DRAFT DECISION
Amadeus Gas Pipeline Access Arrangement

2021 to 2026

Attachment 2
Capital base

November 2020

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to APT Pipelines (NT) Pty Ltd (APTNT)'s Amadeus Gas Pipeline for the 2021–2026 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

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Contents

2 Capital base

The capital base roll forward accounts for the value of APTNT's regulated assets over the access arrangement period. The opening capital base value for a regulatory year within the access arrangement period is rolled forward by indexing it for inflation, adding any conforming capital expenditure (capex), and subtracting depreciation and other possible factors (for example, disposals or customer contributions).[1] Following this process, we arrive at a closing value of the capital base at the end of the relevant year. The opening value of the capital base is used to determine the return of capital (regulatory depreciation) and return on capital building blocks.

This attachment sets out our draft decision on APTNT's opening capital base as at 1 July 2021 for the 2021–26 access arrangement period. It also sets out our draft decision on APTNT's projected capital base for the 2021–26 period.

2.1 Draft decision

For this draft decision, we accept APTNT's proposed opening capital base of $125.3 million ($nominal) as at 1 July 2021.[2]

To determine the opening capital base as at 1 July 2021, we have rolled forward the capital base over the 2016–21 period to determine a closing capital base value at 30 June 2021, in accordance with the proposed RFM. This roll forward includes an adjustment at the end of the 2016–21 period to account for the difference between updated actual 2015–16 capex and the estimate approved in our 2016–21 decision.[3]

Table 2.1 summarises our draft decision on the roll forward of APTNT's capital base during the 2016–21 period.

Table 2.1 AER's draft decision on APTNT's capital base roll forward for the 2016–21 access arrangement period ($million, nominal)

	2016–17	2017–18	2018–19	2019–20[a]	2020–21[b]
Opening capital base	115.8	119.4	119.7	122.6	130.6
Net capex[c]	5.3	1.9	4.7	9.9	4.4
Indexation of capital base[d]	1.7	2.3	2.1	2.3	–0.5
Less: straight-line depreciation[e]	3.5	3.8	4.0	4.2	4.4
Interim closing capital base	119.4	119.7	122.6	130.6	130.0

1 The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

2 APTNT, *Amadeus Gas Pipeline 2021-26 Access Arrangement – Attachment 2 – Gas Transmission RFM,* July 2020.

3 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2016–21 decision.

	2016–17	2017–18	2018–19	2019–20[a]	2020–21[b]
Difference between estimated and actual capex in 2015–16 capex					–3.7
Return on difference for 2015–16 capex					–1.0
Closing capital base as at 30 June 2021					**125.3**

Source: AER analysis.

(a) Based on estimated capex provided by APTNT. We will update the capital base roll forward for actual capex in the final decision.

(b) Based on estimated capex provided by APTNT. We expect to update the capital base roll forward with a revised capex estimate in the final decision, and true-up the capital base for actual capex at the next access arrangement review.

(c) Adjusted for actual consumer price index (CPI).

(d) We will update the capital base roll forward for actual CPI for 2020–21 in the final decision.

(e) Adjusted for actual CPI. Based on forecast capex.

We determine a projected closing capital base as at 30 June 2026 of $128.6 million ($nominal). This is $0.1 million ($nominal) higher than APTNT's proposed closing capital base at 30 June 2026 of $128.5 million ($nominal).[4] Our draft decision on the forecast closing capital base value reflects our draft decision on the expected inflation rate (attachment 3),[5] forecast depreciation (attachment 4) and forecast capex (attachment 5).[6]

We accept APTNT's proposal to establish the opening capital base as at 1 July 2026 using the approved depreciation schedules based on forecast capex over the 2021–26 period.[7] These depreciation schedules will be adjusted for actual inflation outcomes over this period.

Table 2.2 sets out the projected roll forward of the capital base during the 2021–26 period.

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[4] APTNT, *Amadeus Gas Pipeline 2021-26 Access Arrangement – Attachment 3 – Gas Transmission PTRM*, July 2020.

