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Victorian Transmission System Stakeholder Engagement Group. 2023-27 access arrangement (AA6).

Roundtable 15 – AER Draft Decision – co-designing engagement topics for APA revised proposal.

12 July 2022



Today's discussion & format

	Topics	Purpose
1	Welcome & Acknowledgement of Country	
2	What's happened since we lodged proposal	Update
3	Purpose today and of ongoing engagement	Inform
4	Recap on R13 & R14 [FYI only]	Inform
5	AER Draft Decision – summary	Involve/ collaborate
6	Word cloud	Involve/ collaborate
7	Next steps	Consult & involve

*Note that the meeting will be recorded for internal purposes only.
Video will not be distributed outside of APA, without getting your agreement.*

*We are hoping to be more collaborative.
We do encourage your views and feedback today.*

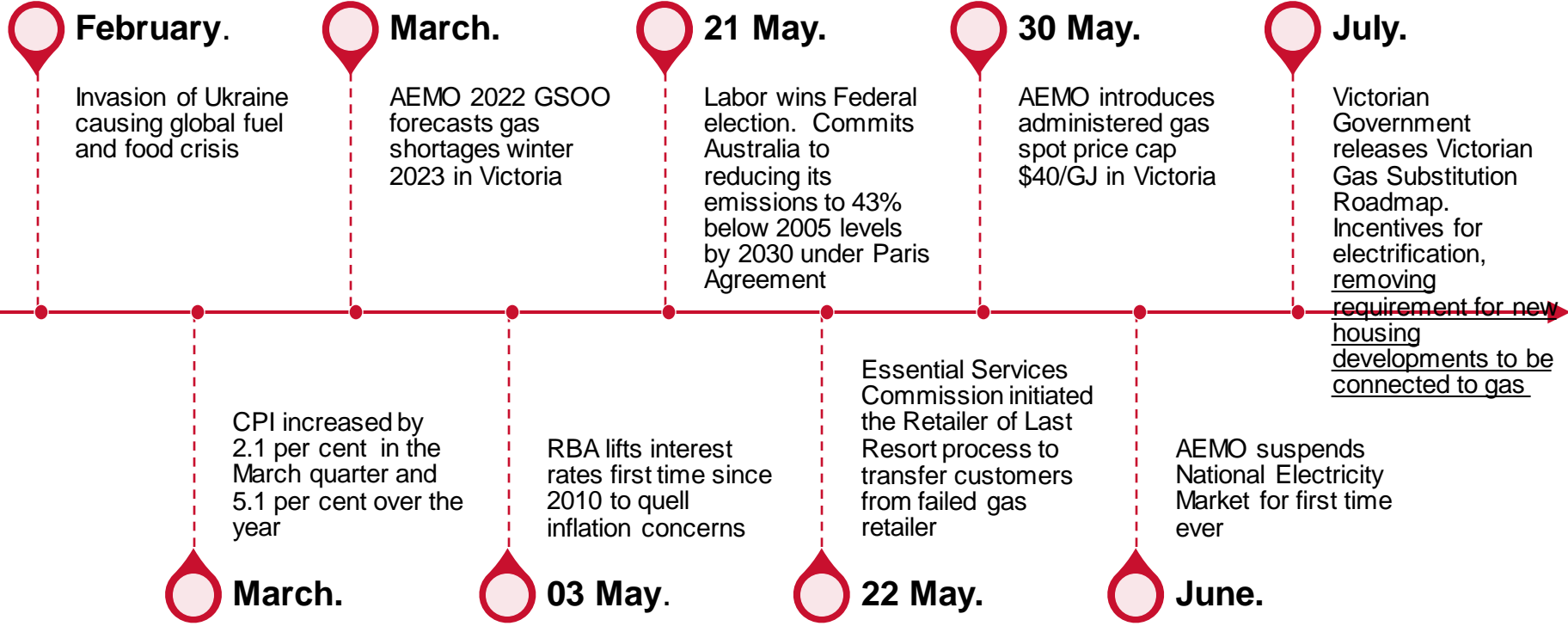
What's happened since we lodged access arrangement proposal in December 2021... and it's only July.....

Dynamic state, national and global environment impacting energy markets

Impacting on cost of living for consumers

Impacting on demand forecasts and affecting investment decision; impact on tariffs

