



MID-WEST AND SOUTH-WEST GAS DISTRIBUTION SYSTEMS

PROPOSED ACCESS ARRANGEMENT

FORUM TO CONSIDER THE REGULATOR'S DRAFT DECISION

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PUBLIC FORUM TRANSCRIPT

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DR MICHAEL: Welcome, ladies and gentlemen, to this public forum on the draft decision for the mid-west and south-west gas distribution system and the access arrangement. I would welcome you all to this meeting and in particular of course I welcome Phil Harvey, the CEO of AlintaGas, who will be giving a session during the course of these discussions a little later, but first of all in welcoming you all, this is the second such forum we have held and we are certainly keen to hear from all of you. I should mention that the proceedings are being recorded. We will be making transcripts; they'll be available if anybody wishes to have them, but could I just mention that if anybody has an objection to any component of it being recorded or the preparation of a transcript, we are pleased to hear that and obviously we will take that on board if that is necessary.

I would expect that what we are all prepared to say today, I'm sure everybody is willing to see made available to others as well. I think it's important that it is.

I should also say that we'll be having questions but I'd ask that you leave the questions to the end when we have the open forum so that we can give AlintaGas the opportunity to make its presentation first. I should also finally mention that comments on the draft decision are still being received until the end of this week, so we are happy to receive not only the comments we get today but we're certainly very happy to receive submissions until the closing date later this week.

If I could just give an outline of the program, Julie - I will speak for about 15 minutes. I should say, for those who haven't met me, my name is Ken Michael, the Western Australian Gas Access Regulator. I will speak for about 15 minutes and I'll give you a brief overview of the draft decision.

Ray Challen, one of our consultants, will be speaking on the key issues and Robert Pullella from our office will be talking on the WACC. We will have morning tea around 10 o'clock so we should take you through to about 10.00 according to the program here. We will then have a break for about half an hour.

That will give time for AlintaGas to set up and get organised for its presentations which will be for up to an hour. We have allowed an hour and it will be whatever it takes up to that time. Then from 11.30 to 12.30 we're intending to have an open forum. I think there's some flexibility there if it happens to just go a little bit longer. That's the outline of the proceedings for the day.

It allows me now to move on to my own presentation. I will provide the overview. Obviously, this forum is here to allow us to receive comments on the draft decision. We have made our draft decision on the basis of comments that have been received to date and also comments received and discussions we have had with AlintaGas.

It's important that we follow this consultation process. It's certainly provided for in the Code and the draft decision will allow us to consider all the comments in coming up with a final decision a little later in the year.

I have always said that the process that the Code puts up, while it's rather prescriptive and in some respects it can be said to be intrusive - we're trying to apply it in as flexible a way as we possibly can within the context of the Code and the law that guides us. I think the process of coming up with a draft decision and allowing comments and forums like this to have discussions allows us to take a more considered position when we come up with the final decision and I think it is a very good mechanism.

This is the opportunity for people to assist us in going forward to the final decision and it certainly makes the whole process transparent.

As far as the role of the regulator, I guess it goes without saying that one of the key requirements is to make sure that the access arrangement conforms with the Code and the law. I think that goes without saying, but very importantly it's about promoting competition within the industry and stimulating it in such a way that will promote economic activity. That allows new players to come into the market. It will encourage innovative ways of using gas as an energy source making it more attractive. I don't think any of us would deny that as a key benefit.

We need to make sure that in coming up with an Access Arrangement we achieve value for the users and the consumers. I mean, that's very much what it's all about and that's what will create that interest in using gas as an alternative source of energy and in creating new industries; but we must not forget the owner. I mean, they need to be able to stay in business and we need to have a reasonable rate of return for the owners.

The code makes it very clear that there's a balance required between all these factors. Trying to achieve that balance is not the easiest task because there are so many different views. However, our job is to take all the comments that we receive and to give them serious consideration in coming up with the draft decision; but balance is certainly a desired key outcome of the whole exercise.

Having prepared the Draft Decision, one of the things that you need to do is that if you have one amendment to make in the whole draft decision, then you must say that it's not approved. I find that rather difficult so I turned it around: the access arrangement needs to be amended before it is approved, to make it clear that there's a little way to go before we consider what should or shouldn't happen. There are amendments that we're requiring in both tariff and non-tariff areas.

The process that we're going through now is an opportunity for those amendments to be discussed both by AlintaGas as the Service Provider and also by yourselves as users, consumers and interested parties - whether we've got it quite right or not. We need to hear your comments so that we can actually put them into the equation and try to consider those amendments that we've suggested in the draft decision in the light of those comments that we do receive.

The decision is a formidable document as well. There's a good summary in front, which covers the main issues and we'll be concentrating on some of those key issues. One

of the key amendments that we see - and I'll be interested in comments from the floor - is the application of a retail margin across all services.

We've asked AlintaGas to review the proposed distribution tariff structures for Reference Service B3 in order to permit reasonable margins in the delivery and sale of gas to residential and small business customers. However, it is the business of the owner and we have asked AlintaGas to consider this and to come forward and propose the sort of retail margin that they consider applicable in this particular case. We see the retail margin as allowing retail competition. We see it as opening the market to other players and industries to utilise gas as an alternative energy source. We consider this to be fairly fundamental in the whole access arrangement and we're certainly very keen to hear comments from yourselves and of course from AlintaGas.

However, it's new and we're not sure what the impact will be so we've put a trigger mechanism in and we will be monitoring the impact of the margin on competition when the market is opened up in a couple of years. We will be putting in as a recommendation or as a proposal that goes forward into the next access arrangement that the retail margin be reviewed at the end of the access arrangement period. This is to understand the impact of the retail margin and the extent to which it impacts the market and stimulates competition that we believe will be encouraged.

If we move to the next slide, the initial capital base always is a key factor in any access arrangement. I should mention that AlintaGas proposed an initial capital base of \$539.4 million, estimated at December 99. The figure that AlintaGas had in the access arrangement was in fact \$530.3 as at 31 December 98, so we've escalated that to bring it into dollars at the start of the access arrangement period.

Our figure, which assumed a 2 percent retail margin - and I say "assumed" because that, as I said, is a matter for AlintaGas to consider - is \$510.4 million, a reduction of 5.4 percent. That's taking into account the aspect of the retail margin at the assumed level of 2 percent and other factors of course.

Moving on to the rate of return, this has been derived using independent advice. It is a very specialised area and while the office does have the skill to make assessments like this, I'm asking for some independent people to give us advice on this issue to ensure that we're approaching this in the fairest possible way. Our assessment is that the return on equity is 13.2 percent and that's a nominal post-tax value. That's based on the ICB that I've talked about which includes the assumed minimum retail margin of 2 percent.

That happens to equate to a weighted average cost of capital, a WACC, of 7.9 percent pre-tax. We have mentioned both because they really need to be taken together and they do translate in that way.

Moving to the next slide, and having said what the ICB is and what the weighted average cost of capital is, we concluded in the draft decision that the overall reduction in tariffs is about 5 percent. That takes into account the various factors and assumptions that

we've made in getting to this point. These now need to be tested through this draft decision period, as well as hearing from yourselves and from AlintaGas.

The initial capital base is lower than that expected by AlintaGas. This is an outcome of the requirement for a minimum retail margin, resulting in lower than anticipated distribution based revenues. That's something that I'm sure will be raised a little later, but I should stress that the overall revenue to AlintaGas remains as specified. I think that's an important factor that we should not lose sight of.

To bring these points to a conclusion, the way we see the draft decision and the way we should see it in the spirit of the Code and the law is that it's there to promote competition. We believe we have achieved that in the way we have developed the draft decision, encouraging investment by others and also hopefully by the owner, with a view to providing value to users and consumers. However, just as important, we should not forget, a reasonable rate of return to AlintaGas, consistent with market expectations.

That's a very broad overview of the situation as we see it. It's difficult course to explain in 15 minutes what has taken many months of discussion. I would have to say at this stage that we've had some very good cooperation and discussion with AlintaGas and I'd certainly like to acknowledge that, Phil, with you and your staff. We've certainly had some very good feedback through the Web site and we intend to continue to make that sort of openness and transparency available to you all so that we can get the best result for everybody.

It's now my pleasure - and I'll move straight on to inviting Ray Challen to come forward. Dr Ray Challen has been our consultant on this exercise, and he is from ERM. Ray will take us through some of the key issues and perhaps add just a bit more flesh to the things that I've been talking about.

KEY ISSUES - DR RAY CHALLEN

DR CHALLEN: As you are all no doubt aware, an access arrangement actually focuses on the delivery of a set of reference services and the qualitative description of what these services are and an indication of reference tariffs, which is effectively a price schedule that the service provider establishes up-front for the delivery of these services to users.

Through the specification of reference services and associated reference tariffs the access arrangement commits the service provider to making available, these defined services at a predetermined price. The actual specification of services and the reference tariffs are not surprisingly the matters of greatest interest and also greatest contention amongst the regulator, the service providers and users of the services.

What I'd like to do in this part of this morning's forum is not so much to concentrate on the qualitative description of what these services are but, rather, go through the thought processes underlying the draft decision in respect of reference tariffs.

Just quickly indicating what these four reference services are, the reference services specified by AlintaGas, and those descriptions are accepted by the regulator in the draft decision, cover a range of user requirements from very large commercial end users of gas - this is particularly Reference Service A - and progressively catering for the needs of smaller users of gas, smaller commercial users, and down to the residential end users with reference service B3.

In looking at specifying tariffs or reference tariffs for these services, section 8 of the Code sets out the requirements for a reference tariff. In broad terms, a reference tariff should be designed to achieve a number of objectives including providing the service provider with an opportunity to earn a stream of revenue, but covers efficient costs of delivering the corresponding services where these costs include a number of cost line items. These are the operating costs or non-capital costs, which are the costs incurred in day-to-day operation and maintenance of the pipeline and associated administrative activities in the provision of services.

There are capital costs or capital expenditure, which caters for an investment in new pipeline assets, extensions and expansions to the pipeline system over the access arrangement period. There are depreciation costs, arising from the depreciation of physical pipeline assets, and there is also a rate of return, a return to the owner or the service provider based on the value of the capital assets of the pipeline.

In the access arrangement and associated documentation - the access arrangement information - AlintaGas provided forecasts of these costs. The regulator assessed these forecasts and came to a conclusion based on information available as to what would comprise reasonable reference tariffs for each of the reference services.

The Code provides a general procedure for the determination of reference tariffs with a number of steps. For the first access arrangement for a covered pipeline or a distribution system, the first step is the estimation of an initial capital base. There's also the estimation of capital expenditure, the estimation of non-capital costs or operation costs, the estimation of an appropriate rate of return and the specification of a forward-looking depreciation schedule of those physical assets of the pipeline.