[5] As discussed in attachment 3, our draft decision estimate of expected inflation is 2.37 per cent per annum for the access arrangement period. We are currently undertaking a review into the treatment of inflation in our regulatory framework, including the method likely to result in the best estimate of expected inflation. The final outcomes of this review are expected in December 2020. If we consider a different method for estimating expected inflation should be adopted, we intend to commence the consultation process under the NGR for amending the PTRM. We expect to apply amendments to the PTRM (if any) in our final decision in April 2021, unless a rule change proposal is required.

[6] Capex enters the capital base net of forecast disposals. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Therefore, our draft decision on the forecast capital base also reflects our amendments to the rate of return for the 2021–26 access arrangement period (attachment 3).

[7] APTNT, *Amadeus Gas Pipeline 2021–26 Access Arrangement Revision Proposal, Overview, July 2020*, pp. 36–37.

Table 2.2 AER's draft decision on APTNT's projected capital base roll forward for the 2021–26 access arrangement period ($million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening capital base	125.3	126.5	126.9	127.6	128.1
Net capex[a]	2.3	2.0	2.4	2.6	2.7
Indexation of opening capital base	3.0	3.0	3.0	3.0	3.0
Less: straight-line depreciation	4.1	4.6	4.8	5.0	5.3
Closing capital base	**126.5**	**126.9**	**127.6**	**128.1**	**128.6**

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC to compensate for the six month period before capex is added to the capital base for revenue modelling.

2.2 APTNT's proposal

APTNT proposed an opening capital base as at 1 July 2016 of $115.8 million ($nominal). Rolling forward this capital base and using depreciation based on forecast capex approved for the 2016–21 period, APTNT proposed a closing capital base as at 1 July 2021 of $125.3 million ($nominal). It has done so by adding actual net capex, removing approved forecast depreciation and adding inflation indexation on the opening capital base in each year of the 2016–21 period.[8]

APTNT's proposed capital base roll forward during the 2016–21 period is shown in Table 2.3.

8 APTNT, *Amadeus Gas Pipeline 2021–26 Access Arrangement Revision Proposal, Overview*, July 2020, pp. 32–33.

Table 2.3 APTNT's proposed capital base roll forward during the 2016–21 access arrangement period ($million, nominal)

	2016–17	2017–18	2018–19	2019–20[a]	2020–21[a]
Opening capital base	115.8	119.4	119.7	122.6	130.6
Net capex[b]	5.3	1.9	4.7	9.9	4.4
Indexation of capital base	1.7	2.3	2.1	2.3	–0.5
Less: straight-line depreciation[c]	3.5	3.8	4.0	4.2	4.4
Interim closing capital base	**119.4**	**119.7**	**122.6**	**130.6**	**130.0**
Difference between estimated and actual capex in 2015–16 capex					–3.7
Return on difference for 2015–16 capex					–1.0
Closing capital base as at 30 June 2021					**125.3**

Source: APTNT, Amadeus Gas Pipeline 2021-26 Access Arrangement – Attachment 2 – Gas Transmission RFM, July 2020.

(a) Based on estimated capex.

(b) Net of disposals and capital contributions, and adjusted for CPI.

(c) Adjusted for actual CPI. Based on forecast capex.

APTNT proposed a projected closing capital base as at 30 June 2026 of $128.5 million ($nominal). This value reflects its proposed opening capital base, forecast capex, expected inflation, and forecast depreciation over the 2021–26 period. The projected roll forward of the capital base during the 2021–26 period is shown in Table 2.4.

Table 2.4 APTNT's proposed projected capital base roll forward during the 2021–26 access arrangement period ($million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening capital base	125.3	126.3	126.7	127.4	128.0
Net capex[a]	2.3	2.0	2.5	2.6	2.7
Inflation indexation on opening capital base	3.0	3.0	3.0	3.0	3.1
Less: straight-line depreciation	4.4	4.6	4.8	5.0	5.3
Closing capital base	**126.3**	**126.7**	**127.4**	**128.0**	**128.5**

Source: APTNT, *Amadeus Gas Pipeline 2021-26 Access Arrangement – Attachment 3 – Gas Transmission PTRM,* July 2020.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC to compensate for the six month period before capex is added to the capital base for revenue modelling.