Impacting on supply forecasts and security of supply



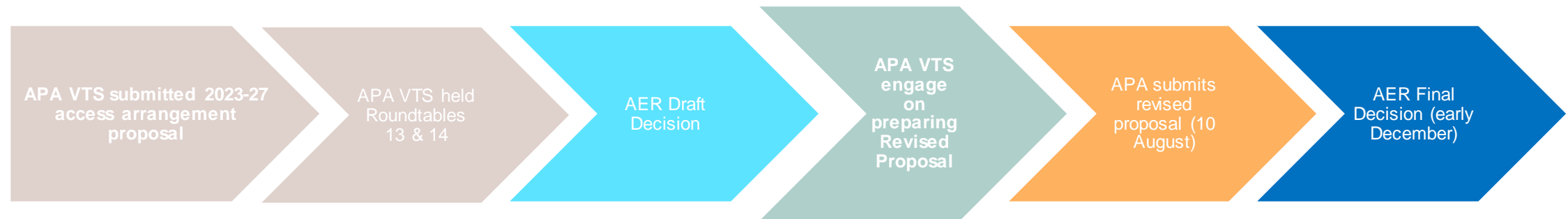
Purpose of today (and ongoing engagement)

We'll provide a summary of AER Draft Decision:

- Outcomes for consumers, and
- Key element of the Draft Decision

Get your feedback on:

1. What topics are most important to you and require further engagement?
2. What would you like to see in APA's proposal?



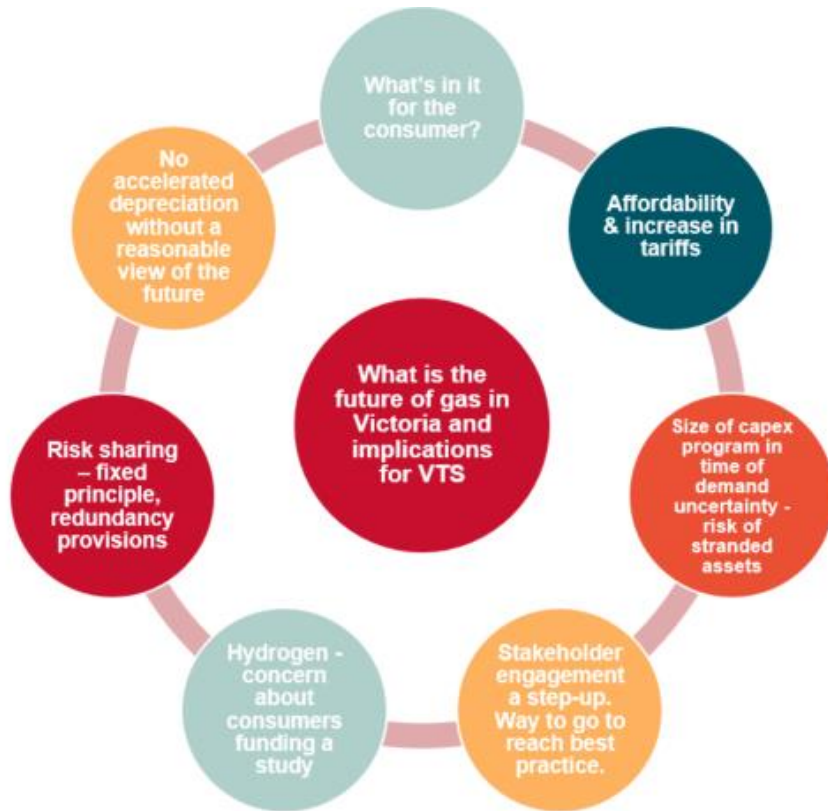
Ongoing engagement:

- R16 – Based on feedback today we'd like to co-design the topics and format for further engagement.
 - Given short time frame and constraints on stakeholder time – need to focus on things that matter most to consumers
- R17 – Collaborate on APA positions for the revised proposal.

Recap of Roundtables 13 & 14

Recap of R13. AEMO 2022 GSOO & Victorian Gas Planning Report Presentation by AEMO. Updates Demand management information paper& WORM business case

Recap of R14. Updates on Winchelsea second compressor; Updates to demand and supply forecasts; Discussion about stakeholder submissions & key themes



Stakeholder submissions & feedback during discussions

- Energy affordability an issue for all consumers
- APA to provide better analysis and information for key parts of proposal – capex and opex
- Proposal to provide more detail and better discussion about the ranging stakeholders views (eg accelerated depreciation, expansion capex)
- Reinforced concern about the size of the proposed capex forecasts and potential for customers to bear asset stranding risk
- Clarification sought about changes to South West expansion investment (Winchelsea)
- Discussion about step change vs progressive change/ Victorian Gas Substitution Roadmap potential implications; high gas prices and scope for demand destruction; impact of volume forecasts on average prices
- Discussion about demand management, and funding sources for hydrogen study.

Breakout room discussion:

- Ongoing accountability for expenditure that had been approved in AER Decisions
- South West capacity currently a constraint
- Concerns about investing in long-lived assets
- Hydrogen funding dilemma – taxpayer, consumer, proponents, APA shareholder?