Once you've determined what are effectively cost line items, you can determine the total revenue requirement for the pipeline or the distribution system. Once you've determined a target total revenue, that revenue is allocated across services and once you've allocated revenue across services, then you move on to determining a reference tariff schedule which involves the determination of tariff structures.

Finally, there's the specification of some incentive mechanism whereby the service provider is provided with some incentive to increase throughput, to provide a particular quality, an improved quality of service and also efficiency in the delivery of that service. Although these steps are set out in the Code in somewhat of a linear fashion, it's unfortunately not a linear process in moving from one step to another until you finally arrive at a reference tariff.

It's very much an iterative process whereby in each of the steps there are various considerations taken into account, the impacts on the service provider, the users of the services, end users of gas and the broad economy, so much so that it ends up a very backwards and forwards process until you arrive at a reasonable balance of interests which is unavoidably perhaps a compromise.

Picking on one of these steps which is the rate of return, Robert Pullella will speak on this just after I've finished, but I will just quickly in this session go through some of the stages in the reference tariff determination in which the regulator had matters to address in the access arrangement, as documented in the draft decision, which may have differed from the approach taken by AlintaGas.

Firstly, with the initial capital base, the Code provides for the value ascribed to the initial capital base to normally be in the range of a depreciated actual cost (DAC) of assets and a depreciated optimised replacement cost or DORC value of assets. There are strong economic arguments for these bounds on the value of the initial capital base. However, beyond consideration of these bounds there are not any general arguments for utilising either of these two values, as opposed to some other value in the range. When you're considering the value that will ultimately be ascribed to the initial capital base, it is very much a process of compromise and consideration of the different perspectives of the users of the services, the service provider and wider economic considerations.

On this note, there appears to be a general view in regulated industries that the value of regulated assets should be set at the DORC value. While it is understandable that a regulated business will strive to achieve the highest regulatory value of assets that's possible - ie, generally the DORC value - it should be recognised that a DORC value has no particular merit vis-a-vis other values in the range of DAC to DORC.

The general approach of regulators in Australia has been to consider a balance of interests between the service provider and users in selecting a value of the initial capital base within the range and in the case of the AlintaGas access arrangement, the methodology used by AlintaGas to arrive at a value for the initial capital base was consistent with this general approach.

The methodology adopted by AlintaGas for determination of the initial capital base involved assigning a value to the assets that is consistent with achieving an a priori forecast of retail and distribution revenues, given various assumptions as to other parameters affecting the determination of total revenue - namely, capital and non-capital costs - a rate of return and depreciation.

The regulator accepted the general methodology used by AlintaGas but questioned several assumptions made in determining the target distribution revenue. In particular, regulator reviewed assumptions as to the magnitude of the retail margins implicit in the determination of the distribution revenue from a given retail revenue, as previously mentioned by Ken.

AlintaGas assumed some decline in retail margins over the access arrangement period, the consequence of which was an implicit transfer of revenue from the AlintaGas retail business to the distribution business. There was no substantiating information provided in the access arrangement information for this assumption.

In the opinion of the regulator, acceptance of AlintaGas's assumptions as to retail margins would be contrary to the obligations of the regulator under section 38 of the Gas Pipelines Access Act, those obligations being to consider effective competition in certain retail gas markets.

In addressing this issue, the regulator revised assumptions to provide for a minimum 2 percent retail margin for all services across the access arrangement period. The result of this was the revision to the capital base that has already been described by Ken, whereby the changes in the assumptions as to retail margins and other revisions to the calculation of reference tariffs resulted in the revision of the proposed value of the initial capital base from an equivalent value at 31 December 1999, from \$539.4 million to \$510.4 million.

In considering this revised value of the initial capital base and also considering some revisions made by the regulator to the other cost line items which were non-capital costs, a rate of return and a depreciation allowance for the physical assets, these revisions resulted in a different total revenue requirement for the distribution systems. The net result was a reduction in the total revenue for each year of the access arrangement period of some 5 to 6 percent, as indicated here.

Moving on from this total revenue requirement, the next step is an allocation of revenue across the services. Again, the regulator accepted AlintaGas's general methodology for a cost allocation or revenue allocation.

Once you've allocated costs across services, you then allocate costs to particular charges in a reference tariff structure. By and large, the regulator considers that the structure of reference tariffs should be a matter of commercial discretion for a service provider, subject to any proposed tariff structure not being unreasonably inconsistent with some criteria of economic efficiency and also some equity considerations.

In addition and as previously mentioned, the regulator is obliged by section 38 of the Gas Pipelines Access Act to consider whether a proposed tariff structure for a reference service relating to residential and/or small business end users of gas is consistent with extending effective competition in the retail supply of natural gas to these end users.

In assessing AlintaGas's proposed reference tariff structures against these broad principles, the regulator identified three matters of concern. The first of these relates to the service catering for the delivery of gas to large commercial end users which is Reference Service A. The matter of concern here was differences in prospective gas distribution costs under the proposed Reference Service A and its tariff structure and the gas distribution costs under the current regulatory framework, which is the Gas Distribution Regulations.

An assessment of the proposed tariff structure and the implications for some hypothetical, if you like, situations of end users of gas indicated that the average gas distribution costs under the two tariff structures may differ quite substantially, with the distribution costs under Reference Service A generally higher than would have occurred under the Gas Distribution Regulations. The actual difference though depended upon the specific circumstances of the end user of the gas or the location of the delivery point for the gas.

The regulator considered that large changes in the average costs of gas distribution in the transition from the Gas Distribution Regulations tariff to the Reference Service A tariff are inconsistent with equity considerations for users and there should be some transitional arrangement put in place in moving from one tariff structure to the other.

The second concern in regard to the tariff structure was differences in prospective gas distribution costs under Reference Service A and B1. These are two reference services still catering for large commercial end users of gas. The particular concern here was that in a transition point for somebody close to the cut-off points for either service, there would be substantial differences in the average cost of gas distribution between one service and the other, so the ability of a user of gas to substantially affect the average cost of gas distribution by increasing or decreasing the amount of gas use may give rise to incentives for the inefficient use of gas.

The regulator considered that the incentives for inefficient use of gas created by these tariff structures for Reference Services A and B1 are unacceptable and the tariff structures should be amended to provide for a more seamless transition in gas distribution costs between these reference services as the level of gas use by an end user crosses this transition point.

The third matter of concern in regard to tariff structures related to an inconsistency of distribution charges for Reference Service B3 with regulated retail tariffs for gas distributed under this service and the consequent implications for effective competition in the supply of gas to residential and small business end users of gas who would be supplied with gas under Reference Service B3.

The particular matter of concern here was that there were low or negative retail margins for gas under certain assumptions of gas cost and the distribution tariffs proposed by AlintaGas; that given the regulated retail cost or retail price of gas for certain gas quantity blocks, there would be these low or negative retail margins which would discourage or potentially discourage any further gas trader or gas retailer from entering the market to provide gas to certain end users and as a result this would potentially impede the development and continuation of effective competition in the supply of gas to these customers.

The resulting amendment required for the access arrangement was that the tariff structure for Reference Service B3, the distribution tariff structure, should be altered to

make provision for reasonable retail margins for different gas blocks, gas quantity blocks.

Moving on to what is at least in the order of things addressed in the Code the final step involved in looking at reference tariffs, this is the provision for tariff variation over the access arrangement period and also the provision of incentive mechanisms for the service provider.

AlintaGas has proposed that reference tariffs be set for the first year of the access arrangement period and then subsequently varied on an annual basis in accordance with a particular set of constraints. The tariff variation mechanism proposed by AlintaGas comprises what is generally known as an average revenue or revenue yield approach to tariff variation, wherein tariffs may be varied subject to a constraint that forecast average revenue per unit of gas delivered for each year in which the tariffs will apply does not exceed some specified maximum allowed average revenue for that year.

Looking at the constraints on AlintaGas in varying tariffs from year to year, the revenue yield mechanism proposed by AlintaGas allows the variation of reference tariffs at its discretion, subject to two particular constraints. The first is that there is a limit on changes to reference tariffs, such that the forecast average revenue in a year does not exceed the maximum allowed average revenue determined in accordance with a fairly standard, if you like, CPI minus X constraint where they're allowed to increase tariffs generally to some extent less than the rate of inflation.

The second constraint on the variation of reference tariffs allowed for a rebalancing of tariffs which effectively comprises a change in the allocation of costs across reference services or a change in the allocation of costs across particular tariff components in the tariff structure. The constraint operating here is that there is a limit on changes to the particular reference tariffs, such that the change to any particular reference tariff component in a year does not exceed a maximum allowed value determined in accordance with a CPI plus Y constraint. In other words, a particular tariff component is allowed to change under this mechanism by the rate of inflation plus some rebalancing amount.

The draft decision indicated that this particular mechanism for the variation of reference tariffs was unacceptable for several reasons, these reasons being associated with certain incentives that this mechanism creates for AlintaGas and also potential consequences for competition in the retail gas market.

The particular concerns in this regard were the incentives of an average revenue or revenue yield approach for inefficient pricing of services inasmuch as when the service provider increases the delivery of a certain service, they don't actually capture the incremental revenue from the delivery of that service but, rather, they increase their average revenue across all services. So there is not a clear price signal for the service provider to increase delivery of certain services according to the value of those services but, rather, there is an incentive to increase average revenue and therefore total revenue for the business and this can create distortions in incentives whereby the service provider has the incentive to increase total throughput and total revenue, possibly by pricing certain services less than

their incremental cost.

Secondly, there's some potential for the strategic pricing of services to discourage competition in particular parts of the retail gas market. This is particularly through the rebalancing provisions of the average revenue mechanism and arises where there are regulated retail tariffs for gas. In other words, there is some scope there for a service provider to allocate costs to services with a regulated retail price and thereby effectively make these services cost prohibitive for competitors.

Finally, on a sort of administrative note, the complexity of a revenue yield form of price control results in potentially higher costs of administration and regulation.

The regulator concluded that the provisions for tariff rebalancing under a revenue yield or average revenue mechanism should be removed from the access arrangement and that a price cap form of price control be implemented whereby individual tariffs may be increased subject to a CPI minus X constraint. Although these revisions or required amendments remove the discretion for AlintaGas to reallocate costs and rebalance tariffs, this does not prevent AlintaGas from changing these cost allocations and rebalance tariffs but, rather, would require this to be undertaken through a review of the access arrangement and with the oversight of the regulator.

I think I'll leave that there; as the major issues that were addressed by the draft decision.

WACC - MR ROBERT PULLELLA

MR PULLELLA: I will be presenting the key aspects of the draft decision as they relate to the rate of return. The code - as Ken has already mentioned, requires that the return should be commensurate with the prevailing conditions in the market for funds and the risk that is involved in delivering a reference service. The rate of return should also be sufficient to motivate investment in pipeline assets.