APTNT proposed to use forecast depreciation to determine the opening capital base as at the commencement of the 2026–31 access arrangement period, consistent with the approach applied in the 2016–21 period.[9]

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9 APTNT, *Amadeus Gas Pipeline 2021–26 Access Arrangement Revision Proposal,* July 2020, cl. 3.5.

2.3 Assessment approach

Our approach to assessing APTNT's projected capital base is consistent with that adopted in previous gas access arrangement decisions made under the National Gas Rules (NGR).[10] In accordance with rules 77(2) and 78 of the NGR, we applied three steps to calculate the projected capital base:

- first, we confirm the value of the opening capital base for the first year of the 2016–21 period (in this case, 1 July 2016). This includes making an adjustment to account for any difference between actual and estimated capex in the final year of the previous access arrangement period (in this case, 2015–16). This adjustment is made at the end of the 2016–21 period, and must also remove any benefit or penalty associated with any difference between the estimated and actual capex for that year.[11] We note that this adjustment is subject to any further changes made in our assessment of conforming capex for 2015–16.
- second, the opening capital base as at 1 July 2016 is rolled forward to determine the closing capital base as at 30 June 2021. This closing capital base is also used as the value of the opening capital base for the 2021–26 period as at 1 July 2021. This involves:[12]
    - adding conforming actual capex for each year - this requires assessing the capex and determining that it is consistent with the provisions of the 2016–21 access arrangement and data from historical Regulatory Information Notices (RINs), as well as the definition of 'conforming capital expenditure' in the NGR[13]
    - removing depreciation for each year based on the approach approved for the 2016–21 period
    - removing any capital contributions during the 2016–21 period[14]
    - adding any speculative capex or previously redundant assets that will be reused during the 2021–26 period
    - removing any redundant assets and disposals during the 2016–21 period
    - indexing the roll forward each year for actual inflation.
- third, the capital base is projected over the 2021–26 period by rolling forward the opening capital base as at 1 July 2021 to 30 June 2026. This involves performing the following on the opening capital base:[15]

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10 For example, AER, *Final decision: APA VTS Australia access arrangement 2018–22*, November 2017; AER, *Final decision: AusNet Services access arrangement 2018–22*, November 2017; AER, *Final decision: Multinet gas access arrangement 2018–22*, November 2017; AER, *Roma to Brisbane Gas Pipeline access arrangement 2017–22,* November 2017; AER, *Australian Gas Networks Victoria and Albury access arrangement 2018–22,* November 2017; AER, *Final decision: Jemena Gas Networks (NSW) access arrangement 2020–25*, June 2020.

11 NGR, r. 77(2)(a).

12 NGR, r. 77(2).

13 NGR, r. 79(1).

14 NGR, r. 82(3).

- adding forecast conforming capex for each year, net of any forecast capital contributions
- removing forecast depreciation for each year
- removing the forecast value of assets to be disposed of during the 2021–26 period
- indexing the capital base of the roll forward each year for expected inflation.

2.3.1 Interrelationships

The size of the capital base substantially impacts the service provider's revenue and the price consumers pay. It is an input into the determination of the return on capital and depreciation (return of capital) building blocks.[16] Factors that influence the capital base will therefore flow through to these building block components and the annual building block revenue requirement. Other things being equal, a higher capital base increases both the return on capital and depreciation amounts. In turn, it increases the service provider's revenue, and prices for its services.

The capital base is determined by various factors, including;

- the opening capital base (meaning the value of existing assets at the beginning of the access arrangement period)
- net capex[17]
- depreciation
- indexation adjustment – so the capital base is presented in nominal terms, consistent with the rate of return.

The opening capital base depends on the value of existing assets as well as actual conforming net capex, actual inflation outcomes and depreciation in the past.

