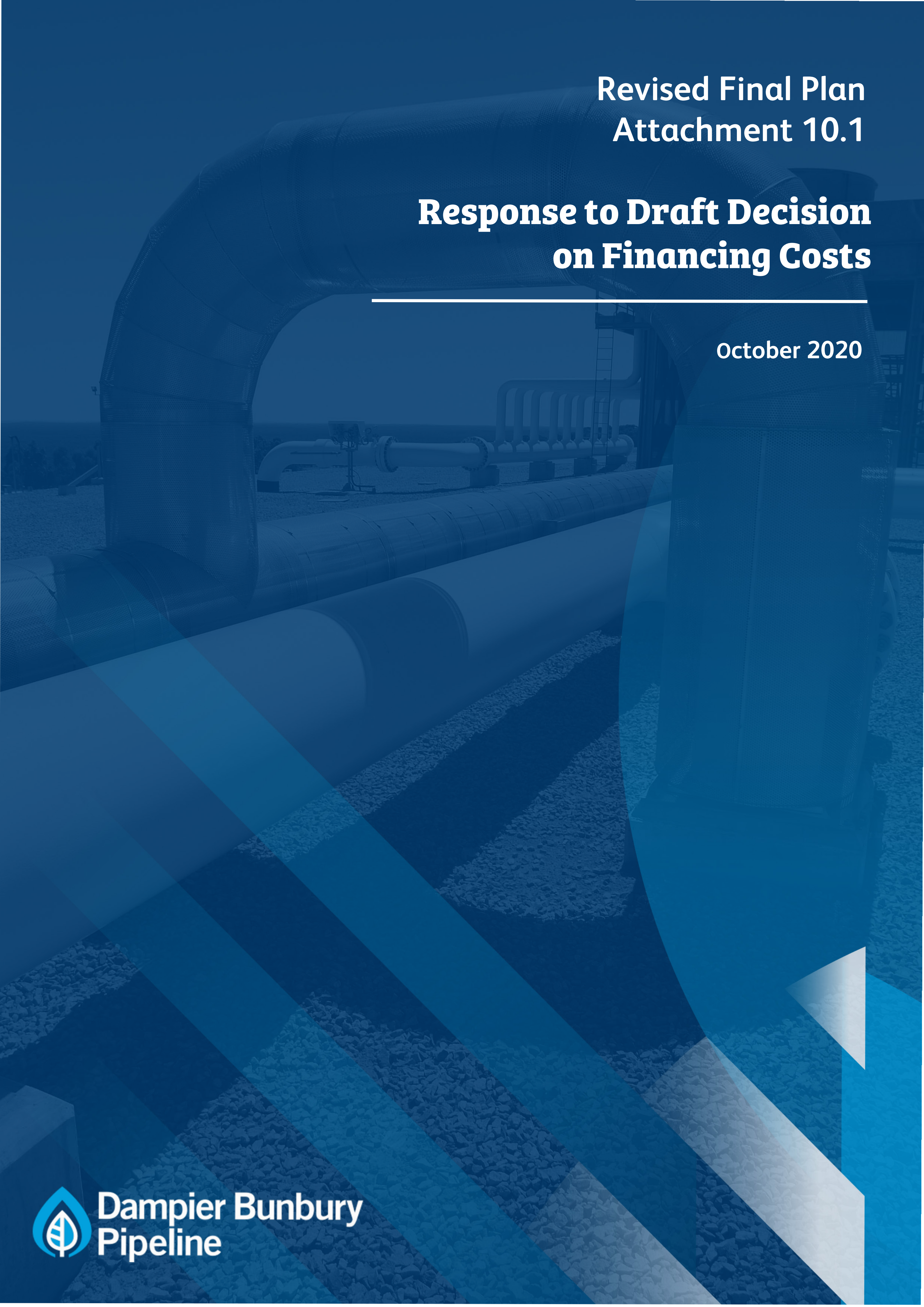

Revised Final Plan
Attachment 10.1

Response to Draft Decision on Financing Costs

October 2020

Dampier Bunbury Pipeline

1. Response to Draft Decision on Financing Costs

We accept the ERA's Draft Decision in respect of the weighted average cost of capital (WACC) and have made only one change to the approach for calculating tax.