Summary of AER Draft Decision (30 June 2022)

AER Draft Decision - outcomes

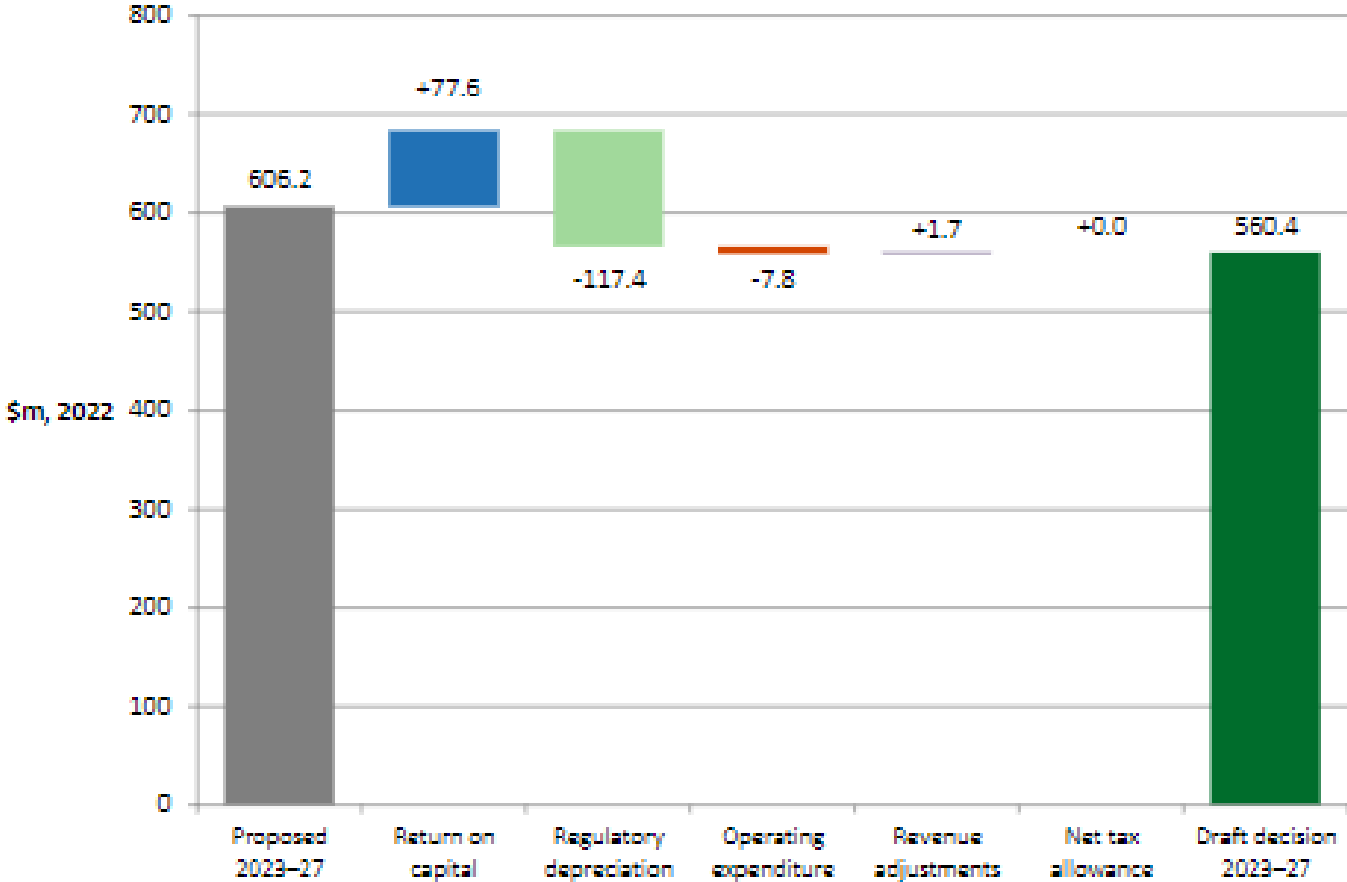
Draft decision

- AER did not accept APA VTS proposal
- AER substituted an alternative

Impact on consumers

- APA to recover \$611.5 million (\$nominal) in revenue for 2023–27 period
- This is a reduction of \$32.6 million (5.1%) from APA VTS proposal.

Figure 1 Comparison of APA's proposal and our draft decision (\$million, 2022)



