where land or easements have an unlimited useful life, these assets may not be depreciated. With reference to AASB 138, we consider that easements with a fixed term life may be amortized.
6	Disclosure of non-standard terms	APGA APA Jemena	The requirement for standing terms goes beyond rule 101E(1)(h) Compliance may result in unprotected breaches of confidentiality Compliance may mislead users because of a lack of context High administrative burden.	We have removed the obligations from the Guidelines related to the publication of non-standard terms.
7	Part 10 financial reporting template: Worksheet 3.5 Depreciation	Jemena	Recommended updates to Worksheet 3.3 depreciation amortisation in the financial reporting template to align with	To align as far as practicable with the AASB requirements, we have updated the methodology of this table to support annual movements.

Explanatory note: Pipeline Information Disclosure Guidelines – October 2023

	Issue	Submission	Comment	AER response
	<i>Amortisation (previously Worksheet 3.3 Depreciation Amortisation)</i>		accounting disclosure requirements, which require annual movements to be reported, consistent with service providers' internal accounting records and AASB 116 paragraph 73(e).	Specifically, we have updated columns within worksheet 3.3 in the Part 10 financial reporting template: <ul style="list-style-type: none"> - Column H should reflect the opening cost base at the beginning of the annual reporting period, taking into account all additions and disposals to the cost base in all years prior to the annual reporting period - Column I should exclusively represent additions that occurred during the annual reporting period. - Column K in the template to only include disposals that have taken place during the annual reporting period. We have also included table 3.1.2 to publish the initial used as the original opening cost base of the pipeline.
8	Treatment of impairment losses	Draft Guidelines Stakeholder Forum	Why are "Impairment losses (nature of the impairment loss)" reported in the "Shared expenses" tab when the majority of the impairment relates the pipeline.	Our position is that impairment losses should not be counted as shared expenses, as an impairment loss is usually specific to the pipeline in question. We note that impairment losses may be recorded as other expenses in the Part 10 financial reporting template.
9	Reporting of light regulation pipelines which have been converted to non-scheme pipeline	Draft Guidelines Stakeholder Forum	Can non-scheme pipelines that were previously under light regulation use the closing RAB as the opening asset base for the depreciated book value method?	We have disallowed non-scheme pipelines that were previously lightly regulated from using the closing regulatory asset base as the opening base for the depreciated book value method. This is because pipelines that were previously under light regulation were able to submit access proposals to the AER on a voluntary basis, and the regulatory asset base was therefore not set or approved by the AER as a matter of course.
10	Inflation	APA	Not including inflation may confuse, as the depreciated book value method for scheme pipelines features indexation of the capital base, whereas depreciated book value method for non-scheme pipelines does not include any inflation.	The guidelines and templates require all values, including the regulatory asset base, to be published in nominal terms. The template has been updated to have separate tabs for the regulatory asset base for scheme pipelines and the depreciated book value method for non-scheme pipelines to avoid confusion.
11	Duplication and reconciliation of DBV and recovered capital method	APLNG	Requiring the publication of both the depreciated book value (DBV) method and the recovered capital method (recovered capital method) is an unnecessary burden and would not assist users to assess the reasonableness of standing price offers, as only one valuation would be used to prepare an offer.	We will maintain our draft position to require both methods to be published. The recovered capital method and depreciated book value method are two different valuation methods and are meant to reveal different aspects of pipeline costs. The depreciated book value represents the historic accounting cost associated with the initial investment that is depreciated over the relevant time period. The recovered capital method represents the residual value of the pipeline asset by calculating the depreciated cost of constructing and/or augmenting the pipeline and depreciated through the return of capital generated since the pipeline was constructed.

