Economic Regulation Authority

Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems

Attachment 5: Operating expenditure

PUBLIC VERSION

24 April 2024

D273609

Economic Regulation Authority

Level 4, Albert Facey House

469 Wellington Street, Perth WA 6000

Telephone 08 6557 7900

Email info@erawa.com.au

Website www.erawa.com.au

This document can also be made available in alternative formats on request.

National Relay Service TTY: 13 36 77

Contents

Attachment 5. Summary iii

Regulatory requirements 1

ATCO proposal 3

Submissions 5

Draft decision 6
- Base year 6
  - Base year adjustment summary 9
- Recurrent step changes 10
  - Enabling renewable gases 10
  - Superannuation guarantee rate increase 11
  - Cyber security 12
  - Gas inspection – safety changes 14
  - Property, plant and equipment operating expenditure threshold increase 15
  - Enterprise Resource Planning (ERP) replacement 15
  - Economic regulatory changes 16
  - Recurrent step change adjustment summary 18
- Non-recurrent step changes 18
  - Pipeline in-line inspections 19
  - Access arrangement 7 and rate of return instrument regulatory preparation 19
  - Software as a service (SaaS) arrangement 20
  - Managed IT services tender renewal 22
  - Non-recurrent step change adjustment summary 23
- Output growth escalation 23
- Input cost escalation 24
- Unaccounted for gas 26
- Ancillary services 28
- Draft decision amendments summary 29

Working Capital 31
- ATCO proposal 31
- Draft Decision 32

List of appendices

Appendix 1 List of Tables 34

Appendix 2 National Gas Rules 35

Note

This attachment forms part of the ERA's draft decision on proposed revisions to the access arrangement for the Mid-West South-West Gas Distribution Systems. It should be read in conjunction with all other parts of the draft decision, which is comprised of the following document and attachments:

Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems – Overview, 24 April 2024

- Attachment 1: Access arrangement and services
- Attachment 2: Demand
- Attachment 3: Revenue and tariffs
- Attachment 4: Regulatory capital base
- Attachment 5: Operating expenditure (this document)
- Attachment 6: Depreciation
- Attachment 7: Return on capital, taxation, incentives
- Attachment 8: Other access arrangement provisions
- Attachment 9: Service terms and conditions

Attachment 5. Summary

ATCO has proposed $455.9 million total operating expenditure for AA6.[1] The estimated total operating expenditure for AA5 was $355.9 million.[2]

ATCO determined its proposed operating expenditure for AA6 using the base-step-trend method combined with specific forecasts for unaccounted for gas (UAFG) and ancillary services. ATCO used its actual operating expenditure from the most recent complete calendar year (2022) as the base to forecast its AA6 operating expenditure levels.

The ERA has considered information provided by ATCO, public submissions and findings from the ERA's technical consultant EMCa to determine the amount of operating expenditure which meets the requirements of the NGR.

Base year

ATCO's base year operating costs in 2022 were $74.7 million. ATCO then proposed to remove $8.0 million in non-recurrent expenditure (including legal costs, AA6 submission costs and corporate restructuring) and the two cost categories for which it will undertake specific forecasts in AA6 – UAFG ($3.3 million) and ancillary services ($0.9 million) – resulting in annual recurrent operating costs of $62.5 million for the base year.

The ERA has determined that an additional $11.8 million in expenditure, including corporate costs, renewable gas programs, staff bonuses and incentive payments and stakeholder engagement, should be removed from the base year. The ERA has determined an efficient base year cost of $50.7 million for ATCO's AA6 operating expenditure.

Step changes

Step changes are additional operating costs not incurred in the base year. Costs can be ongoing from a particular time, one-off expenditure, or have a non-annual ongoing frequency that fall outside the base year.

ATCO has proposed 11 step changes as part of its operating expenses in AA6, totalling $62.6 million. Seven of the step changes are recurrent, totalling $22.5 million, while four step changes are non-recurrent, totalling $40.1 million.

The ERA has determined that $14.4 million can be included for step changes for ATCO's AA6 proposal.

For the recurring step changes, the ERA has accepted in full the superannuation guarantee rate increase, the property, plant and equipment operating expenditure threshold increase and the gas inspection safety changes, totalling $4.5 million. The ERA has accepted $0.6 million of the enterprise resource planning replacement program and has not accepted in full the expenditure for economic regulatory changes, enabling renewable gases and cyber security.

For the non-recurring step changes, the ERA has partially accepted $4.2 million for pipeline inline inspections, and $5.2 million for AA7 regulatory preparation and the rate of return instrument review. The ERA has not accepted in full the expenditure for IT managed services.

1 $ million real as at 31 December 2023. ATCO, *2025-29 Plan,* 1 September 2023, p. 109, Table 9.1.

2 $ million real as at 31 December 2023. The estimated operating expenditure for AA5 reflects actual operating expenditure for January 2020 to December 2022 inclusive and estimates for 2023 and 2024. ATCO, *2025-29 Plan,* 1 September 2023, p. 51, Table 5.4.

For the “software as a service” arrangements, the ERA has determined that $17.6 million of the proposed $27.3 million is expenditure that meets the requirements of the NGR. However, the ERA has determined that this expenditure should be classified as capital expenditure in AA6, rather than operating expenditure as proposed by ATCO. As a result, $17.6 million has been added to the AA6 conforming capital expenditure.

Trends

ATCO has included operating expenditure that it will incur outside of the base or step cost categories for the forecast growth of the network and for the forecast increase in prices.

ATCO incurs additional expenditure as the number of customers connected to the network and the size of the network increases. ATCO has determined a total increase of $10.4 million in operating expenditure over AA6 for the increase in customers and size of the network.

The ERA has accepted ATCO’s proposed method for determining forecast network growth expenditure. The ERA has determined an expenditure value of $14.0 million for forecast growth over the AA6 period. This value is higher than ATCO’s proposed AA6 expenditure, because the ERA has determined an increase in the forecast number of customers connecting to the network over the AA6 period.

Forecast price growth typically accounts for price increases in labour and non-labour costs. ATCO has not applied any real cost escalation for non-labour costs. The ERA has accepted ATCO’s proposal to not include a real price escalation for non-labour costs.

ATCO has proposed forecast price growth to labour costs based on the Wage Price Index for Western Australia and has included a premium for added wage costs based on the electricity, gas, water and waste services industry sector. ATCO has included $12.4 million in operating expenditure in its AA6 forecast based on its labour cost escalation method.

The ERA has not accepted ATCO’s proposal for a premium on top of the WPI for staff working in the electricity, gas, water and waste services industry. The ERA will allow labour escalation at a forecast rate for the Wage Price Index for Western Australia.

The ERA has determined in other access arrangement proposals, that a real labour cost escalation premium for the industry sector would only be considered when a productivity factor reduction was also included, as productivity improvements would be expected for paying a premium to attract labour into an organisation.

Applying the ERA’s cost escalation method and reductions in the base and step expenditures, the ERA has determined the real labour escalation to be included in AA6 operating expenditure should be $4.1 million.

Unaccounted for gas

UAFG is the difference between the measurement of the quantity of gas delivered into the gas distribution system in a given period and the quantity of gas delivered from the gas distribution system during that period. ATCO incurs costs to purchase gas to replace the calculated UAFG.

ATCO’s UAFG costs have reduced over the AA5 period due to targeted projects such as mains replacement and enhancements to find and eliminate leaks. This has resulted in ATCO proposing to include $30.8 million in UAFG expenditure in operating expenditure for AA6.

The ERA has determined that $31.8 million of UAFG can be included in AA6 operating expenditure. The ERA's value differs from ATCO's proposal due to the ERA's revised demand forecast of gas consumption and the price of the UAFG.

ATCO proposed to include the partial injection of renewable gases into the network to account for UAFG. The cost of these renewable gases is higher than the cost of the natural gas that is currently used for UAFG.

As set out in the AA6 capital expenditure review, the ERA has determined that the capital expenditure required to inject renewable gases into the network is not conforming capital expenditure as the legislation allowing it to occur has not yet been enacted. As a result, under the current economic regulatory framework, ATCO is unable to use renewable gases as part of its forecast UAFG and is required to source natural gas which is at present cheaper than the combination of natural gas, biomethane and hydrogen that was proposed by ATCO.

Ancillary reference services

ATCO has included operating expenditure for ancillary reference services of $27.1 million in its AA6 proposal. ATCO's forecast ancillary service volumes are based on historical growth and current retailer demands. ATCO stated that ancillary service costs have been forecast based on the current costs of providing those services.

For its AA6 submission, ATCO has included the re-classified Permanent Disconnection reference service which accounts for $11.4 million of the $27.1 million total.

The ERA considered information provided by ATCO, public submissions and findings from EMCa to determine the amount of operating expenditure that meets the requirements of the NGR.

The ERA has determined that $19.6 million for ancillary reference services be included in AA6 operating expenditure. The ERA's value differs from ATCO's proposal due to the ERA's revised demand forecast for ancillary reference services and for the unit cost of undertaking these services.

The ERA has reviewed the unit costs for ancillary services in AA5 and considers ATCO's proposed increase in unit costs for AA6 is not adequately justified. The ERA has determined unit costs lower than those proposed by ATCO.

Working capital

ATCO included $12.0 million for return on working capital in its AA6 proposal. The working capital model has three core components: inventory, creditors and receivables. ATCO amended one of the components, inventory maintained as a percentage of capital expenditure, in its submission.

The ERA has accepted the change in the inventory component proposed by ATCO. However, the ERA's determination for a return on working capital differs from ATCO's proposal as a result of required amendments to other aspects of the proposal such as capital and operating expenditure.

The ERA has determined a value of $8.7 million for a return on working capital in the AA6 period.

Summary of required amendments

5.1 ATCO must amend its access arrangement information to revise its AA6 2022 base year operating expenditure to $50.7 million ($ real as at 31 December 2023).

5.2 ATCO must amend its access arrangement information to revise its AA6 recurrent step change operating expenditure to $5.1 million ($ real as at 31 December 2023).

5.3 ATCO must amend its access arrangement information to revise its AA6 non-recurrent step change operating expenditure to $9.3 million ($ real as at 31 December 2023).

5.4 ATCO must amend its access arrangement information to revise its AA6 output growth escalation operating expenditure to $14.0 million ($ real as at 31 December 2023).