The rate of return as it has been determined in the draft decision - AlintaGas actually proposed a real pre-tax weighted average cost of capital of 8 percent which corresponds to a return on equity of 11.2 percent. The draft decision determined that the rate of return that would be appropriate would be a 13.2 percent return on equity which is a nominal post-tax return - and a weighted average cost of capital of 7.9 percent, which is a real pre-tax weighted average cost of capital.

In determining this rate, the regulator considered a number of fundamental input parameters. I will just go through these now. These are the financial parameters that were used in determining the weighted average cost of capital. The first of these parameters is the risk free rate and the inflation forecast. Other regulators have used the yield on 10-year government bonds to estimate the risk free rate. Typically they've used a 20-day average and that has been a consistent approach and an accepted method of calculating this rate.

The nominal risk free rate that was calculated using these inputs or using this approach was a 6.85 percent nominal risk free rate and a real risk free rate of 3.65 percent. The forecast inflation rate is derived from the difference in the yield of Commonwealth bond rates and index linked bonds over the same period.

In this instance, yields on bonds - the 10-year yield to maturity - were used and the derived inflation rate was 3.09 percent. The estimation of rates derived using this approach will vary depending on the time of their estimation.

The next parameter that we looked at was the market risk premium. The market risk premium reflects the excess of return achieved by the market as a whole over the risk free return and from the advice received, the accepted values of a market risk premium ranged between 5 and 6 percent. Based on this range for the premium - and this range is typically what was adopted by other Australian regulators to date - the regulator considers that a premium of no more than 6 percent should be used to estimate the weighted average cost of capital for AlintaGas.

The next parameters that we looked at were the asset and equity beta. The advice that we received indicated the asset beta range should be between 0.45 and 0.6. Because of the possible increased risks that are likely to be borne by AlintaGas due to its lower market penetration and higher average costs, an asset beta towards the upper end of this range has been used to estimate the weighted average cost of capital for AlintaGas. This value was determined to be 0.55.

It is worth noting that this asset beta is slightly higher, but not materially different from the value adopted by AlintaGas, which was 0.51. An asset beta of 0.55 corresponds with an equity beta of 1.05 and this equity beta is lower than the equity beta of 1.2 that has been adopted by other regulators.

Next, we looked at the debt margin. AlintaGas appears to have calculated its cost of debt margin by inserting an assumed debt beta into the capital asset pricing model equation and the resulting cost of debt was calculated to be 1.53 percent as a margin.

The debt margins that have been adopted by other regulators in recent regulatory reviews have ranged between 1 and 1.2 percent. On the basis of the financial advice, the regulator has adopted a debt margin of 1.3 percent.

Other parameters that were examined include the capital structure or gearing level, the taxation rate and the dividend imputation factor. Firstly, the capital structure - recent decisions by regulators on gas pipeline infrastructure in other states have proposed gearing levels of 60 percent. Section 8.31 of the Code requires that the financing structure should reflect standard industry structures and therefore to be consistent a gearing level of 60 percent was adopted for the decision.

The taxation rate - the regulator considered that the statutory tax rate of 36 percent would be appropriate and this is consistent with decisions made by other regulators.

Finally the dividend imputation factor - the value of franking credits is incorporated into the weighted average cost of capital calculation to reflect the benefits that shareholders gain from franking and the consequent requirement from shareholders for the rate of return on investment. The mechanism that is used to adjust the WACC is represented by the gamma term. AlintaGas assumed a gamma value of 0.3, which was selected from a range of between 0.2 and 0.4.

On the basis of financial advice, the regulator has decided to use a gamma value of 0.5 in the determination of the weighted average cost of capital and again this is consistent with the decisions of the Australian Competition and Consumer Commission and the Office of the Regulator-General in Victoria.

Lastly, we look at the conversion of a post-tax weighted average cost of capital to a pre-tax weighted average cost of capital. By using the previously selected parameters in the capital asset pricing model, a post-tax weighted average cost of capital is calculated. The conversion of the post-tax weighted average cost of capital to a pre-tax weighted average cost of capital is undertaken by adjusting for the corporate tax rate, including the effects of imputation franking credits.

In most decisions to date, the Australian regulators have based their assumptions about the cost of tax on two simple transformations of a post-tax WACC to a pre-tax weighted average cost of capital. The market practice transformation has typically been used and also the reverse transformation or a combination of both. The calculation of these transformations is explained in the draft decision document, but the essential difference is whether the inflation factor is accounted for before accounting for the taxation rate or after.

The market practice transformation resulted in a weighted average cost of capital of 8 percent and the reverse transformation weighted average cost of capital is 6.3 percent. This was the range that was used by the regulator in determining the final weighted average cost of capital.

The regulator considers that the real pre-tax weighted average cost of capital should lie somewhere towards the upper end of this range and on the basis of financial advice determined that the real pre-tax weighted average cost of capital of 7.9 percent would be appropriate for the AlintaGas distribution system. That concludes my presentation. Thank you.

DR MICHAEL: Thanks, Robert and Ray. I should add that the other person on the table is Peter Kolf who's the Executive Director of the Office of Gas Access Regulation. Peter will be taking part in the open forum. He's going to answer all the questions. Is that right, Peter - something like that?

We're actually ahead of time. I'm going to suggest that we break if we're ready for morning tea, Julie. Would we be ready now? It doesn't look as if we are. Could we just check? It might be worth taking advantage of the fact that we're a little early. Perhaps you

don't feel like a cup of coffee or tea at this stage but we do need to allow AlintaGas time to prepare for their next session.

We also have copies of our overheads outside for anybody who would like to take a copy. It does give you time to sort of mull over the things that we've said and to talk amongst yourselves on these issues. Morning tea and morning coffee is ready, so I'm going to suggest that we come back at 20 past 10 if that's acceptable to everyone. I will give you a call just 5 minutes before then, to give you a chance - and give time to AlintaGas.

I will be passing the session over to Phil Harvey to run the session, which should take up to about an hour. Having heard both aspects of the draft decision, I think it will give you an opportunity then to pose questions. We could take a question time now, but I think it would be far better to take the questions in the context of hearing first from AlintaGas. Let's have a break for about half an hour. Thank you.

**RESPONSE TO DRAFT DECISION - PHIL HARVEY and
DARREN GRONDAL, ALINTAGAS**

DR MICHAEL: This session now will be a presentation for up to about an hour by AlintaGas and then we'll have our open forum. We're scheduled to finish at 12.30 but I'm sure there's a little bit of flexibility in there if we happen to have more questions, but it's my very great pleasure to introduce the Chief Executive Officer of AlintaGas, Phil Harvey, who I would invite to the podium and also ask him to run this session. Thank you.

MR HARVEY: Thank you very much, Dr Michael. Good morning, colleagues, friends and other industry participants. It's a great pleasure and AlintaGas welcomes the opportunity to respond at this public forum to the draft decision on the AlintaGas access arrangement.

The forum is a little unusual. I think those of you who understand the way the system operates in the United States with rate hearings would know that instead of a forum like this, the regulator would be sitting at a table or in some elevated position and industry participants would be making submissions to him. Because it's a forum involving OffGAR, AlintaGas and others, it is in my view more in the nature of public education than a detailed technical response to the draft decision.

However, having said that, let me just indicate to you the outline of the presentation that we intend to make in the next hour or so.

The presentation will take about an hour. It will be along the lines that I have shown here. I will briefly review the background to the access arrangement. I'll talk about the way that it was actually prepared and the amendments proposed in the draft decision in very general terms. I'll make some comments on the regulatory process and some general comments and all that will only take about 5 to 10 minutes.

I will then hand over to Darren Grondal who has been, and still is, responsible mainly for regulatory affairs within AlintaGas. Most of you would know Darren. Darren will then cover the last two dot points but the main meat of the presentation, the main substance of the presentation, will be in those dot points.

Dealing then with the background, it is clear that the decision by the regulator is fundamentally important to AlintaGas, not only in financial terms - and clearly it is the most important determinant of value that AlintaGas faces in the next little while - but it is the first time that AlintaGas and to a large extent the regulator have gone through this process for a system of the size that we're talking about here. We want to make sure that we get it right and I know that Ken and all of the OffGAR staff, Peter and all of his colleagues, also want to get it right.

In terms of timing, we commenced preparation of the access arrangement in September 98. Now, we had actually done some work leading up to that. By the time we submitted the access arrangement in June 99, we'd completed almost 12 months' work on it.

The draft decision of course was given in March of this year and by the time we get to a final decision, there will be almost another 12 months that have gone past, so the process will have taken almost 2 years from the time we commenced preparation of the access arrangement to giving a final decision.

That represents a very significant undertaking in terms of both cost and resources. In terms of direct costs, of course it is AlintaGas that is bearing the cost of its own resources and the consultants and others that it has used but it also bears a fair proportion of the cost of the Office of Gas Access Regulation - and those are not insignificant.

However, in my view the main cost is not so much the dollars but it's the cost in terms of the management time that needs to be put into the preparation of the access arrangement and those other staff members who are diverted from other activities. It's really the opportunity cost of those resources which is probably the most significant cost.

I would like to turn now to preparation of the access arrangement, because many of you might not know the process that we went through. At the time we commenced work on preparing the access arrangement, the regulator had not been appointed. It's very difficult to prepare an access arrangement where policy decisions need to be made without having an opportunity to discuss them with the regulator. Of course, in future that won't be the case but that's the position we found ourselves in.

AlintaGas was at that time, and still is, very conscious that it is government owned. We wanted to comply not only with the details of the access code, but we wanted to comply with the spirit as well. We decided we should establish a steering committee, which included representatives from Treasury, the Office of Energy, the consultants we used (who were KPMG) and other consultants. That steering committee provided guidance to the Access Arrangement Working Group who basically did all of the detailed work.

We were keen to have other State government agencies and departments involved to make sure in the absence of a regulator that we didn't make decisions in isolation that offended the Government in general. I hasten to add that the other government agencies reserved the right to make separate submissions to the regulator. So the steering committee was intended to be helpful but nothing in the access arrangement at all is binding on the views of the other government agencies and departments.

We used independent experts to assist us in developing the WACC, in looking at the valuation of assets, operating expenses, capital expenses, forecasts and so on. We in fact tried to get the best possible advice at the time, knowing that this issue was so important and it was the first one.

Let me turn now to the amendments that are proposed in the draft decision. There are 47 amendments. We consider about 20 of those are material amendments. While in the presentation made prior to morning tea it was indicated that the capital asset base - that is, the initial capital base - is proposed to be reduced from around about \$540 million to \$510 million, it is important to understand that some of the other amendments that are proposed,

when you look at those in detail, may require a further reduction in the capital asset base to achieve what the regulator is seeking to achieve, and in particular the adjustment of the tariffs that has also been mentioned before morning tea. In order to adjust tariffs to achieve the regulator's desired outcome, it may well be necessary to make further reductions in the initial capital base.

