Revised Final Plan
Attachment 12.3

Response to Draft Decision on Incentives

October 2020

Dampier Bunbury Pipeline

1. Response to Draft Decision on Incentives

We are introducing an opex incentive scheme in AA5 to strengthen our incentives to incur efficient opex.

1.1. Overview

This attachment sets out our response to the ERA's Draft Decision on the incentive mechanisms to apply over the next (2021 to 2025) Access Arrangement period (AA5). In particular we are responding to the following of the ERA's Required Amendments:

Required Amendment 15

DBP must amend clause 15.11(b) of the proposed revised access arrangement to read as follows:

(b) any operating expenditure sub-category not forecast using a top-down, revealed cost approach. These costs:

(i) may include, but are not limited to, operating costs incurred by the Operator relating to:

A. system use gas; and

B. non-recurrent operating expenditure.

(ii) must not include operating expenditure previously classified as capital expenditure that was forecast on a bottom-up basis.

Required Amendment 16

DBP must remove clause 15.11(c) from the proposed revised access arrangement.

Required Amendment 17

DBP must remove clause 15.11(e) from the proposed revised access arrangement

Required Amendment 18

DBP must amend clause 15.11(f) of the proposed revised access arrangement to read as follows:

(f) any other operating expenditure amount that the ERA notifies the Operator is required by the ERA to exclude from the E Factor benchmark.

Required Amendment 19

DBP must amend clause 15.12 of the proposed revised access arrangement to read as follows:

Where the Operator changes its approach to classifying costs as either capital expenditure or operating expenditure during the access arrangement period, the Operator will adjust the E Factor benchmark to be consistent with the capitalisation policy changes to the effect that outcomes under the efficiency mechanism are not affected by the change in capitalisation policy.

Required Amendment 20

DBP must amend clauses 15.2(c) and 15.8 of the proposed revised access arrangement to correct the following typographical errors:

In clause 15.2(c), the reference to "clause 16.11" must be changed to "clause 15.11".

In clause 15.8, the reference to "(A5 in paragraph (16.7) above)" must be changed to "(A5 in paragraph (15.7) above)".

The following sections provide a summary of the ERA's Draft Decision and our response to the ERA's Draft Decision on incentives which forms our Revised Final Plan.

1.2. ERA Draft Decision

The ERA has accepted our proposal to introduce the E Factor scheme for AA5 as it is consistent with the revenue and pricing principles and the national gas objective, subject to the following modifications summarised in Table 1.1 below.

Table 1.1: Summary of ERA's Draft Decision on Incentives

	ERA Draft Decision	ERA Comment
E factor exclusions – capex to opex (Required Amendment 15)	**Accept**	Accepted proposal but requires a clarifying amendment that recurrent 'capex to opex' forecast on a bottom-up basis is not subject to exclusion from the E factor benchmark.[1]
E factor exclusions - costs not reasonably within our control (Requirement Amendment 16)	**Reject**	Rejected our proposal to exclude costs not reasonably within our control from the benchmark considering it is inconsistent with schemes administered by the AER and not comparable with the gain sharing mechanism as applied by Western Power.[2]
E factor exclusion - Cost pass through events (Requirement Amendment 17)	**Reject**	Cost pass through events should not be excluded from the benchmark.[3]
E Factor exclusion – Any other operating expenditure amount (Requirement Amendment 18)	**Modify**	Our agreement as a precondition to exclude other costs from the E factor benchmark is inconsistent with the revenue and pricing principles and the national gas objective and should be removed.[4]
Capitalisation policy changes (Required Amendment 19)	**Accept**	Accepted proposal but requires a clarifying amendment that outcomes under the mechanism will be unaffected by the change in capitalisation policy.[5]
Administrative amendments (Required Amendment 20)	**Modify**	Typographical errors in the Access Arrangement.[6]

Note: In this 'traffic light' table, green shading represents the ERA's acceptance of our Final Plan, orange represents the ERA's modification of our Final Plan and red shading represents the ERA's rejection of our Final Plan.

1 ERA Draft Decision, [1110] to [1112]
2 ERA Draft Decision, [1115] to [1126]
3 ERA Draft Decision, [1132] to [1136]
4 ERA Draft Decision, [1137] to [1143]
5 ERA Draft Decision, [1114] to [1146]
6 ERA Draft Decision, [1174]

1.3. Our Response to the Draft Decision

We welcome the ERA's Draft Decision to accept our proposal to include the E Factor scheme for AA5. We have accepted all of the ERA's proposed changes, with some minor modifications to clarify:

- specific fees and levies which should be excluded from the operation of the E Factor; and
- any costs related to a cost pass through event should be adjusted in the E factor benchmark before any carryover under the scheme is calculated.

A summary of our response to the ERA's Draft Decision is provided in Table 1.2 below.