5.5 ATCO must amend its access arrangement information to revise its AA6 input cost escalation operating expenditure to $4.1 million ($ real as at 31 December 2023).

5.6 ATCO must amend its access arrangement information to revise its AA6 unaccounted for gas operating expenditure to $31.8 million ($ real as at 31 December 2023).

5.7 ATCO must amend its access arrangement information to revise its AA6 ancillary services operating expenditure to $19.6 million ($ real as at 31 December 2023).

5.8 ATCO must amend its access arrangement information to revise its AA6 return on working capital to $8.7 million ($ real as at 31 December 2023).

Regulatory requirements

1. Under the regulatory framework, operating expenditure means:

> Operating, maintenance and other costs and expenditure of a non-capital nature incurred in providing pipeline services and includes:
>
> (a) expenditure incurred in increasing long-term demand for pipeline services and otherwise developing the market for pipeline services; and
>
> (b) expenditure, in providing pipeline services, that contributes to meeting emissions reduction targets.[3]

2. A forecast of operating expenditure is one of the components (or building blocks) for determining the service provider's total revenue requirement using the building block approach, which is required by the regulatory framework set out in the NGR.[4] The total revenue requirement is the amount that is needed by the service provider to recover the efficient costs incurred in operating the pipeline (that is, the service provider's cost of service).

3. The criteria governing operating expenditure is set out in rule 91:[5]

   - The operating expenditure must be expenditure that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable costs of delivering pipeline services in a manner consistent with the achievement of the national gas objective.
   - The forecast of required operating expenditure must be for expenditure that is allocated between reference services; other services provided by means of the covered (regulated) pipeline; and other services provided by means of uncovered (unregulated) parts of the pipeline (if any), in accordance with the allocation provisions set out in rule 93.

4. Rule 71 sets out the considerations that the regulator may and should have regard to when evaluating whether operating expenditure satisfies the governing criteria. The regulator:

   - May, without embarking on a detailed investigation, infer compliance from the operation of an incentive mechanism or on any other basis that is considered appropriate.
   - Must consider and give appropriate weight to, submissions and comments received in response to an invitation for submissions on whether a service provider's access arrangement proposal should be approved.

---

3 NGR, rule 69.

The definition of operating expenditure has changed since the last review of ATCO's access arrangement. The amended definition supports the new national gas objective (which includes an emissions reduction objective) that came into effect in Western Australia on 25 January 2024.

4 NGR, rule 76.

5 Rule 91 was amended on 1 February 2024 to support the new national gas objective. The ERA has applied the amended rule in this draft decision.

5. The NGR require the following operating expenditure information to be included in the service provider's Access Arrangement Information (AAI).[6] AAI is information that is reasonably necessary for users (including prospective users) to understand the background to the access arrangement; and the basis and derivation of the various elements of the access arrangement.

   - Where an access arrangement commences at the end of an earlier access arrangement period, AAI must include operating expenditure (by category) for each year of the earlier access arrangement period (rule 72(1)(a)(ii)).
   - AAI must include a forecast of operating expenditure over the forthcoming access arrangement period and the basis on which the forecast has been derived (rule 72(e)).

[6] NGR, rule 72.

ATCO proposal

6. ATCO has proposed $455.9 million total operating expenditure for AA6. Estimated total operating expenditure for AA5 is $355.9 million.[7,8]

7. Table 5.1 shows ATCO's estimated operating expenditure for AA5. These figures are actual operating expenditure for January 2020 to December 2022, and estimates for 2023 and 2024.

Table 5.1: ATCO Actual and forecast AA5 operating expenditure ($ million real at 31 December 2023)

	2020 (actual)	2021 (actual)	2022 (actual)	2023 (estimated)	2024 (estimated)	AA5 total
Network	32.2	35.5	36.3	25.6	35.2	**174.7**
Corporate	20.1	19.2	24.6	25.3	24.2	**113.5**
IT	7.8	8.8	4.7	5.7	4.8	**31.9**
UAFG	2.7	3.8	3.3	4.2	4.1	**18.1**
Ancillary services	1.6	0.9	0.9	0.8	0.8	**5.1**
Confidential	0.0	7.8	4.8	0.0	0.0	**12.6**
Total	**64.4**	**76.0**	**74.7**	**71.2**	**69.0**	**355.9**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 51, Table 5.4.

8. ATCO presented its operating expenditure forecasts for AA6 using two methods:

   - A forecast which used the base-step-trend approach for network, corporate and IT categories and specific forecasts for the UAFG and ancillary services categories.
   - A bottom-up forecast.

9. The bottom-up forecast was used to consider the reasonableness of the forecast derived from the base-step-trend method.

10. ATCO's comparison of bottom-up and base-step-trend methods showed no material differences between the two forecasts for the AA6 period.

11. To determine forecasts using the base-step-trend method, ATCO has used its actual operating expenditure from the most recent complete calendar year being 2022 as being representative of its AA6 operating expenditure levels.

[7] $ million real as at 31 December 2023.
ATCO, *2025-29 Plan,* 1 September 2023, p. 109, Table 9.1.

[8] $ million real as at 31 December 2023. The estimated operating expenditure for AA5 reflects actual operating expenditure for January 2020 to December 2022 inclusive and estimates for 2023 and 2024.
ATCO, *2025-29 Plan,* 1 September 2023, p. 51, Table 5.4.

12. The base-step-trend method takes the efficient costs incurred in the base year and uses the assumption that operating expenditure is mostly recurrent. Base-step-trend forecasting starts by establishing the base operating expenditure then adjusting for:

- any expenditure not reflective of the recurrent cost base
- categories of operating expenditure affected by discrete step changes
- changes in output and cost input trends over the period.

13. Table 5.2 shows ATCO's proposed forecast operating expenditure for AA6 according to the base-step-trend method combined with specific forecasts, broken down into the Base-Step-Trend components.

Table 5.2: ATCO proposed forecast operating expenditure for AA6 ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Base year	62.5	62.5	62.5	62.5	62.5	312.6
Recurrent step changes	4.0	4.9	4.7	4.4	4.5	22.5
Non-recurrent step changes	5.0	13.3	13.3	5.2	3.4	40.3
Output growth escalation	1.2	1.6	2.1	2.5	3.0	10.4
Input cost escalation	1.4	2.1	2.7	2.9	3.3	12.4
Sub-total network, corporate and IT	**74.1**	**84.4**	**85.3**	**77.5**	**76.7**	**398.0**
UAFG	5.8	5.8	6.1	6.2	6.8	30.8
Ancillary services	4.9	5.4	5.5	5.6	5.7	27.1
Total forecast operating expenditure	**84.8**	**95.6**	**96.9**	**89.3**	**89.3**	**455.9**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 111, Table 9.2; *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, p. 113, Table 9.3; *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, p. 125, Table 9.15.

Submissions

14. Alinta Energy raised concerns about the absence of any key performance indicators or accountability for permanent disconnections, noting that ancillary services contribute $27.1 million to the proposed AA6 operating expenditure.

15. Alinta also noted that ATCO's investment in renewable gases did not satisfy the current criteria applying to capital and operating expenditure under the NGR.

16. Alinta noted that ATCO's forecast AA5 expenditure is expected to be $22 million less than the ERA's forecast in the AA5 final decision. Alinta asked the ERA to consider whether this underspend may be indicative of systemic over-forecasting, which may warrant the ERA adjusting ATCO's proposed AA6 operating expenditure downwards.

17. Alinta questioned ATCO's selection of 2022 as its base year on the basis that it is the most recent year of actual expenditure. Alinta considered that is not the requirement of the NGR but rather ATCO should have selected the most efficient year, balanced against consideration of selecting a year that is likely to be reflective of future costs. In addition, Alinta does not consider the COVID-19 pandemic to be a relevant reason to disregard any of the years in AA5 as potential base years.

18. The Department of Energy, Mines, Industry Regulation and Safety's Building and Energy division noted that ATCO is responsible for inspecting and ensuring the safety of consumer gas installations connected to the GDS. DEMIRS supports ATCO's submission to establish and execute a new model for directing the performance of remedial work to address unsafe consumer gas installations.

Draft decision

19. The ERA's draft decision is set out below broken down by the Base-Step-Trend components and the specific forecasts for UAFG and ancillary services.

Base year

20. ATCO has proposed to use its 2022 actual operating expenditure as the starting point to derive the efficient base year for network, corporate and IT operating expenditure, as the 2022 calendar year is the most recent year of actual expenditure.

21. ATCO's unadjusted AA6 base year forecast is $74.7 million.

22. ATCO has made four adjustments to the base year costs to remove non-recurrent costs in the base year, these reductions total $7.9 million:

- Legal costs [redacted] ($5.3 million combined).
- Preparation of the AA6 submission ($1.2 million).
- Corporate restructuring ($0.8 million).
- Inline pipeline inspection program ($0.6 million).

23. The ERA's consultant, EMCa, requested additional information from ATCO on these four adjustments. EMCa was satisfied with the explanations received and considered it likely that the deductions are representative of the non-recurrent costs incurred, and that ATCO has appropriately removed these costs from its base year operating expenditure.

24. EMCa also asked for additional information relating to costs incurred in the 2022 base year to ensure all non-recurrent costs had been removed from the base year. As a result of ATCO's response, EMCa identified four areas of ATCO's base year of concern.

Clean Energy Innovation Hub (CEIH) and blending projects

25. In response to the information request from EMCa, ATCO advised that it had incurred $0.3 million of operating expenditure on its CEIH and blending projects in 2022.

26. EMCa noted that these projects were not approved as conforming capital expenditure in the AA5 final decision, nor do they now meet the relevant test for conforming capital expenditure.[9] Therefore the associated operating expenditure is also not conforming, nor reflective of the efficient recurring operating expenditure in ATCO's base year.

27. The ERA has determined that the costs relating to ATCO's CEIH and blending projects do not form part of an efficient base year's costs and are to be removed from ATCO's 2022 actual operating expenditure.

Other Corporate Support costs

28. EMCa notes that, ATCO's projected AA5 corporate operating expenditure of $121.2 million is expected to be $22.0 million (or 22 per cent) higher than the forecast included in the AA5 final decision ($99.2 million). ATCO incurred 306 per cent higher

[9] As set out in ERA Draft Decision – Attachment 4 – regulatory capital base, pp 15-16, April 2024.

