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# Victorian Transmission System 2023-27 access arrangement. Revised Proposal

## Presentation to VTS stakeholder engagement group

31 August 2022



# Agenda

## Topics

Welcome.

Acknowledgement of Country

- 1 Overview of Revised Proposal
- 2 Context for VTS 2023-24 access arrangement  
- uncertainty & competing objectives
- 3 Brief overview of revised proposal
- 4 Accelerated depreciation – scenario modelling
- 5 Revised costs of WORM
- 6 Hydrogen safety and integrity testing
- 7 Impacts on consumers
- 8 Summary of stakeholder engagement for revised proposal

***Today's session is to inform stakeholders about APA's VTS 2023-27 revised proposal submitted on 10 August.  
And to provide opportunity for Q&A.***

# Overview of Revised Proposal

APA's revised proposal will enable VTS to continue to provide gas transmission services to two million Victorian residential gas consumers, commercial and industrial businesses in a safe, reliable, secure, and cost-effective way.

Our revised proposal acknowledges the need to adapt to an uncertain environment in the energy sector. We propose to do this by keeping options open in a prudent and nimble way.

## Building on key themes from stakeholder engagement key aspects of Revised Proposal

### Affordability

- VTS regulated revenue components has been viewed through the lens of affordability and the impact on consumers
- Reducing costs as much as possible, deferring projects
- Reduced proposed capital expenditure by 21%
- Smoothed tariff impact as much as possible.

### Security of supply, but not at any price

- Invest in what is needed and no more.
- To reduce uncertainty, supply forecasts include only projects that have reached Final Investment Decision
- We have adjusted our proposed investment in South West Pipeline in response to changes in Victorian supply conditions
- Support policy makers, AER & AEMO investigating demand management on the VTS.

### Intergenerational equity

- Shortening maximum asset lives to accelerate depreciation of assets will be more beneficial to future consumers than doing nothing
- We maintain the principle of start early, start small, and monitor towards accelerated depreciation.

### Investing under uncertainty requires flexibility

- Adapting the regulatory tools that are available to us now
- We will review asset lives and depreciation profile if there is a change in circumstances
- We propose to undertake hydrogen safety study over 10 years (rather than 5) to assess possibility of repurposing VTS pipelines.

# Context for VTS 2023-24 access arrangement – competing objectives & increasing uncertainty

During stakeholder engagement we characterised the gas market environment as becoming increasingly uncertain. At the same time as managing uncertainty for the VTS, APA was seeking to balance competing objectives.

### Balancing competing objectives

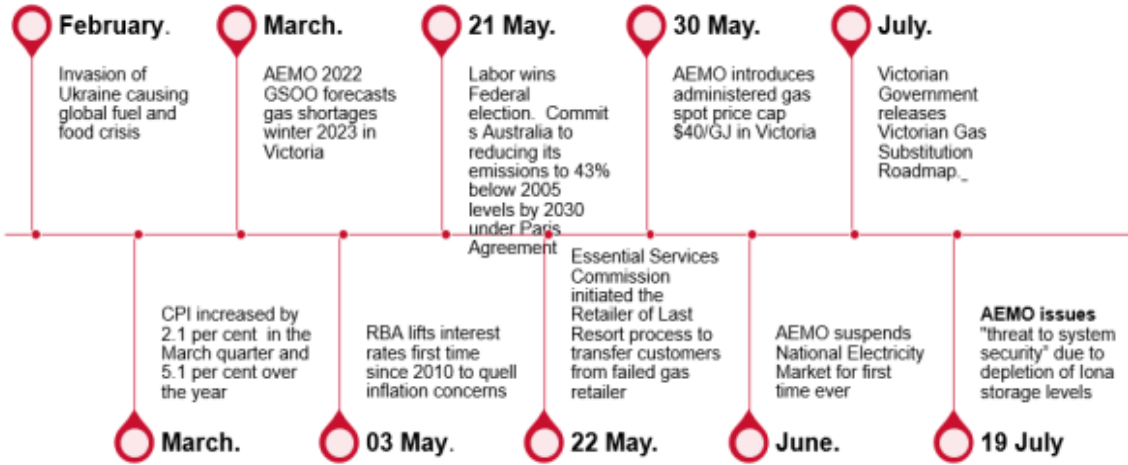
Revised proposal considered through the lens of meeting consumers needs, especially, affordability for consumers

Forecast declining consumption vs safety & security obligations; risk of asset stranding vs need for resilience in face of declining supply, legislative obligations & ageing assets



### Uncertainty in energy

Since we submitted initial proposal, fragility of the demand and supply balance in the east-coast region was revealed with a ‘perfect storm’ of events.



