Final Decision

Roma to Brisbane Pipeline Access Arrangement 2022 to 2027

(1 July 2022 to 30 June 2027)

Attachment 6 Operating expenditure

May 2022

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on the access arrangement that will apply to APT Petroleum Pipelines Pty Limited's (APTPPL) Roma to Brisbane Pipeline for the 2022–27 access arrangement period. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 3 – Rate of return

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 9 – Reference tariff setting

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6 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses, incurred in the provision of pipeline services. Forecast opex is one of the building blocks we use to determine a service provider's total revenue requirement.

This attachment outlines our assessment of APTPPL's proposed opex forecast for the Roma to Brisbane Pipeline (RBP) for the 2022–27 access arrangement period (2022–27 period).

6.1 Final decision

Our final decision is to accept APTPPL's revised proposal total opex forecast of $103.6 million ($2021–22), including debt raising costs, for the 2022–27 period.[1] This is because our alternative opex estimate of $104.5 million is not materially different ($0.9 million or 0.9% higher) than APTPPL's revised proposal total opex forecast. Therefore, we consider that APTPPL's revised proposal total opex forecast satisfies the opex criteria,[2] and satisfies the criteria for forecasts and estimates.[3]

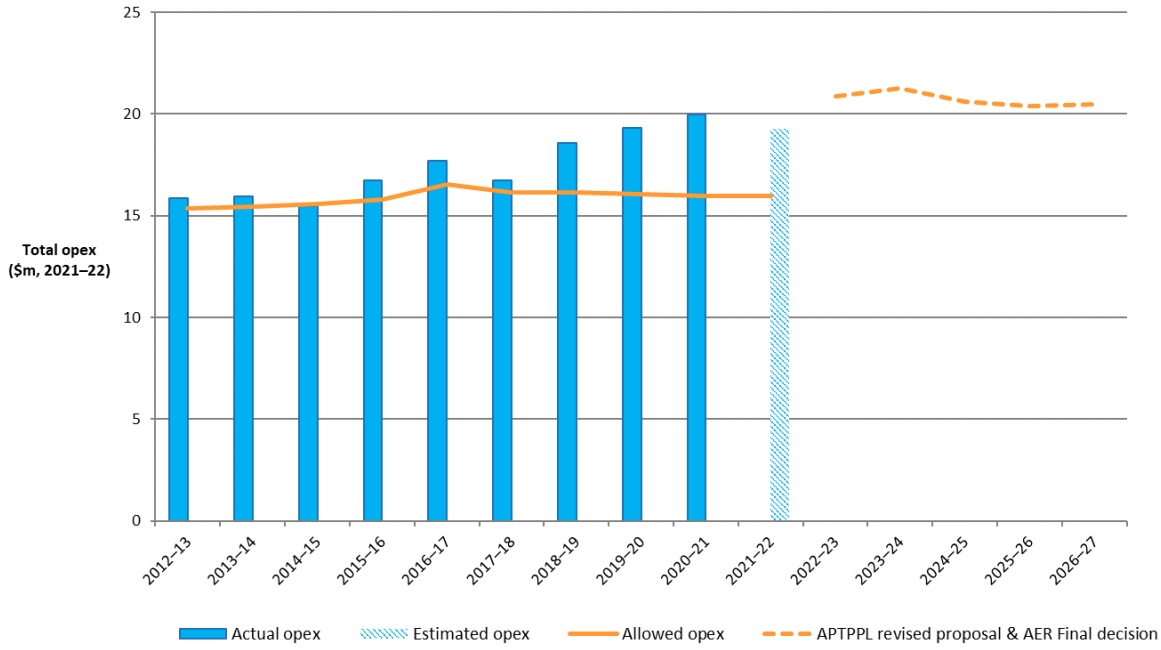
Our final decision is:[4]

- $23.3 million (29.0%) higher than the opex forecast we approved in our final decision for the 2017–22 period.
- $9.7 million (10.3%) higher than APTPPL's actual (and estimated) opex in the 2017–22 period.
- $9.4 million (9.9%) higher than our draft decision for the 2022–27 period.
- $3.9 million (3.6%) lower than APTPPL's updated initial proposal for the 2022–27 period.

Figure 6.1 shows APTPPL's actual and estimated opex, our previous approved forecast opex, and APTPPL's revised proposal.

1 APTPPL, *Roma to Brisbane Pipeline 2022–27, Attachment 8 – Forecast opex model – revised proposal,* January 2022.
2 NGR, r. 91.
3 NGR, r. 74.
4 Adjusted to real dollar terms based on June quarter CPI.

Figure 6.1 APTPPL's RBP opex over time ($ million, 2021–22)



Source: AER analysis.