($6.5 million) costs in 2022 for the Other Corporate Support category than the average annual amount of $1.6 million over the AA4 period.

29. ATCO advised that the increase was a result of ATCO's response to COVID-19 and an increase in the support cost allocation from ATCO's corporate head office in Canada.

30. EMCa considered that while there were likely to be additional costs involved in implementing COVID-19 protocols, and these costs may have been present in 2022, the costs to implement protocols for COVID-19 cannot be considered as recurrent costs.

31. ATCO also advised that the cost allocation from Canada increased by 1.9 per cent "to align with the ATCO group allocation methodology under the Massachusetts formula" and that prior to this change, ATCO benefited from an under-allocation of group costs. EMCa noted that ATCO has not provided any compelling information regarding the value-for-money of the Canada head office charge.

32. EMCa notes that ATCO has not provided a breakdown of the incremental costs attributable to the COVID-19 and Canada head office costs as part of the total Other Corporate Support costs. As a result, in the absence of better information, EMCa considered that the increase of $6.8 million over the AA4 average spend on Other Corporate Support has not been sufficiently justified as being reflective of an efficient cost.

33. The ERA considers that ATCO has not provided sufficient information on why the COVID-19 costs should be included in recurrent base year costs and what benefits ATCO will receive from the increase in corporate head office costs from Canada to be included in the base year recurrent costs.

34. ATCO has raised an issue with EMCa's assumption on the increase in head office costs from Canada just prior to publication of this Draft Decision. Notwithstanding any potential misunderstanding on the potential drivers for the increase in costs, ATCO has not adequately explained the increase in Corporate Support costs. ATCO can provide further information in its response to the Draft Decision.

35. The ERA has determined that the Other Corporate Support costs are not at an efficient level to be included in the base year's costs. The ERA determines that in the absence of additional supporting information the efficient level of costs for Other Corporate Support costs are based on the AA4 average, resulting in a reduction of $6.8 million from the 2022 base year operating expenditure.

Staff bonuses

36. ATCO's base year includes $3.7 million of expenditure incurred under its Short-Term Incentive Program (STIP) to which ATCO noted:

> "STIP bonus payments are payments made to staff within ATCO to not only attract and retain employees but to primarily promote a culture of high performance. STIP participants include senior executive, managerial and professional roles that have a direct impact on business results.[10]

37. ATCO provided a history of STIP payments which has increased significantly in 2021 and 2022 compared to the previous five years.

[10] ATCO response to Information Request EMCa52, 13 December 2023.

38. The ERA considers that payments like those under the STIP are ‘bonus’ payments and are not required, to perform the operations of the pipeline. However, the ERA does appreciate that such payments can be beneficial in allowing the service provider to achieve its targets earlier than planned and/or at a more efficient cost than forecast. Under such circumstances, payments under the STIP may be appropriate.

39. Payments would not be appropriate where projects/programs are completed on time and/or on budget. Meeting targets is already accounted for in staff wages as part of their job description and STIP payments would only be appropriate when targets are exceeded.

40. In cases where targets are exceeded, there would likely be a financial benefit of achieving this outcome and payments made under the STIP should come from savings achieved exceeding expenditure targets.

41. As set out below in paragraphs 131 to 146, the ERA has not accepted ATCO’s proposed labour escalation premium for the energy, gas, water and waste services sector due to a lack of productivity adjustment.

42. The ERA considers that a business with no productivity growth is unlikely to sustain real wage growth at above-average rates in the long term. This would also be the case for STIP payments, it is not sustainable in the long term to pay bonus payments without achieving productivity growth.

43. As a result, the ERA has determined that the costs relating to ATCO’s Short-Term Incentive Program do not form part of an efficient base year’s costs and are to be removed from ATCO’s 2022 actual operating expenditure.

Stakeholder Engagement

44. ATCO’s operating expenditure category, Corporate – Stakeholder Engagement, incurred $2.8 million in expenditure in 2022. In response to an information request from EMCa, ATCO noted that expenditure in this category included operating expenditure to operate a business improvement team. From the information provided by ATCO, this has been classified as a corporate function for the entire AA5 period.

45. ATCO noted in its response that the team has been successful in identifying inefficiencies, waste and errors in the processes which also result in cost reduction by eliminating those issues from the system.

46. EMCa noted that ATCO’s response did not provide a split between what EMCa would traditionally consider to be stakeholder engagement and/or stakeholder management activities and those described as delivering cost reductions such as its business improvement team.

47. EMCa considered that the costs associated with a business improvement team such as those described by ATCO should be offset by the cost reductions that the team achieves so as to avoid a duplicated cost being recovered from gas customers.

48. As a result, the ERA has determined that the $1.0 million in costs relating to ATCO’s Corporate – Stakeholder Engagement do not form part of an efficient base year’s costs and are to be removed from ATCO’s 2022 actual operating expenditure.

Base year adjustment summary

49. The ERA has accepted ATCO's proposal to use 2022 as its base year. The ERA considers that the most recent full year of actual costs is an appropriate selection on which to base its forecast costs after taking out one off and non-recurring costs in that year. The ERA also considers that selecting a base year during the COVID-19 pandemic period would not be representative of ATCO's forecast expenditure in the AA6 period.

50. Taking ATCO's 2022 actual operating expenditure and removing the specific forecasts (UAFG and ancillary service costs) and the non-recurrent costs identified by ATCO and the additional non-recurrent costs identified by the ERA results in a 2022 efficient base year determined by the ERA of $50.7 million as shown in Table 5.3 below.

Table 5.3: Comparison of ATCO's and ERA's determined efficient base year operating expenditure for 2022 ($ million real at 31 December 2023)

	ATCO proposal	ERA draft decision
ATCO 2022 unadjusted base operating expenditure	74.7	74.7
LESS: ATCO adjustments for non-recurrent operating expenditure	(7.9)	(7.9)
LESS: ERA determined three additional adjustments for non-recurring operating expenditure		
• CEIH and blending		(0.3)
• Other Corporate Support		(6.8)
• STIP		(3.7)
• Stakeholder engagement		(1.0)
2022 base year operating expenditure (excluding only non-recurrent costs)	**66.7**	**54.9**
LESS: UAFG	(3.3)	(3.3)
LESS: Ancillary services	(0.9)	(0.9)
Efficient base year operating expenditure for 2022	**62.5**	**50.7**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 112, and ERA analysis.

Required Amendment

5.1 ATCO must amend its access arrangement information to revise its AA6 2022 base year operating expenditure to $50.7 million ($ real as at 31 December 2023).

Recurrent step changes

51. Table 5.4 shows ATCO's proposed recurrent step changes it has included in its forecast operating expenditure for AA6.

Table 5.4: ATCO proposed recurrent step changes for AA6 ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Enabling renewable gases	1.4	1.5	1.5	1.4	1.5	**7.3**
Superannuation guarantee rate increase	0.5	0.5	0.5	0.5	0.5	**2.6**
Cyber security	1.3	0.9	0.9	0.7	0.7	**4.5**
Gas inspection – safety changes	0.2	0.2	0.2	0.2	0.2	**1.0**
Property, plant and equipment operating expenditure threshold increase	0.2	0.2	0.2	0.2	0.2	**0.9**
Enterprise Resource Planning replacement	0.0	1.0	1.0	1.0	1.0	**4.1**
Economic regulatory changes	0.5	0.5	0.3	0.3	0.3	**2.0**
Total	**4.0**	**4.9**	**4.7**	**4.4**	**4.5**	**22.5**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 113, Table 9.3.

52. Each of these step changes is discussed below.

Enabling renewable gases

53. Table 5.5 shows ATCO's proposed enabling renewable gases operating expenditure it has included in its forecast operating expenditure for AA6.

Table 5.5: ATCO AA6 forecast enabling renewable gases operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Renewable gas injection points	0.1	0.2	0.3	0.4	0.5	**1.5**
Sustainability reporting system	0.1	0.1	0.1	0.1	0.1	**0.4**
Industry and community consultation program	0.7	0.8	0.7	0.8	0.7	**3.7**
Renewable gas supporting programs	0.5	0.5	0.3	0.2	0.2	**1.7**
Total	**1.4**	**1.5**	**1.5**	**1.4**	**1.5**	**7.3**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 117, Table 9.8

54. ATCO has proposed a step change associated with its program of enabling renewable gases at a forecast cost of $7.3 million, comprising four components:

- Renewable gas injection points - $1.5 million for operation and maintenance of six injection points.
- Sustainability reporting system – $0.4 million for new licensing fees and running costs for sustainability reporting system software to support ATCO's reporting obligations under the National Greenhouse and Energy Reporting Scheme.
- Industry and community consultation program - $3.7 million to discuss and provide feedback on issues related to renewable gas development, production, and use.
- Renewable gas supporting programs - to complete one-off projects to (i) review the compatibility of renewable gas infrastructure and ensure compliance with ATCO's safety obligations ($0.7 million), and (ii) enable safe and secure operation of ATCO's injection points ($1.0 million).

55. ATCO noted that the expenditure aims to support the energy transition and help reduce greenhouse gas emissions, and that the expenditure is linked to the six renewable gas injection stations that are proposed for AA6. ATCO considered the expenditure is necessary to ensure its activities are consistent with good industry practice, including meeting its emission reduction targets detailed in its Sustainability Strategy and regulatory compliance, including reporting requirements under the National Greenhouse and Energy Reporting scheme.

56. EMCa noted that there is currently no regulatory obligation for undertaking the associated capital expenditure projects linked with this operating expenditure.

57. As set out in Attachment 4 – regulatory capital base, the ERA has not approved the capital expenditure relating to ATCO's renewable gas injection stations. As a result, the associated operating expenditure linked to the capital expenditure projects in this proposed step change is not required. In addition, some costs, such as the industry and community consultation program are costs that are not required for the efficient operation of a gas network and ATCO would need to demonstrate how these costs would be required.

58. As a result, the ERA has determined that the proposed step change expenditure of $7.3 million for the enabling renewable gases projects does not satisfy the operating expenditure criteria of rule 91 of the NGR for inclusion in the AA6 operating expenditure proposal.

Superannuation guarantee rate increase

59. Table 5.6 shows ATCO's proposed superannuation guarantee rate increase it has included in its forecast operating expenditure for AA6.