1.1. Overview

This section summarises our response in respect of financing costs; WACC and tax. It covers the ERA's Amendment's 12 and 14 in its Draft Decision.

1.2. ERA Draft Decision

The ERA required the following amendments in respect of financing costs:

Required Amendment 12

Subject to the nomination of a final averaging period, DBP must amend its rate of return to be 4.03 per cent (vanilla nominal after-tax).

Required Amendment 14

DBP must amend the calculation of income tax as follows:

i. Amend the approach to use unsmoothed revenue to determine taxable income.
ii. Amend the approach to maintain a 20-year tax asset life for 'Other depreciable' assets.
iii. Separately identify any building assets from its tax assets purchased on or after 1 January 2021, which should be depreciated using straight-line depreciation.
iv. Separately identify any refurbishment capital expenditure in its access arrangements that is to be included in forecast operating expenditure and capital expenditure.
v. Amend the formula for the diminishing value method to use an asset's effective life.
vi. Amend the estimate cost of corporate income tax in accordance with the values set out in Table 120 of this draft decision.

1.3. Our Response to the Draft Decision

Our response to Amendments 12 and 14 is summarised in Table 1, and then detailed below.

Table 1: Summary of our response to the ERA's Draft Decision on Financing Costs

ERA Draft Decision Reference	Our Response	Our Comment
Required Amendment 12	**Modify**	We accept the ERA's approach on WACC, but have used August 2020 information in this response.
Required Amendment 14 (i)	**Accept**	
Required Amendment 14 (ii)	**Reject**	We have changed the "other" category for regulatory purposes, removing the assets identified by the ERA such that the remaining assets reflect an economic life of ten years. This has a flow-on effect for tax.
Required Amendment 14 (iii)	**Accept**	While we have accepted this change, we note that it should be revisited to ensure it supports decisions relating to the economic life of the DBNGP.
Required Amendment 14 (iv)	**Accept**	There is no refurbishment capex proposed for AA5.
Required Amendment 14 (v)	**Accept**	
Required Amendment 14 (vi)	**Modify**	We have estimated the cost of corporate income tax in accordance with our responses to the ERA's proposed amendments above, rather than in accordance with Table 120 in the Draft Decision.

1.3.1. Weighted average cost of capital

The process for determining the weighted average cost of capital is set out in the ERA's 2018 Rate of Return Guidelines, which are binding on both the ERA and ourselves. Accordingly, these Guidelines were followed in both our Final Plan and in the ERA Draft Decision, with the only difference being timing in respect of the risk-free rate.

The WACC used to determine reference tariffs as part of the ERA's Final Decision will be determined based upon our confidential averaging period, which has been accepted by the ERA. Table 2 below summarises the WACC we have used in this response, based on an averaging period of August 2020, and compares this with the Final Plan and Draft Decision.

Table 2: Draft decision response rate of return estimate

Component	Final Plan	Draft Decision	Draft Decision Response
Averaging period	*October 2019*	*February 2020*	*August 2020*
Return on debt (%)			
5-year interest rate swap (effective yield)	1.11	0.84	0.37
Debt risk premium (10-year average)	2.280	2.240	2.280
Debt issuing cost + hedging cost	0.214	0.214	0.214
Nominal return on debt	*3.61*	*3.29*	*2.87*
Return on equity			
Nominal risk free rate (%)	0.96	0.74	0.43
Market risk premium (%)	6.00	6.00	6.00
Equity beta	0.7	0.7	0.7
Nominal return on equity (%)	*5.16*	*4.94*	*4.63*

Other parameters			
Debt proportion (%)	55	55	55
Inflation (%)	1.19	1.29	0.94
Corporate tax rate (%)	30	30	30
Franking credit	0.5	0.5	0.5
Nominal after-tax WACC (%)	**4.31**	**4.03**	**3.66**
Real after-tax WACC (%)	3.08	2.71	2.69

1.3.2. Tax

We have accepted all required amendments to determine the cost of tax aside from the requirement to adopt a 20 year life in respect of the "other" category, which is discussed in this section. The resultant cost of tax taking into consideration this one change and other consequential changes in our response to the Draft Decision, including in respect of the WACC, is set out in Table 3.