Explanatory note: Pipeline Information Disclosure Guidelines – October 2023

	Issue	Submission	Comment	AER response
			Instead, suggest pipeline service providers be allowed to choose the methodology which best suits them.	Taken together, both methodologies provide useful information so that a user or prospective user can better understand and assess the reasonableness of prices.
12	Consistency between RIN and Guidelines	Jemena	There should be consistency in definition of terms used in the RINs and the Guidelines.	We have endeavoured to align categories and definitions between the two instruments. However, as noted in the explanatory note to the draft Guidelines, it is not practical to completely align the two processes as they have different purposes.
13	How and where to publish information	Jemena	Suggest amendments to section 5.1.1: Remove the word “direct” from the first principle. Amend second principle to read: “ensure that all information for each pipeline is readily accessible from a single webpage”.	Our position is to maintain the position in the draft guidelines, but to amend the second principle in line with Jemena’s suggestion. We note that the first principle already captures Jemena’s intent in suggesting to remove the word “direct” from the first principle in section 5.1.1, by allowing a pipeline service provider to publish “on the home page for the pipeline as appropriate”. We expect that service providers adopt a “common-sense approach” to adhering to the publishing principles and note that the intent is to ensure that all Part 10 information is easily accessible to users.
14	Grandfathering recovered capital values	Draft Guidelines Stakeholder Forum Epic Energy	Queries whether recovered capital values calculated under the Part 23 reforms would be grandfathered into recovered capital values calculated under Part 10.	Our position is that: <ul style="list-style-type: none"> • Where the asset values used to calculate the previous Part 23 reform recovered capital values have been based on construction costs, these recovered capital values may be grandfathered. • Where the asset values used to calculate the previous Part 23 reform recovered capital values have <u>not</u> been based on construction costs, pipeline service providers must recalculate recovered capital values based on construction costs (or a best estimate if actual construction costs are unavailable). <p>This is because rule 113Z(5) of the NGR specifically requires the value of assets used in the recovered capital method calculation to be based on construction costs. Further, grandfathering recovered capital values that were not based on construction costs may lead to overstated asset values where the opening capital base was substantially higher than construction costs.</p>
15	Regulatory asset base as opening value for recovered capital method	Draft Guidelines Stakeholder Forum	Queries regarding the use of regulatory asset base values as the opening value in the recovered capital method calculation.	We have disallowed the inclusion of regulatory asset base values in the recovered capital method calculation to reduce the risk of overinflated asset values and to better align with rule 113Z of the NGR, which refers specifically to construction costs.
16	Gamma value in WACC	APA	Suggest gamma should be 0, as recovered capital method is a cash-flow based approach, and the treatment of gamma must recognise the incidence of these cash-flows. Any cash-flow	For eligible shareholders, imputation credits offset their Australian income tax liabilities. The AER’s rate of return instrument takes account of the value of imputation credits (known as gamma) to

Explanatory note: Pipeline Information Disclosure Guidelines – October 2023

	Issue	Submission	Comment	AER response
			relating to imputation credits accrues wholly to end shareholders – there is no cash-flow to the reporting entity.	recognise that the imputation credits benefit equity holders, in addition to any dividends or capital gains they receive. We have maintained our position to apply a gamma value to the WACC. This is because the service provider, in whatever legal form it exists, operates for the profits of its investors. Imputation credit benefits to its investors are a tangible return of value to these investors.
17	Reconciliation between depreciated book value and recovered capital value	Jemena	Acknowledgment of our statement that “high-level responses will be sufficient in most circumstances” with respect to the requirement that service providers qualitatively explain the difference between the depreciated book value method and the recovered capital method (or any other method published)	We wish to clarify that while we anticipate that high-level responses will be sufficient in most circumstances, the explanations must be detailed enough to provide users or prospective users with a reasonable understanding of the differences in asset values and, broadly, what these differences mean in terms of negotiated outcomes. Our expectation is that where a more detailed explanation is required to achieve this, that this will be provided.
18	Major capital projects and pipeline expansions and extensions - Relevance to scheme distribution pipelines	Jemena	Relevance of publishing information on planned expansions and extensions (including estimated costs) for scheme distribution pipelines is very limited.	While we acknowledge that reference service charges for scheme pipeline charges and pipeline expansion or extension costs would generally be subject to approval by the AER as part of the access arrangement process, we note that a fundamental objective of the Guidelines is to ensure that financial and historical demand information is available and accessible to all users. Under the access regime for scheme pipelines, the AER sets the price for a defined reference service. It is also possible for users to negotiate price and non-price terms below that set by the AER. A user who wishes to do so is unlikely to be familiar with this AER regulatory process for scheme pipelines and may find pipeline expansion and extension information under this process to be difficult. Further, it is possible that a scheme pipeline may be subject to a form of regulation change to a non-scheme pipeline, in which case the publication of this information will be useful to future users in assessing the reasonableness of tariffs offered. As this information would already be readily available to the pipeline service provider of the scheme pipeline, we also consider that the additional compliance burden is relatively small. As such, we have decided to maintain our position that publication requirements for pipeline expansions and extensions apply to both scheme and non-scheme pipelines.
19	Historical demand	APA APGA	To be fully compliant when using historical demand data from the Gas Bulletin Board data, operators must also provide detailed instructions on	We have consulted with the Australian Energy Market Operator on availability and extraction of the Gas Bulletin Board data. We are advised that service providers are able to generate the required information from the Gas Bulletin Board. To adequately guarantee