Table 5.6: ATCO AA6 forecast superannuation guarantee rate increase operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Network	0.3	0.3	0.3	0.3	0.3	**1.6**
Corporate	0.2	0.2	0.2	0.2	0.2	**0.9**
IT	0.0	0.0	0.0	0.0	0.0	**0.1**
Total	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**2.6**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 118, Table 9.9.

60. ATCO advised it is obligated to pass on the superannuation increase prescribed by the *Superannuation Guarantee (Administration) Act 1992 (Cth)*.

61. EMCa considered the proposed step change to be reasonably based, and in response to a change in regulatory obligations.

62. The ERA determines that the superannuation guarantee rate increase step change of $2.6 million meets the criteria under rule 91 of the NGR.

Cyber security

63. Table 5.7 shows ATCO's proposed cyber security expenditure it has included in its forecast operating expenditure for AA6.

Table 5.7: ATCO AA6 forecast cyber security operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Compliance activities	0.3	0.3	0.3	0.3	0.3	**1.5**
Prevention activities	0.5	0.2	0.2	0.0	0.0	**0.9**
Protection activities	0.3	0.3	0.3	0.3	0.3	**1.5**
Incident preparedness activities	0.1	0.1	0.1	0.1	0.1	**0.7**
Total	**1.3**	**0.9**	**0.9**	**0.7**	**0.7**	**4.5**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 121, Table 9.10.

64. ATCO noted that its cyber security strategy is designed to protect critical Information Technology and Operational Technology systems and data, ensure regulatory compliance, and enhance its overall cyber security. ATCO stated that its investment in cyber security is aimed at continuing to implement a combination of polices, processes, and technologies to cost-effectively achieve and maintain an acceptable level of loss exposure or an optimal risk position.

65. ATCO noted that in addition to the internal investment driver, it is subject to Critical Infrastructure Risk Management Program obligations. As a critical infrastructure entity,

ATCO must take reasonable steps to comply with these obligations through implementing controls and mitigating risks.

66. ATCO proposes to spend $4.5 million on cyber security over the AA6 period, on four areas:

- compliance activities ($1.5 million)
- prevention activities ($0.3 million)
- protection activities ($1.5 million)
- incident preparedness activities ($0.7 million).

67. EMCa noted that in accordance with amendments to the *Security of Critical Infrastructure (SOCI) Act 2018* and particularly the *Security Legislation Amendment (Critical Infrastructure Protection) Act 2022*, ATCO is required to achieve and sustain the following level of cyber security by the end of 2024:

- Security Profile 1 (SP-1) under the Australian Energy Cyber Security Framework (AESCSF) or equivalent.
- A Critical Infrastructure Risk Management Plan (CIRMP), covering cyber security hazards, physical security and natural hazards, personnel hazards, and supply hazards.

68. ATCO has declared that it will achieve [redacted] requirements by the end of [redacted] under the SOCI Act.[11]

69. EMCa noted that ATCO has proposed an operating expenditure step change to achieve SP-3, the highest level of cyber security under the Australian Energy Sector Cyber Security Framework, by 2029 in response to the recommendation in the Framework for high criticality asset owners. However, the Australian Energy Market Operator (per the Framework) stresses that the SP-3 is a recommended target and not a legislative obligation.

70. EMCa noted that as of 2023 ATCO has [redacted] under the Framework.

71. EMCa considered that ATCO has not demonstrated that expenditure to achieve SP-3 is a new regulatory obligation, or that it meets other operating expenditure criteria required under the NGR, despite stating that:

> "This option provides ATCO proactive steps taken to prevent, test controls efficacy leading to reduced loss and meeting compliance requirements."[12]

[11] There are three positive security obligations that can apply to all critical infrastructure assets, depending on their asset class.
- Provide operational and ownership information to the Register of Critical Infrastructure Assets.
- Report cyber incidents which impact the delivery of essential services to the Australian Cyber Security Centre.
- Adopt, maintain and comply with a written risk management program.

[12] ATCO AA6 Attachment 09.013.00 – IT – Cyber security program business case – page 10, 28 August 2023.

72. EMCa concluded that ATCO has not demonstrated that its proposed AA6 cyber security expenditure is likely to qualify as an operating expenditure step change having failed to demonstrate that it has a regulatory obligation to achieve SP-3 nor has it demonstrated that doing so would provide a beneficial capital expenditure – operating expenditure trade-off.

73. The ERA notes EMCa's advice and considers that, as ATCO has stated that it will meet a level of cyber security consistent with its regulatory obligations by the end of the AA5 period and within its current AA5 expenditure limits, a step change to meet a level of cyber security at a level that it is not obligated to do so does not satisfy the operating expenditure criteria for inclusion in the AA6 operating expenditure proposal.

74. As a result, the ERA determines that all of the $4.5 million step change for cyber security operating expenditure proposed by ATCO does not meet the criteria under rule 91 of the NGR.

Gas inspection – safety changes

75. Table 5.8 shows ATCO's proposed gas inspection – safety changes it has included in its forecast operating expenditure for AA6.

Table 5.8: ATCO AA6 forecast gas inspection safety changes operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Gas inspection team	0.2	0.2	0.2	0.2	0.2	**1.0**
Total	**0.2**	**0.23**	**0.2**	**0.2**	**0.2**	**1.0**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 122, Table 9.11.

76. ATCO noted that in May 2023, the Department of Energy, Mines, Industry Regulation and Safety decided that to avoid actual or perceived conflicts of interest, ATCO gas inspectors must not operate as gas fitters for consumer gas installations or related gas fitting work from 1 January 2024.

77. ATCO has outlined the steps it needs to take to comply with this new obligation which arises under the *Gas Standards Act 1972*.

78. EMCa noted that in summary, ATCO must expand its gas inspection team to undertake specific inspection tasks that can no longer be undertaken by the current gas distribution officers. EMCa considered that the supporting information provided by ATCO represents a new regulatory obligation on its business, and that the steps undertaken by ATCO are reasonable to respond to this new obligation.

79. The ERA considers that ATCO has an obligation that it must meet, and the expenditure required is efficient. As a result, the ERA determines that the $1.0 million proposed operating expenditure by ATCO for gas inspection safety changes meets the criteria under rule 91 of the NGR.

Property, plant and equipment operating expenditure threshold increase

80. Table 5.9 shows ATCO's proposed property, plant and equipment operating expenditure threshold increase it has included in its forecast operating expenditure for AA6.

Table 5.9: ATCO AA6 forecast property, plant and equipment operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Property, plant and equipment	0.2	0.2	0.2	0.2	0.2	**0.9**
Total	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.9**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 123, Table 9.12.

81. ATCO has proposed that from 1 January 2025 it will change its approach to capitalising low-value assets after a review of the capital expenditure process revealed that the policy threshold for capitalising assets had not been increased from $300 for several years. ATCO reviewed the number of low-value assets purchased annually to determine the associated administrative burden of purchasing, managing, and reporting these low-value assets.

82. ATCO determined that increasing the threshold from $300 to $1,000 would have significant benefits that would drive administrative, governance and cost efficiencies and would not adversely affect the tax treatment of low-value asset pool deductions.

83. EMCa noted that benefits of changing the threshold is primarily to reduce administrative burden. Also, that this change has the effect of transferring capital expenditure to operating expenditure which EMCa considered is reasonable as it reflects an efficient operating expenditure – capital expenditure trade-off.

84. The ERA considers that the proposed threshold change would be efficient operating expenditure and as a result determines that the $0.9 million proposed operating expenditure by ATCO for the property, plant and equipment threshold increase meets the criteria under rule 91 of the NGR.

Enterprise Resource Planning (ERP) replacement

85. Table 5.10 shows ATCO's proposed ERP replacement expenditure it has included in its forecast operating expenditure for AA6.

Table 5.10: ATCO AA6 forecast ERP replacement operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
ERP annual licencing fee	0.0	1.3	1.3	1.3	1.3	**5.3**
LESS: current maintenance fee	0.0	-0.3	-0.3	-0.3	-0.3	**-1.2**
Total	**0.0**	**1.0**	**1.0**	**1.0**	**1.0**	**4.1**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 123, Table 9.13.

86. ATCO has proposed an operating expenditure step change of $4.1 million for the net increase in its annual licencing fees as a result of replacing its current ERP program.

87. EMCa noted that this expenditure is in relation to the proposed capital expenditure for the ERP replacement included in ATCO's capital expenditure proposal for AA6 and that the step change is based on ATCO's recommended option 4 (a "best of breed" solution), which has been developed by adding 30 per cent to its cost estimate for option 2 and deducting the current maintenance fee for its current ERP.[13]

88. As set out in Attachment 4 – regulatory capital base, the ERA has not approved the capital expenditure for ATCO's proposed option 4 (best of breed solution) but has determined option 2 is the program that will satisfy the conforming capital expenditure criteria.

89. As a result, the ERA has determined that the proposed step change expenditure of $4.1 million for the ERP replacement does not satisfy the operating expenditure criteria for inclusion in the AA6 operating expenditure proposal.

90. The ERA has determined that for ERP option 2, the additional licensing fee costs on top of the existing licencing fee for the current ERP is $0.2 million per year which does meet the criteria under rule 91 of the NGR to be included as operating expenditure for the AA6 period. This additional licencing fee expenditure is scheduled to begin being incurred from 2027 onwards resulting in a step change of $0.6 million in the AA6 period.

Economic regulatory changes

91. Table 5.11 shows ATCO's proposed economic regulatory changes expenditure it has included in its forecast operating expenditure for AA6.

Table 5.11: ATCO AA6 forecast economic regulatory changes operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Economic regulatory changes	0.5	0.5	0.3	0.3	0.3	**2.0**
Total	**0.5**	**0.5**	**0.3**	**0.3**	**0.3**	**2.0**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 124, Table 9.14.

13 Option 2 – [redacted]

92. ATCO noted that on 31 March 2022, Energy Ministers agreed to the final package of changes to the legal and regulatory framework to give effect to reforms to gas pipeline regulation. The changes to the NGL and NGR have been implemented in other jurisdictions but are yet to be implemented in Western Australia.

93. ATCO expects the obligations to be implemented in Western Australia during 2024 and as a result proposed additional costs to be incurred. ATCO considers the obligations to include:

- common prohibitions and safeguards
- information disclosure
- information on the individual prices paid by shippers
- access negotiation framework
- compliance approach.