Note: Includes debt raising costs

We have compared APTPPL's revised proposal, which we have accepted, and our alternative opex estimate for the final decision in Table 6.1 which shows the key differences.

Table 6.1 AER's alternative opex estimate compared to APTPPL's revised proposal ($million, 2021–22)

Opex Category	APTPPL updated initial proposal	AER draft decision	APTPPL revised proposal	AER alternative estimate	Difference (Alternative – revised proposal)
Base (reported opex in 2019–20)	92.6	94.5	92.2	96.6	4.4
Base year adjustments	–1.3	–1.3	–1.3	–1.3	–0.0
Final year increment	0.9	–0.3	0.9	–0.3	–1.2
Trend: Output growth	–	–	–	–	–
Trend: Real price growth	1.1	1.4	1.1	1.4	0.3
Trend: Productivity growth	–	–1.4	–	–1.4	–1.4
Step changes	13.0	–	9.4	8.1	–1.3
Category specific forecasts	–	–	–	–	–
Total opex (excluding debt raising costs)	**106.3**	**92.9**	**102.2**	**103.1**	**0.8**
Debt raising costs	1.2	1.4	1.4	1.4	0.1
Total opex (including debt raising costs)	**107.5**	**94.2**	**103.6**	**104.5**	**0.9**
Percentage difference to proposal					**+0.9%**

Source: APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated opex model*, 30 September 2021; APTPPL, *Roma to Brisbane Pipeline 2022–27, Attachment 8 – Forecast opex model – revised proposal,* January 2022; AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Opex model,* November 2021; AER analysis.
Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '–0.0' represent small variances and '–' represents no variance.

APTPPL's updated initial proposal included total forecast opex of $107.5 million ($2021–22) for the 2022–27 period.[5] Our draft decision adopted a lower total forecast opex of $94.2 million. The key differences between our draft decision and APTPPL's updated initial proposal were that:

- We did not include APTPPL's proposed transformation and technology step change of $13.0 million in our draft decision. This step change included costs associated with replacing existing information technology (IT) systems with cloud-based services along with cyber security and critical infrastructure security requirements resulting from the *Security Legislation Amendment (Critical Infrastructure) Bill 2020.* We did not include this step change in our draft decision as APTPPL's proposal did not provide sufficient information for us to assess the prudency and efficiency of the proposed costs.

[5] APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated opex model,* 30 September 2021.

- We included a forecast productivity growth rate of 0.5% per year in our draft decision, whereas APTPPL forecast zero productivity growth for the 2022–27 period.
- We calculated the final year increment by following the standard approach set out in our Expenditure Forecast Assessment Guideline[6], which ensures consistency between opex and the efficiency carryover mechanism.
- We included the latest consumer price index (CPI) and wage price index (WPI) forecasts, available at the time, in our draft decision.

APTPPL's revised proposal did not adopt our draft decision amendments, as noted above, to its total opex forecast. It maintained its updated initial proposal approach for the base and trend components of the opex forecast. However, it reduced its step change amount from $13.0 million to $9.4 million.

We assessed APTPPL's revised proposal by applying our 'base–step–trend' forecasting approach to develop an alternative opex estimate. In building our alternative estimate, we maintained our draft decision amendments with a few exceptions:

- We updated the inflation estimate for 2021–22 with the latest inflation forecast published by the Reserve Bank of Australia in its latest *Statement of Monetary Policy*.[7]
- We updated price growth for the latest WPI forecasts from our consultant, Deloitte.[8]
- We included a step change amount of $8.1 million, compared to zero in the draft decision.

Our draft decision opex attachment[9] provides further details on our assessment of the base and trend components of APTPPL's initial proposal, which is the same as its revised proposal.

The key difference between our draft and final decisions is our assessment of APTPPL's proposed step changes. We discuss our final decision assessment of APTPPL's revised proposal step changes for IT cloud and security of critical infrastructure (SoCI) costs in section 6.1.1 below.

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6 AER, *Expenditure forecast assessment guideline for electricity transmission*, November 2013, pp. 22–23.

7 RBA, *Statement on monetary policy, Appendix: Forecasts*, February 2022.

8 Deloitte Access Economics, *Wage Price Index forecasts*, March 2022, p. 36.

9 AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Attachment 6 – Operating expenditure*, November 2021, pp. 14–20.

6.1.1 Step changes

In developing our alternative opex estimate, we typically include step changes for cost drivers such as new regulatory obligations or efficient capex/opex trade-offs. As we explain in the Expenditure Forecast Assessment Guideline, we will include a step change if the efficient base opex and the rate of change in opex of an efficient service provider do not already include the proposed cost.[10]

APTPPL proposed two step changes totalling $9.4 million ($2021–22) for the 2022–27 period, made up of $3.8 million for SoCI and $5.6 million for IT cloud. Our alternative estimate of $8.1 million for the final decision, includes $2.5 million for SoCI and $5.6 million for IT cloud.