# Brief overview of revised proposal

	AER draft decision	Our revised proposal	Impact on consumers
<b>Inputs &amp; assumptions</b>			
<b>Demand forecasts</b>	AER used a “Progressive Change” placeholder	Propose Delayed Step Change scenario – AEMO Progressive Change scenario for the first five years (the period of this AA) then shift to AEMO Step Change scenario	Lower average tariffs for customers relative to adopting Step change scenario.
<b>Rate of Return</b>	AER applied the Rate of Return Instrument	Accepts AER approach to Rate of Return. 2022 instrument comes into effect early December 2022	Rate of return is higher relative to current regulatory period
<b>Shortening asset lives &amp; accelerating depreciation</b>	AER rejected pending further analysis	Engaged external expertise to prepare scenario analysis. Resubmitting proposal for accelerating depreciation with average remaining life of 30 years	Starting accelerated depreciation now before there is a large-scale shift by residential gas consumers to electrify will reduce costs borne by remaining gas customers
<b>Investment environment</b>			
<b>Fixed principle</b>	AER rejected; SWP and WORM not considered to be short term	We have accepted that stakeholders and AER do not support Fixed principle proposal	Less risk for customers
<b>Rule 80 pre-approval</b>	AER rejected as it had rejected SWP expansion	We have accepted that stakeholders and AER do not support rule 80 pre-approval for SWP investment We have retained the “pre-approved capex” pass through to retain flexibility	No impact Improved flexibility

# Brief overview of revised proposal

Proposed expenditure	AER draft decision	Our revised proposal	Impact on consumers
<b>Total capital expenditure</b>	AER approved \$186.3 million (\$2022) . This is 47 percent less than APA's proposed capex.	Reduced proposal capital expenditure program to \$279.7m (21%) less than initial proposal	Lower tariff and bill impact for customers
<b>Replacement (stay-in-business) capital expenditure</b>	AER forecast \$96.3 million for replacement capex (\$27m or 21.6% lower than proposed).	APA's revised forecast of \$103m is 17% lower than initial proposal	Balances meeting safety and integrity obligations and energy affordability. Proposed program costs residential customer \$1.24 per year
<b>Western Outer Ring Main</b>	AER accepted project; \$49m in 2018-22 period	Revised capital expenditure forecast is \$216 million (from \$185m). Most of this incurred in current period	WORM will improve VTS security & resilience by winter 2023. Delays in obtaining approvals, domestic & global supply issues, & cost increases issues have been detrimental
<b>South West Pipeline &amp; Winchelsea compressor</b>	AER accepted project; \$ to be determined	In response AEMO 2022 GSOO concerns, and with support from Vic government, APA submitted proposal to expediate investment for second compressor at Winchelsea (\$60.1m). APA has withdrawn initial SWP570 proposal (\$90.1m)	Improving VTS resilience and reducing the risk of gas shortfalls will help to ensure Victorian households, businesses and manufacturers have gas available to meet their needs and in particular heating needs during winter 2023 and beyond
<b>IOT: Information &amp; Operational Technology</b>	APA proposed \$10m capex & \$9.4m opex. AER forecast \$0.	Revised information to support IOT proposal. Proposing capex of \$10.1m and opex of \$8.1m	The average bill impact for residential customers is 73 cents per year
<b>Security of Critical Infrastructure</b>	AER did not accept forecast for physical security & other domains	Revised business case for SoCI physical security & other domains	Reduce risk of potentially significant impact to public safety and reduces risk of interruptions to gas supply. Bill impact for revised SoCI proposal is \$1.25 per year for residential customers
<b>Hydrogen safety &amp; integrity study</b>	AER rejected based on risk assessment	Propose to undertake hydrogen study over 10 years starting in 2023. Proposing to depreciate the study over life of pipe. Proposed capital expenditure is \$18.9 million over 2023-28	Average bill impact for residential customers is 20 cents per year with study depreciated over 30 years.
<b>Carbon offset certificates</b>	AER rejected – no legislative requirement	Includes purchase of offset certificates to offset Scope 1 emissions	Approximately 9¢ per residential customer per year

# Accelerated depreciation - scenario modelling

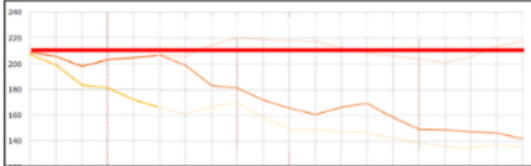
As volumes fall in an environment of recovering largely fixed costs, the inevitable result is that tariffs rise. These increases would be borne by customers that do not have resources to switch fuels, and hard to abate commercial & industrial customers.