94. ATCO's operating expenditure step change is for two additional full-time employees (FTE's) in 2025 and 2026 and dropping down to one FTE from 2027 to 2029 inclusive to implement and manage the new obligations.

95. EMCa considered that ATCO has not adequately demonstrated that it is subject to a new regulatory obligation or that the cost of $2.0 million is an efficient level having considered the available alternatives.

96. The ERA considers that, as the changes to the NGL and NGR have not been implemented in Western Australia nor is there a legislative timeline for them to be implemented, ATCO has not demonstrated the regulatory obligation to justify the step change. The ERA also considers that even in the event the regulatory framework is amended, the additional costs to be incurred appear excessive and that ATCO would need to demonstrate how these costs would be required to comply with obligations.

97. As a result, the ERA determines that the $2.0 million for economic regulatory changes operating expenditure proposed by ATCO does not meet the criteria under rule 91 of the NGR.

Recurrent step change adjustment summary

Table 5.12: Comparison of ATCO's and ERA's determined Recurrent step change operating expenditure for AA6 ($ million real at 31 December 2023)

	ATCO proposal	ERA draft decision
Enabling renewable gases	7.3	0.0
Superannuation guarantee rate increase	2.6	2.6
Cyber security	4.5	0.0
Gas inspection – safety changes	1.0	1.0
Property Plant and Equipment threshold increase	0.9	0.9
Enterprise Resource Planning replacement	4.1	0.6
Economic regulatory changes	2.0	0.0
Total	**22.5**	**5.1**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 113, and ERA analysis.

Required Amendment

5.2 ATCO must amend its access arrangement information to revise its AA6 recurrent step change operating expenditure to $5.1 million ($ real as at 31 December 2023).

Non-recurrent step changes

98. Table 5.13 shows ATCO's proposed non-recurrent step changes it has included in its forecast operating expenditure for AA6.

Table 5.13: ATCO proposed non-recurrent step changes for AA6 ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Pipeline inline inspections	1.0	1.6	1.0	1.6	1.0	6.3
Access arrangement 7 and Rate of Return Instrument regulatory preparation	0.0	0.2	1.0	3.0	1.8	6.2
Software as a service (SaaS) arrangement	3.7	11.2	11.2	0.6	0.6	27.3
Managed IT services tender renewal	0.3	0.3	0.0	0.0	0.0	0.5
Total	**5.0**	**13.3**	**13.3**	**5.2**	**3.4**	**40.3**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 125, Table 9.15.

Pipeline in-line inspections

99. Table 5.14 shows ATCO's proposed pipeline in-line inspections expenditure it has included in its forecast operating expenditure for AA6.

Table 5.14: ATCO AA6 forecast pipeline inline inspections operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
No. of inspections	**1**	**3**	**2**	**3**	**2**	**11**
Expenditure	1.0	1.6	1.0	1.6	1.0	6.3
Total	**1.0**	**1.6**	**1.0**	**1.6**	**1.0**	**6.3**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 126, Table 9.16.

100. ATCO noted that high-pressure steel pipelines that require internal in-line inspections as prescribed in the Australian Standards are undertaken in accordance with the Gas Regulations. Pipeline in-line inspections are scheduled according to the established inspection cycle and in accordance with the regulations.

101. As a non-recurrent step change, ATCO has removed expenditure associated with the in-line inspections from its base year. In the AA6 period, ATCO has proposed for 11 inspections to be undertaken in AA6.

102. The ERA notes that, as set out in Attachment 4 – Regulatory capital base (pages 42-44), the ERA has not approved the capital expenditure required to enable in-line inspections for the work to prepare the three Bunbury pipelines for pigging.

103. As a result, the ERA has deducted the operating expenditure for the Bunbury pipelines from the proposed step change but considers that, for the remaining in-line inspections planned for the AA6 period, that the scope and cost are likely to reflect an efficient cost.

104. The ERA has determined that $2.1 million of the proposed $6.3 million step change for in-line inspections does not satisfy the operating expenditure criteria. The remaining $4.2 million of the step change for in-line inspections does meet the criteria under rule 91 of the NGR to be included as operating expenditure for the AA6 period.

Access arrangement 7 and rate of return instrument regulatory preparation

105. Table 5.15 shows ATCO's proposed economic regulatory changes expenditure it has included in its forecast operating expenditure for AA6.

Table 5.15: ATCO AA6 forecast economic regulatory operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Rate of return instrument review costs	0.0	0.2	0.0	0.0	0.0	0.2
AA7 preparation costs	0.0	0.0	1.0	3.0	1.8	5.8
Total	**0.0**	**0.2**	**1.0**	**3.0**	**1.8**	**6.2**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 126, Table 9.17.

106. ATCO has proposed a non-recurrent step change of $6.1 million over AA6 for the preparation of its AA7 submission and for the cost of participation in the ERA's gas rate of return instrument review. As a non-recurrent step change, ATCO has removed expenditure relating to the preparation of its AA6 submission from its base year.

107. EMCa noted that ATCO provided a cost estimate which indicates that ATCO's AA7 preparation cost is 19 per cent higher than the expected AA6 preparation cost of $5.2 million. EMCa also noted that ATCO argues that it requires the uplift for the AA7 submission process because it was under-resourced during the AA6 submission process.

108. EMCa did not consider that the arguments presented by ATCO present any additional regulatory obligations that would reasonably require an increase in operating expenditure or that could not be achieved through ongoing prioritisation of resources with its operating expenditure allowance. EMCa considered the proposed step change does not satisfy the regulatory change criterion and it recommended a step increase of $5.2 million for the AA7 period preparation being equal to its forecast cost for its AA6 preparation.

109. The ERA considers that ATCO has not justified the proposed non-recurrent step change for the AA7 and rate of return instrument regulatory reviews. The ERA has determined that the efficient cost is the AA6 forecast cost.

110. As a result, the ERA has determined that proposed step change expenditure of $0.9 million for the AA7 and rate of return instrument regulatory reviews does not satisfy the operating expenditure criteria of rule 91 of the NGR for inclusion in the AA6 operating expenditure proposal.

111. The ERA has determined that $5.2 million of the step change for AA7 and rate of return instrument regulatory reviews does meet the criteria under rule 91 of the NGR to be included as operating expenditure for the AA6 period.

Software as a service (SaaS) arrangement

112. Table 5.16 shows ATCO's proposed Software as a Service arrangement expenditure it has included in its forecast operating expenditure for AA6.

Table 5.16: ATCO AA6 forecast software as a service arrangement operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
HR and payroll upgrade	0.7	0.0	0.0	0.0	0.0	0.7
ERP replacement	2.5	10.8	10.8	0.0	0.0	24.0
IT continuous improvement program	0.2	0.2	0.2	0.2	0.3	1.1
Data and analytics program	0.0	0.0	0.0	0.0	0.0	0.2
Digital improvement program	0.1	0.1	0.1	0.1	0.1	0.4
IT sustainability program	0.2	0.2	0.2	0.2	0.2	1.0
Total	**3.7**	**11.3**	**11.3**	**0.5**	**0.5**	**27.3**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 128, Table 9.20.

113. ATCO has proposed six projects as part of its software as a service (SaaS) arrangement step change operating expenditure in AA6 totalling $27.3 million.

114. ATCO has also adopted a change to its accounting treatment for SaaS, ATCO noted that the International Accounting Standards Board has provided explicit guidance that all implementation, customisation and subscription costs must be treated as operating expenditure despite the enduring nature of the benefits provided by the expenditure. This means that previously capitalised implementation and customisation costs are not accounted for as operating expenditure.

115. With regards to the projects that make up the proposed step change, the ERA notes that as set out in Attachment 4 – Regulatory capital base (pages 61-62), the ERA has not approved the capital expenditure for the HR and payroll upgrade. As a result, the ERA does not approve the associated operating expenditure for this project.

116. EMCa noted that the IT continuous improvement program, data and analytics program and digital improvement program are discretionary projects that EMCa did not consider satisfied the step change criterion. EMCa also considered that for the IT sustainability program, ATCO had not adequately justified the introduction of a new regulatory obligation that required additional expenditure, or that the proposed expenditure is reflective of an efficient cost having considered the alternatives.

117. The remaining project, ERP replacement, is the project that incurs the majority of the proposed step change expenditure. As set out in Attachment 4 – Regulatory capital base (pages 56-59), the ERA has not approved the capital expenditure relating to ATCO's proposed ERP replacement option 4 (best of breed solution) but has determined option 2 is the program that will satisfy the conforming capital expenditure criteria. In addition, as set out above in the recurrent step change analysis, the ERA has determined the conforming operating expenditure for the ERP licencing is the value associated with option 2.

118. As a result of the ERA determining that for the ERP replacement project that option 2 is the option that meets the conforming expenditure criteria, the ERA determines that for the SaaS – ERP replacement project proposed step change, the conforming

expenditure value is $17.6 million which is the expenditure associated with ERP replacement option 2.

119. The ERA has considered ATCO's proposal to change the accounting treatment of SaaS to class it as operating expenditure instead of capital expenditure and determined that while accounting standards require these costs to be regarded as operating expenditure, regulatory accounts do not require full adherence to the accounting standards.

120. Accordingly, the ERA has determined that the SaaS step change expenditure should remain classified as capital expenditure for the AA6 period. This decision is because of the uncertainty around the projects being undertaken and to what value, with ATCO's own consultant selecting a different preferred option to the one chosen by ATCO in its AA6 submission.

121. As a result, the ERA determines that of the proposed $27.3 million of SaaS, $17.6 million relating to the ERP replacement project is regarded as efficient expenditure, however, this expenditure will be included as capital expenditure for the purposes of this draft decision.

Managed IT services tender renewal

122. Table 5.17 shows ATCO's proposed managed IT services tender renewal expenditure it has included in its forecast operating expenditure for AA6.

Table 5.17: ATCO AA6 forecast managed IT services tender renewal operating expenditure ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Managed IT services tender renewal	0.2	0.3	0.0	0.0	0.0	0.5
Total	**0.2**	**0.3**	**0.0**	**0.0**	**0.0**	**0.5**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 130, Table 9.21

123. ATCO has proposed a $0.5 million operating expenditure step change to renew the tender for IT managed services before the expiry of the current contract in August 2026.

