



DRAFT DECISION
Amadeus Gas Pipeline
Access Arrangement
2016 to 2021

Attachment 11 – Reference
tariff variation mechanism

November 2015

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Note

This attachment forms part of the AER's draft decision on the access arrangement for the Amadeus Gas Pipeline for 2016–21. 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 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency carryover mechanism

Attachment 10 - Reference tariff setting

Attachment 11 - Reference tariff variation mechanism

Attachment 12 - Non-tariff components

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Shortened forms

Shortened form	Extended form
AA	Access Arrangement
AAI	Access Arrangement Information
AER	Australian Energy Regulator
AGP	Amadeus Gas Pipeline
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CESS	Capital Expenditure Sharing Scheme
CPI	consumer price index
DRP	debt risk premium
EBSS	Efficiency Benefit Sharing Scheme
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	Value of Imputation Credits
GSL	Guaranteed Service Level
MRP	market risk premium
NEGI	north eastern gas interconnector
NGL	national gas law
NGO	national gas objective
NGR	national gas rules
NPV	net present value
opex	operating expenditure
PFP	partial factor productivity
PPI	partial performance indicators
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model

Shortened form	Extended form
TAB	Tax asset base
UAFG	Unaccounted for gas
WACC	weighted average cost of capital
WPI	Wage Price Index

11 Reference tariff variation mechanism

This attachment sets out the AER's consideration of the reference tariff variation mechanism proposed by APTNT for the Amadeus Gas Pipeline. The reference tariff variation mechanism:

- permits building block revenues to be recovered smoothly over the access arrangement period, subject to any differences between forecast and actual demand
- accounts for actual inflation
- accommodates other reference tariff adjustments that may be required, such as for an approved cost pass through event
- sets administrative procedures for the approval of any proposed changes to reference tariffs.

11.1 Draft decision

We do not accept APTNT's proposed reference tariff variation mechanism for the 2016–21 access arrangement period. We consider that some elements of the proposed reference tariff variation mechanism are not consistent with the NGL. In particular:

- the proposed initial reference tariffs and X factors must be revised to reflect the changes to the forecast total revenue identified in the draft decision overview attachment
- we do not accept definitions for certain parameters within the tariff variation mechanism
- we do not accept APTNT's proposed definitions of several pass through events.

We have also included in APTNT's reference tariff variation mechanism an adjustment factor to accommodate additional variations to the reference tariff for an approved cost pass through event.

Our reasons for this decision are discussed below.

11.2 APTNT's proposal

APTNT proposed to retain the same reference tariff variation mechanism for its reference service (the firm service) for the 2016–21 access arrangement period, with the following amendments:

- variations to the access arrangement to distinguish the two components of the reference tariff variation mechanism:
 - the Scheduled Reference Tariff Variation Mechanism
 - the Cost Pass-through Reference Tariff Variation Mechanism
- inclusion of a mechanism for the annual updating of the return on debt

- variation to the tariff variation process under the Scheduled Reference Tariff Variation Mechanism
- drafting changes to refer to:
 - the reference service as the firm service
 - refer to the tariff variation mechanism instead of a tariff adjustment mechanism to be consistent with NGR drafting.¹

11.2.1 Cost pass through events

The inclusion of a pass through mechanism recognises that a services provider can be exposed to risks beyond its control, which may have a material impact on costs. A cost pass through enables a service provider to recover (or pass through) the costs of defined unpredictable, high cost events.

APTNT’s proposed pass through events for the Amadeus pipeline are set out in Table 11.1.

Table 11.1 APTNT’s proposed pass through events

Proposed event	Proposed definition
Regulatory Change Event	<p>Regulatory change event—means:</p> <p>An imposition of, a change in, or the removal of a regulatory obligation or requirement that:</p> <p>(a) falls within no other category of Cost Pass-through Event; and</p> <p>(b) occurs during the course of the access arrangement period; and</p> <p>(c) affects the manner in which Service Provider provides the Firm Service; and</p> <p>(d) materially increases or materially decreases the costs of providing the Firm Service.</p>
Service Standard Event	<p>Service standard event—means:</p> <p>A legislative or administrative act or decision that:</p> <p>(a) has the effect of:</p> <p>(i) varying, during the course of the access arrangement period, the manner in which Service Provider is required to provide the Firm Service; or</p> <p>(ii) imposing, removing or varying, during the course of an access arrangement period, minimum service standards applicable to the Firm Service; or</p> <p>(iii) altering, during the course of an access arrangement period, the nature or scope of the Firm Service, provided by Service Provider; and</p> <p>(b) materially increases or materially decreases the costs to Service Provider of providing the Firm Service.</p>
Tax Change Event	<p>Tax change event—means:</p> <p>A tax change event occurs if any of the following occurs during the course of the</p>

¹ APTNT, Amadeus Gas Pipeline access arrangement revision proposal submission, August 2015, pp. 173–177.

