# ATTACHMENT 16.002
# TARIFF SETTING METHOD

## ATCO PLAN 2025-29

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# Contents

# 1. INTRODUCTION

The purpose of this document is to detail the process undertaken by ATCO to set tariff structures, individual charging parameters and the result of that process for AA6 reference tariffs.

## 1.1 How ATCO set the AA6 tariff structures

ATCO's process to set the AA6 tariff structures can be summarised as:

- Determine the over-arching tariff setting objectives – see section 1
- Determine the tariff classes – see section 3
- Allocate costs to tariff classes so that tariffs can be set to recover those costs – see section 4
- Estimate the long-run marginal cost of providing reference services so that tariffs can be set to promote efficient utilisation of the network – see section 5
- Set tariff components so the usage charge takes account of the long-run marginal cost (Chapter 5) and the costs of providing the reference service are recovered – See section 7
- Confirm that for each tariff class, the revenue expected to be recovered by the tariff charges lies between an upper bound of the stand-alone cost of providing the reference service and a lower bound of the avoidable cost of providing the reference service.

## 1.2 Factors contributing to the AA6 tariff structures

In setting tariffs for AA6 ATCO has had regard to:

- The Reference Service Proposal and Decision, which lists the reference services approved by the ERA for AA6
- Feedback from customers and retailers including the balance of cost recovery versus the step in prices from AA5 to AA6
- Regulatory precedent
- Compliance with relevant legislation including the requirements of rules 93 and 94 of the National Gas Rules
- Administrative cost
- Price signals to customers to promote efficient investment in and utilisation of the network, including ensuring that year-by-year tariff revenue approximates cost of service.

## 1.3 Summary of AA6 tariff outcomes

The reference tariff classes in AA6 will be the same as in AA5, as there are no material changes in the:

- types of haulage services required by customers in each tariff class; or
- types of customers requiring reference services.

These tariff structures are also supported by regulatory precedent. Tariff classes, based on groups of customers with similar characteristics, including the delivery facilities they require, remain unchanged from AA5. By grouping customers according to the delivery facilities, required tariffs

can be constructed to reflect the costs of serving that tariff class and provide suitable price signals.

In AA6, we are proposing to remove the first tariff band for the B3 tariff class that provides for the first 1.825 GJ to be provided at no charge. The free B3 tariff band was originally introduced in AA4 to mitigate the impact of raising the standing charge to more closely aligning with the fixed costs of providing a B3 service. By the end of the 2024, this band has been in place approaching 10 years and we note that retail tariffs were not adjusted in response to the free B3 tariff band. The market has now had time to adjust to the level of the standing charge. Removing this band also simplifies tariffs and demand forecasting. It also reduces distribution charges at average B3 tariff class consumption by $4.

The features of the AA6 tariff structures and price setting include:

- **A1 – B3:** The tariff structures across all tariff classes are a standing charge and a 2-band declining block usage tariff
- **A1:** The A1 tariff class retains a demand charge reflecting the capacity required by the customer
- **New tariff:** A new tariff has been introduced for the new ancillary reference service "Permanent Disconnection" (previously 'Demolition'). This tariff for the 'Permanent disconnection' service seeks to recover the costs of this service on a user pays basis, similar to all other ancillary reference service tariffs.
- **Price path:** To ensure appropriate price signals are sent to customers and to promote stability in future tariffs, a price path is proposed that seeks to align tariff revenue to approximate cost of service.

The sections below document how ATCO implemented the process to set tariffs for the AA6 period.

# 2. ATCO'S PRICING GOALS

In determining the tariff structures for AA6 ATCO has considered feedback received from customers. At the same time ATCO must bear in mind the National Gas Objective to "… promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas…"[1] through the price signals sent by tariffs and comply with legislated tests and regulatory requirements.

## 2.1 Customer and retailer preferences

We understand that affordability is a top priority for our customers, so we strive to keep our distribution charges as low as reasonably possible. This issue was raised throughout our customer engagement. In the current high inflation and interest rate environment, we understand that affordability is more important than ever. We are constantly looking for ways to reduce costs and improve efficiencies in our operations, and we are proud of our performance as one of the most efficient gas distribution businesses in Australia.

> … inflation and the regulatory rate of return represent over 50% of the forecast increase. For an average residential (B3) customer, the average distribution charge will increase by $78 between 2024 and 2025. If this increase is fully passed on by retailers, this represents an increase of 12% on an annual retail gas bill at the gazetted retail price.

Feedback on the Draft Plan (published April 2023) from retailers indicated mixed views on the overall price path. One retailer had a preference to smooth the transition from AA5 tariffs to AA6 tariffs with equal increases from 2025 to 2029. Whereas another retailer supported the price path in the Draft Plan as it makes it more efficient to establish multi-year contracts.

All feedback received on the Draft Plan, and ATCO's responses relevant to tariff structures, are summarised in ATCO's Plan at section 16.2.

## 2.2 Economically efficient price signals

ATCO has sought to provide economically efficient price signals by setting tariffs in a way that seeks to minimise:

- tariff variability *within* the access arrangement period.
- tariff variability *between* access arrangement periods.