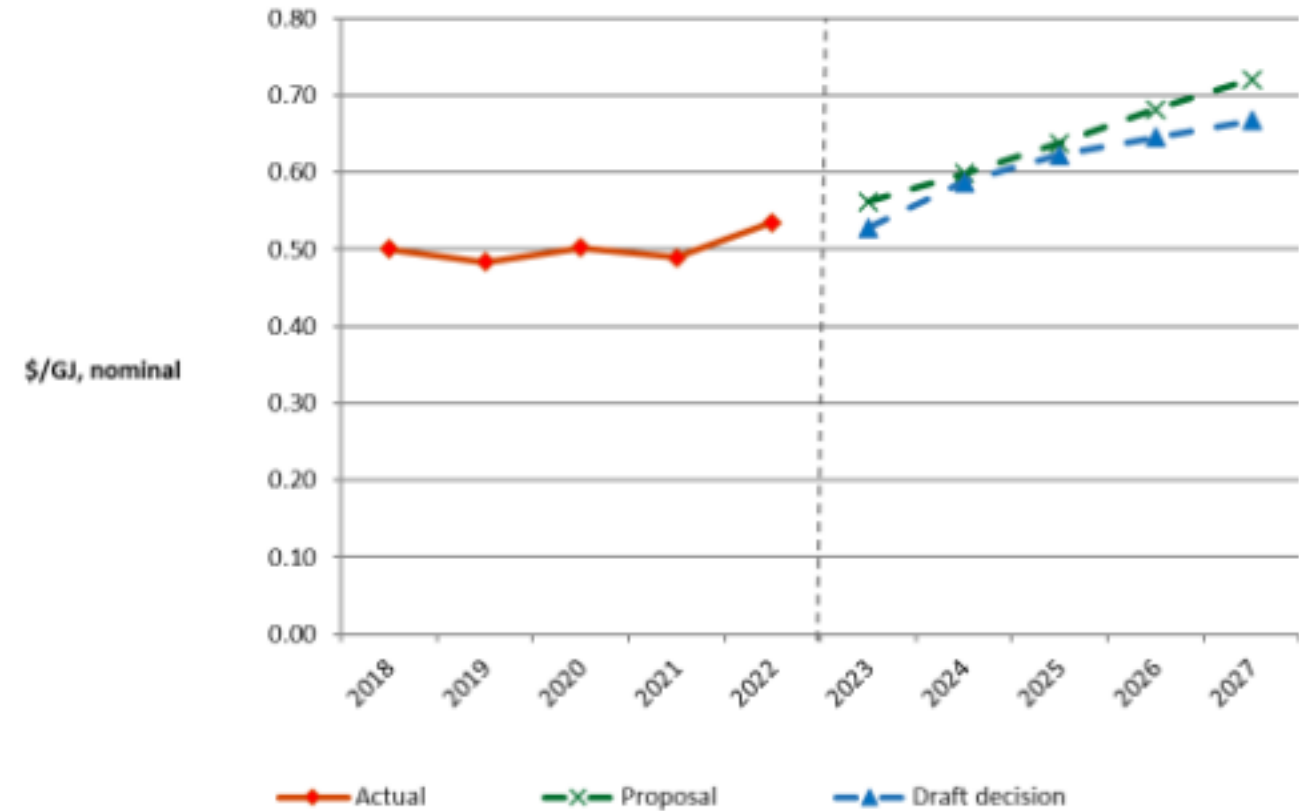
Key outcomes – outcomes

AER confirmed approval of APA VTS proposed Tariffed Transmission Service as the reference service

Average tariff outcomes

- AER draft decision – from \$0.53/GJ to \$0.67/GJ
- estimated increase of 25%
- Compared to APA proposed average tariffs from \$0.56/GJ to \$0.72/GJ
- proposed estimated increase of 37%

Figure 3 Indicative average reference tariffs from 2018 to 2027 (\$nominal)



	2023 ^a	2024	2025	2026	2027
AER's draft decision (\$, million)	108.0	116.7	126.5	130.2	130.2
Forecast volume (PJ)	204.5	198.7	203.1	201.7	195.1
Nominal price (\$/GJ)	0.53	0.59	0.62	0.65	0.67
Nominal price change	-1.2%	11.2%	6.1%	3.7%	3.4%
APA's proposal (\$, million)	116.3	122.1	128.6	134.2	142.9
Forecast volume (PJ)	207.0	204.3	201.5	196.9	198.2
Nominal price (\$/GJ)	0.56	0.60	0.64	0.68	0.72
Nominal price change	4.3%	6.4%	6.7%	6.8%	5.8%

Key elements of AER Draft Decision – inputs - demand forecasts & Rate of return on capital

APA proposal	AER Draft Decision (accept or not)
<p>Rate of return on capital. APA proposal applied the 2018 Instrument. (Proposed RoR of 4.27%)</p>	<p>TBD AER is required by the National Gas Law (NGL) and the National Gas Rules(NGR) to apply the rate of return instrument to estimate an allowed rate of return.1For this decision, we apply the current 2018 Rate of Return Instrument (2018 Instrument).</p> <p>AER placeholder allowed rate of return is 5.19 percent (nominal vanilla). This will be updated for our final decision on the averaging periods. This would apply to the first year of the 2023–27 period. A different rate of return would apply for the remaining regulatory years of the period. This is because we will update the return on debt component of the rate of return each year.</p>
<p>Demand forecasts. APA submitted updated demand forecasts based on new information in AEMO 2022 Gas Statement of Opportunity.</p> <p>APA’s demand forecast is based on AEMO’s 2022 GSOO and VGPR progressive change scenario adjusted to reflect APA expectations of injections and withdrawals on the VTS. (Discussed in R13 and R14).</p>	<p>TBD AER has included APA’s <u>updated</u> demand figures as a placeholder. AER final decision may end up accepting a step change scenario, or a hybrid, depending on the outcome of further assessment.</p>
<p>Comment. APA preparing updated information which we will share with you before we submit the revised proposal.</p>	