Table 1.2: Summary of our response to the ERA's Draft Decision on Incentives

	ERA Draft Decision	Our response	Our comment
E factor exclusions – capex to opex (Required Amendment 15)	**Accept**	**Accept**	We have accepted the ERA's Required Amendment 15.
E factor exclusions - costs not reasonably within our control (Requirement Amendment 16)	**Reject**	**Modify**	We have refined our exclusions to the E Factor by identifying specific fees and levies we propose to exclude. This is discussed in section 1.3.1 below.
E factor exclusion - Cost pass through events (Requirement Amendment 17)	**Reject**	**Modify**	We agree there should be the same incentive to incur efficient costs resulting from a cost pass through event. We have, however, clarified the mechanism to ensure the forecast costs related to a cost pass through event are reflected in the opex benchmark before any carryover is calculated under the scheme. We believe this modification has the same intent as the ERA's required amendment 17. We have modified clause 15.11(e) and is discussed in section 1.3.2 below.
E Factor exclusion – Any other operating expenditure amount (Requirement Amendment 18)	**Modify**	**Modify**	We have accepted the ERA's Draft Decision to remove our agreement as a precondition, however we have modified clause 15.11(f) to not preclude us from proposing costs to be excluded to the ERA. This is discussed in section 1.3.3 below.
Capitalisation policy changes (Required Amendment 19)	**Accept**	**Accept**	We have accepted the ERA's Required Amendment 19.
Administrative amendments (Required Amendment 20)	**Modify**	**Accept**	We have accepted the ERA's Required Amendment 20.

Note: In this 'traffic light' table, green shading represents the acceptance, orange represents a modification and red shading represents a rejection

The following sections outline the reasons for our response to the ERA's Draft Decision in this Revised Final Plan.

1.3.1. Costs not reasonably within our control

We have refined our exclusions to the E Factor by identifying specific fees and levies we propose to exclude. It is appropriate to exclude these fees and levies as:

- They are set externally;
- Annual revision of these fees and levies are subject to a number of factors in addition to CPI, including but not limited to, government bond rates, volume of work from the industry as a whole, pass through of costs from related project work and any changes to the customer base from which costs can be recovered;
- We have no ability to influence the factors that are included when they are set or revised; and
- We do not have access to accurate forecasts over AA5 such as likely movements in many of the factors included in the annual revision of fees and levies.

The intent of an opex incentive scheme is to encourage efficiency in the provision of services. As we cannot control the costs of fees and levies we must incur, it isn't appropriate for these costs to impact any efficiency gains or losses that we may obtain under the E Factor scheme.

1.3.1.1. Refined exclusion of land access fees, licence fees, ERA costs and safety levies

In our Final Plan we proposed to exclude government charges consisting of permits, licence fees, rates and taxes, which was a subcategory of our base year opex, from our E Factor Benchmark. We proposed to exclude the entire subcategory to focus only on those costs that are beyond our direct control and where annual cost movements cannot be forecast with any degree of accuracy.

In response to the ERA's Draft Decision, we have:

- further reviewed this subcategory of government charges to identify specific costs that should be excluded as these costs are reasonably unforeseeable and where we have no ability to influence. We propose the following government charges to be excluded from the E Factor:
  - land access fees payable under the *Dampier to Bunbury Pipeline Act 1997* (WA);
  - licence fees consisting of:
    - our P40 pipeline licence payable under the *Petroleum Pipelines Act 1969* (WA);
    - our radiocommunication licences under the *Radiocommunications Act 1992* (Cth) and associated Determinations;
  - costs payable to the ERA under *Economic Regulation Authority (National Gas Access Funding) Regulation 2009* (WA); and
  - safety levies payable to the Department of Mines, Industry Regulation and Safety WA; and
- amended the proposed E Factor Calculation Model (see Attachment 12.1A) to separate out the opex costs in our AA5 forecast opex for land access fees, licence fees, ERA costs and safety levies.

By making the changes above, we have clearly identified the description and amounts of these fees and levies included in our AA5 forecast opex, which total $4.4 million in the 2019 base year ($0.3 million less than the amount we proposed to exclude in our Final Plan). This allows them to be excluded from the forecast opex as well as the actual opex when the E Factor is applied, so that there are no efficiency gains or losses attributable to movements in these fees and levies which are either greater or less than the trend applied to our opex base year. We propose that only the fees and levies identified at the start of AA5 can be excluded in the E Factor for AA5.

Accordingly, we have updated our proposed E Factor Calculation Model (see Attachment 12.1A) and amended clause 15.11(c) of the proposed revised access agreement to read as follows:

(c) any operating expenditure sub-category not reasonably within the control of the Operator. These costs may include, but are not limited to, operating costs incurred by the Operator relating to:

(i) ~~permits~~ land access fees;

(ii) licence fees;

(iii) ERA costs; and

(iv) ~~rates and taxes~~ safety levies.

Consistency with the NGR and comparable schemes

While we recognise that the EBSS or equivalent efficiency carryover mechanism administered by the AER does not exclude similar costs (those not reasonably within the control of the operator), this is not a reason of itself for the ERA not to accept the exclusions. In fact, and of more relevance, the exclusion of these types of costs is consistent with the approach adopted by the ERA for Western Power's Gain Sharing Mechanism in AA3 and AA4.