The capital base when projected to the end of the access arrangement period may increase due to forecast new capex and the indexation adjustment. The size of the indexation adjustment depends on expected inflation (which also affects the nominal rate of return or WACC) and the size of the capital base at the start of each year.

Depreciation reduces the capital base. The depreciation amount depends on the size of the opening capital base, the forecast net capex and the depreciation schedules applied to the assets.

We maintain the capital base in real terms by indexing for inflation. A nominal rate of return WACC is multiplied by the opening capital base to produce the return on capital

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15 NGR, r. 78.

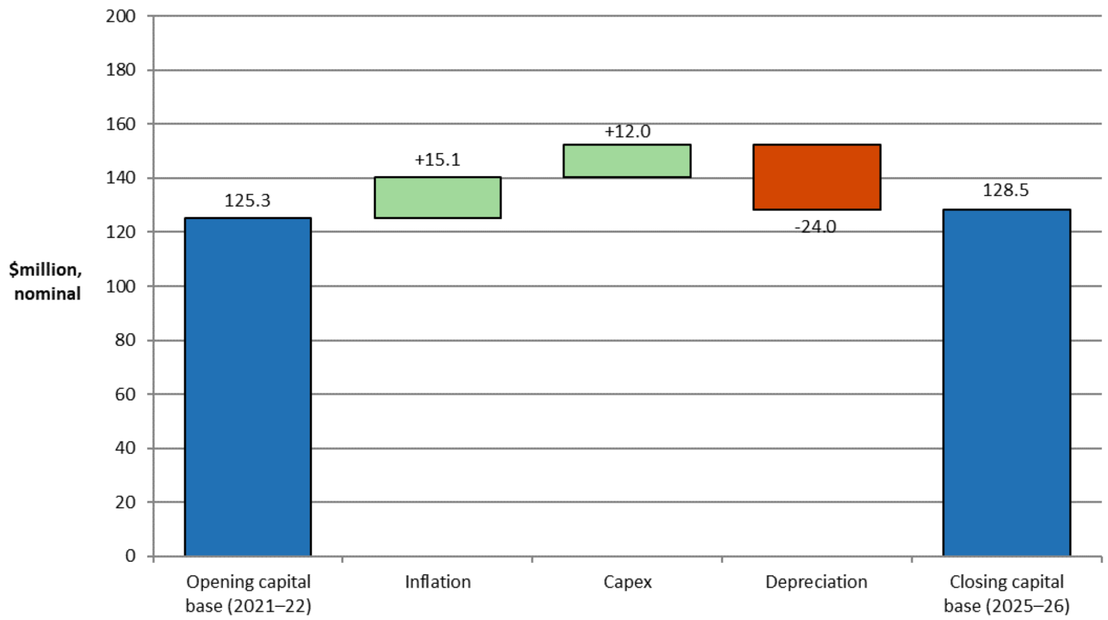
16 The size of the capital base also impacts the benchmark debt raising cost. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

17 Net capex is gross capex less disposals and capital contributions.

building block.[18] To prevent double counting of inflation through the nominal WACC and indexed capital base, the regulatory depreciation building block has an offsetting reduction for indexation of the capital base.[19] Indexation of the capital base and the offsetting adjustment made to depreciation results in smoother revenue recovery profile over the life of an asset than if the capital base was un-indexed. The implications of our approach to indexing the value of the capital base on revenues are discussed further in attachment 4.

Figure 2.1 shows the key drivers of the change in the capital base over the 2021–26 period as proposed by APTNT. Overall, the closing capital base at the end of the 2021–26 period would be 2.5 per cent higher than the opening capital base at the start of that period based on the proposal, in nominal terms. The proposed forecast net capex increases the capital base by about 9.6 per cent, while expected inflation increases it by about 12.1 per cent. Forecast depreciation, on the other hand, reduces the capital base by about 19.1 per cent.

Figure 2.1 Key drivers of changes in the capital base proposed by APTNT ($million, nominal)



Source: APTNT, *Amadeus Gas Pipeline 2021-26 Access Arrangement – Attachment 3 – Gas Transmission PTRM,* July 2020.

