AlintaGas

AlintaGas Response to the Draft Decision

2 May 2000

Outline of Presentation

- Background
- Preparation of Access Arrangement
- Amendments in Draft Decision
- Regulatory process
- General comments
- Identify key material amendments
- Response to key material amendments

Background

- **Fundamentally important to AlintaGas**
- **Timing**
  - – Commenced - September 1998
  - – Submitted - June 1999
  - – Draft Decision - March 2000
- **Significant undertaking in terms of resources and cost**

Preparation of Access Arrangement

- **Access Arrangement Steering Committee**
  - AlintaGas, Office of Energy, State Treasury, KPMG Management Consulting and other consultants
- **Access Arrangement Working Group (operational, commercial, legal)**
- **Lead consultant - KPMG Consulting**
- **Independent experts for WACC, asset valuation, OPEX, CAPEX, forecasts**

Amendments in Draft Decision

- **47 amendments - about 20 considered material**
- **The detail may affect the "headline numbers"**
- **Prepared to accept most of the amendments**
- **Today - focus on 13 of the material amendments**
- **Will provide further information to Regulator in full response**
  - look forward to detailed discussions with OffGAR

Regulatory Process

- **Obvious from timeframes that this has been a long process**
  - recognise this is the first access arrangement for distribution system
  - but a concern for all participants in the gas industry
  - should be an objective to reduce timeframes to be consistent with Code
- **Ways of shortening the process and reducing costs (eg. joint use of experts) need to be examined**

General Comments

- **The proposed Access Arrangement was not an “ambit claim”**
  - a document that provided a reasonable balance of interests
- **Overall concerns:**
  - a more heavy-handed and intrusive approach to regulation than required by the Code
  - attaches undue weight to section 38 of the Act
  - further reduction in the ICB and unreasonable requirements in relation to reference tariff B3

Key Material Amendments

- Trigger Mechanisms
- Total Revenue
- Reference Tariffs
- Reference Tariff Variations
- Fixed Period

Trigger Mechanisms

- Defined specific major events that trigger an obligation for AlintaGas to submit revisions
- Regulator specified four trigger events which will enable him, if he wishes, to trigger a review
- Significant regulatory risk issue - decreases certainty about the term of the Access Arrangement

Trigger Mechanisms (continued)

- **AlintaGas intends to object:**
  - lack of necessity
  - not "specific major events"
  - Code does not provide Regulator with discretion
  - none of the four specified events justify a review of the Access Arrangement
- **Regulatory precedent ?**

Initial Capital Base (General)

- Reduction in ICB from $540M to $510M (6%)
- Note: represents a write-down from DORC of about $200M
- AlintaGas intends to object

ICB (Retail Margins)

- 2% net retail margin overall and on each reference service
- If 2% required for each reference service, AlintaGas distribution should not be the only market participant required to contribute to it
- Further reduction in ICB - AlintaGas distribution is the only party contributing
- Residential tariff caps

ICB (Shift in Revenue)

- **Assertion about a shift in revenue between retail and distribution businesses**
- **AlintaGas does not accept the assertion**
- **Will need to clarify basis for Regulator's claim:**
  - assumed significant reductions in retail prices in response to competition
  - this is the first time implicit distribution revenues have been calculated

ICB (Section 38)

- Regulator seems to argue that section 38 requires B2 and B3 provide a 2% net retail margin
- AlintaGas intends to object to the Regulator's interpretation of section 38
- Regulator has given undue weight to section 38 and insufficient weight to competing interests (eg. AlintaGas's interests)

ICB (Retail Cost Elements)

- **Regulator appears to have based his decision on the assumed costs of AlintaGas's retail business**
- **AlintaGas submits this approach is unreasonable**
  - retail costs should be assessed by reference to the costs of a range of new market entrants

ICB (DORC)

- **Regulator had some technical concerns about GHD's DORC valuation**
  - AlintaGas reduced DORC by $170M
- **Led to asserted significant valuation uncertainty of $200M, and overstatement of $85M**
- **AlintaGas believes that the Regulator is incorrect about the uncertainty**
  - will provide further information and discuss prior to Final Decision

Capital & Operating Expenditure

- AlintaGas did not put forward an “ambit claim”
  - reasonable and arrived at on a reasonable basis
  - AlintaGas benchmarks well
- Appreciate that assessment requires judgment
- Provide further information
- Will discuss prior to the Final Decision

WACC

- Regulator's approach does not differ in any material respect from AlintaGas's proposed calculation methodology
- Outcome is proximate to the WACC proposed by AlintaGas
- Compliant revision

GDR Transition

- Regulator requires a reasonable transition from GDR prices to Reference Tariff A prices
- Do not agree with Regulator's reasoning, but appreciates the concerns cited by the Regulator
- To address the Regulator's concerns AlintaGas intends to propose transitional arrangements

Seamless Transition for Reference Tariffs A & B1

- Regulator requires amendments to allow for a reasonably seamless transition between Reference Tariffs A and B1
- AlintaGas acknowledges the issue raised by the Regulator and intends to propose a change to tariff structures to accommodate a “reasonably seamless transition”

Retail Margins for B2 & B3

- **Regulator requires "reasonable retail margins, both in total for any residential end user and for any gas quantity block"**
- **Amendment 39 is uncertain:**
  - "reasonable" margin?
  - "gross retail margin" or "net retail margin"?
- **The clarification of these uncertainties is critical - could have a significant effect**

Retail Margins for B2 & B3 (continued)

- **Amendment is based on interpretation and application of section 38**
  - do not agree with the interpretation
  - section 38 does not require a retail margin for every customer for every level of consumption
- **Unreasonable to require retail margin for every residential customer for every level of consumption**
- **Large residential consumers - third step not cost reflective**

Variation Mechanisms

- Regulator requires that reference tariff variations be approved by him (CPI-X and Regulatory and taxation pass through)
- AlintaGas approach - consistent with section 8.3
- Significantly reduces regulatory certainty
- Inappropriate balance of interests

Incentive Regulation

- **Regulator requires a CPI-X price cap on each reference service**
  - no re-balancing of Reference Tariffs.
- **AlintaGas disagrees**
  - interpretation and application of section 38 in respect of the removal of re-balancing provisions.
  - objections to the revenue yield mechanism
- **Complex area - further discussions**

Fixed Period

- **Fixed period no greater than 5 years**
- **AlintaGas intends to objects to the amendment**
  - did not have regard to AlintaGas's interests
  - Code clearly indicates that fixed period is intended to exceed the Access Arrangement Period
- **Duration of the fixed period is a key regulatory risk issue**
- **Inconsistent with Code policy**

Conclusion

- **Look forward to issue of Final Decision**
- **Timing of the Final Decision is important due to the impending sale of AlintaGas**