Proposed event	Proposed definition
	<p>access arrangement period for Service Provider:</p> <p>(a) a change in a relevant tax, in the application or official interpretation of a relevant tax, in the rate of a relevant tax, or in the way a relevant tax is calculated;</p> <p>(b) the removal of a relevant tax;</p> <p>(c) the imposition of a relevant tax; and</p> <p>In consequence, the costs to Service Provider of providing the Reference Service are materially increased or decreased.</p>
Terrorism Event	<p>Terrorism event—means:</p> <p>An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which materially increases the costs to Service Provider of providing a Firm Service.</p>
Insurer Credit Risk Event	<p>Insurer credit risk event—means:</p> <p>An event where the insolvency of the insurers of Service Provider occurs, as a result of which Service Provider:</p> <p>(a) incurs materially higher or materially lower costs for insurance premiums than those allowed for in the access arrangement; or</p> <p>(b) in respect of a claim for a risk that would have been insured by Service Provider’s insurers, is subject to a materially higher or lower claim limit or a materially higher or lower deductible than would have applied under that policy; or</p> <p>(c) incurs additional costs associated with self-funding an insurance claim, which, would have otherwise been covered by the insolvent insurer.</p>
Insurance Cap Event	<p>Insurance cap event—means:</p> <p>An event whereby:</p> <p>(a) Service Provider makes a claim on a relevant insurance policy</p> <p>(b) Service Provider incurs costs beyond the relevant policy limit; and</p> <p>(c) the costs beyond the relevant policy limit materially increase the costs to Service Provider of providing the Firm Service.</p> <p>For the purposes of this Insurance cap event:</p> <p>(a) the relevant policy limit is the greater of Service Provider’s actual policy limit at the time of the event that gives rise to the claim and its policy limit at the time the Regulator made its Final Decision on Service Provider’s access arrangement proposal, with reference to the forecast operating expenditure approved in the Regulator’s Final Decision and the reasons for that decision; and</p> <p>(b) a relevant insurance policy is an insurance policy held during the Access Arrangement Period or a previous period in which access to the pipeline services was regulated.</p>
Natural Disaster Event	<p>Natural disaster event—means:</p> <p>Any major fire, flood, earthquake, or other natural disaster beyond the control of Service Provider (but excluding those events for which external insurance or self-insurance has been included within Service Provider’s forecast operating expenditure) that occurs during the access arrangement period and materially increases the costs to Service Provider of providing the Firm Service.</p>

Source: Amadeus, *Amadeus Gas Pipeline Access Arrangement – August 2015*, pp.18–20.

11.3 AER's assessment approach

Under the NGR, a reference tariff variation mechanism for an access arrangement:

- must be designed to equalise (in present value terms):
 - forecast revenue from reference services over the access arrangement period, and
 - the portion of total revenue allocated to reference services for the access arrangement period.
- may provide for variation of a reference tariff:
 - in accordance with a schedule of fixed tariffs, or
 - in accordance with a formula set out in the access arrangement, or
 - as a result of a cost pass through for a defined event, or
 - by the combination of two or more of these operations.²

A formula for varying reference tariffs may (for example) provide for variable caps on the revenue to be derived from a particular combination of reference services; or tariff basket price control; or revenue yield control; or a combination of all or any of these factors.³ However, the reference tariff variation mechanism must give us adequate oversight and powers to approve reference tariff variations.⁴

We must have regard to various factors in deciding whether an access arrangement's reference tariff variation mechanism is appropriate. These are:

- the need for efficient reference tariff structures
- the possible effects of the reference tariff variation mechanism on administrative costs
- the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed reference tariff variation mechanism
- the desirability of consistency between regulatory arrangements for similar services
- any other relevant factor.⁵

Having regard to these, we considered the implications of the proposed reference tariff variation mechanism for efficient tariff structures and administrative costs on natural gas consumers, potential users and APTNT as the operator of the Amadeus pipeline. In doing so we took into account the nature and scope of pipeline reference services to which reference tariffs are applicable. Our assessment also included a comparison of:

² NGR, rr. 92(2), 97(1).