ATCO has also considered the need for tariffs to:

- reflect efficient costs to provide the service; and
- provide signals to promote efficient utilisation of, and investment in the network.

Fundamentally, meeting these requirements requires that tariff revenue approximates cost of service and individual tariff charging parameters reflect the cost of providing the service.

## 2.3 Regulatory framework

The National Gas Law (NGL) includes objectives and principles that influence the approach that ATCO takes to setting reference tariffs. The associated National Gas Rules (NGR) set out a process to establish tariff classes and the tariffs for those tariff classes.

In relation to the NGL, particular regard should be had to the National Gas Objective[2] and Revenue and Pricing Principles[3].

The National Gas Objective states:

> *"The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."*
>
> *Regarding setting tariffs, the Revenue and Pricing Principles contained in sections 24(3), 24 (6) and 24(7) of the NGL are relevant because they relate to the effect tariffs can have on efficient investment in and utilisation of the network. These sections of the NGL are restated below.*
>
> *24 (3) A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides.*
>
> *The economic efficiency that should be promoted includes—*
>
> *(a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and*
>
> *(b) the efficient provision of pipeline services; and*
>
> *(c) the efficient use of the pipeline*
>
> *24 (6) Regard should be had to the economic costs and risks of the potential for under and over investment by a service provider in a pipeline with which the service provider provides pipeline services.*
>
> *24 (7) Regard should be had to the economic costs and risks of the potential for under and over utilisation of a pipeline with which a service provider provides pipeline services*

In summary, what the Revenue and Pricing Principles require is that tariffs should reflect the costs of providing reference services and provide price signals that promote efficient investment in and utilisation of the network.

Meeting the objectives and compliance with the principles, processes and requirements of the legislation is a necessary consideration when setting tariffs. The tests in the NGR provide a method to implement the NGL principles and include testing the expected tariff revenue, given the tariffs set, against the requirements that:

- for each tariff class the expected tariff revenue is between the avoidable cost and stand-alone cost of providing the reference service to that tariff class;
- in net present value terms, the total cost of service equals the expected tariff revenue; and
- the need to take account of long-run marginal cost when setting tariffs.

[2] National Gas Access Act WA (2009), Section 23
[3] National Gas Access Act WA (2009), Section 24

Furthermore, ATCO must also take account of the *National Gas Access (WA) (Local Provisions) Regulations 2009* regarding setting a uniform tariff for customers using up to one terajoule of gas and the effect on those customers as well as retailers. The *National Gas Access (WA) (Local Provisions) Regulations 2009* requires that:

- the impact on small-use customers and retailers must be taken into account; and
- uniform tariffs must be applied to small-use customers for the same service irrespective of their location.

## 2.4 Summary: tariff setting objectives

In summary, ATCO is seeking to satisfy the following objectives in setting tariffs:

- Balancing customer and retailer preferences with other tariff setting objectives
- Compliance with legislation including:
    - taking account of the impact on customers and retailers
    - meeting regulatory tests
    - taking account of long-run marginal costs
    - avoiding unnecessary administrative costs
- Recovery of the cost of providing reference services over AA6 in net present value terms
- Setting price signals to promote efficient use of and investment in the gas distribution network

# 3. TARIFF CLASSES

The reference tariff classes in AA6 will be the same as in AA5, as there are no material changes in the:

- types of haulage services required by customers in each tariff class; or
- types of customers requiring reference services.

Maintaining the same tariff classes also:

- Contributes to the stability in the bills experienced by customers
- Avoids costs associated with changing systems, including retailer systems, to accommodate changes to tariff classes

ATCO's tariff classes for haulage reference services are defined by the type of delivery facilities that are provided to certain customer groups. By grouping customers according to the delivery facilities required, tariffs can be constructed to reflect the costs related to serving that tariff class and provide suitable price signals. **Table 3-1** details the AA6 tariff classes.

**Table 3-1: AA6 tariff classes**

| TARIFF CLASS | CUSTOMER CHARACTERISTICS | DELIVERY FACILITIES |
|---|---|---|
| **A1** | Large industrial customers that use over 35TJ per year. These customers often:<br>• have direct impact on the designed capacity of the network; and<br>• are directly connected to the high pressure network. | These customers require specific facilities to supply their gas consumption including peak load requirements. |
| **A2** | Industrial and commercial customers that use 10TJ to 35TJ per year. These customers are generally accommodated within the distribution gas network, downstream of the high pressure network. | These customers require specific facilities to supply their gas consumption including peak load requirements. |
| **B1** | Smaller industrial and commercial customers that use up to 10TJ per year. These customers are generally accommodated within the distribution gas network, downstream of the high pressure network. | These customers usually require specific facilities to supply their gas consumption including peak load requirements.<br>However, there are a significant number of customers also served by a standard 18$m^3$ per hour meter. |
| **B2** | Commercial enterprises using up to 1TJ per year. This tariff class may also include some residential customers with demand requiring a meter larger than for a B3 tariff class. | Standard 12$m^3$ per hour meter. |
| **B3** | Generally, residential customers but may include some small commercial enterprises. Median consumption is in the 10GJ to 12GJ per annum range. | Standard 6$m^3$ to 10$m^3$ per hour meter. |

ATCO has a single tariff class for each ancillary reference service. The seven reference ancillary services available in AA6 can be accessed by the tariff classes detailed in the Access Arrangement and Access Arrangement Information.