Note: Capex is net of forecast disposals and capital contributions. It is Inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

[18] NGR, r. 87.

[19] If the asset lives are extremely long, such that the capital base depreciation rate is lower than the inflation rate, then negative regulatory depreciation can emerge. The indexation adjustment is greater than the capital base depreciation in such circumstances. Please also refer to section 4.3.1 of attachment 4 of this draft decision for further explanation of the offsetting adjustment to the depreciation.

The capital base would decrease by 8.9 per cent in real terms over the 2021–26 period based on APTNT's proposal. The depreciation amount also largely depends on the opening capital base, which in turn depends on capex. In this draft decision, we have accepted APTNT's proposed forecast capex of $11.1 million ($2020–21) for the 2021–26 period.[20] Our review of APTNT's forecast capex is set out in attachment 5 of this draft decision.

A 10.0 per cent increase in the opening capital base causes revenues to increase by about 4.0 per cent. However, the impact of the annual change in capital base on revenues depends on the source of the capital base change, as some drivers affect more than one building block cost.[21]

2.4 Reasons for draft decision

We accept APTNT's proposed opening capital base of $125.3 million ($nominal) as at 1 July 2021.

We forecast a closing capital base value of $128.6 million by 30 June 2026. This represents an increase of $0.1 million (or 0.1 per cent) compared to APTNT's proposal. This results from our draft decision on the inputs used to determine the projected capital base in the PTRM. We are satisfied this amendment is necessary having regard to the requirements of the NGR.

The reasons for our decision are discussed below.

2.4.1 Roll forward of capital base during 2016–21 period

APTNT has established its opening capital base as at 1 July 2021 using our roll forward model (RFM). Therefore, we reviewed the key inputs of APTNT's proposed RFM, such as actual inflation, rate of return, gross capex values, forecast depreciation amounts and asset lives. We found these inputs were largely correct and reconciled with relevant data sources such as ABS data, RINs and the 2016–21 decision models.[22]

While we accept the proposed opening capital base value as at 1 July 2021, we have made the following amendments in the RFM. However, these amendments do not materially affect the total opening capital base value:

- APTNT proposed to roll in the remaining value of its existing leases (about $4.1 million) to the capital base due to a change in the accounting standards AASB16 in

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20 This amount is net of capital contributions and equity raising costs and excludes half-year WACC adjustment.

21 If capex causes the capital base to increase, then return on capital, depreciation, and debt raising costs all increase too. If a reduction in depreciation causes the capital base to increase, then revenue could increase or decrease. In the latter case, the higher return on capital is offset (perhaps more than offset) by the reduction in the depreciation amount. Inflation naturally increases the capital base in nominal terms.

22 At the time of this draft decision, the roll forward of APTNT's capital base includes estimated capex values for 2019–20 and 2020–21. We will update the 2019–20 estimated capex with actuals in the final decision. We may also update the 2020–21 estimated capex with a revised estimate in the final decision.

2019–20. Leases were treated as opex prior to this change. We accept this proposal because the proposed roll in value of $4.1 million reasonably reflects of the remaining value of APTNT's existing leases with respect to the Amadeus Gas Pipeline as at 2019–20, and is appropriately reflected in the RFM. However, we have updated APTNT's RFM for final year adjustments at the end of the 2016–21 period to reflect the reallocation of capitalised leases from existing asset classes to the new asset class of 'Leased assets'. APTNT has made these adjustments in its proposed PTRM, but not the RFM. Therefore, we have updated the RFM so that the closing capital value at the asset class level is consistent with the PTRM opening capital value.

- we have updated the 2020–21 nominal WACC input in the RFM to reflect the value in the 2020–21 return on debt updated PTRM.

Conforming capital expenditure in the 2016–21 period

Our assessment of conforming capex is set out in attachment 5. In determining the opening capital base as at 1 July 2021, we assessed whether APTNT's proposed capex amounts for the 2016–21 access arrangement period are properly accounted for in the capital base roll forward.