124. EMCa noted that the assumption that ATCO will continue to outsource its IT services with a similar scope to the current model is reasonable, as is the cost estimate, however, EMCa considers this is a routine operational expense. EMCa considered that ATCO has discretion in its prioritisation and allocation of expenditure for advice such as proposed for this step change, and it is not reflective of an additional cost that is imposed by the introduction of a new regulatory obligation or an efficient capital expenditure / operating expenditure trade-off. Accordingly, EMCa considered that ATCO has not adequately justified that the proposed operating expenditure step change is reflective of an efficient cost against the step change criterion.

125. The ERA considers that ATCO has not demonstrated the regulatory obligation to justify the step change. As a result, the ERA determines that the $0.5 million for managed IT services tender renewal operating expenditure proposed by ATCO does not meet the criteria under rule 91 of the NGR.

Non-recurrent step change adjustment summary

Table 5.18: Comparison of ATCO's and ERA's determined Non-Recurrent step change operating expenditure for AA6 ($ million real at 31 December 2023)

	ATCO proposal	ERA draft decision
Pipeline in-line inspections	6.3	4.2
Access Arrangement 7 regulatory preparation and RORI review	6.2	5.2
Software as a Service (SaaS) arrangements	27.3	0.0
IT Managed services	0.5	0.0
Total	**40.3**	**9.3**

Source: ATCO, 2025-29 Plan (Access Arrangement Information), 1 September 2023, p. 125, and ERA analysis

Required Amendment

5.3 ATCO must amend its access arrangement information to revise its AA6 non-recurrent step change operating expenditure to $9.3 million ($ real as at 31 December 2023).

Output growth escalation

126. The ERA considers it reasonable to include an output growth escalation factor in ATCO's operating expenditure forecast to account for fluctuations in the scale of ATCO's operations.

127. ATCO considered that the output growth for operating expenditure includes expected growth in customer numbers and expected growth in the physical size (measured in kilometres of mains) of the distribution network. The weightings proposed by ATCO for customer numbers and kilometres of mains were 55 per cent and 45 per cent, respectively.

128. ATCO proposed to include $10.4 million for output growth escalation in the AA6 operating expenditure period.

129. As set out in Attachment 2 – Demand, the ERA has forecast alternative demand values for average customer numbers in the AA6 period. These are considered to be the best forecast possible, as required by rule 74(2)(b).

130. Using the ERA's determined average customer numbers, the ERA has determined output growth escalation of $14.0 million in the AA6 period.

Required Amendment

5.4 ATCO must amend its access arrangement information to revise its AA6 output growth escalation operating expenditure to $14.0 million ($ real as at 31 December 2023).

Input cost escalation

131. The ERA considers it reasonable to include an input cost escalation factor in ATCO's operating expenditure forecast to account for increases in labour and materials costs above inflation in the AA6 period.

132. The weightings proposed by ATCO for labour and materials costs (62 per cent and 38 per cent) have been included in calculating the input real growth escalation factor. These weights are consistent with the AA5 decision and similar to a number of the AER's recent decisions.

133. ATCO has applied no real cost escalation for non-labour costs, meaning it has forecast that materials will not incur any additional price rises over and above inflation. The ERA accepts ATCO's proposal to apply no real cost escalation for non-labour costs in the AA6 operating expenditure period.

134. ATCO engaged Synergies Economic Consulting to advise it on cost escalation for the AA6 period. As a result, ATCO has applied real cost escalation for labour costs in its AA6 operating expenditure submission to a value of $12.4 million over the period. ATCO's submission has used an adjusted version of the ERA's preferred forecasting methodology to calculate its real labour cost forecast.

135. ATCO has based its forecast on a four-year average of Western Australian Treasury CPI and WPI forecasts from 2023/2024 to 2026/27, rather than a five year average that would include 2022/23 as ATCO does not consider the value in 2022/23 to be representative of expected CPI growth in the AA6 period.

136. ATCO has also included in its forecast a premium on top of the ERA's preferred forecasting method. The premium is an average of the energy, gas, water and waste services WPI over the All Industries WPI series from 2000 to 2022, resulting in an average premium of 0.40 per cent.

137. Including this premium, ATCO's determined labour cost escalation factor equals 1.06 per cent.

138. With real wage growth in the 'All Industries' and the 'energy sector' currently close to zero, the 1.06 per cent per year real wage growth assumption essentially relies on economic conditions in Western Australia improving and wages in the energy sector regaining a premium of 0.4 per cent over All Industries.

139. EMCa noted, however, that between 2018 and 2023 the average wage premium has been -0.27 per cent. The premium that Synergies Economic Consulting has calculated has largely arisen from the lag in energy sector wages falling in the second decade of the data, relative to wages in All Industries. EMCa considered this to be only a weak indicator that such a premium will develop again and persist over AA6.

140. EMCa noted recent analysis by KPMG for the Australian Energy Regulator concluded that:[14]

> "There is no material difference between utilities WPI and general WPI".

141. The ERA notes that ATCO's operating expenditure proposal does not include a productivity adjustment. Given that a business with no productivity growth is unlikely to sustain real wage growth at above-average rates in the long term, it is not reasonable to expect wages growth for ATCO to exceed average wages growth without increases in ATCO's productivity.

142. As a result, the labour cost escalation proposed by ATCO cannot be considered reliably representative of the best forecast for the AA6 period, and is therefore inconsistent with rule 74(2)(b) of the NGR.

143. To calculate the best forecast of real labour escalation, the ERA has used the average of recent and forecast Western Australian Treasury wage price index Treasury WPI growth and CPI growth.

144. This is the method used by ATCO, however the ERA has not included a sector premium and has used the most recently available data at the time of publishing this draft decision. This results in a real labour escalation factor of 0.49 per cent as set out below in Table 5.19.[15]

Table 5.19: Western Australian Wage Price Index and Consumer Price Index data included in calculating the real annual labour escalation for the AA6 period (%)

	2023/24 mid-year revision estimate	2024/25 forward estimate	2025/26 forward estimate	2026/27 forward estimate	Average
Annual average WPI	4.25	3.50	3.25	3.00	3.50
Annual average CPI	4.00	3.00	2.50	2.50	3.00

Source: WA Department of Treasury, Western Australia State Budget 2023-24, Budget Paper no. 3, Economic and Fiscal Outlook (online)[accessed 12 April 2024].

145. The ERA has accepted ATCO's change in method and used a four-year average to determine the real labour escalation for this draft decision as the value in 2022/23 does not appear to be representative of expected CPI growth in the AA6. However, the ERA will consider the reintroduction of a five-year average using the available data at the time of the final decision if appropriate.

146. Using the 0.49 per cent real labour cost escalation value, the included value for labour escalation in the AA6 period is $4.1 million.

14 KPMG Report used by AER for ElectraNet Final Decision (March 2023), pp. 10 -11.

15 Derived by using the Fisher equation, not via subtraction.

Required Amendment

5.5 ATCO must amend its access arrangement information to revise its AA6 input cost escalation operating expenditure to $4.1 million ($ real as at 31 December 2023).

Unaccounted for gas

147. ATCO proposed UAFG operating expenditure of $30.8 million for AA6. ATCO's proposed UAFG operating expenditure is distributed over AA6 as shown in Table 5.20.

Table 5.20: ATCO forecast UAFG cost for AA6 ($ million real at 31 December 2023)

	2025	2026	2027	2028	2029	Total
UAFG	5.8	5.8	6.1	6.2	6.8	30.8

Source: *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, p. 134, Table 9.26.

148. ATCO's UAFG operating expenditure is determined using three inputs being:

- forecast UAFG percentage rates
- forecast gas volumes
- an assumed gas price.

Forecast UAFG percentage rates

149. ATCO has proposed a forecast UAFG percentage annually over AA6 as shown in Table 5.21.

Table 5.21: ATCO proposed forecast UAFG annually over AA6 (%)

	2025	2026	2027	2028	2029
UAFG	1.67	1.67	1.66	1.65	1.64

Source: *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, Attachment 09.008, UAFG strategy and forecast p. 4, Table 1.

150. The ERA notes that ATCO's UAFG actual and forecast percentage in AA5 was 1.70 per cent for all the years of AA5, with the exception of 2022 where the UAFG percentage dropped to 1.15 per cent. ATCO noted that the hot summer and milder winter in 2022 contributed to the decline in UAFG during that period.

151. The ERA accepts ATCO's proposed forecast UAFG annual percentages for AA6 in this draft decision, however, the ERA will review these percentages again in the final decision with the available data at the time including 2023 actuals.

Forecast gas volumes

152. To calculate its UAFG operating expenditure, ATCO has relied on the demand forecast as prepared by its consultants, Core Energy & Resources. As set out in Attachment 2 – Demand (pages 18-19), the ERA has forecast alternative demand values resulting in

higher gas consumption numbers in the AA6 period to those used by ATCO in its forecast.

153. The ERA has used its forecast gas consumption values to calculate ATCO's UAFG for the AA6 period. Table 5.22 below shows ATCO's and the ERA's determined UAFG volumes (TJ) based on its demand gas consumption values.

Table 5.22: ATCO and ERA's determined UAFG volumes (TJ)

	2025	2026	2027	2028	2029
ATCO – UAFG volume	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ERA – UAFG volume	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, Attachment 09.008, UAFG strategy and forecast p. 14, Table 3 *and ERA analysis.*

154. In order to meet its UAFG requirements in AA6, ATCO has proposed using a combination of natural gas, biomethane and hydrogen. As set out in Attachment 4 – Regulatory capital base (pages 36-41), the ERA has not approved the capital expenditure relating to enabling renewable gases, which is required to be able to inject biomethane and hydrogen into the network.

155. As a result of the capital expenditure being disallowed, the ERA has subsequently rejected the use of biomethane and hydrogen as a UAFG replacement. The ERA has determined that ATCO's UAFG requirement for AA6 will be met entirely with natural gas.

Assumed gas price

156. In ATCO's proposal the forecast unit gas price for UAFG has been estimated based on the most recent publicly available information and predictions. ATCO noted that the forecast unit rate for AA6 will be subject to change via a tender process to begin in late 2023. ATCO's tender process will inform ATCO and the ERA of the actual price of UAFG per GJ that will be used as the basis for ATCO's response to the draft decision.