Our goal is to take action early to avoid price increases to vulnerable customers in the future.

We engaged ACIL Allen to undertake financial modelling to ascertain what action we should undertake today, to achieve levelised capital-related costs into the future.

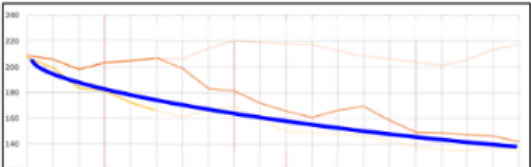
Results are sensitive to the load forecast chosen:

### AEMO's Progressive Change scenario



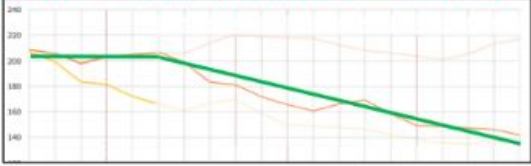
In the *Progressive Change* scenario, there is no clear benefit to accelerating depreciation today to reduce tariffs in the future

### AEMO's Step Change scenario

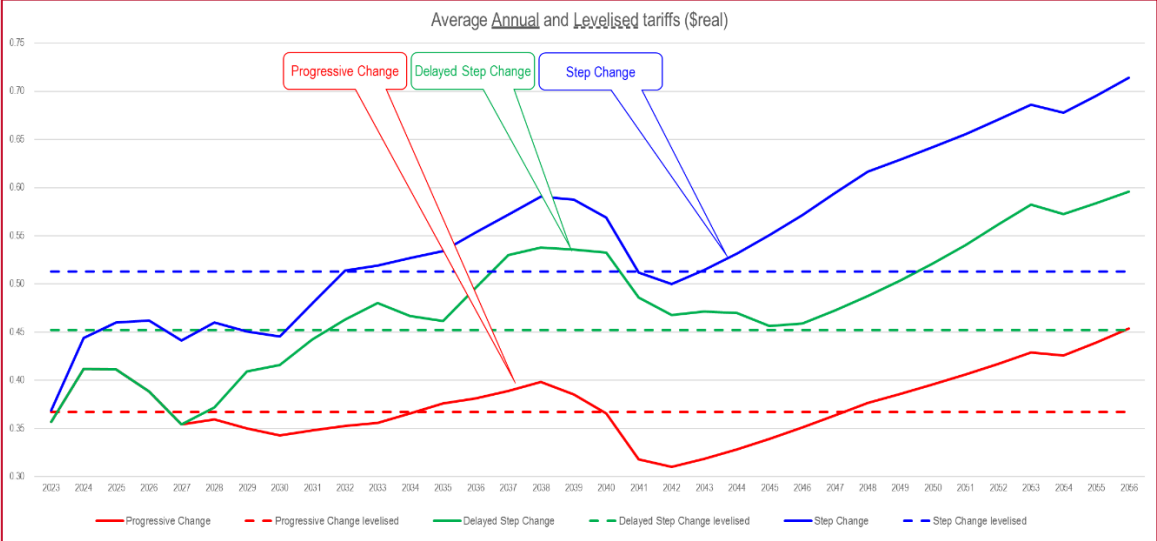


In the *Step Change* scenario, we can take steps today to reduce tariffs in the future

### Hybrid – Step Change with a 5-year policy lag



In the *Delayed Step Change* scenario, we can take steps today to deliver lower future tariffs than under the *Step Change* scenario.



ACIL Allen’s analysis indicated that we would need to accelerate depreciation delivering a tariff impact in the order of 7¢/GJ (relative to the AER draft decision) to achieve the levelised tariffs.

We propose to “start small, start early, and monitor”.

We propose to reduce the standard and remaining life of the Pipelines asset class to 30 years.

This delivers a tariff impact in the order of 2.6¢/GJ relative to the AER draft decision (\$1.44 per residential customer per year).

# Security of supply (expansion) WORM revised capital expenditure forecast

In the 2022 updated WORM business case, cost to complete the WORM was forecast at \$185 million (excluding overheads).

The revised forecast was based on the best information available at the time but had not been approved by APA Board.

We noted in the business case that there may be further changes to the forecast costs to address matters from the Environment Effects Statement (EES).

Further uncertainty was flagged because construction contracts had not been market tested and outcomes would depend on the tenders received for construction.