We accept APTNT's proposed actual capex as conforming capex during the 2016–21 period. Therefore, we accept that actual conforming capex has been properly accounted for in the proposed capital base roll forward consistent with the requirements of the NGR.[23] However, we note that the proposed capex for 2019–20 and 2020–21 are estimates. Therefore the 'approved' capex in this draft decision for 2019–20 and 2020–21 are placeholder amounts. We expect that APTNT will provide actual capex for 2019–20 in its revised proposal and the 2020–21 capex estimate may be revised based on more up to date information. We will assess whether the actual capex for 2019–20 and any revised estimate for 2020–21 are conforming capex in our final decision.

2.4.2 Projected capital base during 2021–26 period

We forecast a closing capital base of $128.6 million ($nominal) as at 30 June 2026 for APTNT's Amadeus Gas Pipeline, which represents an increase of $0.1 million (or 0.1 per cent) compared to APTNT's proposed amount of $128.5 million. This results from our draft decision on the inputs to the determination of the projected capital base. We have amended the inputs in the following ways:

- we updated APTNT's proposed expected inflation rate of 2.39 per cent per annum for the 2021–26 access arrangement period to 2.37 per cent per annum (attachment 3). This results in a decrease to the indexation of the capital base component for the 2021–26 period by $0.1 million ($nominal) or 0.4 per cent, all else being equal (where the capital base is unchanged from APTNT's proposal).

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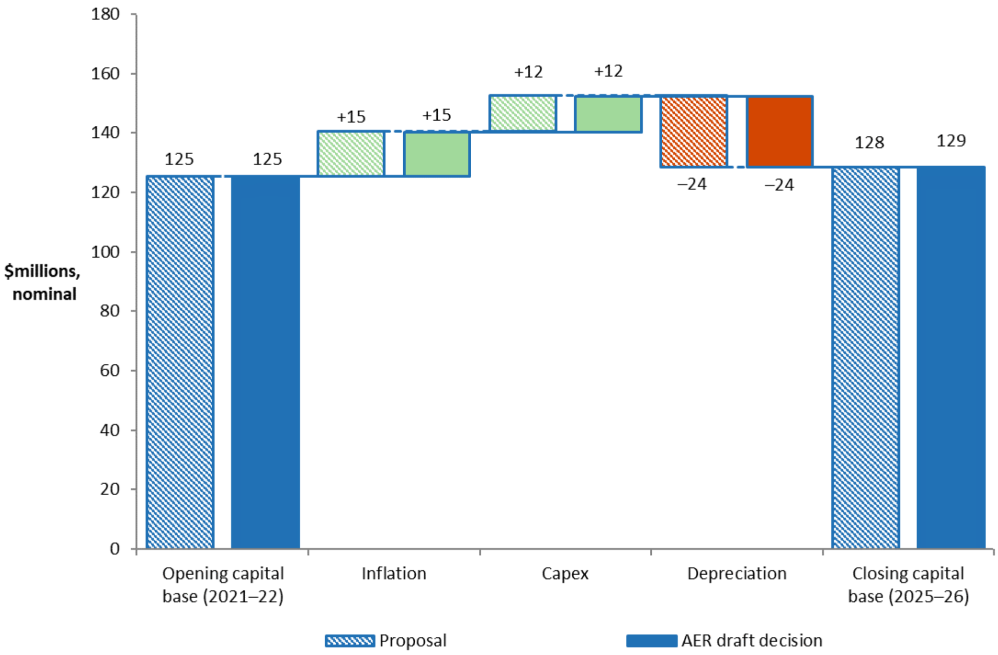
[23] NGR, r. 77(2)(b).

- we reduced APTNT's proposed forecast straight-line depreciation amount for the 2021–26 access arrangement period by $0.2 million ($nominal) or 0.7 per cent.[24] Our assessment of the proposed forecast depreciation is set out in attachment 4.