Explanatory note: Pipeline Information Disclosure Guidelines – October 2023

	Issue	Submission	Comment	AER response
			extracting the data. Each operator will need to do this, which is an unnecessary duplication of effort.	the accuracy of the historical demand information service providers are required to describe the methodology used to collect and aggregate the historical demand data, including how volumes were metered or estimated and any adjustments to the raw data. In the case that daily average utilised capacity by pipeline service is not known, service providers must allocate total daily average utilised capacity to each pipeline service, having regard to any relevant allocation principles and estimation principles in Section 3.4 of these Guidelines.
20	Price escalation mechanism (Part 18A)	Lochard Energy	The intended effect of the reference to price escalation mechanism is unclear and should be removed or clarified.	The reference to the price escalation mechanism as described in the draft Guidelines has been removed and a reference to the price escalation mechanism added to the actual prices payable template.
21	Identifying services (Part 18A)	Lochard Energy	Strict requirement to separately list prices and terms does not reflect the diverse nature of the products and contracting structures used by service providers and should be more flexible.	Guidelines have been updated to better allow for diverse products and contracting structures used by service providers.
22	Standing terms (Part 18A)	Lochard Energy	Service providers should be permitted to publish their standing terms in full, rather than only in 'tabular form'.	After consideration, the wording has been updated in the Guidelines from 'must be published in tabular form' to 'should be published in tabular form'. This allows for standing terms to be published in full, albeit preference is still towards a 'tabular form' approach keeping in mind accessibility and transparency for prospective users.
23	Actual prices payable – standard template	APGA Jemena	Stakeholders consider that there is sufficient guidance in the Rules to enable preparation of reporting on a basis which will be accessible and meaningful to users making the need for a standard template unnecessary.	As stated in the workshops, after consideration, our position is that we will not be providing an actual prices payable template under Part 10.
24	Recovered Capital Method	Jemena APA	Concerns that the return on capital and rate of return requirements are highly prescriptive and will lead to return on capital and recovered capital method valuations that are inconsistent with the outcomes of a workably competitive market.	See section 1.7 of this explanatory note.
25	Part 10 financial reporting template	Draft Guidelines Stakeholder Forum	Are comparatives required to be reported for the first reporting period?	We understand the administrative work involved to recalculate the values of the previous reporting period to compare them with values from the current reporting period. However, this allows comparability