# 4. COST ALLOCATION

ATCO has adopted the following method to allocate the building block costs (Total Revenue) to each tariff class:

1. Where costs are directly attributable to a tariff class they are allocated to that tariff class.
2. Where costs are not able to be directly attributed to a tariff class, operations and asset managers have used their expertise and network modelling techniques to estimate the proportion of costs required to serve an individual tariff class.

Costs have also been allocated to non-reference services in accordance with ATCO's Cost Allocation Method document.

The following sections detail ATCO's approach to allocation for each of the building blocks.

## 4.1 Return on and return of assets building blocks

Return on and return of (depreciation) building blocks relating to the forecast asset base are allocated to tariff classes based on a combination of network modelling and other bases of allocation including peak demand.

Network modelling is used to allocate pipeline and telemetry assets to tariff classes as well as pipeline pressure used and peak demand. Meters and service pipes, vehicles, equipment and IT are allocated based on tariff class delivery points. Land and buildings are allocated based on both delivery points and pipeline kilometres. Regulators and gate stations are allocated based on tariff class volume.

## 4.2 Operating cost building block

ATCO has separately considered the method to allocate the operating costs to each tariff class.

ATCO has used 2022 costs as a base to allocate operating costs to tariff classes using the following three step process:

1. Direct costs such as unaccounted for gas are directly allocated to tariff classes.
2. Maintenance activities are evaluated as to the proportion of the activities' costs that would be required for each tariff class.
3. The balance of costs by cost centre are evaluated as to the proportion of the cost centre's costs that would be required for each tariff class.

Using 2022 actual costs as a base, the proportion of total operating costs required for each tariff class has been determined. That proportion is then applied to the operating costs over AA6 to arrive at the total operating costs for each tariff class.

## 4.3 Other building blocks

The remaining elements of cost of service (working capital allowance, tax and imputation credits) are allocated proportionate to the allocation of operating costs, depreciation and return on assets.

## 4.4 Allocators adopted for indirect allocations

For the building blocks where ATCO is unable to directly attribute the cost to a tariff class, ATCO estimates the proportion of costs required to serve an individual tariff class based on nine different cost allocators.

**Table 4-1** shows examples of the cost allocators used to allocate operating costs not directly attributable to a tariff class. A weighted average of up to three cost allocators is used to allocate costs by activity or cost centre to tariff classes. Costs centres hold the balance of costs after costs have been charged out to jobs as the activities take place.

**Table 4-1: Cost allocator examples**

| TARIFF CLASS | VOLUME (ADJUSTED FOR PEAK CAPACITY) | DELIVERY POINTS | WINTER DEMAND | LENGTH OF MAINS |
|---|---|---|---|---|
| A1 | 23.9% | 0.0% | 38.2% | 2.1% |
| A2 | 3.3% | 0.0% | 6.6% | 9.6% |
| B1 | 4.3% | 0.3% | 8.1% | 10.2% |
| B2 | 5.6% | 1.7% | 4.5% | 9.3% |
| B3 | 62.9% | 98.0% | 42.7% | 68.8% |
| **TOTAL** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

## 4.5 AA6 cost allocation by tariff class

**Table 4-2:** shows the outcome of ATCO's allocation of Total Revenue in present value terms to tariff classes for AA6.

**Table 4-2: Total cost allocation by tariff class**

| TARIFF CLASS | ESTIMATED COST OF SERVICE ($M PRESENT VALUE) | TOTAL COSTS ALLOCATED (%) |
|---|---|---|
| A1 | 72.4 | 6.4% |
| A2 | 35.3 | 3.1% |
| B1 | 74.5 | 6.6% |
| B2 | 57.9 | 53.1% |
| B3 | 872.2 | 76.7% |
| Ancillary services | 24.5 | 2.2% |
| **TOTAL REVENUE PRESENT VALUE** | **1,137.8** | **100.0%** |

ATCO used the estimated cost of service per tariff class as a guide to setting the tariff revenue per tariff class.

# 5. LONG-RUN MARGINAL COST

Conceptually, long-run marginal cost (LRMC) is the additional, marginal, cost of supplying an additional unit of demand when all factors of production are variable. LRMC can be thought of as including both capital and operating expenditure.

Literature commonly discusses two methods used in regulation for assessing long-run marginal cost:

1. the perturbation (also known as the Turvey method); and
2. average incremental cost methods.

Each method involves, in one form or another, looking at the impact on costs given an increment or decrement in volume. Each method has pros and cons. Regulators have acknowledged that no matter which method is used, LRMC is only an estimate and should be used as a *guide*[4] to setting usage charging parameters (as opposed to seeking a precise value to be used in setting usage charging parameters).