Table 3: AGIG's calculation of the estimated cost of corporate income tax for AA5 ($ million nominal)

	2021	2022	2023	2024	2025
Unsmoothed revenue	**391.35**	**307.92**	**311.03**	**303.61**	**303.08**
Tax expenses					
- Operating expenditure, System use gas	19.26	19.12	19.19	14.67	14.50
- Operating expenditure, other expenses	74.64	73.80	74.99	72.47	70.68
- Tax depreciation	99.53	113.09	116.45	116.17	118.38
- Interest on debt	53.18	51.64	50.86	49.78	48.84
Total tax expenses	**246.62**	**257.65**	**261.49**	**253.09**	**252.40**
Estimated taxable income	144.73	50.27	49.54	50.52	50.68
Tax loss carried forward	0.00	0.00	0.00	0.00	0.00
Estimated taxable income (net of tax loss)	144.73	50.27	49.54	50.52	50.68
Estimated cost of tax (tax rate=30 per cent)	43.42	15.08	14.86	15.16	15.20
Value of imputation credits (γ=0.5)	-21.71	-7.54	-7.43	-7.58	-7.60
Cost of corporate income tax net of imputation credits	**21.71**	**7.54**	**7.43**	**7.58**	**7.60**
Cost of corporate income tax ERA Draft Decision Table 120	*10.42*	*6.30*	*5.92*	*5.92*	*5.96*

Amendment 14 (ii) – the "other" category

The ERA's decision to change the life of the "other" category from 10 years to 20 years[1] is a direct consequence of its treatment of the "other" category in regulatory depreciation, detailed in Draft Decision in paragraphs 906 to 913. For regulatory depreciation, the ERA rejected the shorter asset life on account of certain assets remaining in the "other" category, which assets the ERA

[1] see Draft Decision, [994].

determined would have a life longer than ten years. Consistent with this reasoning, the ERA has likewise kept the tax asset lives for the other category at 20 years.

In our response to the Draft Decision, we have taken the approach recommended by the ERA's consultants EMCa[2] and removed the relevant assets from the "other" category for the purposes of regulatory depreciation. We have therefore also removed those same assets from the "other" tax asset class (placing them in the tax asset class equivalents of where they were placed for regulatory depreciation).

As a result of this change, we have returned the "other" category to 10 years consistent with the life used for regulatory depreciation.

Amendment 14 (iii) – building assets

The ERA Draft Decision requires that we identify all of the building assets in our capex for AA5 and to put these assets into a separate class that is depreciated using straight line depreciation, rather than the diminishing value method used for other assets. The building assets in our AA5 capex are shown in Table 4 below. The total value of buildings capex in AA5 is $16.3 million.

Table 4: Building assets in AA5 capex

Asset detail	Project in capex	Value	Life (yrs)
Upgrade Repeater Site Equipment Shelters	Northern Comms	$5,057,700	40
Glazing (for heat and noise reduction)	CS Accomodation	$1,000,000	40
Building inspection and certification in cyclone prone areas and allowance for subsequent rectification	CS Accomodation	$350,000	40
Replacement of 16 transportable accommodation units to permanent accommodation	CS Accomodation	$1,920,000	25
Site specific pest/vermin control audits and rectification works	CS Accomodation	$270,000	40
Upgrades to kitchens, bathrooms, communal areas including carpets, tiling, fittings, window furnishings	CS Accomodation	$800,000	40
Office facility upgrade	Jandakot	$3,135,000	40
Accommodation facilities	Jandakot	$917,000	40
Earthworks associated with accommodation facilities and removal of old buildings	Jandakot	$151,000	40
Warehouse extension to accommodate additional undercover storage area.	Jandakot	$1,690,000	40
Heavy Vehicle Parking & Driveway – Includes Concrete pavement, storm water drainage and lighting	Jandakot	$625,000	40
Light Vehicle Car Park – Includes asphalt pavement, storm water drainage and lighting	Jandakot	$420,000	40

We note that creating a "building" category with a tax asset life of 40 years will need to be re-visited in AA6 in light of decisions made on the economic life of the pipeline.

[2] see Draft Decision, [911].

1.4. Summary

We have accepted almost all of the ERA's amendments associated with financing costs aside from the change in the tax asset life of the other category, which is a consequential change to ensure consistency with the approach taken for regulatory depreciation.