Key elements of AER Draft Decision – inputs – forecast scenarios

Three demand (consumption) scenarios

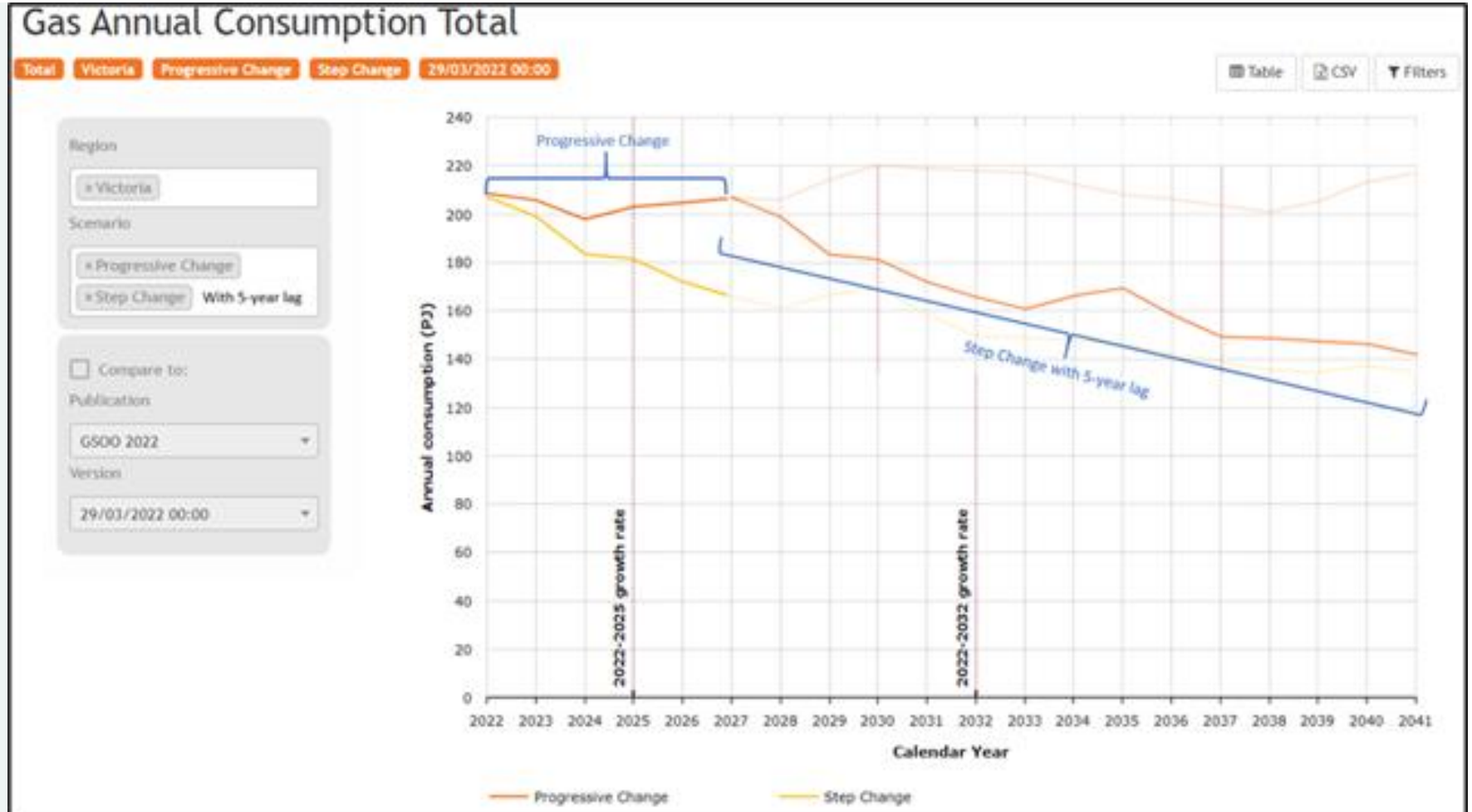
1. Step change
2. Progressive change
3. Hybrid of 1 & 2- assumes a five-year lag

Reasoning for hybrid assumptions:

- Expect lag in changes to planning requirements in Victoria and flow through to consumer behaviour
- Will developers electrify housing stock?
- Lag in consumer behaviour to switch to electric appliances (see Lynne Gallagher opinion piece)
- Consumer preferences? Will consumers choose to switch?

For discussion today

What are your views on the most likely demand scenario?