## 5.1 Perturbation method adopted to calculate LRMC for AA6

ATCO is restricted to using the perturbation method because the average incremental cost method relies on there being an increase in forecast demand. In ATCO's case, in all tariff classes, demand is forecast to decrease over AA6.

The perturbation approach estimates the LRMC as the direct change in total forward-looking operating and capital expenditure resulting from a change in capacity required by:

- first, estimating forward-looking total operating and capital expenditure for each year over a time horizon of, say, ten years;
- second, re-estimating forward-looking operating and capital expenditure for each year over the time horizon as a consequence of a small but permanent increment in demand; and
- third, dividing the present value of the difference between the two forward-looking operating and capital expenditure estimates by the demand increment applied.[5]

The perturbation method can be represented by the formula:

- $$LRMC\ (perturbation) = \frac{\text{PV(revised optimal capex plus opex} - \text{optimal capex plus opex)}}{\text{PV(additional demand served)}}$$

The principal feature of the perturbation method is that it directly estimates the change in cost as a consequence of small changes in demand, which most closely resembles the theoretical 'marginal cost'. Where capital expenditure is necessarily 'lumpy', this approach considers current conditions and so will result in lower estimates of the LRMC where current capacity is sufficient to satisfy incremental changes in demand. Equivalently, it produces higher estimates of the LRMC where small changes in demand lead to bringing forward near-term investments. *This most closely resembles the price signals that promote more efficient use of network infrastructure.*[6]

ATCO has attempted to estimate LRMC using the perturbation method in two ways: by reviewing actual and forecast projects and the increased demand they were devised to serve; and by conducting a theoretical calculation of LRMC for different methods of increasing network

[4] AER, Draft Decision Multinet gas Access arrangement 2018 to 2022, Attachment 10 – Reference tariff setting, page 12
[5] NERA Economic Consulting, Economic Concepts for pricing Electricity Network Services, A report for the Australian Energy Market Commission, 21 July 2014, page 14
[6] Ibid, page 15

capacity. When calculating the LRMC for a tariff class it is important to take account of the capacity required in the network at peak loads versus average loads. For example, in the B3 tariff class it is estimated the peak load for a customer is almost seven times the average flow. Therefore, the LRMC per unit of capacity used (demand) is seven times the LRMC per unit of theoretical capacity created, because capacity must be built to meet peak loads although average usage is lower.

## 5.2 LRMC estimates for AA6

ATCO has estimated the LRMC using the perturbation method. A 10-year period was used to estimate net present values. The demand increment used is the forecast average flow for the type of asset assumed constructed. Demand was forecast to increase linearly to reach the forecast average flow in the tenth year. The results are shown in **Table 5-1**.

**Table 5-1: Long run marginal cost (Perturbation method) ($/GJ real as at 31 December 2023)**

| | A1 | A2 | B1 | B2 | B3 |
|---|---|---|---|---|---|
| Network Reinforcement (HPR) | 2.11 | 2.11 | 2.52 | 2.52 | 2.52 |
| Network Reinforcement (MPR) | | | | | 3.09 |
| Mains Extension (PE x 1km) | | | | 1.25 | 0.84 |
| Mains Extension per km (PE MAOP =<350kPa) | | | 0.84 | | |
| Mains Extension per km (PE MAOP > 350kPa) | 0.76 | 2.01 | | | |
| **AVERAGE** | **1.44** | **2.06** | **1.68** | **1.88** | **2.15** |

ATCO cross-checked these theoretical values with actual and forecast projects. The project evaluations are based on a more practical scenario where the period evaluated is 20 years and a residual value is calculated for pipeline assets. The results are in **Table 5-2**.

The table shows the range of costs calculated depends on the type of asset constructed to augment capacity. The result is also dependent on how demand was forecast to grow over the forecast period.

**Table 5-2: Long run marginal cost based on actual/forecast projects ($/GJ real as at 31 December 2023)**

| Asset Type | LRMC A1 | LRMC A2 | LRMC B1 | LRMC B2 | LRMC B3 |
|---|---|---|---|---|---|
| MP PE | 0.15 | 0.16 | 0.20 | 0.42 | 0.64 |
| MP regulator | 0.24 | 0.25 | 0.32 | 0.67 | 1.02 |
| MP regulator and mains extension | 0.29 | 0.31 | 0.39 | 0.82 | 1.24 |
| **Average** | **0.23** | **0.24** | **0.30** | **0.63** | **0.97** |

Compared to AA5 these values are lower than expected due to a smaller pool of projects on which to draw due to the relatively flat network demand creating less need for network reinforcement. The type of projects such as an MPR upgrade were less capital intensive than projects such as spurlines and mains extensions.

The results in **Table 5-1** and **Table 5-2** were further cross-checked against calculated avoidable cost per GJ based on 2022 data, noting that avoidable cost may include elements of cost such as meters and service pipes which do not vary with the marginal GJ of consumption.

The average long run marginal cost values shown in **Table 5-1** and **Table 5-2** are compared to the forecast 2025 marginal tariff in **Table 5-3**.