Explanatory note: Pipeline Information Disclosure Guidelines – October 2023

	Issue	Submission	Comment	AER response
				between different reporting periods allowing users access to more information when negotiating access.
26	Rate of Return	Jemena	Rate of Return definition should refer to NGL definition.	The definition has been updated to refer to the NGL definition.
27	Appendix B – Pipeline asset lives	Draft Guidelines Stakeholder Forum	Can the asset categories detailed in Appendix B include all the asset categories detailed in this table?	We have updated appendix B of the Guidelines.
28	Part 10 financial reporting template: Table 3.1: Pipeline assets	Draft Guidelines Stakeholder Forum	Why are inventories and deferred tax reported in the "Total shared supporting assets allocated"? Most of these categories would relate directly to the pipeline.	Inventories and deferred tax should be reported under these headings only to the extent that they are considered shared assets. Additionally, other non-depreciable assets such as inventories and deferred tax to the extent that they are considered direct pipeline assets should be included under "Other non-depreciable assets".
29	Receipt and delivery points	APA	APA suggest that the AER clarify Rule 101E(1)(g)(ii)(A) to focus on reporting on key receipt and delivery points only.	There is no scope under rule 101E of the NGR to allow Service providers to publish actual prices payable information for only key receipt and delivery points. Service Providers may choose to categorise the receipt and delivery points by the same prices and terms paid, however, if there are any differences in the prices and terms for a receipt and delivery point, it must be separately identified. Please refer to 4.2 in the Guidelines.

Appendix A Further discussion of pipeline asset valuation principles

The recovered capital method is an asset valuation technique that calculates the depreciated cost of constructing and augmenting a pipeline, with the depreciation component reflecting the return of capital generated since the pipeline was constructed. This valuation technique is intended to reveal the residual value of the pipeline asset, through showing the value that has been recovered from users since the pipeline was constructed.

By revealing this residual value and the cost-of-service provision, the publication of the recovered capital values assists users (and prospective users) to assess the reasonableness of prices offered for pipeline services and imposes greater discipline on service providers when setting prices.

Once the pipeline is operational, the initial recovered capital value is expected to eventually reduce to zero as the invested capital is recovered (assuming no further capital expenditure). This is represented by the return of capital component of the recovered capital method, and under the recovered capital method occurs when the revenue is greater than the operating expenses net tax liabilities, and the return on capital.

The recovered capital values may increase momentarily over the lifetime of the pipeline, but this would usually be when further capital expenditure has been incurred or when there are shortfalls in revenue such that revenue for that year is insufficient to cover the sum of operating expenses, tax liabilities, and the return on capital required. This concept is described in box 1 below.

Box 1 – The relationship between the cost of capital and recovered capital value

The recovered capital method can be expressed formulaically as follows:

$$\begin{aligned} \text{Value of Capital Base}_t &= \text{Construction Cost}_0 + \sum_{i=1}^t \text{Capex}_i - \sum_{i=1}^t \text{Asset Disposals}_i \\ &\quad - \sum_{i=1}^t \text{Return of Capital}_i \end{aligned}$$

where:

$$\begin{aligned} \sum_{i=1}^t \text{Return of Capital}_i &= \\ \sum_{i=1}^t \text{Revenue}_i - \left[\sum_{i=1}^t \text{Opex}_i + \sum_{i=1}^t \text{Return on Capital}_i + \sum_{i=1}^t \text{Net Tax Liabilities}_i \right] \end{aligned}$$

and:

$$\sum_{i=1}^t \text{Return on Capital}_i = \sum_{i=1}^t \text{Opening Asset Value}_i * \text{WACC}_i$$

When the sum of revenues is less than the sum of operating costs, return on capital and net tax liabilities, this means that the return of capital will be negative. That is, the return of capital at year t will *add* to the recovered capital method capital base, rather than subtract from it.

In this case, the recovered capital method will be expressed formulaically as:

$$\begin{aligned} \text{Value of Capital Base}_t &= \text{Construction Cost}_0 + \sum_{i=1}^t \text{Capex}_i - \sum_{i=1}^t \text{Asset Disposals}_i \\ &\quad + \sum_{i=1}^t \text{Return of Capital}_i \end{aligned}$$

Owing to the relatively large size of the opening asset value and based on AER analysis of pipeline recovered capital values, WACC will tend to be the most influential component in determining whether the return of capital is positive or negative, and therefore whether the recovered capital values for that year will add to, or subtract from, the recovered capital value.