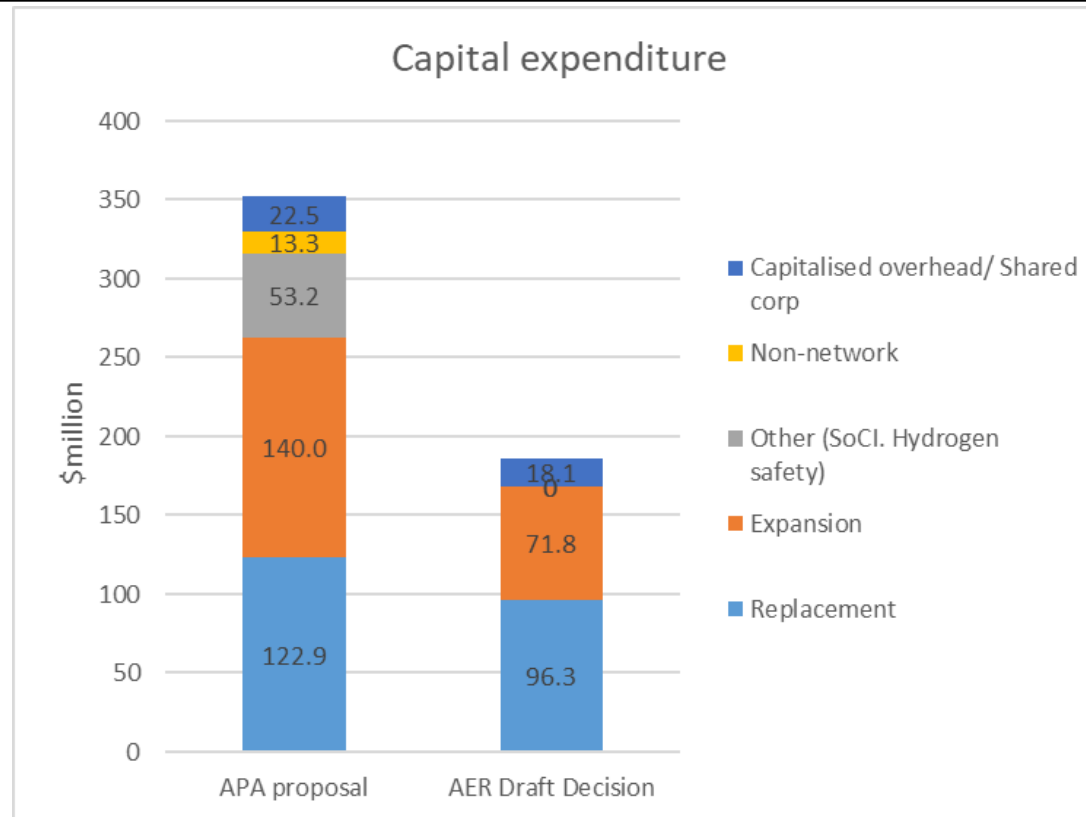
Key elements of AER Draft Decision – Depreciation

APA proposal	AER Draft Decision (accept or not)
<p>Regulatory depreciation. APA proposal included the standard asset lives for depreciating new assets associated with forecast capital expenditure (capex), and proposal to shorten standard asset lives for those asset classes with standard asset lives of greater than 30 years.</p> <p>The remaining asset lives for depreciating existing assets in the opening capital base, including the proposed shortening of the remaining asset lives for those asset classes with remaining asset lives of greater than 30 years.</p> <p>APA proposed depreciation of \$205.3 million (\$ nominal).</p>	<p>AER accepted APA's proposed straight-line depreciation but not accelerated depreciation. AER draft decision of \$81.6 million (\$ nominal) for depreciation represents a reduction of \$123.7 million (60.2%) from APA's proposed regulatory depreciation.</p> <p>✘ One of the key reasons for the decrease compared to APA's proposal is higher expected inflation rate for the 2023–27 period, which increases the adjustment for indexation of the capital base that is offset against straight-line depreciation in determining regulatory depreciation.</p> <p>AER did not accept APA's proposal to accelerate depreciation on four grounds:</p> <ul style="list-style-type: none">• the policy environment is not sufficiently clear that demand will fall to the point that stranding is a risk• the AER saw incongruity between the levels of capex and the proposal to accelerate depreciation to mitigate stranding risk• APA's proposal was based on high level principles rather than detailed modelling• APA's proposal was for a modest acceleration of depreciation – it was not clear that there was a need to move now rather than wait 5 years to the next AA review.

Comment. In discussions with AER we have undertaken to conduct scenario analysis to provide stakeholders with more information on impacts of accelerated depreciation. We have engaged ACIL Allen to undertake scenario analysis.