In the ERA's Draft Decision to Western Power's proposed revised access arrangement for AA3: [7]

> *The Authority agrees that costs relating to ……licence fees and the Energy Safety Levy are outside the control of Western Power and that it is therefore reasonable that such costs should be excluded from the gain sharing mechanism. However, this is subject to Western Power having clearly identified the amounts of these costs in its forecast operating costs for AA3 so that, when the gain sharing mechanism is applied, there is no difficulty in excluding these costs from the original forecast operating expenditure as well as from the actual operating expenditure.*

This decision to exclude these types of costs was also maintained by the ERA in Western Power's AA4 decision.[8]

We note we are not subject to the same prescribed services standards like Western Power as stated by the ERA:[9]

> *the E Factor scheme is not comparable to the gain sharing mechanism as applied to Western Power under the Electricity Networks Access Code. Specifically, section 6.26 of the Access Code states that an above-benchmark surplus does not exist to the extent that*

[7]See:http://www.erawa.com.au/cproot/10284/2/20120329%20Draft%20Decision%20on%20Proposed%20Revisions%20to%20the%20AA%20for%20the%20WPN%20-%20Submitted%20by%20WP.pdf, [1256].

[8] See: https://www.erawa.com.au/cproot/18947/2/WPAA4%20-%20Draft%20Decision.PDF, [256] to [257].

[9] ERA Draft Decision, [1119]

> *a service provider has achieved efficiency gains by failing to maintain prescribed minimum service standards*.

We, in practice, have strict conditions in our shipper contracts and operating licence that require us to maintain public safety, ensure a reliable supply, and to deliver a high quality of service. Deterioration in any of these conditions would result in financial penalties, which would likely offset any potential benefits to us under the E Factor.

We note that the ERA did not receive any submissions that considered whether our contractual obligations and operating licence conditions provide inadequate incentives for it to maintain service performance and supply reliability.[10]

Finally, we would suggest that the exclusion of fees and levies from the E Factor scheme furthers, rather than detracts from, the intent of the opex incentive scheme under the NGR.

1.3.2. Pass-through mechanism

We agree with the ERA that the same incentives to incur efficient costs should also apply for costs related to a cost pass through event. Therefore, it is appropriate that cost pass through events should not be excluded from the E Factor benchmark. While we accept the ERA's Draft Decision, we have clarified that the opex benchmark should be adjusted to reflect the forecast costs for any cost pass through events before the carryover is calculated.

Costs related to cost pass through events are incurred as a result of circumstances beyond our control. As stated by the ERA, these costs are unforeseen costs and are not similar to costs which have been included in the approved forecast opex.[11] Therefore it is appropriate for the approved forecast opex to be adjusted for the forecast efficient costs related to a cost pass through event.

Without the adjustment to the approved opex, the inclusion of these costs in the E Factor may unfairly penalise us for incurring these costs. This is inappropriate when the approval of a cost pass through event itself recognises that these are efficient costs that are recoverable from customers immediately. This ensures actual costs are compared against benchmark on a like for like basis.

Accordingly, the adjustment of the approved opex forecast used to calculate any carryover of efficiency gains or losses under the E Factor is appropriate and consistent with the NGR and the revenue and pricing principles of the NGL.

We have amended clause 15.11(e) of the proposed revised access agreement to read as follows:

> *(e) the Operator will adjust the E Factor benchmark to include the forecast operating expenditure arising from the cost pass through event or other ERA approved expenditure arising from cost pass through events which apply in respect of that year*

1.3.3. Any other operating expenditure amount

We accept the ERA's Draft Decision to remove the pipeline operator's agreement as a precondition to the exclusion of other costs from the E Factor benchmark. However we consider the ERA's amended clause precludes us from proposing to the ERA any other operating expenditure amount that the ERA should exclude from the E Factor benchmark.

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[10] ERA Draft Decision, [1160]

[11] ERA Draft Decision, [1135]

Accordingly we have amended clause 15.11(f) of the proposed revised access agreement to read as follows:

> *(f) any other operating expenditure amount that the ERA ~~notifies the Operator is required by the ERA~~ agrees to exclude from the E Factor benchmark.*

1.3.4. Inclusions and Exclusions

Table 1.3 below summarises the updated E Factor inclusions and exclusions proposed.

Table 1.3: Updated E Factor inclusions and exclusions

Opex category	Opex sub-category	Excluded items	Forecasting method
Government charges	Permits, licence fees, rates and taxes	• land access fees; • licence fees; • ERA costs; and • safety levies.	Roll-forward, externally driven
System use gas	Fuel gas	Entire category	Bottom-up build, externally driven
Field expenses	Turbine / GEA overhauls	Entire category	Bottom-up build, non-cyclical

1.4. Summary

We will introduce the E Factor scheme in AA5 which will strengthen our incentive to deliver operating cost savings and efficiency improvements, and allow benefits to be shared with our customers. In doing so, we have accepted a number of the ERA's proposed amendments to the scheme, and made some minor modifications to others.