## Timing of capital expenditure for WORM

The timing of the forecast costs are expected to be:

\$m	2018	2019	2020	2021	2022	2023	2024	Total
<b>WORM project</b>	0.8	6.7	8.7	22.3	117.8	59.5	1.0	<b>216.8</b>

## Revised proposal

In late May 2022, APA Board approved additional expenditure for the WORM project bringing the total to \$216.8 million.

The project has incurred additional costs linked to two-year delay to prepare EES; and works to implement additional recommendations from the EES.

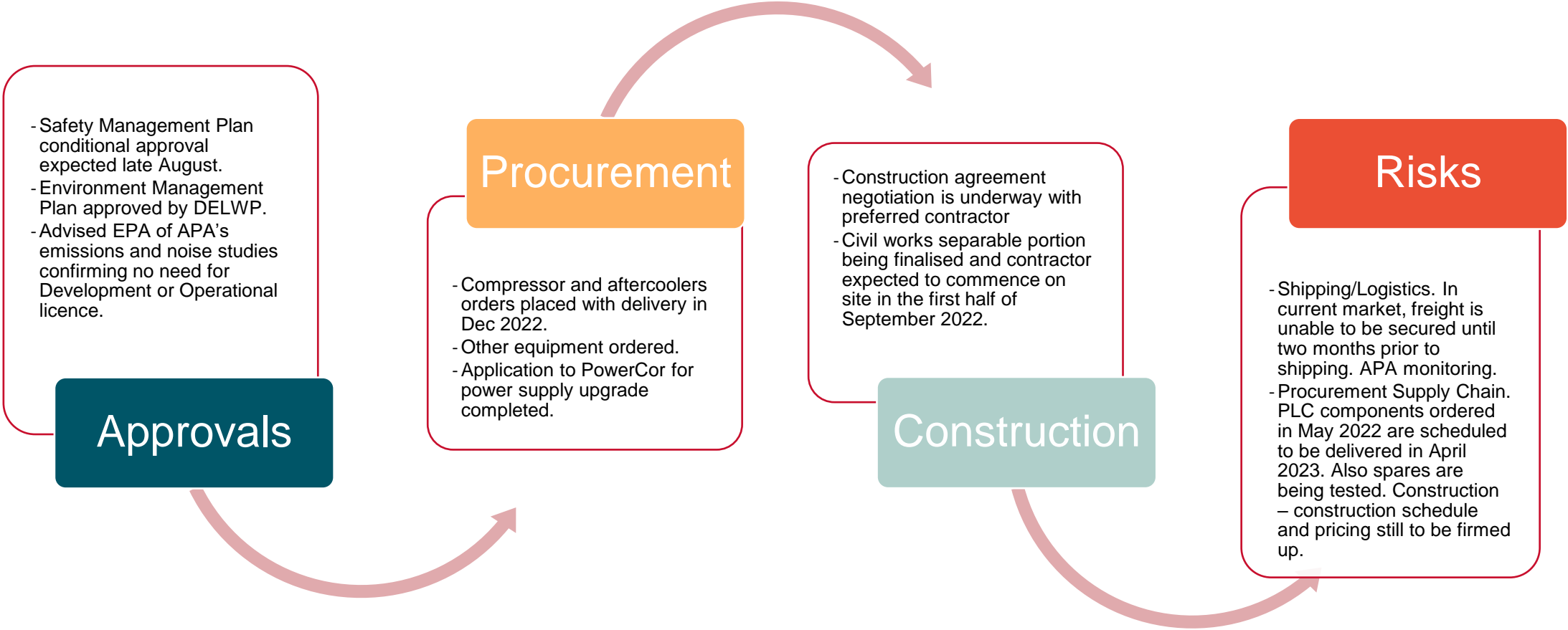
APA has gone to market for construction and other services. Current squeeze in the labour market and global supply chain backlogs are affecting the bid prices from contractors to undertake the work. This has resulted in cost increases outside of APA’s control.

There are ongoing risks associated with landowners, cultural heritage, and construction that are being managed and mitigated. These costs cannot be quantified as yet.



# Winchelsea compressor 2 - status

Project is on track for completion ahead of winter 2023, however there are numerous risks to manage and mitigate



# Hydrogen safety & integrity testing

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## Changes since initial proposal

Victorian Gas Substitution Roadmap models outcomes where natural gas is displaced by hydrogen and biomethane by 2030s and 2040s

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Victorian Government is considering a renewable gas scheme and targets to help drive investment

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Energy Safe Victoria articulated the need for a safety assessment before any hydrogen will be allowed to be introduced into a pipeline.