Key elements of AER Draft Decision – Capital expenditure forecasts

APA proposal	AER Draft Decision (accept or not)
<p>Total capex. APA proposed \$352.0 million (\$2022) total net capex for the VTS for the 2023–27 access arrangement period</p>	<p style="text-align: center;">✘</p> <p>AER approved \$186.3 million (\$2022) . This is 47 percent less than APA's proposed capex.</p> <p>AER has requested further information to support proposal.</p>



Key elements of AER Draft Decision – Expansion forecasts

APA proposal	AER Draft Decision (accept or not)	
<p>Western Outer Ring Main. APA proposed \$144.8 million (\$2022) of capex in the final two years of the current period and \$49.0 million for 2023-27.</p>	<p>Yes✓</p>	<p>AER approved \$49.0 million capex for the WORM in 2023-27 on the basis that it will provide benefits including increased gas supply and faster gas flow between the east and west systems, increased linepack storage capacity close to Melbourne to balance peaking residential and GPG demand, and reduced operating costs.</p>
<p>Winchelsea second compressor. APA original proposal included \$90.9 million for two compressors on the SWP – one at Stonehaven in 2024 and another at Pirron in 2025.</p> <p>APA submitted a revised business case to install a second compressor at Winchelsea which will increase Iona’s injection capacity to 517 TJ/d. That is, 41 TJ/d of additional gas supply capacity to the VTS during the winter peak period (from post WORM 476 TJ/d) .</p> <p>APA resubmitted proposal for a second compressor at Winchelsea based on information in the 2022 GSOO. Capital expenditure forecast to be \$60.01 million (\$37.2 million in CY2022 and \$22.81 million in CY2023).</p>	<p>Yes but \$ TBD</p>	<p>AER approved placeholder amount of \$22.8 million for the SWP based on assessment that only one compressor is prudent at this time given AEMO’s 2022 GSOO demand forecasts</p> <p>AER seeking more information on the increase in land and approvals cost in the revised proposal.</p>
<p>Fixed principle. APA also proposed the application of a fixed principle to not apply redundancy provisions to SWP or WORM.</p>	<p>✘</p>	<p>AER have not approved the fixed principle on the basis that AER did not consider SWP and WORM have a short-term use only.</p>

Key elements of AER Draft Decision - Replacement forecasts

APA proposal	AER Draft Decision (accept or not)
<p>Replacement/ stay-in-business capex. Stay-in-business. APA proposed \$122.9 million for 31 programs & projects.</p> <p>The drivers for replacement program are compliance with legislative obligations (pipeline licensing and Australian Standard for pipelines (AS2885); safety, integrity and reliability.</p> <p>Other factors impacting investment are the ageing asset and greater urban encroachment of development close to pipelines.</p>	<p style="text-align: center;">×</p> <p>Draft decision is to forecast \$96.3 million for replacement capex (\$27m or 21.6% lower than proposed).</p> <p>31 projects proposed by APA, we have approved 18, provided replacement forecasts for 3 and not approved capex for 10 of these projects.</p> <p>AER gave weight to AEMO submission which questioned need for investment in Brooklyn Compressor (units 8&9) (\$10.3m); Wollert Compressor Station A (\$1.3m), Iona Aftercooler (\$3.2m) and several other projects.</p>
<p>Comment. APA has met with AEMO to discuss projects that it had not supported. We are continuing to work with AEMO and are likely to revise our replacement capex proposal.</p>	

Key elements of AER Draft Decision – Hydrogen

APA proposal	AER Draft Decision (accept or not)
<p>Hydrogen safety & integrity study. APA proposed \$37.9 million (\$2022) in capex to undertake a technical assessment of the VTS network’s ability to withstand exposure to hydrogen blended natural gas.</p>	<p>✘ AER rejected APA’s proposed \$37.9 million capex on the basis that APA has not provided sufficient evidence of an assessment of risk, how the proposed study would mitigate it, or that its proposed costs of completing this study are efficient.</p>
<p>Comment. APA is preparing information to address AER concerns.</p>	

Key elements of AER Draft Decision – SoCI, IT

APA proposal	AER Draft Decision (accept or not)
<p>Security of Critical Infrastructure. APA proposed \$16.0 million (\$2022, including overheads) of capex for the SoCI project including cyber, physical security and programs.</p> <p>Comment. APA is preparing information to address AER concerns.</p>	<p>✘ AER considered the cyber component to be prudent. However, AER considered there was a lack of a substantive risk analysis as contemplated by the Bill Exposure Draft and as now required by the Act means that AER was unable to determine that the proposed expenditure for the physical security and program parts of the SoCI project is prudent and efficient. AER did not approve physical security and program components and have made a replacement forecast of \$0.</p>
<p>IT. APA proposed \$10.6m of capex for the VTS share of APA Group’s Information Technology Portfolio project – consisting of \$6.6m for Enterprise Program Management Office (EPMO), \$3.8m for the Operational Technology projects and \$0.3m for the Information Technology projects.</p> <p>Comment. APA is preparing information to address AER concerns.</p>	<p>✘ AER did not approve the APA proposal and made an alternative forecast of \$0 for the IT portfolio project. APA did not:</p> <ul style="list-style-type: none">• describe or provide evidence of what was obsolete or needing a routine upgrade• what was required to be cloud based or• which technologies would no longer be supported.