**Table 5-3: AA6 Long run marginal cost and avoidable cost estimates ($/GJ real as at 31 December 2023)**

| | A1 | A2 | B1 | B2 | B3 |
|---|---|---|---|---|---|
| Average perturbation method | $1.44 | $2.06 | $1.68 | $1.88 | $2.15 |
| Average LRMC forecast/actual projects | $0.23 | $0.24 | $0.30 | $0.63 | $0.97 |
| Avoidable cost | $0.07 | $0.18 | $0.46 | $0.52 | $2.30 |
| Forecast 2025 marginal usage tariff | $0.14 | $1.52 | $4.89 | $6.68 | $6.85 |

ATCO has used the data in **Table 5-3** to guide the setting of the variable tariff components for AA6. ATCO has balanced the outcomes of the LRMC analysis against the need for stability in pricing, the allocation of Total Revenue to each tariff class and the need to fully recover Total Revenue.

# 6. AVOIDABLE COST AND STANDALONE COST

ATCO is required to demonstrate the revenue to be recovered by each tariff class lies on or between[7]:

- an upper bound representing a standalone cost of providing the reference service to customers who belong to that tariff class; and
- a lower bound representing the avoidable cost of not providing the reference service to those customers.

**Standalone cost**

The standalone cost for a tariff class is the cost of supplying only the tariff class considered while all other tariff classes are not supplied. The rationale for setting standalone cost as an upper limit for the expected revenue to be recovered is that standalone cost represents the cost for a new service provider to provide an alternative service for a single tariff class. If revenue received from a tariff class was greater than the standalone cost, it would create the possibility of inefficient bypass of the existing infrastructure. Standalone costs include both sunk costs as well as forward-looking costs.

**Avoidable cost**

The avoidable cost for a tariff class is the reduction in network costs that would occur if the tariff class were no longer supplied. It is assumed all other tariff classes remain supplied. The rationale for setting avoidable cost as the lower bound for expected revenue from a tariff class is that if customers were to be charged below the avoidable cost it would be financially beneficial to stop supplying the tariff class being considered.

Avoidable cost is a forward looking concept. That is, costs that will continue to be incurred due to past network decisions cannot be avoided. For example, the costs of depreciation, funding and maintenance of pipelines already in the ground cannot be avoided, at least in the short term. Similarly, where facilities are shared among tariff classes, it is likely that avoided costs are nil or minimal as the facilities are retained, even if one tariff class is not supplied.

## 6.1 Method

ATCO has determined the standalone and avoidable costs using methods that allocate elements of the building block costs to each tariff class:

- Where costs are directly attributable to a tariff class they are allocated to that tariff class.
- Where costs are not able to be directly attributed to a tariff class, operations and asset managers have used their expertise and network modelling techniques to estimate the proportion of total costs required to serve an individual tariff class.

### 6.1.1 Operating costs

Using 2022 costs as a base, operating costs have been allocated to tariff classes on a standalone and avoidable cost basis using a three step process:

1. Direct costs such as unaccounted for gas and meter reading are directly allocated to tariff classes.

[7] Per National Gas Rule 94(3)

2. Maintenance activities are evaluated as to the proportion of the activities' costs that would be required for each tariff class.

3. The balance of costs by cost centre in each tariff class are evaluated as to the proportion of the cost centre's costs that would be required for each tariff class.

Using 2022 actual costs as a base, the proportion of total operating costs required for each tariff class on a standalone or avoidable cost basis has been determined. That proportion is then applied to the operating costs over AA6 to arrive at the standalone or avoidable operating cost.

### 6.1.2 Return on and of assets

Depreciation and return on asset costs relating to the forecast asset base at 1 January 2025 and AA6 capital expenditure, are evaluated separately as described below.

**Forecast asset base at 1 January 2025**

Network modelling is used to allocate pipeline and telemetry assets to tariff classes on a standalone basis. Meters and service pipes are allocated based on tariff class delivery points. Other asset classes are allocated based on the experience of asset and operations managers.

Depreciation and return on asset costs relating to the opening asset base at 1 January 2025 are not regarded as avoidable, being sunk costs, and so no allocation is made on an avoidable cost basis.

**AA6 capital expenditure**

Capital expenditure is allocated to tariff classes depending on which tariff classes would require that capital expenditure.

Having allocated the assets, the value of depreciation and return on assets over AA6 can be calculated applicable to each tariff class.

### 6.1.3 Other building block components

For 'standalone costs', the remaining elements of cost of service (working capital allowance, tax and imputation credits) are allocated on the same basis as used for total cost allocation. In the case of avoidable costs, the remaining elements of cost of service are allocated based on the impact of avoidable capital expenditure.

## 6.2 Estimates of avoidable and standalone cost for AA6

The elements of cost of service on a standalone or avoidable basis are added together and the net present value over AA6 calculated for comparison to the tariff class expected revenue net present value.

The expected revenue lies between standalone and avoidable costs, as shown in **Table 6-1**, and complies with NGR 94(3).

