Access Arrangement for the Mid-West and South-West Gas Distribution Systems

FINAL DECISION

How does the ERA regulate gas?

The Economic Regulation Authority (ERA) is responsible for reviewing ATCO Gas Australia Pty Ltd.'s (ATCO) and other regulated gas infrastructure in Western Australia. The ERA makes decisions to ensure the terms, conditions and charges that a service provider proposes are consistent with the long term interest of consumers and that users of the infrastructure have fair access to services.

Who is ATCO?

ATCO owns and operates the Mid-West and South-West Gas Distribution System. This is the gas network that retailers such as Alinta and Kleenheat use to deliver natural gas to homes and businesses in the Mid-West (Geraldton) and South-West (Perth, Busselton and Mandurah) of Western Australia.

What is an access arrangement?

An access arrangement sets out the terms and conditions including price (tariff) under which third parties can use a pipeline. It must specify at least one reference service likely to be sought by a significant part of the market, and a reference tariff for that service.

An access arrangement normally covers a period of five years. This is the fourth access arrangement period for this regulated gas network but covers a five-and-a-half year period between 1 July 2014 and 31 December 2019.

Why does it matter?

The revenue that the Final Decision allows ATCO to recover affects the distribution component of a customer's final gas bill. Distribution charges are one component of the customer's gas bill, which also includes costs to produce gas, transmit it from its source to the gas network and retail costs.

The ERA's Final Decision

The Final Decision of the ERA is to not approve ATCO's revised access arrangement proposal.

The Final Decision has reduced ATCO's expected revenue for the period 1 July 2014 to 31 December 2019 from $1,124.52 million (nominal dollars) to $914.04 million (nominal dollars).

The ERA's Assessment

The ERA's assessment process includes a 'building block' approach to calculate total expected network revenue. The ERA uses this total revenue and demand forecasts to derive network reference tariffs.

The building block approach is used to identify the costs that comprise total revenue and are expected to be incurred by an efficient service provider providing pipeline services. These costs include operating expenditure, return on assets, depreciation and taxation. The ERA's assessment of each building block is explained below.

Operating Expenditure

Operating expenditure includes expenditure of a non-capital nature that is incurred in providing pipeline services. Operating expenditure must reflect the costs incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering reference services as per rule 91 of the National Gas Rules (NGR).

ATCO proposed to spend $443.26 million (nominal dollars) over the course of the fourth access arrangement period. The ERA approved $394.28 million (nominal dollars) of the proposed forecast operating expenditure with the main adjustments affecting ATCO's proposed network, corporate support and business development and marketing expenditure.

Return on assets – Capital Expenditure

Conforming capital expenditure is added to the projected capital base. Capital expenditure refers to the cost of sustaining and growing the gas distribution network, which includes the costs for IT, structures and equipment. Capital expenditure must be conforming under rule 79 of the NGR.

ATCO proposed to spend $642.49 million (nominal dollars) over the course of the fourth access arrangement period. The ERA approved $473.86 million (nominal dollars) for the conforming capital expenditure with the main adjustments addressing ATCO's proposed sustaining and growth capital expenditure.

Return on assets - Rate of Return

The ERA is required to determine the rate of return to be applied to the projected capital base for each year of the regulatory period in accordance with rule 87 of the NGR.

The ERA's Final Decision sets the rate of return for the:

- 2014-15 financial year (which is applied from 1 July 2014 to 31 December 2014) at 5.97 per cent (nominal vanilla); and
- 2015 calendar year (which is applied from 1 January 2015 to 31 December 2015) at 6.01 per cent (nominal vanilla).

Applying the ERA's rate of return to the projected capital base allows a return of $383.33 million (nominal dollars) over the course of the fourth access arrangement period. This compares to ATCO's proposed $512.53 million (nominal dollars) which used a rate of return of 7.64 per cent (nominal vanilla).

Depreciation

The ERA did not approve ATCO's proposed approach for calculating depreciation. The ERA required that the Current Cost Accounting approach be adopted for depreciation rather than ATCO's proposed Historical Cost Accounting transition approach.

The ERA approved $123.69 million (nominal dollars) for depreciation compared to ATCO's proposed amount of $127.68 million (nominal dollars) over the fourth access arrangement period.

Taxation

An estimate of the income tax payable is calculated based on the formula stated in rule 87A(1) of the NGR.

The ERA has approved ATCO's adoption of the straight line method to depreciate new capital expenditure in its tax asset base after 1 July 2014. The ERA has not approved ATCO's estimated cost of corporate income tax net of imputation credits. The ERA has calculated tax payable based on its revenue and costs determined in the Final Decision.

The ERA approved $12.74 million (nominal dollars) for tax compared to ATCO's proposed amount of $41.05 million (nominal dollars) over the fourth access arrangement period.

Tariff Impact on customers

A1, A2, B1 and B2 tariff classes

The ERA's Final Decision allows an annualised reduction of 8.6 per cent (nominal dollars) over the course of the fourth access arrangement period for the A1, A2, B1 and B2 tariff classes.

Residential customers (B3 tariff class)

The B3 tariff consists of a standing charge and variable charge. The ERA has accepted ATCO's proposal to increase standing charges to recover the avoidable cost (the cost of connecting a B3 customer to the network). The ERA has decided that ATCO's proposed increase in the standing charge should be phased in over the fourth access arrangement period. This results in the current standing charge increasing from approximately $70 per B3 customer connection, rising incrementally to a maximum of approximately $105 in 2019 (in real dollars at 30 June 2014).

The ERA's Final Decision means an average residential gas customer should see cumulative gas bill savings of over $200 in the period to 31 December 2019.

Next Steps

The ERA must now prepare an access arrangement to implement the required amendments noted in the Final Decision. The ERA must publish this access arrangement within the next two months.

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