Having said that, it's clear that we are prepared to accept most of the amendments. Today we want to focus on 13 of the material amendments that are proposed. We will of course provide further information to the regulator in a full written response and that written response will be put to the regulator before the end of the week. We expect of course that the regulator will make it available on the Web site and so you will all be able to see what we have to say in detail in our response to the decision that has been given.

I should hasten to add that if anybody wants a copy of the overheads that we use in this presentation here, we don't have them to hand out afterwards, but if anybody wants to get a set, rather than wait for the full submission on the OffGAR Web site, if you leave your business card with Darren Grondal or with me, we'll make sure that you get a copy of the overheads. If you'd rather leave your business card with Ken or the OffGAR staff for some reason - you would not like to be identified to us - do that as well and we'll make copies available. There's nothing underhanded in this, believe me.

I should say of course that in providing a response to the regulator we're looking forward to the detailed discussions that will flow from that. There is a timing imperative. We've already taken quite a large amount of time in terms of the preparation of the access arrangement, the consideration by the regulator and so on. I think all of us are now looking forward to getting the final decision as quickly as we can. Nevertheless, there will be a need for some detailed discussions.

Just before handing over to Darren to deal with the detail, I want to take this opportunity just to make a couple of general remarks on the regulatory processes. I've already mentioned that it took AlintaGas something like 12 months to prepare the submission and then a further 12 months. In future, I hope we can get the timing better than that. 2 years from the time one starts to the end point is a process that in my view is simply too long.

Let me hasten to say that these comments I'm making on the regulatory processes in no way reflect on Ken or on Peter and their staff. I have some comments to make on the process that we are all operating under, the process which is determined by the legislation we have and the national access code.

We recognise that this is the first access arrangement for the distribution system and of course the results are of interest and concern to all participants in the gas industry, but there should be an objective in my view to try and reduce the time frames while being consistent with the Code.

In my view, there are ways that we should examine of shortening the process and

reducing the costs. For example, the joint use of experts needs to be considered in future. Instead of being seen as opponents, the regulator and AlintaGas, on the other side of the table trying to beat each other to death, I certainly prefer a view that says we should work jointly to attempt to achieve an outcome which properly reflects the balance of all the interests. We will be exploring some of those things as we go down the track with the regulator.

Just moving to my last slide and some very general comments, it is important to understand that the proposed access arrangement that we submitted was not an ambit claim. It was a document which in our view provided a reasonable balance of interests and we believe there are good arguments why all of the amendments, the 47 amendments, that are proposed are not necessary. However, we understand there are different views on these things and I've indicated earlier that we look forward to discussing the most important of those with the regulator.

In our view the access arrangement which we submitted reflected not only AlintaGas's views but those of the steering committee and therefore our government ownership.

The overall concern with the draft decision that has been given is that it is more heavy-handed and intrusive than is required by the Code, in our view. Secondly, it attaches in our view undue weight to section 38 of the Act. Section 38 of the Act, as was indicated earlier, details or sets out the fact that the regulator has to take into account competition and promote competition, but there is a range of other issues which the regulator is required to take into account and it's the balance of those issues which is the important thing.

Within AlintaGas, we take very seriously the matter of separating the distribution business from the retail business. The distribution business is required to be ring-fenced, as it is, and in the new AlintaGas Ltd arrangement it will not only be ring-fenced; it will be a separate legal entity as required by the Code.

Comment was made earlier about the desirability from the regulator's viewpoint of having retail margins that are roughly the same across reference tariffs. Within AlintaGas of course there's no particular reason why the distribution business should have or does have knowledge of retail margins. If one envisages a world, and we are all going into this world, where there are several retailers out there buying gas under a whole range of different arrangements, then one has to question I believe what a retail margin is.

Even if one takes the view that one can model that and that the distribution charges need to be set in such a way that a retailer can make a profit, if that means that somebody has to take some pain, I would also question why it is that AlintaGas distribution has to take that pain. The model represents the complete gas chain. For a retailer to make a profit, he has to buy gas, transport it through the transmission system, through the distribution system and sell it. If the regulator requires the retailer to make a margin and some pain has to be taken, I don't understand why it has to be distribution, rather than, for example, shared with the transmission business.

However having said that you can see that we have some broad concerns with the draft decision that has been given and it's my pleasure now to hand over to Darren Grondal who has the primary responsibility within AlintaGas for dealing with regulatory matters. Thank you.

MR GRONDAL: Good morning, ladies and gentlemen. As Phil has indicated, I'm going to take you through what were the last two bullet points on our outline summary. Just to remind you of what they were, I'm going to highlight the key material amendments as AlintaGas sees them and I'm going to provide you with a brief overview of AlintaGas's response to each of those key material amendments.

Just to reiterate what Phil said, we are putting in a detailed response to the draft decision on Friday. What we say today will only provide the very barest of summaries of what we intend to say in that response.

To move on to a quick summary of where we see the key material amendments, we have put them into five categories. The first of these is trigger mechanisms - the mechanisms by which the regulator may require an early review of the access arrangement.

There are amendments in relation to total revenue, which covers components such as the derivation of the initial capital base, the calculation of the weighted average cost of capital, and forecast capital and operating expenditure.

Another grouping is that which relates to reference tariffs, in particular the structure and design of reference tariffs. Fourthly, reference tariff variations - the manner in which AlintaGas proposes to vary initial reference tariffs within an access arrangement period. And, finally, the fixed period - the period for which fixed principles cannot be changed without the agreement of AlintaGas.

You will note from this list of five rough groupings that AlintaGas's concerns with some of the material amendments extend beyond what the regulator has discussed this morning. The regulator has concentrated very much on the middle three bullet points - total revenue, reference tariffs and reference tariff variations. AlintaGas's concerns extend beyond these because we are also very interested in the form and structure of regulation as it will extend into the future.

I will now turn to the first of the key material amendment areas, which relates to trigger mechanisms. Section 3.17 of the Code states that the regulator can require that the access arrangement include defined specific major events that trigger an obligation for AlintaGas to submit revisions. When AlintaGas submits revisions after the occurrence of one of these specific major events, it will trigger a full review under section 2.28 of the Code.

The regulator, in amendment 25, specified four trigger events, which will enable him, if he wishes, to trigger a review. AlintaGas views this as a significant regulatory risk issue. It

decreases AlintaGas's certainty about the term or the duration of the access arrangement. The occurrence of a trigger event will trigger an obligation to submit revisions. That will significantly reduce the term of the current access arrangement.

AlintaGas intends to object to amendment 25 for a number of reasons. The first of these is that the reasons for decision do not disclose that the regulator considered whether or not each of the trigger events was necessary for the purposes of achieving section 8.1 of the Code. Secondly, AlintaGas doesn't accept that each of the four specific events defined by the regulator are specific major events as required by section 3.17 of the Code.

It is also clear from what I said before that, if a trigger event occurs, AlintaGas has an obligation to submit revisions. From there, the regulator has an obligation under the Code to undertake a full review of the access arrangement. AlintaGas comments that the Code does not seem to provide the regulator with discretion about whether or not he will actually undertake a review.

Finally, in addition to all the points above, AlintaGas is of the view that none of the four specified events justify a full review of an access arrangement. AlintaGas cannot see why any of the events should trigger an early review of the 5-year access arrangement which we have proposed.

Finally, and we put a question mark up against this, we question whether or not the decision in this area puts forward a regulatory precedent. We haven't been able to identify a similar provision in any other access arrangement or final decision in Australia.

I'll now move on to the issues relating to a calculation of total revenue. The first of these, and the major area, concerns the initial capital base. AlintaGas calculated the initial capital base using an optimised deprival value methodology. This methodology resulted in a value of \$530 million as at 31 December 1998, corresponding to a value of \$540 million as at 31 December 1999.

The regulator's amendment 28 will see a further reduction in the initial capital base from roughly \$540 million to \$510 million. An important point to note here is that this would represent a write-down from the depreciated optimised replacement cost value in the order of about \$200 million. AlintaGas's DORC valuation came in at \$707 million. AlintaGas voluntarily wrote down the DORC value to \$530 million, and the regulator's decision will write it down even further.

As you can see, AlintaGas intends to object to this amendment. It intends to do so for a number of reasons concerning retail margins, the regulator's comments in relation to a shift in revenue, reasons related to section 38 of the Act, retail cost elements and the depreciated optimised replacement cost valuation.

The first of these areas concerns retail margins. The regulator states in the reasons for decision that he requires a 2percent net retail margin overall and on each reference service. If the 2 percent net retail margin is required for each reference service, AlintaGas

should not be the only market participant required to contribute to it.

The effect of amendment 28 in further reducing the ICB means that AlintaGas distribution will be the only party to contribute to the achievement of that objective. AlintaGas will submit that this does not represent a reasonable balance of interests. It does not represent a reasonable balance of interests between the interests of AlintaGas and other market participants and it does not represent a reasonable balance of interests between AlintaGas and the perceived public interest in the extension of effective competition which are all matters that the regulator must balance under section 2.24 of the Code.

Finally, AlintaGas notes that many of the problems created in this area are the result of residential tariff caps in respect of which it is government policy to continue into the future. AlintaGas observes that tariff caps will make it very difficult to deliver positive net retail margins for all sectors of the market.

The next area in relation to the initial capital base concerns the regulator's assertion about a shift in revenue between the retail and the distribution businesses. AlintaGas doesn't accept this assertion. AlintaGas's modelling for reference tariff determination assumes significant reductions in retail prices in response to competition, and that is where much of the reduction in revenue for the retail sector of the market comes from.

In addition, as this is the first time that implicit distribution revenues have been calculated, AlintaGas finds it hard to understand how it could be said that we've shifted from anything.

The next point in relation to the ICB concerns section 38. As you heard from the regulator's presentation, section 38 figures very heavily in the draft decision. The regulator seems to argue that section 38 requires that reference service B2 and B3 provide a 2 percent net retail margin. AlintaGas will oppose this on the basis that it does not agree with the regulator's interpretation of section 38. The reasons for that view will be set out in some detail in our response on Friday.

We will also argue that, despite the matters of interpretation, undue weight has been given to section 38 and that insufficient weight has been given to competing interests, and most particularly of relevance to AlintaGas, its legitimate business interests.

The next area in relation to the initial capital base concerns retail cost elements. In the draft decision, the regulator seems to have based his decision on the assumed costs of AlintaGas's retail business. AlintaGas will submit that this approach is unreasonable. We believe that retail costs should be assessed by reference to the costs of a range of new market entrants, not the costs of AlintaGas's retail business.

The final area in relation to the initial capital base concerns the depreciated optimised replacement cost valuation. The regulator expressed some technical concerns about the valuation, which was carried out for AlintaGas by GHD. AlintaGas notes that it had already reduced its DORC by \$170 million from the initial valuation of \$707 million.