Workable Competition

Workable competition refers to a standard of competition signifying that the relevant competitive process is capable of producing outcomes in terms of economic efficiency and consumer welfare that, at the very least, is considered satisfactory. This concept recognises that it is more relevant to analyse industries in terms of forms of competition closer to those actually observed, than an abstract and idealised notion of competition.

While competition is well-defined as meaning a process of rivalry, creating strong incentives for firms to seek out ways of better serving their customers, the way that this might manifest can vary from one industry or market to another. As such, what is “workable competition” cannot narrowly prescribe the types of forms of economic organisation and business conduct which may be consistent with the standard.

Gas pipelines are natural monopolies with high levels of capital intensity and asset specificity. This means that they cannot be redeployed to other uses or locations without a large loss in value (if at all). The risk of hold-up associated with these sunk costs is therefore large. In the Australian East Coast gas market, the resulting hold-up problem⁴ is conventionally resolved through long term contracts which underwrites the pipeline development.

One way in which workable competition may therefore be reconciled with industries characterised by a natural monopoly and large sunk costs is in observing that the use of long-term contracts provides an opportunity for “competition for the market” to occur, resulting in competitive terms for the construction and operation of gas pipelines.⁵ Provided that these terms are competitive and are reflected in pricing decisions, competition for the market can result in a monopolist delivering outcomes consistent with workably competitive markets. Changes in the geography of supply and demand for pipeline services can result in multiple rounds of competition for the market. The potential for competition for the market to constrain market power for gas pipelines in this way was recognised by the ACCC in the East Coast gas inquiry, and in the Vertigan review.⁶

2.1.1.1 The rate of return under the recovered capital method

Jemena and APA provided submissions to the draft Guidelines on the specification of inputs for the WACC for the purposes of the publishing of recovered capital method values, advocating for a more flexible approach. APA submitted that specifying a methodology and parameters for the rate of return would require the business to artificially adjust the one remaining parameter, the equity beta, by back calculating the desired rate of return.⁷ Jemena submitted that the proposed approach was highly prescriptive and inconsistent with workably competitive markets.⁸

Jemena notes that the recovered capital values will only reflect the outcomes of a workably competitive market when that value reflects the expectations held by parties at the time that they entered into the agreement underwriting the pipeline investment. These expectations, and a rate of return assurance, are reflected in the service provider’s revenues agreed to under the foundation pipeline agreement underwriting the pipeline development (and any

⁴ This is referred to as the ‘hold-up problem’, which occurs when parties to a transaction are required to make sunk investments but refrain from doing so due to the risk that the other party may expropriate the value of those sunk investments once they are made.

⁵ ‘Competition for the market’ refers to competition between firms to be the supplier of a *whole* market, rather than for market share. For pipeline services, this would mean that firms compete to build and operate the pipeline.

⁶ ACCC, Inquiry into the East Coast Gas Market, April 2016, pp. 96-97; Vertigan M, Examination of the Current Test for the Regulation of Gas Pipelines, December 2016, p. 37.

⁷ APA, Submission to the Draft AER Pipeline Information Disclosure Guidelines, August 2023, p. 7.

⁸ Jemena, Submission to the Draft AER Pipeline Information Disclosure Guidelines, August 2023, pp. 7-9.

subsequent medium- to long-term contracts underwriting additional augmentations). The rate of return implied through these agreements and revenues in practice may also reflect:

- the hurdle rate required by the service provider
- any economic rent appropriated by the pipeline from users owing to the bargaining imbalance between the parties
- the allocation of risks between the service provider and the user (e.g., whether changes in operating expenditure are passed through to tariffs).⁹

As pipeline investments feature sunk and irreversible investments that cannot be repurposed without incurring large losses, charges set by long-term contracts for pipeline services reflect not the current value of the pipeline, but the allocation of costs for supply decisions already made. This is reflected in the recovered capital method, which is initially set at the capital expenditure incurred and, assuming no further capital expenditure, eventually declines to zero in the long-term through the return of capital.