Based on the information available, we consider the alternative estimates of these step changes likely represent the efficient and prudent costs of meeting new regulatory obligations or represent an efficient capex/opex trade-off. We discuss our assessment of each of these step changes in further detail below.

6.1.1.1 IT cloud opex

APTPPL's revised proposal included a $5.6 million ($2021–22) opex step change for IT cloud costs. We have included this step change in our alternative estimate as we consider the capex/opex trade-off results in forecast expenditure that is prudent and efficient.

Table 6.2 IT cloud step change ($ million, 2021–22)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
APTPPL's RBP revised proposal	1.4	1.8	1.0	0.7	0.7	5.6
AER alternative estimate	1.4	1.8	1.0	0.7	0.7	5.6
Difference	–	–	–	–	–	–

Source: AER analysis.

APTPPL explained that its proposed IT cloud expenditure is associated with replacing several legacy IT systems (such as its asset management systems) which are at the end of their technical life and are unable to be replaced like-for-like due to limited or no vendor support.[11] APTPPL submitted that it is replacing its obsolete IT systems with IT cloud-based services.

APTPPL further submitted that the International Financial Reporting Interpretations Committee has clarified how arrangements in respect of a specific part of cloud

[10] AER, *Expenditure forecast assessment guideline for electricity transmission*, November 2013, p. 24.

[11] APTPPL, *Roma to Brisbane Pipeline 2022–27, Attachment 10 – Information Technology Information Paper,* January 2022, p. 5.

technology, Software-as-a-Service (SaaS), should be accounted for.[12] It has clarified that SaaS arrangements are likely to be service arrangements (opex), rather than intangible or leased assets (capex). This is because the customer typically only has a right to receive future access to the supplier's software running on the supplier's cloud infrastructure and, therefore, the supplier controls the intellectual property of the underlying software code. Accordingly, APTPPL has shifted its forecast SaaS expenditure from capex to opex.

We consider that the proposed expenditure addresses a reasonable identified need and is therefore prudent given it relates to obsolete systems which need to be replaced with cloud-based services due to lack of ongoing vendor support. This is consistent with the industry-wide move to SaaS arrangements. Therefore, we are satisfied that including this step change in our alternative opex forecast is more likely to result in an opex forecast which reasonably reflects the opex criteria and provide APTPPL with a reasonable opportunity to recover at least its efficient costs to meet its IT expenditure requirements on the RBP.

We consider that this opex substitution reduces ongoing capital investment costs associated with updating and replacing related IT systems. APTPPL has incurred $13.7 million in IT capex in the 2017–22 period.[13] We note that no IT costs were included in opex for the 2017–22 period. APTPPL provided a list of its IT programs in the current period and we consider they reflected their whole of business needs and the cost allocation was reasonable.[14]

APTPPL proposed this $5.6 million step change as a capex/opex trade-off. This increase in opex is associated with a more than proportionate reduction in APTPPL's forecast recurrent capex (i.e. it is not included in the capex forecast for the 2022–27 period). We consider that APTPPL has demonstrated a corresponding reduction to its capex to support the underlying proposition that the substitution is efficient. We have not been in a position to separately test the efficiency of the proposed step change costs by examining the market-based responses to requests for quotes. This reflects that this is a whole of business technology program and this information was not available to inform our final decision. While we would normally take this information into account as a part of our assessment, we are satisfied that APTPPL has demonstrated the case for an efficient capex/opex trade-off in this step change.

6.1.1.2 Security of Critical Infrastructure (SoCI) opex

In making this final decision, we included a step change of $2.5 million for new cyber security obligations resulting from the *Security Legislation Amendment (Critical infrastructure) Act 2021* in our alternative estimate. This is lower than APTPPL's revised proposal which included $3.8 million for SoCI costs.

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12 Ibid, p. 6.

13 APTPPL, *Roma to Brisbane Pipeline 2022–27, Attachment 6 – Transmission roll forward model,* January 2022.

14 APTPPL, *Response to Information request AER011*, 14 September 2021, pp. 4–8.

Table 6.3 SoCI step change ($ million, 2021–22)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
APTPPL's RBP revised proposal	0.8	0.8	0.8	0.8	0.8	3.8
AER alternative estimate	0.5	0.5	0.5	0.5	0.5	2.5
Difference	–0.3	–0.3	–0.3	–0.3	–0.3	–1.3

Source: AER analysis.