**Table 6-1: Standalone and avoidable cost ($ net present value)**

| TARIFF CLASS | STAND-ALONE COSTS | EXPECTED REVENUE | AVOIDABLE COSTS |
|---|---|---|---|
| A1 | 205.2 | 48.2 | 205.2 |

| TARIFF CLASS | STAND-ALONE COSTS | EXPECTED REVENUE | AVOIDABLE COSTS |
|---|---|---|---|
| A2 | 322.4 | 31.4 | 322.4 |
| B1 | 544.2 | 64.1 | 544.2 |
| B2 | 546.2 | 66.3 | 546.2 |
| B3 | 935.6 | 903.0 | 935.6 |
| Ancillary services | 24.5 | 23.7 | 24.5 |
| **EXPECTED TARIFF REVENUE** | | **1,136.7** | |

# 7. SETTING AA6 TARIFFS – HAULAGE TARIFFS

Having estimated LRMC as well as total cost, avoidable and standalone cost by tariff class ATCO has applied the tariff setting objectives outlined in section 2 and set tariff classes as stated in section 3 to determine the tariffs for AA6.

The process taken by ATC to determine the value of individual charging parameters is described in section 7.3.3

4. The results of this process were confirmed to comply with the NGR.

- Revenue for each tariff class was between an upper bound of the stand alone cost and a lower bound of the avoidable cost.
- The net present value of revenue equated to the net present value of cost of service over the AA6 period.
- Tariff charging parameters took account of estimated marginal cost

## 7.1 Background & Context

The final rate of return for AA5 was determined in September 2019 at a time of relatively low interest rates compared to the current interest rate environment. These higher interest rate have contributed to a significantly higher AA6 rate of return determined in accordance with the ERA's 2022 RoRI; 7.33% for AA6 compared to 4.16% nominal post tax for AA5. .

Additionally, all economies including Australia have experienced and continue to experience a period of high inflation. Inflation not only has a direct impact on prices but effects the value of the asset base which is funded.

To a lesser extent a combination of factors necessary for the continued safe operation of the network including step changes in operating expenditure (see chapter 9 of our Plan) and the adoption of accelerated depreciation due to uncertainty (see chapter 11 in our Plan). The need for accelerated depreciation has been incorporated with the aim to preserve equitable pricing into future access arrangement periods while making an initial step to reduce the risk of the cost of the asset base not being recovered.

The value of tariff parameters have been set taking into account the overall cost of service for AA6, which incorporates these cost increases. Further detail is provided in chapter 16 of our Plan.

## 7.2 Tariff structure

How tariff structures and tariff parameter values are set to recover the cost of service is discussed in more detail below.

- **Usage charges**: Usage charges reflect costs placed on the network by *additional usage*. That is, the marginal usage charge has been set taking account of long run marginal cost so that it reflects the cost of providing additional capacity. The first band of usage charges is set for an initial level of consumption to assist with recovery of cost not recovered by the marginal usage charge. Usage charges have had to be increased compared to AA5 to align cost of service and expected tariff revenue to meet the National Gas Objective of efficient use and investment in the network. Using a two band tariff structure helps reduce the barrier of a higher fixed charge to customers connecting and thus promotes the sharing of fixed costs across a larger number of customers to the benefit of all customers. Using a 2 band tariff structure is also generally consistent with the band structure of retailers creating the potential for better transmission of distribution charge price signals to end users. There is regulatory precedent for multiple usage bands in gas distribution recognising the positive incentive effects of multiple usage bands on network utilisation to the benefit of all customers.
- **Fixed charges**: The fixed charge is set to recover the cost of service *not recovered via the usage charges*. The use of fixed charges to recover this 'residual revenue' minimises the distortion to price signals and is supported by regulatory precedent.

After setting the fixed charge and other than marginal usage bands as well as the marginal usage charge the resultant expected tariff revenue by tariff class approximates the estimated costs of service by tariff class so that price signals promoting efficient investment in and utilisation of the network were created.

## 7.3 Tariff charging parameters

The following sections describe the rationale for individual charging parameters for each tariff class.

### 7.3.1 AA6 Price Path summary

The first step in calculating tariff charging parameters is to decide on a price path. We have adopted a price path that increases tariffs on 1 January 2025 with no further real tariff increase in AA6. This price path provides stability for our customers and aligns our cost with our revenue to provide efficient incentives regarding the use of and investment in the gas distribution network.

As a result, we have given primary weight to smoothing tariffs within AA6 while keeping the final year divergence of smoothed revenue and unsmoothed revenues as low as possible.

In setting this price path, we have balanced the longer-term interests of consumers with the short-term price changes. This has been achieved through the following principles:

- Unsmoothed and smoothed revenue should be equalised in net present value terms.
- Proposed tariffs should reflect their underlying efficient costs.
- Proposed tariffs should minimise tariff variability between each year of AA6.
- Minimise the likelihood of tariff variability at the start of AA7.

Adjusting tariff revenue to the approximate cost of service ensures that efficient price signals are sent to customers and efficient use of and investment in the gas network is made.