Jemena's submission (and supporting report by HoustonKemp) argued that the rate of return methodology set in the draft Guidelines, and in particular the requirement that the return of capital is to be estimated and updated shortly prior to the start of each year, undermines the rate of return assurance through long-term contracts.¹⁰ However, this is already reflected in the revenues secured through these contracts. The return on capital under the recovered capital method signifies the compensation to investors for the opportunity cost of the capital invested, with the cost of capital representing the minimum return estimated to attract capital to that investment.

The recovered capital method is also highly sensitive to the inputs and assumptions used. Jemena and APA submitted that greater flexibility when calculating the rate of return under the recovered capital method will produce recovered capital values that are more likely to be consistent with a workably competitive market.¹¹ However, the July 2019 ACCC Gas Market Inquiry Interim Report found that a number of service providers had reported recovered capital values that were well above their construction cost and depreciated book value. This was also found in a review by the Brattle Group of the financial information reported under the Part 23 regime, which noted the large negative depreciation component in the published recovered capital values for some pipelines.¹²

Based on a review of these reports and our analysis of pipeline recovered capital values, we consider that this is owing to recovered capital values increasing over a sustained period, which appears inconsistent with the financial performance of those pipelines and driven in

⁹ Owing to information asymmetry and bargaining power imbalances between service providers and users, it cannot be assumed that the allocation of risks in pipeline services contracts will be efficient for all contracts. For example, shocks in operating expenditure could be passed through to users under the agreed tariff structure and represented as higher (or lower) revenue under the recovered capital values reported.

¹⁰ Jemena, Submission to the Draft AER Pipeline Information Disclosure Guidelines, August 2023, p. 8; HoustonKemp, Rate of return for the calculation of RCM asset values: a report for Jemena, August 2023, p. 11.

¹¹ Jemena, Submission to the Draft AER Pipeline Information Disclosure Guidelines, August 2023, p. 9; APA, Submission to the Draft AER Pipeline Information Disclosure Guidelines, August 2023, pp. 6-8.

¹² The Brattle Group, Financial Information Disclosed by Gas Pipelines in Australia under Part 23 of the National Gas Rules, October 2019, pp. 51, 55.

most cases by the return of capital component of the recovered capital method. While this would be expected for pipelines that have been underutilised since they were built, such as the Tasmanian Gas Pipeline, this has also occurred for pipelines that have been underwritten by foundation contracts (and will therefore be likely to have secured revenue capable of recovering the value of the pipeline capital expenditure plus a return on investment).

From our analysis of pipeline recovered capital values, we consider that the specific driver of the increasing recovered capital values is WACC estimates that are above the implied rate of return from the revenue secured under the pipeline foundation contracts. This is supported by the July 2019 Gas Market Inquiry Report which, in analysing a sample of pipeline recovered capital values, noted that “the rates of return assumed by some pipeline operators [in the recovered capital values calculation] were higher than the rates used internally”, and higher than “the rates assumed by other pipeline operators and those allowed by contemporaneous regulatory decisions”.¹³ This is discussed in box 2.

Box 2 – Recovered capital values found to be overstated

The July 2019 ACCC Gas Market Inquiry Report reviewed a sample of recovered capital values and concluded that they were being overstated.

The pipelines reviewed were:

- APA’s South West Queensland Pipeline, Moomba to Sydney Pipeline and South East South Australia Pipeline
- Jemena’s Eastern Gas Pipeline
- SEA Gas’s Port Campbell to Adelaide Pipeline and Port Campbell to Iona Pipeline
- Epic Energy’s Moomba to Adelaide Pipeline System.

The review revealed:

- that a range of input and calculation errors had been made by pipeline operators.
- that the rates of return assumed by some pipeline operators were higher than the rates of return used for internal purposes. They were also higher than what was assumed by other pipeline operators and allowed for in contemporaneous regulatory decisions.
- that service providers employed a range of different approaches to calculate key inputs (e.g. rate of return, net tax liabilities, shared costs, and the initial cost of the pipeline)
- inconsistencies in calculations between the return on capital, rate of return, and net tax liabilities
- inconsistencies in the approach used to allocate parent company’s shared costs and shared assets to pipelines.¹⁴

These errors, assumptions, and approaches were found to have the effect of understating revenues or overstating operating expenses and components of the WACC. Overall, this had

¹³ ACCC, July 2019 Gas Inquiry 2017-2020 Interim Report, July 2019, p. 147.