The regulator said that these technical concerns led to an asserted significant valuation uncertainty of \$200 million and a potential overstatement of \$85 million. AlintaGas believes that the regulator is incorrect about these uncertainties and looks forward to providing further information in discussing this matter with the regulator prior to the final decision.

The next area that I wish to touch on is in relation to the calculation of forecast capital and operating expenditure, which is also relevant to the calculation of total revenue. AlintaGas wishes to stress that it did not put forward an ambit claim in calculating capital and operating expenditure. Its forecasts were reasonable and arrived at on a reasonable basis. We also make the note that we benchmark well in these areas.

We appreciate that the assessment of forecast capital and operating expenditure requires a good deal of judgment in terms of whether or not those forecasts satisfy the test in the Code. AlintaGas intends to provide further information to the regulator to support the capital and operating forecasts and we look forward to discussing those with the regulator prior to the final decision.

The next area concerning total revenue relates to the weighted average cost of capital. I guess we should stress that AlintaGas also took independent advice in calculating the weighted average cost of capital and submitted its access arrangement based on that advice. AlintaGas notes that the regulator's approach does not differ in any material respect from AlintaGas's proposed methodology for the weighted average cost of capital. The outcome, furthermore, is proximate to the WACC proposed by AlintaGas and, should this amendment appear in the final decision, we'd intend to submit an amendment that complies with it.

The next area to discuss relates to reference tariffs. We've now completed the discussion on total revenue. We're moving on to reference tariff design issues. The first of these relates to amendment 37 in which the regulator requires a reasonable transition from GDR prices to Reference Tariff A prices.

Whilst AlintaGas doesn't agree with the reasoning that takes the regulator to that point, we do appreciate the concerns cited by the regulator. To address the concerns, we intend to propose appropriate transitional arrangements for pricing between the GDRs and reference tariff A.

The next tariff issue relates to the seamless transition for Reference Tariffs A and B1. In amendment 38, the regulator requires amendments to allow for a reasonably seamless transition between Reference Tariffs A and B1. Ray went over that earlier on. We acknowledge the issue raised by the regulator and intend to propose a change to the tariff structures for Reference Tariffs A and B1 to accommodate the requirement for a reasonably seamless transition. We look forward to discussing that with you prior to the final decision.

The next area is very significant. It relates to retail margins for Reference Tariffs B2 and B3. As Phil has already indicated, the potential effect of the amendment in this area is not reflected in the headline numbers. This amendment is not reflected in the initial capital base of \$510 million.

The amendment states that the regulator requires reasonable retail margins both in total for any residential end user and for any gas quantity block. AlintaGas has interpreted that to mean that the regulator would like to see that a positive retail margin is provided for every customer, regardless of the amount of gas consumed by that customer.

AlintaGas intends to object to this amendment. In the first place, we find that amendment 39 is uncertain. This is a matter that we have had some discussions about with OffGAR and look forward to continuing. The first issue is: what does the regulator mean by the term "reasonable margin"? The second uncertainty is: in referring to 'reasonable retail margins', does the regulator mean 'gross retail margins' or 'net retail margins'. These uncertainties could have a significant effect on the access arrangement and on the business of AlintaGas.

The amendment proposed by the regulator is based on his interpretation and application of section 38. As we've previously indicated, AlintaGas does not agree with the regulator's interpretation of section 38, and we will outline the reasons for that in our response to the draft decision.

We will particularly argue that section 38 does not require a retail margin for every customer for every level of consumption. We'll also argue that it's unreasonable to require a retail margin for every residential customer for every level of consumption. We'll argue that it is unreasonable to require that because it will give priority to the interests reflected in section 38 at the expense of AlintaGas's legitimate business interests. AlintaGas believes it put forward a proposal that reflected a reasonable balance of interests. Movement away from that will result in an unreasonable weighting of interests.

Finally, in relation to large residential consumers, the regulator has expressed concern about the extension of effective competition for those residential customers taking more than 45 gigajoules of gas per annum. AlintaGas observes that difficulties in this area are largely the result of a third step in a retail tariff cap that is not cost reflective.

I'll now move from reference tariff issues to discuss variation mechanisms. By variation mechanisms, I'm talking about the manner in which initial reference tariffs vary within the access arrangement period. AlintaGas established certain reference tariffs that apply from the first day the access arrangement commences, and those reference tariffs were intended to vary throughout the access arrangement period in accordance with a CPI minus X price path and a pass through mechanism which would allow the recovery of additional regulatory and taxation cost burdens.

Part of that process, importantly, was that AlintaGas would put to the regulator statements which requested approval to increase the prices. The regulator would be

obligated to make a decision to approve those increases or variations - in fact, they could be decreases - as long as the manner of calculating the reference tariff variations was consistent with schedules 2 and 3 of the access arrangement; namely, the CPI minus X methodology and the regulatory and taxation pass through mechanism.

Furthermore, an obligation was to be imposed upon the regulator to undertake that approval process within a certain time frame. In putting this proposal forward, AlintaGas believed that assessment of variations in reference tariffs for compliance with CPI minus X and regulatory and tax pass through mechanisms would largely be a fairly mechanical auditing task.

However, the regulator has stated that he will require that reference tariff variations be approved by him and that he will have no obligations to process the applications, other than those which would arise under a full review under the Code.

AlintaGas intends to object to this amendment. It believes that its approach was consistent with section 8.3 of the Code. Section 8.3 of the Code says that, provided it's consistent with section 8.1 of the Code, the manner in which reference tariffs may vary within an access arrangement period is at the discretion of the service provider.

AlintaGas observes that the regulator's decision in this area will significantly reduce regulatory certainty. AlintaGas feels that it will not have the certainty necessary to know that its tariffs can change on an annual basis in accordance with its CPI minus X methodology and its regulatory and taxation pass through. Finally, AlintaGas believes that the decision in this area will not reflect an appropriate balance of interests.

The next area that I wish to touch upon is that of incentive regulation. AlintaGas proposed that its initial reference tariffs would vary within an access arrangement period in accordance with a revenue yield model of CPI minus X. There would be a further constraint of CPI plus 2percent on the extent to which individual components of tariffs could vary within the access arrangement period.

The regulator, however, has stated that he requires a CPI minus X price cap on each reference service, and the key factor motivating that amendment appears to be a desire to not allow rebalancing of reference tariffs by AlintaGas, short of a full review of the access arrangement. AlintaGas will disagree and object to the proposed amendments in this area. It will argue that the interpretation and application of section 38 in respect of the removal of rebalancing provisions is unreasonable and incorrect.

We will further disagree with objections to the revenue yield mechanisms. The regulator has catalogued a series of objections to the revenue yield mechanism, which AlintaGas asserts are theoretical and largely unsubstantiated. AlintaGas, however, notes that this is a fairly complex, albeit important, area and we look forward to further discussions prior to the issue of the final decision.

The final area that I wish to touch upon concerns the fixed period. The fixed period

is a period of time during which the regulator can't change certain specified fixed principles without the agreement of AlintaGas. AlintaGas's proposal was to have a fixed period of 10 years. Under amendment 47, the regulator has indicated that the fixed period should be no greater than 5 years, which is the length of the first access arrangement period.

AlintaGas intends to also object to this amendment. Based on our reading of the reasons for decision, it is not clear that the regulator had regard to AlintaGas's interests in making this decision. We note, particularly, that sections 8.47 and 8.48 of the Code make it clear that regard should be had to our interests in this assessment process in relation to the fixed period.

We're also of the view that the Code makes it quite clear that the fixed period is intended to exceed the access arrangement period. The proposal put forward by the regulator would effectively result in an equation of the fixed period with the access arrangement period. AlintaGas believes the duration of the fixed period is a key regulatory risk issue. It is a period during which certain fundamental factors and principles that underscore the access arrangement will apply without variation.

Finally, AlintaGas will argue that the regulator's decision in this area is inconsistent with the policy of the Code.

That really brings me to the end of our brief summary of the key material amendments. AlintaGas looks forward to the issue of the final decision and we note that the timing of the final decision is important due to the impending sale of AlintaGas. Thank you.

DR MICHAEL: Thank you, Phil, and thank you, Darren, for that presentation. There are a number of issues raised. It's not my intention to respond to any of those unless they come up through the forum. I suppose the only point I would make - and as I said, the key issue is the retail margin and we highlighted that. We may not have highlighted some of the other issues, but I believe they're not that straightforward and we do need to sit down and go through the process. That's why we welcome the submission and we will welcome the details later in the week.

I might add that we didn't indicate a 2percent margin. We used the 2percent margin to determine the initial capital base. We assumed a 2percent margin but I think you'll find the amendment reads "for AlintaGas to consider a retail margin and to advise us what they think in respect of that". I think the team would tend to support that. We might touch on that in a little while. I don't know if anybody wishes to make any comment on that because it was a key aspect of that presentation.

OPEN FORUM

DR MICHAEL: What I would like to do now is to commence the open forum. We have got quite a bit of time. We have got till 12.30. What I would ask is that there's a roving mike so please use that. Please direct your questions to the chair and would you please give your name and affiliation. We need both obviously for follow up, if we need to, and

certainly for recording purposes. We would welcome any comments at all.

Phil and his team are quite happy to respond to any issues that are raised and I'll leave it to Phil to determine to what extent he wishes to do that, but certainly he has that opportunity and we would welcome that input if he or his team so desires. Do we have a first question or comment?

MR KING: Yes. It's David King from CMS Energy who are the owners of the Parmelia pipeline and the Dongara processing facility. It was an interesting presentation today. There were some matters that CMS made in their public submission prior to the draft decision that appear to have been somewhat glossed over. We would just like to bring at least one of those to your attention. This is the issue of gas quality.

Perth Basin producers are the key to promoting a competitive environment - these are the words that Ken and yourself used in the initial introduction - and encouraging economic activity. The proposed broader spec as in the draft decision to some extent limits the Perth Basin producers from putting gas into the AlintaGas distribution system. The gas specifications as laid out in the regulations, the Gas Standards Act, allow Perth Basin producers to put gas into the AlintaGas system, whereas the new broader specs do not. I wondered if you had a comment on why you've adopted the broader spec. We would argue that the broader spec is a misnomer there because the spec is actually tighter than the Gas Standards Act which would preclude a significant competitive group of people in the Perth Basin from putting gas into the distribution system.

DR MICHAEL: Peter?

MR KOLF: Thank you, David, for that question. Yes, I am aware that there are certain parameters within the broader spec that may be seen as inconsistent with the Gas Standards Act.

There are some additional specifications in the broader specification which are there that don't exist in the regulations. These were put forward by AlintaGas. We haven't objected to them. Let me say that they were determined to be reasonable specifications through a process that was operated by the Office of Energy some years ago now. For these reasons, we have not seen it appropriate to challenge those views. However, as I said, the decision is a draft decision. If this is felt as a matter in dire need of adjustment, then we can look at that again, but I would suggest that we need to refer back to the work that has been done in this area that has considered the broader specification to be a reasonable specification.