³ NGR, r. 97(2).

⁴ NGR, r. 97(4).

⁵ NGR, r. 97(3).

- the proposed reference tariff variation mechanism arrangements with the current arrangements for the Amadeus pipeline, and
- other recent gas access arrangement decisions,

for consistency in approach across the provision of similar services.

We assessed the potential impact of the proposal on incentives for pipeline operation in a manner consistent with the national gas objectives and with the revenue and pricing principles.⁶ We also judged the implications of the proposed reference tariff variation mechanism for effective risk management that would be in the long term interests of consumers of natural gas.

11.3.1 Cost pass through reference tariff variation mechanism

This section sets out our approach to assessing cost pass throughs, and should be read in conjunction with the information directly above in section 11.3.

Pass through events transfer financial risks from service providers to consumers. Generally, if one of the pass through events occurs, the costs of the event are passed through to consumers and network charges increase accordingly.

In deciding on the appropriateness of a proposed cost pass through event we must consider the factors in rule 97(3) and assess its consistency with the NGO. We have full discretion to withhold approval to an element of a reference tariff variation mechanism if we believe that a preferable alternative exists.⁷

Our approach to assessing pass throughs includes taking into account the Revenue and Pricing Principles, providing the service provider with a reasonable opportunity to recover at least the efficient costs the operator incurs,⁸ while also providing effective incentives to promote economic efficiency.⁹ It promotes a balance between the economic costs and risks for promoting efficient investment.¹⁰

We also consider a set of criteria used by us in previous decisions¹¹ to assess pass throughs against both the NGO and the National Electricity Objective (NEO).¹² In 2012 these criteria were incorporated into the National Electricity Rules (NER) as nominated pass through event considerations. We consider that these same criteria remain relevant as general principles to help determine whether a proposed cost pass through event for a gas network is consistent with the NGO.¹³

⁶ Including NGR, r.97 (3)(e).

⁷ NGR, r. 40(3).

⁸ NGL, s. 24(2).

⁹ NGL, s. 24(3).

¹⁰ NGL, s. 24(6).

¹¹ For example, our June 2015 decision on the access arrangement for Jemena Gas Networks (NSW) Ltd

¹² We consider that the NGO and NEO are sufficiently similar for the same criteria to be relevant.

¹³ NGR, r. 97(3)(e).

The criteria we have had regard to in this draft decision (as adopted by the AEMC as nominated pass through event considerations in the NER) are:¹⁴

The nominated pass through event considerations are:

(a) whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to(4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to(4) (in the case of a transmission determination);

(b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;

(c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;

(d) whether the relevant service provider could insure against the event, having regard to:

(1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or

(2) whether the event can be self-insured on the basis that:

(i) it is possible to calculate the self-insurance premium; and

(ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and.

(e) any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.

Our approach to assessing proposed pass through events also considers whether it is good regulatory practice, in the context of a national regulatory framework, to achieve consistency across and between energy sectors.¹⁵ Our approach also considers whether the risk transferred to consumers via the pass through is appropriate.¹⁶

These considerations involve an assessment of the incentives on service providers to manage their risks efficiently. For systematic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. These activities are generally compensated through opex and capex allowances. Beyond this, and where possible, a service provider may manage other risks through a number of other strategies including:

- prevention (avoiding risk)
- mitigation (reducing the negative effect of probability of the risk)

¹⁴ NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

¹⁵ NGR, r. 97(3)(d).

¹⁶ NGR, r. 97(3)(e).

- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risky event).

An efficient service provider will manage its risk by employing the most cost effective combination of these strategies. For example, if a cost is reasonably predictable, a service provider should factor it into its opex and capex proposed expenditure. In addition, a service provider may invest in its networks to mitigate the impact of certain events occurring. Alternatively, if the probability of events occurring can be readily estimated then the event should be insurable.

Pass through events cover those limited circumstances for which the risks cannot be managed efficiently in these ways, and for which the service provider should be able to recover its efficient costs.

A factor for us to consider, which is reflected in our approach to assessing pass throughs, is who is best placed to manage risk. It is acknowledged practice that the party who is best placed to manage the risk should bear the risk. If the service provider, or customers, are fully exposed to a risk this may lead to adverse outcomes.

For example, if insurance is not available on commercial terms or self-insurance is not appropriate, a service provider might invest too much in its network. Over the longer term, this is likely to affect efficient costs of operating the network and would not be in consumers' long term interests. In such circumstances, the consumer may be best placed to bear the risk if the unforeseen event occurs.¹⁷ On the other hand, if the service provider is able to pass through all the costs of an unforeseen event, this may dilute the service provider's incentive to take prudent actions upfront to manage these risks.