### 7.3.2 B3 reference tariff

In AA6, we are proposing to remove the first tariff band for the B3 tariff class that provides for the first 1.825 GJ to be provided at no charge.

The free B3 tariff band was originally introduced in AA4 to mitigate the impact of raising the standing charge to more closely aligning with the fixed costs of providing a B3 service. By the end of the 2024, this band has been in place approaching 10 years and we note that retail tariffs were not adjusted in response to the free B3 tariff band. The market has now had time to adjust to the level of the standing charge.

The first 1.825 GJ of consumption will have a charge in AA6. In introducing this change we have ensured that the revenue recovered through the B3 tariff class approximates the estimated cost for the B3 tariff class

After setting the tariffs for 1 January 2025 the B3 usage charges are proposed to increase at the rate of inflation so that in NPV terms the cost of service approximated expected tariff revenue.

### 7.3.3 Haulage reference tariffs

This section describes how the values of individual tariff charging parameters were determined.

1. The B3 usage band tariffs were reset for 2025 so that the revenue recovered in the AA6 single usage band up to 9.855 GJ approximated the revenue that would be recovered across the free 1.825 GJ band and from the band greater than 1.825 GJ to 9.855 GJ had there been no changes to the tariff structure.
2. Having decided on a “one step” price path with real price increases on 1 January 2025 and no further real dollar price increases during AA6 a percentage increase was applied to all tariffs to equate the present value of cost of service to the present value of AA6 revenue.
3. The results were reviewed and some minor adjustments made in light of that review to ensure that the relativities between the B2 and B3 tariffs were maintain. This resulted in some modifications to the pricing outcomes as follows:
    a) B2:
        i) After applying a fixed percentage increase to the B2 first 100 GJ usage charge it appeared to be too high relative to the B3 tariff class usage charges. It is expected higher volume gas users will on average incur lower usage charges due to the average cost per GJ being lower. Therefore, the B2 first 100 GJ usage charge was reduced $0.56 per GJ so that the AA5 relativity to the B3 first usage band tariff was maintained.
        ii) The fixed charge was increased $27 ($ real 2023). This was to offset decrease in the first usage band tariff. The adjusted standing charge was checked to the fixed costs of a B2 service estimated to be in the range of $400 to $500, for reasonableness.
        iii) Similarly, the B2 over 100 GJ usage charge was increased to maintain relativities to the B3 tariff class marginal usage band.
    b) B3
        i) The B3 standing charge was reduced by $19 ($ real 2023) which offsets the majority of the additional charges for the first 1.825 GJ. The adjusted standing charge was checked to the fixed costs of a B3 service, estimated to be in the range of $150 to $175, for reasonableness and as a means of taking into

account the impact on small-use customers and retailers as required by the *National Gas Access (WA) (Local Provisions) Regulations 2009*.

ii) B3 usage charges for the first 9.855 GJ were increased $1.50 ($real 2023) and also increased for consumption over 9.855 GJ $1.00 ($ real 2023) to offset the reduced fixed charge revenue as well as maintain usage charge relativity to the B2 usage charges.

Having calculated the individual tariff charging parameters compliance with regulatory tests was confirmed as shown in section 7.5.

A final check was done of percentage revenue by tariff class to the revenue by tariff class percentage in the AA5 final decision as shown in **Table 7-1**. This check is not a requirement of the NGL but is an additional overall reasonableness check of the tariff charging parameters.

**Table 7-1: Percentage of tariff revenue**

| Tariff Class | AA5 | AA6 |
|---|---|---|
| A1 | 4.3% | 4.2% |
| A2 | 2.7% | 2.8% |
| B1 | 5.9% | 5.6% |
| B2 | 5.8% | 5.8% |
| B3 | 79.2% | 79.4% |
| Ancillary services | 2.1% | 2.1% |
| **TOTAL** | **100.0%** | **100.0%** |

## 7.4 Indicative prices

This section details indicative prices for each tariff class over AA6. The actual prices charged in each year are likely to differ from these indicative prices due to the annual operation of the tariff variation mechanism, which allows prices to change due to inflation, the annual update for cost of debt and cost pass-through events. The tariff variation mechanism is detailed in ATCO's Access Arrangement.

Customers relying on this information to make business or investment decisions should consider the potential volatility between an indicative price and final outturn price and the risks inherent with relying on them.