DR MICHAEL: David, does that answer - - -

MR KING: Yes, it answers it to some extent. The Office of Energy was involved in the gas regulations, which were changed at the end of last year where a broader spec wasn't adopted. I guess we would argue that the broader spec is suitable for the Dampier-Bunbury pipeline but for Perth Basin producers in some respects, as you've pointed out, is more

stringent and it doesn't really line up with the specifications in the Eastern States of Australia, for example, where on several aspects the specification is broader and would enable Perth Basin gas to be put into the system.

MR KOLF: We'll take those comments on board.

DR MICHAEL: Thank you. Yes, please.

MR FORCKE: Alex Forcke from Arc Energy. Just as a follow up to the particular issue that David has just addressed, as you know we are a Perth Basin producer. We own and operate the Dongara gas field. As most of you will know, the Dongara gas field in addition to some other Perth Basin producers has in fact provided gas into the metropolitan area for a number of years. It provided the majority of gas up until the mid-eighties. The quality of gas that was provided at that time is exactly the same as it is now, so I have to seriously question the particular issue that David has raised as well. That is, at this particular point in time where the market is meant to be opened up for competition - and people like us play a key role in that - why suddenly through this change that is proposed to be adopted are we meant to be quarantined from supplying our gas into the metropolitan area?

DR MICHAEL: Peter, do you have any further comment to make? I think we certainly have to take that on board.

MR KOLF: That's right. That was in the nature of a comment, rather than a question I take it, and we will take that on board.

DR MICHAEL: I think AlintaGas might like to make a comment.

MR TER KUILE: Art ter Kuile from AlintaGas. In broad terms, I think it's important to understand what the purpose of the gas quality specification is. As we see it, there needs to be two things we need to comply with: (1) the gas needs to conform with the statutory requirements and (2) we need to provide an environment in which people can design equipment to use the gas and have some concept of what its quality will be.

Now, AlintaGas is also very keen to interconnect with the Parmelia pipeline, as David well knows. One of the items we identified in that discussion was the hydrocarbon dew point. Traditionally, we've always set a hydrocarbon dew point of zero degrees C and that was in part based on gas supplies being better than zero degrees C. What we intend to introduce as an amendment to our current access arrangement is that in each instance we'll agree a temperature between zero and 10 degrees C, provided that the gas is also delivered above that agreed temperature. In other words, what we can't accept from a technical perspective is an increased hydrocarbon dew point without an increased delivery temperature because we could actually get drop-out of liquids in our system. Does that clarify it, David?

MR KING: If that appears in the amendment that would certainly go a long way to appease our concerns.

DR MICHAEL: That sounds a good outcome. Thank you. Are there any other questions or comments? We'll take both. Yes, please - one here and then one over there, Julie.

MR DOUGLAS: Steve Douglas, Midwest Development Commission. I don't understand a lot of the technical nature of the discussion, but I suppose within our region we are concerned about the competition - or lack of, if you like - of the spur that runs off the Dampier line into Geraldton. There are some high tariffs involved with that one. I would just like to know what the implications of this are for that particular line and future arrangements.

DR MICHAEL: I'm wondering; can we comment on that? It might be difficult.

MR KOLF: No, I don't think that we can really comment on that. I think this is something that we would need to refer back to the parties, CMS and AlintaGas and perhaps even Epic.

DR MICHAEL: Does anybody wish to make a comment on that? Darren?

MR GRONDAL: By that question, we understand that you're asking about distribution tariffs for the use of the Geraldton lateral. Under our proposed reference tariffs, the prices that are paid for a user of the Geraldton lateral will be calculated on the same basis as they will for any other user in any other part of the mid-west and south-west area of the state.

DR MICHAEL: Thanks, Darren. Steve, you have a further comment?

MR DOUGLAS: That's fine, but within our region there's certainly at least one, perhaps two, major users of gas who are severely disadvantaged. Being 400 kilometres for instance north of Perth, one or two users are paying significantly more for their gas and I understand predominantly because of the tariff imposed, rather than the cost of the gas itself. That to us is a severe disincentive obviously for major gas users. I'm talking here particularly of the brickworks and perhaps also the port.

DR MICHAEL: Thank you. Do you want to have another comment? Just a final comment here from Ian - if you would mention your name.

MR DEVENISH: Ian Devenish from AlintaGas. I would just like to make a couple of comments about being disadvantaged. First of all, this regime that we've developed tariffs under is a significantly different regime than the Gas Distribution Regulations. We have developed a tariff model, which basically is complying with the Code and we've tried to balance all interests in that.

There's obviously a number of different rules that have been applied in developing these prices under the national access code and a number of different factors are taken into account. Probably the most important is that we're moving from a prescribed tariff regime

to one of a more negotiated regime. We've also attempted to make tariffs more cost-reflective, complying with the Code.

Obviously we're aware that prices in the past have been developed under completely different circumstances and we are prepared to accept that there will be some users who are disadvantaged by this regime and some who are obviously advantaged by the regime. We don't necessarily think that that will lead to tariff shock. Obviously there's a number of components which make up the final gas price and AlintaGas distribution will obviously be wanting to deal with all parties in relation to these tariffs and we would expect to have detailed discussions with users who have individual circumstances where they will be disadvantaged. We'd also note that we are proposing a transition arrangement from the GDRs to the access arrangement tariffs.

DR MICHAEL: Which will address some of those issues that have been raised, I guess, Ian, is what you're saying. Thank you for those comments. We're certainly noting those comments and taking them on board. We'll examine with AlintaGas the impact that that does have - what is being proposed and the impact that that's had on the sorts of things that you've raised. Thank you. There was a question just over here.

MR SOUTHWELL: Phil Southwell, Western Power. Just a question on something that was raised by Ray Challen and then also referred to when Darren was talking, which is basically the move from the proposed revenue yield to the individual price cap regime. I'm just wondering if someone would like to make a comment on the impact that that has on the incentives for the pipeline business to actually better utilise its assets. It seems that it's a very interventionist way of controlling the business and takes away virtually any incentive for reducing prices generally on some assets that they want to better utilise.

I understand there are concerns about the business taking advantage of that and using that to keep out competition, but it does seem to ignore the fact that there's ring-fencing between the retail and the distribution business. The whole revenue and pricing basis is around trying to reasonably control the revenue of the business. It's better to let the business try to find smart ways of doing its business than for the regulator to continually control it. That's my opinion. I'm just wondering whether perhaps someone from the regulator's side could make a comment. Thank you.

DR MICHAEL: Ray, would you like to comment on that?

DR CHALLEN: As I think I mentioned and as Darren mentioned, the issue of the reference tariff variation mechanisms is extremely complex. The concerns we had with the average revenue or revenue yield approach proposed by AlintaGas were related to the incentive for efficient pricing for a distribution system in isolation. In particular, the point I mentioned about the incremental revenue to a distribution system or to a service provider from providing an additional unit of throughput reflecting an average revenue across all of the services provided by that provider, rather than the incremental value of the particular service to which the increase in throughput relates.

Then there were also some concerns related to the existence of regulated retail tariffs and to the fact that AlintaGas is both a distributor and a retailer, taking into account that although there are ring-fencing provisions, it is to some extent and certainly perhaps in the eyes of a shareholder total profitability of that group that would matter, rather than the individual sections.

Just to reiterate on that, our concerns were both to our distribution system in isolation and relating to the fact that there are regulatory type tariffs and there is a vertical integration between a distribution company and a retail company.

In regard to the commercial discretion and the appropriateness of intervening - regulatory intervention - in this area, I guess I'm not going to go into a detailed discussion here due to the complexity of the issue but there has been fairly extensive documentation of the experience of the Eastern States' regulators with these different forms of regulatory mechanism and some of the experiences, looking back at what's actually happened with the use of revenue yield and average revenue mechanisms, particularly the Victorian distribution systems, so there are lengthy discussions there in public documents from the other regulators. We have taken that experience into account also in this, if you like, regulatory intervention.

DR MICHAEL: That gives you the flavour but not necessarily the answer. Do you want to add any more comment? Sorry, Peter.

MR KOLF: That's all right. Phil, I just wanted to add to that a little bit. I'm just not quite clear on your comments regarding the impact of this on asset utilisation. Clearly, this is something where I'd need to have a bit more of an understanding as to exactly what your concerns there are.

However, insofar as the rebalancing processes that are involved here, our concern was really not to prevent rebalancing but, rather, to be more explicitly aware of it. The approach that we're seeking to take here is not one that would prevent rebalancing but one to make it more transparent and one that would provide a process for comment by interested parties where a rebalancing tariff arrangement is being proposed.

DR MICHAEL: Thanks, Peter. Do you wish to come back at that? The question of intervention and intrusiveness I've raised many times. I raised the same issue at the conference recently. One of the difficulties as a regulator where I sit and I hear the comments is trying to meet some of the objectives of the regulation, particularly in relation to competition and in relation to stimulating the economy while still recognising that there's an owner there who needs to be able to make a business out of all this. That's not forgotten in all this exercise.

Having said that, the process itself is fairly prescriptive and I've said that many times. In some instances we can only work on what others have done as precedents themselves so that we can test the market as to how effective those processes have been, so there is an element of what you say in the whole process, although it's my intention - and if it hasn't

come through I'll certainly make a point here: it's my intention to use those in as a constructive a way as possible, not in an interventionist manner in trying to be obstructive in coming up with decisions.

It's very difficult to work through what is a very complex system of regulation compared with what I believe are complex business structures in trying to come up with a very simple answer, so there is a lot more discussion required; but that's the attitude behind it. I make no apology about using one of the sections to promote competition because that's the nature of the business and that's the nature of what we're trying to achieve.

However, that's got to be couched in terms of a reasonable rate of return for the business entity and that's not forgotten, as I say. If we did forget it, we'd be quickly reminded, I can assure you, as we were today. If you would like to come back on that - that's just a general pitch from me I guess. Phil?

MR SOUTHWELL: Just to come back briefly, I appreciate where you're coming from and I fully support that. I guess what seems to happen everywhere with regulators is that they start with this light-handed desire and then as they learn more about the business, they get more worried and they want to intervene more. I guess as we're starting out on this we seem to be starting out with a fairly heavy-handed approach and perhaps it would be better to see whether the revenue yield approach works first, rather than leaping in; there's a lot more control.

DR MICHAEL: Thanks for that comment. It certainly wasn't intended to go in heavy-handed and I've noticed that comment used twice today. That's not the intent. I guess my attitude is very clear. I see in front of us - and I said this at the conference - a regulatory system which has minimum oversight by the regulator. That will require substantial changes to what we have before us. If out of this series of 5 years of access arrangement we don't learn something from that, I'd be very, very disappointed.

It's not my intention to take that other line. I'm sure if that happens, there's a lot of people around here who would remind me that it's happening through such forums, which we should encourage rather than discourage, so I thank you for those comments and certainly they will be taken on board. Any other comments or questions? There's one at the back and one in the front here a little later, Julie.