We considered all of these issues when assessing APTNT's proposed pass through events for the Amadeus pipeline, with the aim of achieving the right balance, in the long term interests of consumers.

11.3.2 Interrelationships

As mentioned above, pass through events are not the only mechanism in this decision by which APTNT can manage its risks. Pass through events are interrelated with other parts of this decision, in particular with the proposed opex and capex allowances and the rate of return. These interrelationships require the AER to balance the incentives under the various parts of its decision.

11.4 Reasons for draft decision

We do not approve Amadeus' proposed reference tariff variation mechanism for the 2016–21 access arrangement period.

¹⁷ AEMC, *Cost pass through determination*, 2 August 2012, p.18.

The reasons for our decision are set out below.

11.4.1 Annual reference tariff variation mechanism

Revenue equalisation

The annual reference tariff variation mechanism must be designed to equalise (in present value terms) the building block costs associated with reference services and the portion of total revenue allocated to reference services. We consider APTNT's proposed annual reference tariff variation formula complies in principle with rule 92(2) but the initial reference tariffs must be revised to reflect the draft decision on forecast total revenue and forecast demand. The changes in total revenue and forecast demand are outlined in their respective sections of this draft decision.¹⁸

Reference tariff variation mechanism

We accept the form of APTNT's proposed reference tariff variation mechanism because it is generally consistent with that applied in the current access arrangement. However, there are some aspects of the proposed reference tariff variation mechanism we do not accept.

Although accepting the inclusion of a mechanism for the annual updating of the return on debt, we do not accept APTNT's proposed formula to give effect to this adjustment.¹⁹ Our position on the proposed formula reflects our draft decision on APTNT's return on debt proposal. Our reasons and our draft decision formula are set out in appendix I of attachment 3.

We also do not accept APTNT's proposal to make the tariff notification it submits to the AER for approval 50 days before its implementation of a draft notification. APTNT proposed this as a draft because a key input—the Australian Bureau of Statistics (ABS) March quarter consumer price index—is not available until after this time.²⁰ It proposed that a subsequent updated tariff notification would be provided once the March quarter CPI became available. Such practice has been undertaken in the current access arrangement period.

We consider this process is administratively inefficient. We are now adopting a December quarter CPI in place of the March quarter, meaning that a 50 business day's submission now works without administrative headaches.²¹ Only one tariff variation will

¹⁸ NGR, r. 92(2).

¹⁹ APTNT, *Access arrangement for the Amadeus Gas Pipeline: 1 July 2016 to 30 June 2021*, August 2015, cl. 4.7.1; APTNT, *Amadeus Gas Pipeline access arrangement revision proposal submission*, August 2015, pp. 174–175.

²⁰ APTNT, *Access arrangement for the Amadeus Gas Pipeline: 1 July 2016 to 30 June 2021*, August 2015, cl. 4.7.2; APTNT, *Amadeus Gas Pipeline access arrangement revision proposal submission*, August 2015, p. 173.

²¹ As the same timing of CPI escalation will be used for the RAB roll forward at the next regulatory reset for APTNT in 2021, this change will allow us to update the actual CPI for RAB roll forward purposes well before the publication date of the AER's decision at the next reset. We note that there will be an overlapping issue of the March quarter CPI when the transition to the December quarter CPI occurs (this will occur in the 2017–18 tariff variation

now be required. We note this approach is consistent with the timing of CPI escalation for other gas distribution networks such as ActewAGL and Jemena Gas Networks (New South Wales).

Our draft decision also includes an adjustment factor in APTNT's reference tariff variation mechanism to accommodate additional variations to the reference tariff for an approved cost pass through event. This inclusion will allow a transparent and administratively simple approach to making these adjustments. The adjustment factor we have included is consistent with that applied for other gas distribution networks such as ActewAGL and Jemena Gas Networks (New South Wales). Our draft decision pass through adjustment factor formula is set out in Figure 11.2.

We have also made some minor changes to the definitions for some parameters within the tariff variation mechanism. These include changing the reference to the upcoming financial year from year n to year t . These changes create consistent references to definitions of tariff variation mechanism parameters across gas distributors in the national gas market.

Reference tariff variation mechanism formula

Our draft decision reference tariff variation mechanism formula, including the above mentioned amendments is set out in Figure 11.1.