157. The ERA considers ATCO's price for natural gas forecast for the AA6 period is reasonable for the purposes of this draft decision and notes that ATCO's tender is currently been assessed and will help inform the gas price used in determining the final decision UAFG operating expenditure.

ERA UAFG forecast operating expenditure

158. Taking into account the ERA's determination on forecast UAFG percentage rates, gas volumes, and assumed gas price, the ERA has determined UAFG operating expenditure of $31.8 million for AA6.

Required Amendment

5.6 ATCO must amend its access arrangement information to revise its AA6 unaccounted for gas operating expenditure to $31.8 million ($ real as at 31 December 2023).

Ancillary services

159. The ERA has not accepted ATCO's AA6 proposal for ancillary reference services of $27.1 million.

160. As set out in Draft Decision Attachment 2 – Demand (pages 17-19), the ERA has forecast alternative volumes of ancillary reference services to be undertaken by ATCO in the AA6 period. These are considered to be the best forecast possible for ancillary services volumes, as required by rule 74(2)(b), and therefore these volumes have been applied to calculate the ancillary services operating expenditure included in this draft decision.

161. ATCO noted in its submission that the ancillary services costs have been forecast based on the current costs of providing these services. The ERA sent an information request to ATCO after reviewing the unit costs set out in the operating expenditure model and the financial information provided to the ERA in ATCO's annual regulatory information notice (RIN).

162. ATCO reiterated that the AA6 ancillary services operating forecast was based on the forecast costs to provide those services. ATCO noted that the costs had been forecast using a bottom-up build method developed using the most recent costs of providing those services adjusted for expected cost increases including anticipated renegotiation of contractor rates.

163. The ERA has reviewed the most recent cost information for ancillary services, being the 2022 RIN data, of $0.9 million for ancillary services expenses. The ERA used the ancillary services expenses value and not the ancillary services revenue value of $1.8 million in 2022 as the revenue from ancillary services was not equal to the expenses for ancillary services in 2022 (as with 2020 and 2021).

164. Using the 2022 expense value of $0.9 million and the volume data for each ancillary service undertaken in 2022 (does not include the permanent disconnection service which ATCO has proposed to include as an ancillary reference service in AA6) the ERA determined the most recent available cost unit rates for each service. These values were then converted into 2023 dollars for comparison with ATCO's proposed values.

165. The ERA's calculated unit rates are between 16 per cent and 60 per cent less than the until rates proposed by ATCO in its AA6 proposal. The ERA considers that, in the absence of any additional information showing why the unit rates should be higher, the most recent actual expense data of 2022, escalated into 2023 dollars, is the best forecast possible for ancillary services unit costs (excluding the permanent disconnection service), as required by rule 74(2)(b), and therefore these unit costs have been applied to calculate the ancillary services operating expenditure included in this draft decision.

166. In its AA6 proposal, ATCO has included operating expenditure for the re-classified 'Permanent Disconnection' reference service. In order to assess the unit rate ATCO has proposed for the cost to undertake a permanent disconnection, the ERA requested additional information on the actual costs and number of services performed for the last four years.

167. From ATCO's response, the volume of permanent disconnections in 2020 to 2021 per averaged 2,104 per year compared to an average of 1,295 year in 2022 to 2023. The actual cost of performing these disconnections also was significantly different between

these two periods with the average cost of a permanent disconnection in 2020 to 2021 being $954.87 compared to $1,074.74 in 2022 to 2023.[16]

168. As discussed previously and set out in Draft Decision Attachment 2, the ERA has forecast alternative volumes of ancillary reference services to be undertaken by ATCO in the AA6 period. The volumes determined by the ERA for permanent disconnections during AA6 are consistent with the volumes undertaken by ATCO in the 2020 to 2021 period.

169. The ERA considers that with the permanent disconnection service there would be a relationship that with higher volumes there would be a lower unit cost as evidenced by ATCO's last four years of volumes and actual costs for the permanent disconnection service.

170. Accordingly, the ERA considers that the best possible forecast of a unit rate for the permanent disconnection service is a two-year average of the 2020 and 2021 years where the volumes undertaken are consistent with the forecast volumes to be undertaken in AA6.

171. As a result, the ERA has used a unit rate of $954.87 ($ real as at 31 December 2023) in determining the operating expenditure to be included for the ancillary reference service – permanent disconnection, in the AA6 period.

172. Using the ERA's forecast ancillary service volume and unit rates, the ERA has determined that for the AA6 period, ancillary services operating expenditure should be $19.6 million.

Required Amendment

5.7 ATCO must amend its access arrangement information to revise its AA6 ancillary services operating expenditure to $19.6 million ($ real as at 31 December 2023).

Draft decision amendments summary

173. Taking into account the ERA's required amendments, the ERA has determined that operating expenditure for the AA6 period is $337.4 million as set out below in Table 5.23

[16] All costs are real as at 31 December 2023.

Table 5.23: ERA Draft Decision forecast operating expenditure for AA6 ($ million real as at 31 December 2023)

	2025	2026	2027	2028	2029	AA6 total
Base year	50.7	50.7	50.7	50.7	50.7	253.5
Recurrent step changes	0.9	0.9	1.1	1.1	1.1	5.1
Non-recurrent step changes	0.0	0.8	2.1	3.6	2.8	9.3
Output growth escalation	1.6	2.2	2.8	3.4	4.0	14.0
Input cost escalation	0.5	0.6	0.8	1.0	1.2	4.1
Sub-total network, corporate and IT	**53.7**	**55.2**	**57.5**	**59.8**	**59.8**	**286.0**
UAFG	5.9	5.8	6.4	6.3	7.4	31.8
Ancillary services	3.8	3.9	3.9	4.0	4.0	19.6
Total forecast operating expenditure	**63.4**	**64.9**	**67.8**	**70.1**	**71.2**	**337.4**

Source: ERA Analysis.

Working Capital

ATCO proposal

174. Working capital refers to a stock of funds that must be maintained by a service provider to pay costs as they fall due. In circumstances where the costs of providing services are incurred before the revenues from the provision of services are received, a stock of working capital may need to be derived from a capital investment in the business. The cost of this stock of working capital (that is, the required return on the capital investment) is a cost of the service provider of operating its business and providing services.

175. The NGL and NGR do not make reference to the cost of working capital used by a service provider. Rule 76 of the NGR states that total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach. While the cost of working capital is not specifically included as a building block, ATCO has separately included the cost of working capital as a line item in its building block calculations.

176. ATCO proposed that its working capital refers to stock of funds that it must maintain to pay costs as they fall due, and inventory held to meet service requirements within mandated or reasonable service delivery times.

177. The requirement to maintain a stock of funds arises from the timing misalignment (on average) between incurring the costs of providing services and recovering the revenues associated with those services. In addition, a stock of materials is held to allow the efficient and timely provision of services. Therefore, the cost of working capital represents the efficient costs of a business that receives revenue at a different time than when it incurs costs.

178. ATCO estimated the cost of capital using the ‘working capital cycle model’ which has three core components: inventory, creditors, and receivables. ATCO noted that although the method used is the same as AA5, the parameters applied to each component of working capital have been reviewed and amended where necessary.

- Inventory: In AA5, ATCO proposed that an efficient level of inventory to be maintained was 0.89 per cent of annual capital expenditure. In 2022, ATCO has increased its percentage of inventory to annual capital expenditure to 2.26 per cent.

  ATCO noted that inventory requirements have increased relative to AA5 due to the need to ensure security of supply of materials necessary to operate, maintain and expand the network. ATCO considered this is particularly critical for long lead time items sourced overseas due to the ongoing effects of COVID-19 on supply chains.

- Creditors: ATCO has made no overall change to creditor days from AA5 to AA6. ATCO reviewed the payment terms relating to labour costs, general creditors and UAFG payments and calculated the weighted average creditor days as 19 days.

- Receivables: Receivable days consider the days of unbilled haulage. Unbilled haulage reflects the incurred costs to provide reference services for which revenue has not yet been received. Delays in the receipt of revenue are due to several reasons, the primary reason being the 3-monthy billing of B3 services. Receivable days are unchanged from AA5.

179. ATCO's updated parameters are shown in Table 5.24. ATCO's calculation of its working capital for AA6 is based on these parameters and is shown in Table 5.25.

Table 5.24: ATCO's AA6 working capital parameters

Parameter	AA5 (actual)	AA6 (proposed)	Basis of calculation
Inventory as a % of capital expenditure	0.89%	2.26%	Determined from the average inventory level as a percentage of the forecast capital expenditure program. This measure does not include work in progress or completed assets not yet added to the RAB.
Creditors	19 days	19 days	Determined from the standard terms of payment to suppliers, labour, and suppliers of unaccounted for gas. The amount relates to total expenditure, including capital expenditure.
Receivables	62 days	62 days	Determined from the payment terms of contracts with retailers

Source: *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, p. 222, Table 14.4.

Table 5.25: ATCO's working capital calculation for AA6

	2025	2026	2027	2028	2029
Opening working capital ($million nominal)	23.0	35.9	40.7	42.2	42.4
WACC (% nominal)	7.33%	7.33%	7.33%	7.33%	7.33%
Return on working capital ($million nominal)	1.7	2.6	3.0	3.1	3.1
Deflator to $real 2023	0.943	0.919	0.895	0.872	0.849
Return on working capital ($million real 2023)	**1.6**	**2.4**	**2.7**	**2.7**	**2.6**

Source: *ATCO, 2025-29 Plan (Access Arrangement Information)*, 1 September 2023, p. 222, Table 14.5.

Draft Decision

180. The ERA notes that ATCO calculated the return on working capital using the same working capital model that was used in AA5, with updated parameters for AA6.

181. ATCO has not amended two of the three approved parameters in the working capital model in AA6 being, creditors (19 days) and receivables (62 days).

182. The parameter that ATCO has amended from AA5 is the inventory maintained as a percentage of capital expenditure. The ERA has reviewed ATCO's proposal to increase the percentage up from 0.89 per cent in AA5 to 2.26 per cent in AA6. ATCO's proposal of 2.26 per cent is the percentage of inventory held by ATCO in its most recent year of 2022.