MR PETRIG: Rudi Petrig from CMS Energy. I've got a comment, which takes us away from the macro level more into the micro level at the customer face I guess and also relates to the proposed tariff A standing charge. Basically, if we look at that from a customer perspective, the customer is up for a standing charge of \$50,000 per annum. With a contestable customer with a take of 100 terajoules per annum, that equates to 50 cents per gigajoule that someone will have to pay and basically the customer will have to pay at the end of the day.

That's a new charge and will make it more difficult for a competitor, be it a trader or whoever, to basically supply an alternative source of gas to a customer. That together with

the overall arrangement for the tariff structure - if again we have an example of a customer, be it a customer in Kewdale or possibly Canning Vale or possibly in the Kwinana strip, 1 kilometre away from the pipeline and a contestable customer of 100 terajoules a year, then basically that customer will be faced in the future with a 14-fold increase in the tariff.

That will make it very difficult for that customer to realise any gains in competition because quite frankly it won't be possible for anyone to get in there and be able to provide a service based on the new tariff regime because basically what they're paying for now will be much less than that, so why should they go to a new arrangement which is open access if they're paying more? That's a question that the office of the regulator may wish to comment on or possibly AlintaGas. How do you respond to a customer who's faced with that sort of dilemma in terms of: what is open access and deregulation doing for that type of customer?

DR MICHAEL: Thank you, Rudi. Ray, did you wish to make a comment on that?

DR CHALLEN: In looking at the proposed tariff structure for Reference Service A, the fact that there was a constant fixed charge there regardless of the location of the delivery point was something that we took into account and we did notice that for customers very close to - or having a delivery point a very short distance away from a transmission pipeline, that that would, due to that \$50,000 fixed charge, - depending on their gas use - result in a very high average cost of gas distribution.

In considering that proposed tariff structure, we did look at both what we might call efficiency criteria and also equity criteria. The efficiency criteria went something along the lines of: if there are substantial fixed costs in providing a service, then it makes some sense for those fixed costs to be recouped through a fixed charge, an up-front charge for a service.

Before I move from that efficiency criteria point, it should be noted that there's a range of different tariff structures that may meet that efficiency criteria. The equity criteria we looked at really related to, if you like, a sharing of the fixed costs of a distribution system between all the users of that distribution system and any sort of equity criterion is very grey and you might say very woolly and there may be several different tariff structures that may be regarded as generally reasonable by people involved.

Having said that, there may be any number of tariff structures proposed by AlintaGas that may meet the efficiency criterion of recouping fixed costs through fixed charges and representing a sharing of costs between users that may be regarded in some sense as reasonable or equitable.

The fact that one particular tariff structure proposed by AlintaGas may differ substantially from an existing tariff structure is not necessarily a reason for rejecting a tariff structure, given that it may still meet reasonable efficiency and equity criteria.

Our concern therefore really related to a transition between the existing tariff regulation and the proposed tariff regulation to avoid tariff shocks. However, if there are

submissions on the tariff structure that relate to equity criteria or the sharing of fixed costs that we haven't considered, we would be quite happy to look again at those before a final decision.

DR MICHAEL: Phil Harvey?

MR HARVEY: Thanks, Ken. I think we need to understand that one of the very fundamental principles of the national access code is negotiated tariffs. It is not in the network owner's interest to have customers drop off the system. It's not in the network owner's interest to be getting zero revenue from a customer by saying, "Here is a reference tariff and you will pay it come hell or high water."

The fundamental principle is negotiation. Having said that, it is also another principle of the access code to try to have prices to a large extent reflect costs. I think an economist would call that economic efficiency.

Over the longer term it is clear that there will be a move towards having prices better reflect costs than they currently do. We do need to understand there's a high level of fixed costs in a gas network and indeed there is a justification for the charges to have a much higher level of fixed charge than currently exists in order to reflect those fixed costs.

When we introduce competition there is absolutely no doubt there will be winners and losers. In the tariff we have proposed for these sorts of customers which is distance-related, we are almost, over a long period of time, forcing customers to build as close to the off-take points as they can. That I think will be one of the outcomes of this process as people try to reduce their costs.

An economist would say that's an efficient thing to do. Whether from a State point of view it's an efficient thing to do I don't really know but I would like to assure existing customers and potential customers out there that as a network owner we are keen to carry gas and if that means we negotiate a tariff below the reference tariffs in order to do it, that's what we'll do.

DR MICHAEL: Thanks. I think that's a good summary. I think the issue Phil makes is very important. The reference tariffs that we set are maximum tariffs that you work to. How you negotiate within that framework is a commercial interest between the user of gas and the Service Provider. However, I think Ray has quite rightly said, just before I call on you again, Rudi, the question of interventionist - here's an example. We're saying that AlintaGas are the best people to tell us how these things are put together, even in respect of the retail margin. We're not saying it has to be this figure. We're saying as a principle that's what we'd like to see and that's where the debate is going to take place, but that sets the framework, as I see it. Rudi, did you want to make a further comment?

MR PETRIG: Yes, I wouldn't mind. Phil, thanks for your comments, although I'd like to say that it kind of misses the point in that if you look at what's happening in terms of competition at the moment and you're looking around the 100 terajoules per year customer,

I mean, that is where the competition is at. In terms of giving someone a special arrangement, what incentive is there for AlintaGas to give someone a better arrangement if they are going to compete in the system - compete with the other arm of AlintaGas?

You're talking about AlintaGas the pipes business, which may have the fixed costs, attached to it but in terms of AlintaGas the trading business, that would lose the customer. Now, where's the incentive? I really can't see where the incentive is and I can't see that you'll get any competition whatsoever from other producers, smaller producers who basically need to get into the competitive chain.

DR MICHAEL: Fair enough. Did you want to come back at that, Phil?

MR HARVEY: Yes.

DR MICHAEL: I will let Phil and then Peter - - -

MR HARVEY: I will be brief. Thanks, Ken. The fact is that AlintaGas distribution will charge and be required to charge AlintaGas retail the reference tariff; AlintaGas retail will be the same as for any other retailer. If there is a special deal done between AlintaGas distribution and AlintaGas retail, because it's not an arm's length transaction, the regulator has to get involved in that. So, the regulator has a role in ensuring that AlintaGas distribution doesn't give preference to AlintaGas retail in the competitive situation of that customer, Rudi, that you're talking about. There is the protection of the regulator there.

DR MICHAEL: There's a plus for the regulator. I will ask Peter to make a comment.

MR KOLF: Thanks, Ken. I just wanted to respond to Rudi's original point and question. We did in fact take the matters that he raised into account. Ray has certainly addressed the transitional aspects as being one of those things that we specifically took into account in addressing that particular problem.

There is another aspect that we also did take into consideration and that is the relationship between the A and the B1 tariff. AlintaGas, if my understanding is correct, are proposing to revisit that particular aspect of it which may also help to address the particular problem that you raised there, Rudi.

DR MICHAEL: Certainly, Rudi, we'll take that on board and if you've got any other information from your own group that you would like to provide us with, and your opinion, we would welcome it. I think the spirit is there to try to come up with something that's fair and reasonable on both sides, so I'm pretty sure that we can address those issues. There was a question just here I thought.

MR TURNBULL: Thanks. Greg Turnbull here from Western Power. I'd just like to explore a little bit further from what Phil's original question was regarding a price cap. It seemed to me in reading the draft decision that one of the reasons for going for a price cap was that there's a constraint in that the existing retail tariffs need to be kept in place and

therefore if you've got built-in cross-subsidies with the existing retail tariffs and those retail tariffs have been there for a long time and are there for all sorts of reasons.

If you're going to require those retail tariffs to be retained, then their cross-subsidies have to also be retained and therefore you are sort of designing network tariffs to take that into account. Therefore, if you don't allow rebalancing, you are going to retain those cross-subsidies but you're also going to prevent those cross-subsidies from being unwound over time. I'd just like your comment on that firstly.

The other question that I've got is with respect to incentives in a price cap regime versus a revenue yield. In a price cap regime it seems that the incentives for the gas company to change customer behaviour are much reduced because essentially if they have tariffs in place which can change customers' behaviour, then what they can end up with is in fact lower revenue because people either use less gas or they reduce their demand and therefore simply the gas company is the loser in that they get less revenue, whereas under a revenue yield arrangement, they can put incentives in place to change customers' behaviour and to improve the utilisation of the network while not destroying their own income. Can you comment on those two issues please?

DR MICHAEL: Peter?

MR KOLF: Thanks, Ken. In relation to the first question, I'd just like to point out that the draft decision does not make any reference to the retaining of retail tariffs, quite the contrary. The way it is operating is that there are certain retail tariffs that are currently in place and it is seeking to ensure that given those retail tariffs (indeed the retail tariffs are a matter for government policy, not this particular regulator) the purpose of the draft decision is to endeavour to ensure that competition can take place with those retail tariffs in place and hence a reasonable retail margin is required in order to make it worthwhile for other players to participate in the market.

It is not there to enshrine retail tariffs. There is no reason why government policy could not change, but the present situation in that regard is that retail tariffs are to increase in a certain way with CPI.

Insofar as the second question is concerned, it's probably better for Ray to comment on that but I would say that we have looked quite hard at the whole question of the revenue yield approach. Our advice from all over the world is that the revenue yield approach does provide opportunities for service providers to play in the market or at least utilise their opportunities there to effect the market in such a way as to be particularly detrimental to the competitive circumstances in the market.

Now, under those sorts of circumstances we have taken the view as have other regulators, particularly in recent times, that if any particular recommendations for changes in the balancing or rebalancing of tariffs is necessary that it is best dealt with in an explicit way, rather than on an automatic basis as is proposed by the revenue yield approach. Ray may wish to comment further on that.

DR CHALLEN: Just commenting on the issue of cross-subsidies that you raised. Addressing an issue of cross-subsidy or even the definition of cross-subsidies when you are dealing with a service that is provided where a very high proportion of your price or revenue is made up of recovery of sunk capital costs, cross-subsidies - just because somebody is bearing a higher proportion of capital costs than somebody else does not necessarily mean that there is a cross-subsidy. Cross-subsidies really relate to a forward-looking view and whether an additional customer meets their incremental cost of providing a service.

I think the discussion of cross-subsidies was quite extensive in the draft decision in trying to clarify a few of these matters. Certainly, we're not convinced that there's any cross-subsidies existing there at the moment. In terms of an argument preventing rebalancing, preventing some cross-subsidy being wound back over time that is there by virtue of current regulation, there's no indication at least to us that there's that need at the current time, nor that some rebalancing mechanism would achieve that and that the service provider would have an incentive to achieve that if there were such cross-subsidies existing.