Figure 11.1 Reference tariff variation mechanism formula

$$\text{Reference Tariff}_t = \text{Reference Tariff}_b \times \frac{\text{CPI}_t}{\text{CPI}_b} \times \prod_{j=1}^t (1 - X_j) \times (1 + \text{PT}_t)$$

where:

$\text{Reference Tariff}_t$ is the Reference Tariff for the year t

t is the year in which the adjusted Reference Tariff is to be applied

$\text{Reference Tariff}_b$ is the Reference Tariff for the Firm Service for the year 2016–17

CPI is the ABS CPI All Groups, Weighted Average of Eight Capital Cities. If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

CPI_t is the ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year $t-1$

proposal). This is because the CPI for the March quarter 2017 will be reflected in both 2016–17 and 2017–18 prices. However, we consider this is only a transitional issue and will not have a material impact on the APTNT's tariffs or revenue.

CPI_b is the ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year 2015–16

X is the X factor for each financial year of the 2016–21 access arrangement period as determined in the PTRM as approved in the AER's final decision, and annually revised for the return on debt update calculated for the relevant financial year during the access arrangement period in accordance with that approved in the AER's final decision.

$\prod_{j=1}^n (1 - X_j)$ is the product of X factors calculated as follows:

where

n is the number of X factors

- for 2017–18, $n=1$, and

$$\prod_{j=1}^n (1 - X_j) = 1 - X_{2017-18}$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18

- for 2018–19, $n=2$, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19

- for 2019–20, $n=3$, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})(1 - X_{2019-20})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19, and $X_{2019-20}$ is the X factor for 2019–20 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2019–20

- for 2020–21, $n=4$, and

$$\prod_{j=1}^n (1 - X_j) = (1 - X_{2017-18})(1 - X_{2018-19})(1 - X_{2019-20})(1 - X_{2020-21})$$

where $X_{2017-18}$ is the X factor for 2017–18 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2017–18, and $X_{2018-19}$ is the X factor for 2018–19 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2018–19, and $X_{2019-20}$ is the X factor for 2019–20 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2019–20, and $X_{2020-21}$ is the X factor for 2020–21 as determined in the PTRM as approved in the AER's final decision after revision for the return on debt for 2020–21

PT_t is the cost pass through factor for financial year t calculated as outlined below.

Pass through adjustment factor

Our draft decision pass through adjustment factor formula is set out in Figure 11.2.

Figure 11.2 Pass through adjustment factor formula

$$PT_t = \frac{(1 + PT'_t)}{(1 + PT'_{t-1})} - 1$$

where:

PT_t is:

- zero when financial year t–1 refers to financial year 2016–17
- the value of PT'_t determined in the financial year t–1 for all other financial years in the access arrangement period

and

$$PT'_t = \frac{AP_t}{(1 + CPI)(1 - X_t) \sum_{j=1}^n p_{t-1} q_{t-2}}$$

where

AP_t is:

- any determined pass through amount that the AER approves in whole or part in financial year t; and/or
- any pass through amounts arising from pass through events (as that termed is defined in the access arrangement applying to APTNT in the immediately prior

access arrangement period) occurring in the immediately prior access arrangement period that APTNT proposed to pass through in whole or in part in financial year t ,

CPI_t is the annual percentage change in the Australian Bureau of Statistics (ABS) CPI All Groups, Weighted Average of Eight Capital Cities from the December quarter in year $t-2$ to the December quarter in year $t-1$, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year $t-1$

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in financial year $t-2$

minus one.

If the ABS does not, or ceases to, publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

X_t means the X factor for each financial year of the 2016–21 access arrangement period as determined in the PTRM as approved in the AER's final decision, and annually revised for the return on debt update calculated for the relevant financial year during the access arrangement period in accordance with that approved in the AER's final decision

p_{t-1} is the prevailing reference tariff in year $t-1$

q_{t-2} is the audited quantity of component reference tariff that was sold in year $t-2$ (expressed in the units in which that component is expressed, e.g. GJ)

t is the financial year for which the reference tariff is being set.

11.4.2 Cost pass through events

This section sets out our reasons for:

- not approving the proposed regulatory change event as currently defined, and requiring amendments to the definition
- not approving the proposed service standard event as currently defined, and requiring amendments to the definition
- approving the proposed tax change event as currently defined
- not approving the proposed terrorism event as currently defined, and requiring amendments to the definition
- not approving APTNT's proposed natural disaster event as currently defined, and requiring amendments to the definition

- not approving the proposed insurer credit risk event as currently defined, and requiring amendments to the definition
- not approving the proposed insurance cap event as currently defined, and requiring amendments to the definition.