¹⁴ ACCC, July 2019 Gas Inquiry 2017-2020 Interim Report, July 2019, pp. 147, 152.

the practical effect of reporting a return of capital under the recovered capital method that was likely lower than what was actually being recovered.

Examples of errors, assumptions and approaches found in the Inquiry report include:

- overstating the debt risk premium in the WACC
- assuming a full year return on capital in a period that only covered six months
- including a “single asset size premium” of 0.4 to 2.8 per cent
- including depreciation and a number of categories of overheads in the operating expenditure estimates that should not have been included
- allocating a disproportionate amount of shared costs and assets to some pipelines that had not been allocated to another pipeline owned by the service provider
- applying a premium to operating expenses
- estimating corporate overheads that would have been incurred if each pipeline had their own board of directors, IT systems and conducted their own corporate functions.¹⁵

The July 2019 ACCC Gas Market Inquiry Interim Report also found reported recovered capital values to be at odds with the likely financial position of the pipeline, noting in particular that:

- industry analysts reported that the Moomba to Sydney Pipeline, based on its recovered capital values, “has never obtained an acceptable return...despite foundation contracts ending”, and that SEA Gas “has only recovered 17% of its asset despite foundation contracts nearing an end”¹⁶
- recovered capital values reported for the South West Queensland Pipeline, Berwyndale to Wallumbilla Pipeline, Eastern Gas Pipeline and Moomba to Adelaide Pipeline System imply that they have never generated a positive return on capital, with the effect that the recovered capital values of these pipelines are substantially higher than the costs incurred in the construction and augmentation of the pipelines, and the book value¹⁷
- the financial information revealed by the reported recovered capital values were at odds with information provided previously to the ACCC, which indicated that pipeline investments are ordinarily fully underwritten by shippers through medium-to-long-term Gas Transportation Agreements.

If the assumed rate of return used for the return on capital component of the recovered capital method is higher than the actual hurdle rate implied by the agreements underwriting the pipeline development (or augmentation), the recovered capital values will likely continue to increase despite the pipeline earning a return on investment for the capital expenditure incurred. That is, the recovered capital values will wrongly imply that the pipeline is unable to earn revenue above the rate of return needed to attract capital, resulting in a recovered capital value that not only fails to reflect the residual value of the pipeline asset, but over

¹⁵ ACCC, July 2019 Gas Inquiry 2017-2020 Interim Report, July 2019, pp. 148-149.

¹⁶ ACCC, July 2019 Gas Inquiry 2017-2020 Interim Report, July 2019, pp. 145-146.

¹⁷ ACCC, July 2019 Gas Inquiry 2017-2020 Interim Report, July 2019, Table 6.3.

sufficient time obfuscates it by presenting a value that is likely to be above the construction cost or depreciated book value (or both). Further, any prices based on the recovered capital values where this is occurring is likely to be inflated, such that tariffs offered and agreed to are unlikely to reflect a workably competitive market.

As such, we do not consider that giving service providers greater discretion to set the rate of return would further the objectives of the guidelines. We have therefore maintained our position that the rate of return to be published under the return on capital component of the recovered capital method must follow the Sharpe-Lintner capital asset pricing model and follow a similar approach to that set out in the AER's rate of return instrument.

As noted in the explanatory note to the draft Guidelines, this approach promotes greater consistency when calculating the return on capital between different pipelines. This transparency is in keeping with the objectives of the Guidelines, and better enables users to negotiate with pipelines on a more informed basis.¹⁸

Consistent with this, we have retained our position that service providers must:

- determine the cost of debt and gearing ratio applicable to the pipeline, as the Guidelines are intended to reveal the actual costs incurred by the pipeline to the greatest extent practicable
- the relevant value of gamma must be included in the rate of return calculation, as the service provider, in whatever legal form it exists, operates for the profits of its investors. As such, imputation credit benefits to its investors are a tangible return of value to these investors.