183. The ERA has reviewed ATCO's reasoning for increasing the inventory percentage with the need to ensure security of supply because of supply disruptions during the COVID-19 pandemic. The ERA notes that ATCO's percentage of inventory to capital expenditure had been increasing prior to COVID-19, with inventory representing 1.97 per cent of capital expenditure in 2019. It peaked during 2020 (2.47 per cent) and 2021 (2.44 per cent). For the purposes of this draft decision, the 2022 level for inventory is reasonable, but the ERA may reassess as part of its final decision once the 2023 level of inventory is provided by ATCO.

184. The ERA accepts ATCOs proposed working capital parameters for the level of inventory, creditors and receivables.

185. However, the return on capital will change as a result of required amendments to other aspects of ATCO's proposal such as capital and operating expenditure in AA6. As a result, the ERA has recalculated the return on working capital for AA6 in Table 5.26.

Table 5.26: ERA's Draft Decision working capital calculation for AA6

	2025	2026	2027	2028	2029
Opening working capital ($million nominal)	23.0	30.2	33.2	34.9	36.7
WACC (% nominal)	7.33%	7.33%	7.33%	7.33%	7.33%
Return on working capital ($million nominal)	1.7	2.2	2.4	2.6	2.7
Deflator to $real 2023	0.952	0.928	0.906	0.883	0.862
Return on working capital ($million real 2023)	**1.6**	**2.1**	**2.2**	**2.3**	**2.3**

Source: ERA analysis.

Required Amendment

5.8 ATCO must amend its access arrangement information to revise its AA6 return on working capital to $8.7 million ($ real as at 31 December 2023).

Appendix 1 List of Tables

Table 5.1: ATCO Actual and forecast AA5 operating expenditure ($ million real at 31 December 2023) ... 3
Table 5.2: ATCO proposed forecast operating expenditure for AA6 ($ million real at 31 December 2023) ... 4
Table 5.3: Comparison of ATCO's and ERA's determined efficient base year operating expenditure for 2022 ($ million real at 31 December 2023) ... 9
Table 5.4: ATCO proposed recurrent step changes for AA6 ($ million real at 31 December 2023) ... 10
Table 5.5: ATCO AA6 forecast enabling renewable gases operating expenditure ($ million real at 31 December 2023) ... 10
Table 5.6: ATCO AA6 forecast superannuation guarantee rate increase operating expenditure ($ million real at 31 December 2023) ... 12
Table 5.7: ATCO AA6 forecast cyber security operating expenditure ($ million real at 31 December 2023) ... 12
Table 5.8: ATCO AA6 forecast gas inspection safety changes operating expenditure ($ million real at 31 December 2023) ... 14
Table 5.9: ATCO AA6 forecast property, plant and equipment operating expenditure ($ million real at 31 December 2023) ... 15
Table 5.10: ATCO AA6 forecast ERP replacement operating expenditure ($ million real at 31 December 2023) ... 16
Table 5.11: ATCO AA6 forecast economic regulatory changes operating expenditure ($ million real at 31 December 2023) ... 16
Table 5.12: Comparison of ATCO's and ERA's determined Recurrent step change operating expenditure for AA6 ($ million real at 31 December 2023) ... 18
Table 5.13: ATCO proposed non-recurrent step changes for AA6 ($ million real at 31 December 2023) ... 18
Table 5.14: ATCO AA6 forecast pipeline inline inspections operating expenditure ($ million real at 31 December 2023) ... 19
Table 5.15: ATCO AA6 forecast economic regulatory operating expenditure ($ million real at 31 December 2023) ... 20
Table 5.16: ATCO AA6 forecast software as a service arrangement operating expenditure ($ million real at 31 December 2023) ... 21
Table 5.17: ATCO AA6 forecast managed IT services tender renewal operating expenditure ($ million real at 31 December 2023) ... 22
Table 5.18: Comparison of ATCO's and ERA's determined Non-Recurrent step change operating expenditure for AA6 ($ million real at 31 December 2023) ... 23
Table 5.19: Western Australian Wage Price Index and Consumer Price Index data included in calculating the real annual labour escalation for the AA6 period (%) ... 25
Table 5.20: ATCO forecast UAFG cost for AA6 ($ million real at 31 December 2023) ... 26
Table 5.21: ATCO proposed forecast UAFG annually over AA6 (%) ... 26
Table 5.22: ATCO and ERA's determined UAFG volumes (TJ) ... 27
Table 5.23: ERA Draft Decision forecast operating expenditure for AA6 ($ million real as at 31 December 2023) ... 30
Table 5.24: ATCO's AA6 working capital parameters ... 32
Table 5.25: ATCO's working capital calculation for AA6 ... 32
Table 5.26: ERA's Draft Decision working capital calculation for AA6 ... 33

Appendix 2 National Gas Rules

The National Gas Law (NGL) and National Gas Rules (NGR), as enacted by the *National Gas (South Australia) Act 2008*, establish the legislative framework for the independent regulation of certain gas pipelines in Australia. The *National Gas Access (WA) Act 2009* implements a modified version of the NGL and NGR in Western Australia.

The legislative framework for the regulation of gas pipelines includes a central objective, being the national gas objective, which 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—
>
> (a) price, quality, safety, reliability and security of supply of natural gas; and
>
> (b) the achievement of targets set by a participating jurisdiction—
>
> (i) for reducing Australia's greenhouse gas emissions; or
>
> (ii) that are likely to contribute to reducing Australia's greenhouse gas emissions.
>
> **Note—**
>
> The AEMC must publish targets in a targets statement: see section 72A.[17]

The following extracts of the NGR, as they apply in Western Australia, are provided for information to assist readers.

> **71 Assessment of compliance**
>
> (1) In determining whether capital or operating expenditure is efficient and complies with other criteria prescribed by these rules, the [ERA] may, without embarking on a detailed investigation, infer compliance from the operation of an incentive mechanism or on any other basis the [ERA] considers appropriate.
>
> (2) The [ERA] must, however, consider, and give appropriate weight to, submissions and comments received when the question whether a relevant access arrangement proposal should be approved is submitted for public consultation.
>
> **72 Specific requirements for access arrangement information relevant to price and revenue regulation**
>
> (1) The access arrangement information for a full access arrangement proposal (other than an access arrangement variation proposal) must include the following:
>
> (a) if the access arrangement period commences at the end of an earlier access arrangement period:
>
> (i) capital expenditure (by asset class) over the earlier access arrangement period; and

[17] NGL, section 23.

The national gas objective has changed since the last review of ATCO's access arrangement. The amended objective came into effect in Western Australia on 25 January 2024. See: *Western Australian Government Gazette 24 January 2024 No.8* (online) (accessed April 2024).

(ii) operating expenditure (by category) over the earlier access arrangement period; and

(iii) usage of the pipeline over the earlier access arrangement period showing:

(A) for a distribution pipeline, minimum, maximum and average demand and, for a transmission pipeline, minimum, maximum and average demand for each receipt or delivery point; and

(B) for a distribution pipeline, customer numbers in total and by tariff class and, for a transmission pipeline, user numbers for each receipt or delivery point;

(b) how the capital base is arrived at and, if the access arrangement period commences at the end of an earlier access arrangement period, a demonstration of how the capital base increased or diminished over the previous access arrangement period;

(c) the projected capital base over the access arrangement period, including:

(i) a forecast of conforming capital expenditure for the period and the basis for the forecast; and

(ii) a forecast of depreciation for the period including a demonstration of how the forecast is derived on the basis of the proposed depreciation method;

(d) to the extent it is practicable to forecast pipeline capacity and utilisation of pipeline capacity over the access arrangement period, a forecast of pipeline capacity and utilisation of pipeline capacity over that period and the basis on which the forecast has been derived;

(e) a forecast of operating expenditure over the access arrangement period and the basis on which the forecast has been derived;

(f) [Deleted];

(g) the allowed rate of return for each regulatory year of the access arrangement period;

(h) the estimated cost of corporate income tax calculated in accordance with rule 87A, including the allowed imputation credits referred to in that rule;

(i) if an incentive mechanism operated for the previous access arrangement period—the proposed carry-over of increments for efficiency gains or decrements for efficiency losses in the previous access arrangement period and a demonstration of how allowance is to be made for any such increments or decrements;

(j) the proposed approach to the setting of tariffs including:

(i) the suggested basis of reference tariffs, including the method used to allocate costs and a demonstration of the relationship between costs and tariffs; and

(ii) a description of any pricing principles employed but not otherwise disclosed under this rule;

(k) the service provider's rationale for any proposed reference tariff variation mechanism;

(l) the service provider's rationale for any proposed incentive mechanism;

(m) the total revenue to be derived from pipeline services for each regulatory year of the access arrangement period.

(2) The access arrangement information for an access arrangement variation proposal related to a full access arrangement must include so much of the above information as is relevant to the proposal.

(3) Where the [ERA] has published financial models under rule 75A, the access arrangement information for a full access arrangement proposal must be provided using the financial models.

…

76 Total revenue

Total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach in which the building blocks are:

(a) a return on the projected capital base for the year (See Divisions 4 and 5); and

(b) depreciation on the projected capital base for the year (See Division 6); and

(c) the estimated cost of corporate income tax for the year (See Division 5A); and

(d) increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency (See Division 9); and

(e) a forecast of operating expenditure for the year (See Division 7).

…

91 Criteria governing operating expenditure

(1) Operating expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services in a manner consistent with the achievement of the national gas objective.

(2) The forecast of required operating expenditure of a pipeline service provider that is included in the access arrangement must be for expenditure that is allocated between:

(a) reference services;

(b) other services provided by means of the scheme pipeline; and

(c) other services provided by means of non-scheme parts (if any) of the pipeline, in accordance with rule 93.

…

93 Allocation of total revenue and costs

(1) Total revenue is to be allocated between reference and other services in the ratio in which costs are allocated between reference and other services.

(2) Costs are to be allocated between reference and other services as follows:

(a) costs directly attributable to reference services are to be allocated to those services; and

(b) costs directly attributable to pipeline services that are not reference services are to be allocated to those services; and

(c) other costs are to be allocated between reference and other services on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the [ERA].

(3) The [ERA] may, however, permit the allocation of the costs of rebateable services, in whole or part, to reference services if:

(a) the [ERA] is satisfied that the service provider will apply an appropriate portion of the revenue generated from the sale of rebateable services to reduce the reference tariff in accordance with rule 97; and

(b) any other conditions determined by the [ERA] are satisfied.

(4) A pipeline service is a rebateable service if:

(a) the service is not a reference service; and

(b) substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service.