As set out below we have taken into account the considerations discussed in section 11.3.1 in assessing the pass through events proposed for the Amadeus pipeline.

11.4.2.1 Regulatory Change Event and Service Standard Event

We do not approve the regulatory change event and service standard event in the form APTNT proposed.

These events allow APTNT to recover costs associated with regulatory and legislative changes that apply to the Amadeus pipeline.

We consider that these events meet the criteria in our assessment approach, namely that they would not be covered by another category, that the nature or type of event can be clearly identified and that APTNT has limited ability to prevent or mitigate the event. As noted in section 11.3.1, how much the service provider controls the event or the impact of the event is a factor in our pass through decision. Where the service provider has little control over whether or not the risk occurs or the cost impact of the event, it is generally desirable to insulate that party from the risk.

Events of this nature have also been consistently approved in other gas access arrangement reviews²² and are prescribed pass throughs events in the NER.²³

However, the definitions APTNT has proposed for these events differ from those approved in our recent access arrangement decisions and those prescribed in the NER for electricity transmission service providers. The latter were developed by the AEMC to achieve consistency with the NEO. The NEO and the NGO are sufficiently similar that a regulatory change and service standard event that is consistent with the NEO will also be consistent with the NGO. Where a pass through event is approved for multiple service providers to address the same risk, we also consider it preferable that the event be defined consistently.²⁴

We therefore require APTNT to amend its definitions of the regulatory change event and service standard event as follows:

Regulatory change event

A change in a regulatory obligation or requirement that:

- (a) falls within no other category of pass through event; and

²² For example, our June 2015 decision on the access arrangement for Jemena Gas Networks (NSW) Ltd.

²³ NER, cl. 6.5.10.

²⁴ NGR, r. 97(3)(d).

- (b) occurs during the course of an access arrangement period; and
- (c) substantially affects the manner in which the Service Provider provides the Firm Service; and
- (d) materially increases or materially decreases the costs of providing those services.

Service standard event

A legislative or administrative act or decision that:

- (a) has the effect of:
 - (i) substantially varying, during the course of an access arrangement period, the manner in which a Service Provider is required to provide the Firm Service; or
 - (ii) imposing, removing or varying, during the course of an access arrangement period, minimum service standards applicable to the Firm Service; or
 - (iii) altering, during the course of an access arrangement period, the nature or scope of the Firm Service, provided by the service provider; and
- (b) materially increases or materially decreases the costs to the service provider of providing the Firm Service.

In both cases, this amendment has the effect of requiring that the impact of the event on the manner in which the reference service is provided is *substantial*.

11.4.2.2 Tax Change Event

A tax change event would allow APTNT to pass through costs resulting from the change, removal or imposition of a relevant tax applying to the Amadeus pipeline. We accept this event, as defined by APTNT. A service provider's ability to mitigate the cost impacts of such an event is limited. APTNT's proposed definition is consistent with the definitions approved in recent decisions by the AER, and with the tax change event prescribed tax change event under the NER.

11.4.2.3 Terrorism Event

A terrorism pass through event would allow APTNT to apply to pass through costs resulting from an act of terrorism. We consider the inclusion of a terrorism event in the 2016–21 access arrangement for the Amadeus pipeline supports the NGO and RPP. However, we have substituted our preferred definition of this event for that proposed by APTNT. This definition reflects our approach in recent decisions.

If a pass through event of this kind were to occur, in assessing an application to pass through costs, we would consider the efficiency of decisions made and actions taken in relation to the risk of the event for the Amadeus pipeline. We would consider, amongst other things, whether insurance has been taken out in respect of the event, the level of insurance an efficient and prudent service provider would obtain in respect of the event and whether a declaration has been made by a relevant government authority that a terrorism event has occurred. This gives the service provider an incentive to mitigate the risks associated with the event including through acquiring an appropriate level of

insurance and implementing other practical risk minimisation strategies in its operations. We consider the incorporation of these factors into the event definition (as we have done in the amended definition below) is important as they provide transparency and increase regulatory certainty around how we will assess an application for this event.

We note in this context that there may be some overlap between a terrorism event and an insurance cap event. However, we accept the case for having both because a service provider may incur costs in a terrorism event that an insurance policy would not ordinarily cover.

For the reasons above, we require APTNT to amend its definition of the terrorism event as follows:

Terrorism Event

Terrorism Event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which materially increases the cost to the Service Provider in providing a Firm Service.