Key elements of AER Draft Decision – Operating expenditure forecasts

APA proposal		AER Draft Decision (accept or not)
<p>Operating expenditure. APA proposed forecast opex of \$180.3 million (\$2022). This include base year opex and step changes.</p>	<p>✘</p>	<p>AER did not accept APA proposal. Draft decision is to include alternative estimate of total opex forecast of \$172.5 million (\$2022) for the VTS.4 This is \$7.8 million (\$2022) (or 4.3%) lower than APA's proposal. AER updated opex for higher inflation and inclusion of final year increment.</p>
<p>Step changes to opex. APA proposed opex step changes of \$27.6 million. Proposing step changes for ToT (IT) of \$9.4 million; SWP & WORM opex, SoCI (\$6.6m), carbon offset certificates(\$1.5m) and increase in property tax (\$3.1m).</p>	<p>✘</p>	<p>AER included \$6.0 million of the total step change value of \$27.6 million (\$2022) proposed by APA. This included step change for WORM opex and part of SoCI opex.</p>
<p>Revised proposal. APA acknowledges comments made by stakeholders and AER. And we intend to provide more information and engagement to support our proposal.</p>		<p>AER draft decision reflects that in some cases AER did not receive sufficient information to be satisfied the proposed step changes would be incurred by a prudent service provider acting efficiently.</p>

Key elements of AER Draft Decision – Tariff structure

APA proposal	AER Draft Decision (accept or not)
<p>APA proposed the continuation of the current reference tariff structures during the 2023–27 access arrangement period.</p>	<p>Yes Accept APA’s proposed reference tariff structure for the VTS. Satisfied that it complies with the NGR requirements and is consistent with current access arrangement.</p>
<p>In nominal terms, APA proposed an increase by CPI to the ‘system-wide’ average tariff of \$0.55/GJ in 2022 to \$0.56/GJ in 2023. By 2027 the tariff was proposed/ forecast to be \$0.72/GJ.</p>	<p>✘ Quantum of the proposed initial reference tariff must be amended to reflect the draft decision on APA’s building block proposal for the VTS.</p>
<p>APA had contemplated an issues paper on tariff structures early in the stakeholder engagement but we reconsidered in light of time constraints to properly review structures.</p>	<p>VTS tariff structures and model are 20 years old and AER noted that for future access arrangement periods, APA is considering moving away from the existing VTS tariff model and tariff structure towards something more straightforward.</p>
<p>Post Final Decision. Understanding concerns about complexity of tariff structures, we intend to review pricing structures with interested stakeholders for the 2028 -2032 period.</p>	

Key elements of AER Draft Decision – Annual tariff variation mechanism

APA proposal	AER Draft Decision (accept or not)
<p>APA proposed amendment to tariff mechanism to re-introduce of the +/- 5.5% cap and collar arrangement (relating on to non-weather related volume variances).</p>	<p>✘ AER did not accept this aspect of APA proposal on basis that APA has been unable to provide further justification and modelled examples. No discernible detriment to consumers has been demonstrated from its absence in the last two access arrangement periods</p>
<p>APA proposed an extension of time for its submission of annual tariff variations for the VTS.</p>	<p>AER did not accept this aspect of APA proposal on the basis that the later submission and shorter assessment period proposed by APA would add pressure to our approval of tariffs under a uniquely complex model.</p>
<p>APA proposed a “pre-approved capex” pass through for capex approved under Rule 80.</p>	<p>AER did not accept this proposal as it did not accept the proposed Rule 80 applications.</p>

Next steps

Next steps

VTS key activities and dates

Phase 4 - After we've submitted proposal

Who	Date	Activity	Topics
APA VTS	13 April 2022	Roundtable 13	AEMO to present on GSOO/ VGPR. Other updates.
APA VTS	25/05/2022	Roundtable 14	Updates & discussion of submissions
AER	30 June 2022	AER Draft Decision	AER publishes Draft Decision
APA VTS	12/07/2022	Roundtable 15	Discuss AER Draft Decision
APA VTS	21/07/2022	Roundtable 16	To be based on key stakeholder topics. (We propose that ACIL Allen present on scenario analysis for accelerated depreciation)
AER	25 July 2022	AER Public Forum	Draft Decision
APA VTS	28 July 2022	Roundtable 17	Revised proposal - collaborating on key positions
APA VTS	10 August 2022	Revised proposal	APA VTS submits revised proposal
Stakeholders	06 September	Stakeholder submissions	Submissions on revised access arrangement proposal and draft decision
AER	Early December 2022	AER Final Decision	AER publishes final decision

Thank you for participating today!

For further information

Scott Young or Nives Matosin

E: scott.young@apa.com.au or

E: nives.matosin@apa.com.au

www.apa.com.au

apa