AER Profitability Reporting
for gas pipelines

APA for Australian Pipelines and Gas Association

energy. connected.

15/05/2018

Objectives of profitability reporting

- ✓ To allow the AER to monitor performance against its regulatory determinations
- ✓ To assist the AER in assessing whether its regulatory settings are in a reasonable range

Any assessment of performance against these objectives must be conducted in the context in which they are formed.

Regulatory profitability reporting must therefore be conducted in a regulatory context

It is meaningless (and misleading!) to assess regulatory outcomes in a statutory reporting framework

Incentives

Purpose of incentives: To encourage businesses to become more efficient through cost reduction, efficient utilisation, etc

Achievement of improved profitability through successful response to incentive mechanisms should be celebrated, not punished

- **The regulatory compact provides that:**
  - the Service Provider retains any additional profit derived from the achievement of these efficiency improvements
  - the benefits of these efficiency improvements are passed through to customers over time (5 years under the Efficiency Benefits Sharing Scheme)
- **Incentives must be excised in any profitability reporting framework**
  - to derive the service provider's underlying profitability
  - to remove the temptation to confiscate those incentives through regulatory settings aimed at targeting "excess profitability"
    - This would undermine the incentives for efficiency improvement

Incentives in the gas access regime

- **The discussion paper only addresses formal incentive mechanisms**
  - EBSS, STPIS, CESS
- **The discussion paper does not address the incentives *inherent in the regime***

In particular:

- **The gas access regime purposefully incentivises increases in asset utilisation**
  - The gas access regime is a price cap regime
    - the Access Arrangement derives a Reference Tariff
  - Pipeliners are fully exposed to volume risk
  - Shippers benefit from increased volumes from the start of the next AA
    - no 5-year retention period

Revenue from volumetric outperformance must be excised from the profitability reporting if it is to meaningful in assessing underlying profitability

Mixing our drinks:
regulatory reporting against a statutory framework

- **The required arbitrary adjustments for subsidiary service providers to derive**
  - "statutory" debt and equity
  - "statutory" interest expense and
  - "statutory" tax (consider the AER's treatment of imputation credits!)
- **will render any regulatory reporting over statutory measures meaningless and misleading.**
  - Regulatory asset values were developed using economic principles – not the statutory reporting framework
    - they will never "reconcile"
    - some assets have a long history of indexation and depreciation deferral
  - Service provider subsidiaries are unlikely to be capitalised in the same way as the consolidated entity
  - Tax liability cannot be "unscrambled" where tax is assessed at the Group level

- **APA/APGA are concerned that the cost/benefit balance of this reporting has not been considered.**

The costs associated with this analysis have been virtually disregarded –
this is a new regulatory imposition with no associated regulatory impact statement.

Mixing our drinks: regulatory reporting against a statutory framework

apa

Regulatory asset values differ from statutory asset values

- **The regulatory Initial Capital Base was established through an extensive regulatory process at the commencement of the gas access regime**
  - and has been rolled forward through AER-approved processes
    - a key feature being mandatory indexation of the capital base and the associated deferral of depreciation
- **The regulatory regime also features benchmark gearing, cost of debt and equity, and treatment of tax**

This is part of the regulatory compact

Comparing revenue outcomes derived under one framework against asset and equity valuation under a different framework can only lead to meaningless results

APA/APGA cannot support any regulatory profitability reporting that assesses regulatory outcomes against a statutory reporting framework

For further information contact:

Scott Young

Regulatory Manager

(02) 9275 0031

scott.young@apa.com.au

Or visit the APA website at:

www.apa.com.au