Note for the avoidance of doubt, in making a determination on a Terrorism Event, the AER will have regard to, amongst other things:

- i. whether the Service Provider has insurance against the event;
- ii. the level of insurance that an efficient and prudent service provider would obtain in respect of the event; and
- iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

11.4.2.4 Natural Disaster Event

This pass through event would allow costs associated with provision of services through the Amadeus pipeline in response to natural disasters to be passed through to consumers.

We consider that inclusion of a natural disaster event is consistent with the NGO and RPP. However, we have substituted our preferred definition of this event for that proposed by APTNT.

In particular, we have included in our definition the requirement that the fire, flood or other event was not a consequence of the acts or omissions of the Service Provider.

Consistent with our approach in recent decisions, we note that if a pass through event of this kind were to occur, in assessing an application to pass through costs, we will consider the efficiency of the service provider's decisions and actions in relation to the

risk of the event. We would consider, amongst other things, whether the service provider has insurance for the event, the level of insurance an efficient and prudent service provider would obtain in respect of the event and whether a declaration has been made by a relevant government authority that a terrorism event has occurred. This provides an incentive to mitigate the risks associated with the event including through acquiring an appropriate level of insurance and implementing other practical risk minimisation strategies in its operations. We consider incorporation of these factors into the event definition (as we have done in the amended definition below) is important as they provide transparency and increase regulatory certainty around how we will assess an application for this event.

For the reasons above, we require APTNT to amend its definition of the natural disaster event as follows:

Natural disaster event

Any major fire, flood, earthquake, or other natural disaster that occurs during the access arrangement period and materially increases the costs to Service Provider in providing the Firm Service, provided the fire, flood or other event was not a consequence of the acts or omissions of the Service Provider.

The term ‘major’ in the above paragraph means an event that is serious and significant.

Note for the avoidance of doubt, in making a determination on a Natural Disaster Event, the AER will have regard to, amongst other things:

- (a) whether the Service Provider has insurance against the event
- (b) the level of insurance that an efficient and prudent service provider would obtain in respect of the event, and
- (c) whether a relevant government authority has made a declaration that a natural disaster has occurred.

11.4.2.5 Insurer Credit Risk Event

This event would allow costs associated with the insolvency of an insurer to be passed through to customers. We consider that inclusion of an insurer credit risk event is consistent with the NGO and RPP. However, we have substituted our preferred definition of this event for that proposed by APTNT and included in its current access arrangement for the Amadeus pipeline.

In the event of the unanticipated collapse of an insurance provider, a service provider that acts prudently and efficiently could still incur material costs. The service provider may therefore still potentially suffer a significant loss as a consequence of an insurer becoming insolvent and thereby unable to satisfy all insurance claims. Service providers are also limited in the extent to which they can avoid such losses, short of taking out multiple insurance policies to cover the same risks. We accept that the options available to service providers to manage these risks are limited, and given the

rarity of such events, may in fact result in greater expenditure on insurance than is prudent or efficient.

We therefore accept that an insurer credit risk event can be consistent with the NGO and RPP, if appropriately defined. We consider a targeted definition of this event—which makes clear that in assessing a pass through application we will have regard to the importance of a service provider reviewing and considering the viability of its selected insurer—will maintain incentives on APTNT to take prudent and reasonable actions in relation to insurance.

In its proposed definition for this event, APTNT sought to include provision for it to pass through costs associated with changes to insurance premiums as a result of an insurer becoming insolvent.²⁵ This is consistent with the insurance cap event approved for the current access arrangement for the Amadeus pipeline. In more recent decisions, however, we have reconsidered this position. Noting that insurance premiums are a typical business expense, subject to ordinary market factors in the economy,²⁶ we now consider this element of the proposed event transfers a risk that the service provider is best placed to manage to its users.

We therefore do not accept APTNT's proposed definition of this event, and have substituted a narrower definition that excludes these costs. This is consistent with our more recent assessments of such events.

We require APTNT to amend its definition of the insurer credit risk event as follows:

Insurer credit risk event

Insurer Credit Risk Event means an event where:

- (a) A nominated insurer of the Service Providers becomes insolvent, and as a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, the Service Provider:
 - i. is subject to a higher or lower claim limit or higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or
 - ii. incurs additional costs associated with self-funding an insurance claim, which would otherwise have been covered by the insolvent insurer.