**Table 7-2** shows the indicative AA5 prices for each tariff class, subject to any annual tariff variation.

**Table 7-2: AA6 Tariff charging parameters ($ Nominal)**

| CHARGING PARAMETER | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|
| **REFERENCE TARIFF A1** | | | | | |
| **Standing charge** | 56,750.79 | 58,262.41 | 59,814.29 | 61,407.50 | 63,043.15 |
| **Demand charge** | | | | | |
| First 10 km | 239.19 | 245.56 | 252.10 | 258.82 | 265.71 |
| Distance > 10 km | 125.90 | 129.25 | 132.69 | 136.23 | 139.86 |
| **Usage charge** | | | | | |
| First 10 km | 0.05059 | 0.05194 | 0.05333 | 0.05475 | 0.05620 |
| Distance > 10 km | 0.02549 | 0.02617 | 0.02687 | 0.02758 | 0.02832 |
| **REFERENCE TARIFF A2** | | | | | |
| **Standing charge** | 31,399.15 | 32,235.50 | 33,094.12 | 33,975.62 | 34,880.59 |
| First 10 TJ | 3.05 | 3.13 | 3.22 | 3.30 | 3.39 |
| Volume > 10 TJ | 1.61 | 1.65 | 1.70 | 1.74 | 1.79 |
| **REFERENCE TARIFF B1** | | | | | |
| **Standing charge** | 1,587.55 | 1,629.84 | 1,673.25 | 1,717.82 | 1,763.58 |
| First 5 TJ | 6.03 | 6.19 | 6.36 | 6.53 | 6.70 |
| Volume > 5 TJ | 5.18 | 5.32 | 5.46 | 5.61 | 5.76 |
| **REFERENCE TARIFF B2** | | | | | |
| **Standing charge** | 427.35 | 438.73 | 450.42 | 462.42 | 474.73 |
| First 100 GJ | 9.51 | 9.76 | 10.02 | 10.29 | 10.56 |
| Volume > 100 GJ | 7.08 | 7.27 | 7.46 | 7.66 | 7.87 |
| **REFERENCE TARIFF B3** | | | | | |
| **Standing charge** | 178.04 | 182.78 | 187.65 | 192.65 | 197.78 |
| First 9.855 GJ | 8.78 | 9.01 | 9.25 | 9.50 | 9.75 |
| Volume > 9.855 GJ | 7.26 | 7.45 | 7.65 | 7.86 | 8.07 |

## 7.5 Tariff Revenue

Given the above indicative tariffs, ATCO has confirmed that the expected tariff revenue:

4. in net present value terms equates to Total Revenue;
5. for each tariff class approximates the forecast Total Revenue for the tariff class; and
6. for each tariff class lies between the lower bound avoidable cost and the upper bound standalone cost over the AA6 period.
7. The results of these tests are shown in **Table 7-3**.

**Table 7-3: NGR 93 and 94(3) test results ($M present value)**

| TARIFF CLASS | TOTAL COSTS ALLOCATED | STAND ALONE COSTS | EXPECTED REVENUE | AVOIDABLE COSTS |
|---|---|---|---|---|
| A1 | 72.4 | 205.2 | 48.2 | 5.6 |
| A2 | 35.3 | 322.4 | 31.4 | 4.1 |
| B1 | 74.5 | 544.2 | 64.1 | 11.0 |
| B2 | 57.9 | 546.2 | 66.3 | 10.7 |
| B3 | 872.2 | 935.6 | 903.0 | 127.8 |
| Ancillary services | 24.5 | 24.5 | 23.7 | 21.3 |
| **TOTAL** | **1,136.7** | | **1,136.7** | |

# 8. SETTING TARIFFS: REFERENCE ANCILLARY SERVICES

The six reference ancillary services provided in AA5 have been retained in AA6. An additional reference service, 'Permanent Disconnection', has been added for AA6.

Tariffs for ancillary services are based on the cost to provide those services and to promote efficient use of the services. Tariffs for ancillary services include:

- The direct cost of operations staff and contractors providing the service.
- The direct administration cost of providing the service.
- An allocation of corporate costs such as accounting services and IT services.

**Table 8-1** shows the ancillary services tariffs.

**Table 8-1: Reference ancillary services tariffs ($ nominal)**

| Ancillary service | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|
| Apply Meter Lock | $51.87 | $53.25 | $54.67 | $56.13 | $57.62 |
| Remove Meter Lock | $21.38 | $21.95 | $22.54 | $23.14 | $23.75 |
| Deregistration Request | $138.32 | $142.01 | $145.79 | $149.67 | $153.66 |
| Disconnect Service | $130.52 | $133.99 | $137.56 | $141.23 | $144.99 |
| Reconnect Service | $180.44 | $185.24 | $190.18 | $195.24 | $200.44 |
| Permanent Disconnection | $1,184.80 | $1,216.36 | $1,248.76 | $1,282.02 | $1,316.17 |
| Special Meter Read | $10.66 | $10.94 | $11.23 | $11.53 | $11.84 |

# 9. SUMMARY

ATCO's primary considerations when setting tariff structures and tariffs, were to ensure economically efficient price signals, to acknowledge the competing preferences of customers, *stability,* compared to the preference of retailers to smooth the transition in tariffs from AA5 to AA6 and legislative compliance.

AA5 tariff structures supported by regulatory precedent have been retained in AA6 to support market stability valued by customers and to minimise transaction costs. ATCO has set tariffs for AA6 balancing several factors:

- Ensuring tariffs reflect the cost to provide services and thus provide appropriate price signals to the market.
- Regulatory compliance.
- Maintaining price stability within the AA6 period and during the transition from AA6 to AA7.

The final setting of the AA6 B3 tariffs also takes into account the impact on small-use customers and retailers as required by the *National Gas Access (WA) (Local Provisions) Regulations 2009*.