Recovered capital method and alternative asset valuation methods

Under the NGR, the Guidelines are to provide for the publication of asset values using the recovered capital method for non-scheme pipelines, or an alternative method if this is inconsistent with the asset valuation objective.¹⁹ The recovered capital method starts with an initial asset value based on the historical construction cost, which is then depreciated through the return of capital component. The return of capital is defined as the residual once operating expenses, taxes and an assumed return on capital are netted from revenue, being pipeline revenue less operating costs, the return on capital and net tax liabilities.

In some circumstances, the recovered capital method may produce values that are inconsistent with the asset valuation objective. For instance, if a pipeline is sold for below the recovered capital value, then this selling price would be the value that is consistent with the valuation objective and not the recovered capital value (as the asset was written down, with prior shareholders bearing the cost of that write-down). As the recovered capital method is highly sensitive to the inputs chosen, incorrectly chosen inputs (and the assumptions

¹⁸ AER, Explanatory Note - Draft Pipeline Information Disclosure Guidelines and Price Reporting Guidelines, July 2023, p. 8.

¹⁹ The asset valuation objective is set out in rule 113Z(5)(a) of the NGR and is: the value of any assets used in the provision of the pipeline service must be determined using asset valuation techniques consistent with the objective of facilitating access to pipeline services provided by means of non-scheme pipelines on reasonable terms, which is taken to mean at prices and on other terms and conditions that, so far as practicable, reflect the outcomes of a workably competitive market.

underpinning them) can also produce recovered capital values that are inconsistent with the asset valuation objective. This is especially likely to be the case for inputs concerning the return of capital component of the recovered capital methodology.

We consider that the recovered capital method is less likely to produce an outcome consistent with workably competitive markets where:

- the WACC (or other inputs to the return of capital component) is set such that the revenue under the methodology is persistently lower than the other components comprising the return of capital of the recovered capital method
- the pipeline (or pipeline capacity expansion or extension) was not underwritten through a long-term foundation agreement (e.g., the pipeline had been publicly built and then sold to a private owner)
- the pipeline has been sold for a price that is below the recovered capital value
- the pipeline is persistently underutilised
- the foundation contract, or any contract underwriting pipeline augmentations or other material capital expenditure, has expired

Where a service provider determines that an asset valuation using the recovered capital method is inconsistent with the asset valuation objective, it must use an alternative asset valuation method that is consistent with the asset valuation objective. The following alternative valuation methodologies could be used:

- modified recovered capital method with an alternative depreciation method (that is, replacing the return of capital component of the recovered capital method with an alternative depreciation method)
- Depreciated Actual Cost

We consider that valuation methodologies based on actual historical costs are most suitable and most likely to produce outcomes consistent with workably competitive markets. This is since pipelines are overwhelmingly characterised by large sunk costs. An appropriate alternative asset valuation method would also broadly reflect the approach that would apply if the pipeline was fully regulated and be based on the lesser of the historical construction cost (or an estimate) or the acquisition cost.

We generally do not support the use of replacement cost methodologies, as they share a similar limitation to the recovered capital method in that they are highly sensitive to the inputs and assumptions used in their calculation. This increases the risks of valuations that are inconsistent with the outcomes of a workably competitive market. We also generally do not support valuations based on revenue (such as net present value) which can raise the problem of circularity: as the valuation is dependent on pipeline cashflows, and which in turn is dependent on the valuation of the pipeline.

However, we emphasise that an arbitrator may consider these asset valuations and those published by service providers in the Part 10 financial reporting template in the event of an arbitration but are not bound to rely on them. It is also up to the service provider or user to argue in a negotiation or arbitration that the recovered capital method or recovered capital values produced are not consistent with a workably competitive market and to advocate for a preferred valuation methodology.