Note for the avoidance of doubt, in making a determination on an Insurer Credit Risk Event, the AER will have regard to, amongst other things:

- i. the Service Provider's attempts to mitigate and prevent the event from occurring by reviewing and considering

²⁵ APTNT, *Amadeus Gas Pipeline Access Arrangement – August 2015*, p. 19.

²⁶ AER, *Final decision: Jemena Gas Networks 2015-20, Attachment 11 – Reference tariff variation mechanism*, June 2015, p. 19.

- the insurer's track record, size, credit rating and reputation, and
- ii. in the event that a claim would have been made after the insurance provider became insolvent, whether the Service Provider had reasonable opportunity to insure the risk with a different provider.

11.4.2.6 Insurance Cap Event

The insurance cap event allows APTNT to make a pass through application if it makes a claim under an insurance policy, and the actual costs exceed its policy limit. APTNT has proposed a revised definition of the insurance cap event to align it with the drafting for this event in the approved access arrangement for APA GasNet.²⁷

Insurance is funded through approved forecast operating expenditure (opex), which allows APTNT to acquire and maintain an appropriate level of insurance coverage. We expect a service provider to acquire prudent and efficient levels of insurance coverage commensurate with its business risk, as reflected in its approved forecast opex.

We accept that an insurance cap event protects service providers from high cost impact events which would be uneconomical to insure against. We consider consumers benefit because they are not required to fund excessive premiums where insurance, if available, would be uneconomic. Consumers then only bear the risk should an insurance cap event occur.

We therefore consider the inclusion of an insurance cap event in the 2016–21 Access Arrangement for the Amadeus pipeline supports the NGO and RPP. However, we have substituted our preferred definition for that proposed by APTNT. In particular, we have included in the amended definition the factors that we will consider when assessing an application for a pass through under this event. We consider including such factors in the definition is important as they provide transparency and increase regulatory certainty around how we will assess an application for this event.

We note if a pass through event of this kind were to occur, in assessing an application to pass through costs, we would consider the efficiency of the service provider's decisions and actions in relation to the risk of the event. We would consider, amongst other things, the level of insurance for the event and consider that in the context of the level an efficient and prudent service provider could obtain. This gives the service provider an incentive to mitigate the risks associated with the event including through acquiring an appropriate level of insurance and implementing other practical risk minimisation strategies in its operations.

²⁷ APA Group, *Amadeus Gas Pipeline Access Arrangement Information, Effective 1 July 2016-30 June 2021, August 2015*, p. 173.

This reflects our approach to insurance cap events in more recent decisions, made after the decision for APA GasNet.²⁸ Where a pass through event is approved for multiple service providers to address the same risk, we consider it preferable that the event be defined consistently.²⁹

For the reasons above, we require APTNT to amend the definition of the insurance cap event as follows:

Insurance Cap Event

Insurance Cap Event means an event where:

- (a) the Service Provider makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;
- (b) the Service Provider incurs costs beyond the relevant policy limit; and
- (c) the costs beyond the relevant policy limit increase the costs to Service Provider of providing the Firm Service.

For the purposes of this Insurance Cap Event:

- (a) the relevant policy limit is the greater of:
 - i. the Service Provider's actual policy limit at the time of the event that gives, or would have given rise to the claim; and
 - ii. the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the Access Arrangement Period;
- (b) a relevant insurance policy is an insurance policy held during the Access Arrangement Period or a previous period in which access to the pipeline services was regulated; and
- (c) the Service Provider will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of the Service Provider in relation to any aspect of the Network or the Service Provider's business

Note for the avoidance of doubt, in making a determination on an Insurance Cap Event, the AER will have regard to, amongst other things:

- i. the insurance policy for the event, and
- ii. the level of insurance that an efficient and prudent Service Provider would obtain in respect of the event.

²⁸ See, for example, *AER, Final decision: Jemena Gas Networks 2015-20, Attachment 11 – Reference tariff variation mechanism*, June 2015.

²⁹ NGR, r. 97(3)(d).

11.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable:

Revision 11.1: Amend clause 4.7.1 in the Amadeus Gas Pipeline access arrangement to be consistent with Figure 11.1 and Figure 11.2 above, as well as appendix I of attachment 3 regarding annual updates for the return on debt.

Revision 11.2: Amend clause 4.7.2 to reflect our draft decision that the tariff variation notification submitted 50 business days before the date of implementation will be the final notification and not a draft notification which is to be updated.

Revision 11.3: Replace the definitions of the following cost pass through events with those set out in section 11.4.2 of this attachment: regulatory change event, service standard event, tax change event, terrorism event, natural disaster event, insurer credit risk event and insurance cap event.