APTPPL's revised proposal included a step change of $3.8 million over the 2022–27 period to meet new compliance requirements under the *Security Legislation Amendment (Critical infrastructure) Bill 2020*. APTPPL assessed its new legislative requirements under the six domains as part of its Critical Infrastructure Risk Management Program (which includes enterprise security governance, personnel security, physical security and natural hazards, cyber security, and supply chain security).[15] APTPPL engaged EY to conduct a gap analysis for the Risk Management Program in relation to these domains, and to develop program costings to address the new obligations.

We note that the original *Security Legislation Amendment (Critical infrastructure) Bill 2020* was split into two separate bills. The first bill, which dealt with the cyber security requirements, became the *Security Legislation Amendment (Critical Infrastructure) Act 2021* in December 2021.[16] The second bill, which deals with the other domains listed above, became the *Security Legislation Amendment (Critical Infrastructure Protection) Act 2022* (the SLACIP Act) in April 2022.[17]

We consider the cyber security requirements under the *Security Legislation Amendment (Critical Infrastructure) Act 2021* impose new obligations in relation to the RBP. These obligations impose a major shift in the way APTPPL must operate and control the RBP. The driver for this step change is out of APTPPL's control. These obligations are expected to have a major impact as they require APTPPL to address its current non-compliance as well as to comply fully with the new obligations during the next access arrangement period. We consider that it is prudent for APTPPL to improve its cyber security maturity to comply with the new legislative and statutory obligations and agree that a step change is required to fund additional investment to achieve this outcome. We consider that the proposed expenditure addresses a legislated regulatory obligation and is consistent with the industry-wide pattern of increasing cyber security expenditure to address a critical and increasing risk. We are also satisfied that the necessary changes to achieve compliance have not been implemented in the current period and are therefore not accounted for in the base opex or rate of change. Given this, we consider this step change is prudent.

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15 APTPPL, *Roma to Brisbane Pipeline 2022–27 access arrangement, Revised proposal,* January 2022, p. 29.

16 Australian Government, *Security Legislation Amendment (Critical Infrastructure) Act 2021*, December 2021.

17 Australian Parliament House, *Security Legislation Amendment (Critical Infrastructure Protection) Bill 2022*, February 2022.

APTPPL's SoCI step change includes $2.5 million to enhance its cyber security program to comply with new regulatory obligations, including the Australian Energy Sector Cyber Security Framework. We have found no evidence of inefficiency in the proposed $2.5 million opex for APTPPL to meet its new cyber security obligations, and hence we have included this amount in our alternative opex estimate for the RBP final decision.

However, we have not included the remainder of the proposed SoCI costs ($1.3 million), which relate to domains other than cyber security, in our alternative opex estimate. These costs are associated with the potential regulatory obligations arising from the SLACIP Act. We note that APTPPL has based its RBP revised proposal on an earlier and different set of requirements of the SLACIP Bill that have now changed.

We note that the SLACIP Act requires critical infrastructure owners or operators to establish and adhere to a risk management program that addresses all 'material risks'.[18] We consider the term 'material risk' is intended to refer to risks that have a substantial impact on the availability, reliability, and integrity of the critical infrastructure asset. Our review of APTPPL's supporting information in its revised proposal concluded that APTPPL did not demonstrate that there is a material risk (excluding cyber security) that requires any change to its current risk management practices, as contemplated by the SLACIP Act. Based on this analysis, we have not included the APTPPL's proposed expenditure for domains other than cyber security in our alternative estimate. This is because we do not consider APTPPL has demonstrated the prudency of the costs associated with these domains.

While we have not included costs associated with the SLACIP Act in our alternative estimate, as discussed in section 6.1, we have accepted APTPPL's total forecast opex for the 2022–27 period for the final decision. Therefore, APTPPL's forecast costs for regulatory obligations associated with the SLACIP Act are included in our final decision.

6.2 Assessment approach

We have not changed our assessment approach for opex from our draft decision. Attachment 6 (section 6.3) of our draft decision details that approach.[19]

[18] Australian Parliament House, Explanatory Memorandum: *Security Legislation Amendment (Critical Infrastructure Protection) Act 2022*, April 2022.

[19] AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Attachment 6 – Operating expenditure*, November 2021, pp. 8–13.

A. Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
APTPPL	Australian Petroleum Pipelines Pty Limited
Capex	Capital expenditure
CPI	Consumer Price Index
IT	Information technology
NGR	National Gas Rules
Opex	Operating expenditure
RBA	Reserve Bank of Australia
RBP	Roma to Brisbane Pipeline
SaaS	Software-as-a-Service
SLACIP Act	Security Legislation Amendment (Critical Infrastructure Protection) Act 2022
SoCI	Security of critical infrastructure
WPI	Wage price index