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AEMO supported the hydrogen study in its submission to the initial proposal

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## APA revised proposal

APA considers it would be prudent to start testing safety & integrity during 2023-27 to provide greater optionality for future energy sources

In response to stakeholder submissions and AER draft decision our revised proposal seeks to reduce bill impact on consumers. We propose to:

- undertake study over two regulatory periods, and
- depreciate to study over the life of the pipe (30 years consistent with proposed accelerated depreciation proposal).

Average bill impact of study for residential customers is 20 cents per year with study depreciated over 30 years

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# Impacts on consumers

## What's in it for consumers?

- Revised proposal minimises tariff impacts while balancing competing objectives
- Continues to ensure safety, integrity, security, and resilience of the VTS
- Looks to the future by keeping options open for hydrogen
- Whilst acknowledging changing demand for gas by seeking to accelerate depreciation of assets to reduce burden on future consumers.

	AER draft Decision	APA VTS Revised Proposal
Total revenue over 5-year period (\$m nominal)	\$610.87	\$695.98
Total Volumes over 5-year period (PJ)	1,176.12	1,176.12
Composite tariff	\$0.5194/GJ	\$0.5918/GJ
Estimated annual cost per residential customer	\$28.26 pa	\$32.19 pa
Estimated annual cost per commercial customer	\$259.70 pa	\$295.88 pa

### APA VTS revised proposal

- Total revenue over five-year period of \$696 million is \$85 million (14%) higher than AER draft decision (nominal terms)
- Composite (average) tariff of \$0.5918/GJ is 0.07 cents (14%) higher than AER draft decision (nominal terms)

### Impact on customer bills, relative to AER Draft Decision

- Average increase of \$3.95 per year to a residential customer bill relative to annual gas bill of \$1,350
- Average increase of \$36.18 per year for a commercial customer relative to annual gas bill of \$9,400.

Note that APA has not updated the AER's forecast of inflation in this revised proposal; APA is mindful that the AER will review inflation assumptions based on information at the time of their final decision

# Phase 4 stakeholder engagement – after we submitted initial proposal

If you have any further questions  
we'd be pleased to meet with you,  
or send us an email

Thank you again for your participation.

Dates 2022	Activity	Topics	IPA2
21 March	Information	<ul style="list-style-type: none"> <li>Western Outer Ring Main (WORM) Project – Business Case Update 2022</li> <li>VTS Demand Management</li> <li>Briefing note summarising stakeholder submissions to APA VTS 2023-27 access arrangement proposal</li> </ul>	Inform & consult
13 April	Roundtable 13	<ul style="list-style-type: none"> <li>Information session with AEMO presenting on 2022 GSOO/ &amp; VGPR.</li> <li>APA presented on Demand Management paper, updated WORM business case; other updates</li> </ul>	Inform & consult
25 May	Roundtable 14	<ul style="list-style-type: none"> <li>Update on expediting second Winchelsea compressor in response to AEMO 2022 GSOO &amp; Victorian government request</li> <li>Update on demand &amp; supply forecast responding the AEMO 2022 GSOO</li> <li>Discussion of stakeholder submissions</li> </ul>	Inform & consult
30 June	AER Draft Decision	AER publishes Draft Decision	
12 July	Roundtable 15	<ul style="list-style-type: none"> <li>Events since we lodged the 2023-27 access arrangement proposal</li> <li>AER Draft Decision, what the AER accepted and rejected                             <ul style="list-style-type: none"> <li>to help inform stakeholders about potential engagement topics for the next phase of the engagement</li> </ul> </li> <li>Co-designing engagement topics for APA revised proposal.</li> </ul>	Involve & consult Collaborate
15 July	APA Discussion papers	<ul style="list-style-type: none"> <li>VTS Business Narrative Discussion Paper sent to stakeholders</li> <li>VTS Load &amp; Demand Discussion Paper sent to stakeholders</li> </ul>	Collaborate
21 July	Roundtable 16	Cancelled due to widespread MS Teams outage impacting APA and other stakeholders	
25 July	AER Public Forum	Draft Decision	
28 July	Roundtable 17	<ul style="list-style-type: none"> <li>Business narrative.</li> <li>Accelerated depreciation analysis.</li> <li>Revised proposal updates on key elements</li> </ul>	Involve & consult
10 August	Revised proposal	APA VTS submitted revised proposal	
31 August	Information session	<ul style="list-style-type: none"> <li>APA revised proposal – key outcomes &amp; key elements                             <ul style="list-style-type: none"> <li>Purpose to assist stakeholders prepare submissions to VTS revised proposal</li> </ul> </li> </ul>	Inform
06 September	Submissions	Submissions on revised access arrangement proposal and draft decision	
Early December	AER Final Decision	AER publishes final decision	

**For further information**

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