Figure 2.2 shows the key drivers of the change in APTNT's capital base over the 2021–26 period for this draft decision. Overall, the closing capital base at the end of the 2021–26 period is forecast to be 2.6 per cent higher than the opening capital base at the start of that period, in nominal terms. The approved forecast net capex and expected inflation increase the capital base by about 9.6 per cent and 12.0 per cent, respectively. Forecast depreciation, on the other hand, reduces the capital base by about 19.0 per cent.

Figure 2.2 Key drivers of changes in the capital base – APTNT's proposal compared with AER's draft decision ($million, nominal)



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

[24] Regulatory depreciation is the net total of straight-line depreciation and inflation indexation of the capital base.

2.4.3 Capital base at commencement of 2026–31 period

The capital base at the commencement of the 2026–31 access arrangement period will be subject to adjustments consistent with the NGR. The adjustments for APTNT include (but are not limited to) actual inflation and approved depreciation over the 2021–26 period.

We accept APTNT's proposal to establish the opening capital base as at 1 July 2026 using the approved depreciation schedules based on forecast capex over the 2021–26 period.[25] This is consistent with the requirement in its current access arrangement which requires that depreciation be based on forecast capex.[26] We approved such an approach in our recent gas access arrangement decisions.[27] This approach is also consistent with the approach outlined in our *Access Arrangement Guideline*.[28] The amount of the forecast depreciation is to be approved by us in the final decision for the 2021–26 period.

We consider APTNT's 2021–26 access arrangement should further provide clarity that the capital base as at 1 July 2026 is to be established using the approved depreciation schedules (straight-line) based on forecast capex at the asset class level.[29] Having regard to the capital base as determined in the preceding access arrangement, we consider this will provide for a forecast of depreciation over the 2021–26 period that provides for continuity and consistency in determining depreciation from one access arrangement period to the next.[30]

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25 APTNT, *Amadeus Gas Pipeline 2021–26 Access Arrangement Revision Proposal,* July 2020, cl. 3.5.

26 APTNT. Amadeus Gas Pipeline, *Access Arrangement Information, 2016–21,* August 2015, pp. 8–10.

27 AER, *Final decision: APA VTS Australia access arrangement 20118–22, Attachment 2 – Capital base*, November 2017, p. 8; AER, *Final decision: AusNet Services access arrangement 2018–22, Attachment 2 – Capital base*, November 2017, p. 23; AER, *Final decision: Multinet gas access arrangement 2018–22, Attachment 2 – Capital base*, November 2017, p. 7; AER, *Roma to Brisbane Gas Pipeline access arrangement 2017–22, Attachment 2 – Capital base,* November 2017, p. 7; AER, *Australian Gas Networks Victoria and Albury access arrangement 2018–22, Attachment 2 – Capital base,* November 2017, p. 6; AER, *Final decision: Jemena Gas Networks (NSW) access arrangement 2020–25*, *Attachment 2 – Capital base,* June 2020, p. 14.

28 AER, *Final access arrangement guideline*, March 2009, pp. 61–62.

29 NGR, r. 90.

30 NGL, s. 24(4) and s. 28(2)(a)(i).

2.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 2.5.

Table 2.5 APTNT's capital base revisions

Revision	Amendment
Revision 2.1	Make all necessary amendments to reflect this draft decision on the roll forward of the capital base for the 2016–21 access arrangement period, as set out in Table 2.1.
Revision 2.2:	Make all necessary amendments to reflect this draft decision on the projected capital base for the 2021–26 access arrangement period, as set out in Table 2.2.
Revision 2.3:	Amend clause 3.5 of the access arrangement as follows: The depreciation schedule (straight-line) for establishing the Capital Base at 1 July 2026 will be based on forecast capital expenditure at the asset class level approved for the 2021–26 access arrangement period.

Shortened forms

Shortened form	Extended form
ABS	Australian Bureau of Statistics
AER	Australian Energy Regulator
APTNT	APT Petroleum Pipelines Northern Territory
capex	Capital expenditure
CPI	Consumer price index
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
PTRM	Post-tax revenue model
RFM	Roll forward model
RIN	Regulatory Information Notice
SL	Straight-line
WACC	Weighted average cost of capital