In terms of your point about preventing rebalancing, limiting the ability or the opportunity to change customer behaviour, I don't think we're going to deny that there are good points about a revenue yield or average revenue approach, such as taking a longer-term view of changing customer behaviour and perhaps having some sort of strategic cross-subsidy there in the short-term to change customer behaviour and to develop a more profitable business in the longer term.

There are also incentives in a revenue yield or average revenue approach, just as in a price cap approach, for the service provider to reduce cost and increase their efficiency in providing the service.

Our position on the revenue yield approach was that the potential advantages of that incentive structure were outweighed by the potential disadvantages with other incentives and, if you like, more strategic incentives for the business to rebalance costs and the potential effects on competition in the market and so on.

DR MICHAEL: Thanks, Ray. Greg, that doesn't answer the question but that certainly gives you the process we took and the means by which we were trying to balance the advantages and disadvantages of the different mechanisms. I certainly welcome anybody else's comment in relation to that approach because it clearly is something that is creating some difficulties certainly with AlintaGas. Greg, is that finished?

MR TURNBULL: Yes, I think so. I was really interested in what your comments were and you've given me - - -

DR MICHAEL: Thank you.

MR TURNBULL: I probably would like to hear Phil.

DR MICHAEL: Right at the outset - I'll leave it to him, but I will say that I have left it to Phil to decide. I think they have a position, which they have explained and they may want to retain that position or may wish to make a comment. I'll accept either view from you, Phil.

MR HARVEY: I think I would rather just leave our arguments in the written material.

DR MICHAEL: I'm quite happy to accept it. By the end of the week, you'll have full details and I'm sure there won't be any confidentiality issues - says he hopefully. That will be on the Web site as quickly as we've had a chance to have a look at it, Phil, so I'll accept that. Rudi was just coming back on that point and then yourself. Rudi, the same point, is it?

MR PETRIG: Yes.

DR MICHAEL: Thank you. Please repeat your name.

MR PETRIG: Rudi Petrig, CMS Energy. On the point that has just been discussed, has the regulator looked at some specific examples of actual customers? I'm talking about the competitive customers that currently exist and will exist until 2002. Has the regulator looked at actual examples, rather than sort of gross macro statements, in terms of what cross-subsidies might do to competition, to those customers? Are they really attainable in terms of people trying to enter the market, the competitive scene? Very simply, has the office looked at actual customers and actual examples?

DR MICHAEL: Peter or Ray?

DR CHALLEN: The short answer to that is: no, we didn't have individual customer data to look at from AlintaGas. We did have some aggregate data and from that we did look at some, if you like, hypothetical customers in different situations and what the proposed tariff structures may mean for those hypothetical customers but the short answer is: no, we didn't look at real examples of individual customers.

DR MICHAEL: Peter, are you right?

MR KOLF: Yes.

DR MICHAEL: I think the response is that when we do get AlintaGas's submission, there may be perhaps more insight into that aspect and we'll be able to address that question but we certainly will take that and note the concerns that you've raised.

In many cases, the difficulty that we do have - and we have to respect the commercial confidentiality of business as well. We have been using aggregate information in a number of instances and it has generally been good enough for us to get a pretty good idea of what's happening. If that's not the case, we do get cooperation from the providers to just add that extra bit of value so we may have to pursue that one just a little bit more if we're able to do so. Thank you for raising it.

MR FORCKE: Alex Forcke from Arc Energy. After another question in relation to one of the issues that was addressed earlier - that is, in relation to negotiated rates on the distribution system; in other words, rates other than reference tariffs for particular customers - I'm just curious to find out what mechanism or what level of transparency does exist under the access arrangement and I guess with the role of the regulator to ensure that any negotiated rate between AlintaGas distribution and AlintaGas trading will also be made available to other users who are competing for customers and ultimately would be seeking fair competition and equity.

DR MICHAEL: I don't know if anybody wishes to address that one. Peter, did you want to have a go at that?

MR KOLF: Yes, I can respond to some extent. There are no specific provisions within the Code that would require the disclosure of negotiated tariffs. It is a matter strictly between the parties to any particular contract. However, to the extent that any particular negotiation takes place, particularly in respect of non-reference services, and if a prospective user is having difficulty in negotiating an appropriate arrangement with the service provider, then the Code does provide an arbitration mechanism whereby those matters can then be referred to the arbitrator for resolution.

DR MICHAEL: Darren?

MR GRONDAL: Thank you. Darren Grondal, AlintaGas. Just to add to what Peter said and to reiterate the point that Phil made earlier. When AlintaGas enters into an agreement between its sales business and its network business, that agreement is an 'associate contract' and will need to be placed before the regulator for his approval. I recall that the test that the regulator needs to satisfy himself of in relation to any 'associate contract' is whether or not it will substantially lessen competition in the market.

Insofar as transparency of rates negotiated between distribution and retail, if there are any, is concerned, we will be placing an 'associate contract' before Dr Michael and he is to undertake a process of assessment which is outlined in the Code. That's really the end of it.

DR MICHAEL: Yes. Phil?

MR HARVEY: I'd like to just add a little to that, Ken. We do need to make a clear distinction between AlintaGas distribution and AlintaGas retail. Now, there's no doubt that AlintaGas retail, which includes trading as the monopoly supplier in the past, as the incumbent retailer, has some advantages. There is diversity and a range of other issues. It's absolutely clear that retail as an existing organisation has some advantages over other companies coming in. That's the same in whichever state you go to. That is a fact of life.

The great thing that competition does is that it drives new players to find new ways to do things to compete with the incumbent. But, we do need to make a very clear distinction between those advantages that retail has compared to distribution. I'd like to say

that in the past the view that we have taken in selling gas to customers as the monopoly supplier was to try not to interfere in the competitive process. For example, if we had - just take a theoretical case - half a dozen brickworks, we attempted in negotiating prices with those brickworks to ensure that there was some sort of relationship between volume and price so that we didn't distort the brick marketplace in Perth by giving one brick supplier a very low price and another one a very high price.

If you can imagine it spread out in geographic terms, we've got half a dozen brick companies paying about the same price, with some effect because of volume - some economies of scale effect.

What we have now is a completely new system where for economic efficiency reasons we're saying there's going to be a distance relationship to tariffs. If your brickworks happen to be close to the pipeline, you'll get a lower charge, in terms of distribution charges only, than a brick supplier who happens to be 25 kilometres away from the pipeline.

In moving from the first of those things, and I would claim there was no cross-subsidy involved - we were genuinely trying not to distort the market - to a point of economic efficiency where the economists are saying, "Now you're at a point of economic efficiency" there will be winners and losers out of that. As I said earlier, over time these distribution charges may result in people thinking much harder about their geographic location; but in terms of distribution as distinct from retail, distribution must be neutral and will be neutral and if it's dealing with its own or an associated organisation, it does need to be approved by the regulator. That's the surety that people have.

DR MICHAEL: As the regulator, it's our job to make sure that everything is fit and proper in that respect. I guess that's where the position of regulator actually has a positive outcome to protect those sort of rather unique situations, I would have to say, that currently exist and which over time I guess, Phil, will change in any case as the sale process goes on and moves into other areas.

Alex, that's the answer but did you want us to take anything on board in respect of that? I certainly can give you the assurance and we could perhaps reiterate that point in our commentary about the role of the regulator where there are two related businesses in this respect to ensure that fairness and equity are there.

MR FORCKE: I think you've answered my question. I look forward to - - -

DR MICHAEL: To see how we write it up? Thank you, Alex. Any other questions or comments?

MR KING: David King, CMS Energy again. I just want to pick up on one of Phil's comments, both in what he said previously and just recently, on the distance based calculation for the distribution tariffs. Under the current GDRs the distance is calculated from the nearest gate station and that I guess could be seen to reflect the actual cost of using the infrastructure, as in the amount of pipe that you're using from the gate station where the

gas would notionally be delivered.

Under the proposed access arrangements, it's calculated as the distance from the nearest pipeline. Now, that raises the issue of a brickworks or whatever close to the Parmelia pipeline who's taking their gas from the Dampier-Bunbury pipeline. Their distance is calculated as the distance from the Parmelia pipeline and not from the pipeline, it is actually taking its gas supply from. In the distribution side of things, couldn't that be deemed to be anti-competitive in the fact that it would be precluding the operators of the Parmelia, CMS, from building a lateral to connect the brickworks up and make efficient use of the Parmelia pipeline itself?

DR MICHAEL: That certainly was an issue that we have addressed, Ray.

DR CHALLEN: Yes. That was an issue that did receive substantial discussion both amongst ourselves and again in the draft decision. From a purely efficiency point of view, any large commercial user should be faced with minimum cost of connecting to a gas service. That is the cost to the nearest pipeline.

The situation we came to was that although AlintaGas may well be charging the price to the nearest pipeline which may not necessarily be the pipeline from which they're actually sourcing gas, or from which gas is sourced, to go to that customer, we regard that as generally an efficient outcome, subject to the particular caveat that if it actually costs AlintaGas more to connect the new customer than they can retrieve through that tariff, that amount cannot be added to the capital base. In other words, that is a cost that they have to bear. This does relate directly to a cross-subsidy issue inasmuch as the new user should meet the incremental cost of connecting to a gas distribution system or to receiving a gas service.

Really, it relies on that particular caveat. If it costs AlintaGas more to connect a particular customer than they're going to get back in the reference tariff, that difference in cost should not be passed on to other users but should be borne by AlintaGas. The way that would be done is related to section 8.16 of the Code where AlintaGas would not be able to roll that incremental cost into the capital base.

MR KING: We can get into the details but, I mean, it's difficult. If you were looking at just the incremental cost of, say, putting a meter station or some pipework into a customer who's going to be connected, how much of the existing system is that customer also using up, so how much of the existing infrastructure which is included in the capital base is that customer taking advantage of?

DR CHALLEN: When you're dealing with sunk capital costs of existing infrastructure, you're not really looking at matters of efficiency. You're more looking at matters of equity in the distribution cost. I'm not sure I can answer that question now. I'd probably have to think more about it, but I guess I can only say that is an issue we did look at in the draft decision and it really does hinge again on that issue of AlintaGas not being able to recover more than the minimum cost of connecting a customer in terms of distance from a

transmission pipeline.

DR MICHAEL: David? If it's not clear in our draft decision, I think it's a point we need to take up to bring out, and I'm sure we'll have further discussions with AlintaGas on that particular issue. Again if there's anything you'd like to provide us with, we would be happy to take it on board but we'll certainly note those comments and utilise them in our discussions with AlintaGas. Rudi, you have another comment?

MR FORCKE: Yes, thank you. I guess it raises a question in my mind, somewhat of a fundamental question; that is, is it okay to have what you're talking about - capital being brought into the calculations? Now, I take it that wouldn't happen for another 5 years, so what we're saying is, "Look, we're going to suffer on one side in that there might be a lack of competition but it's okay because in 5 years' time we'll fix it up?"

DR CHALLEN: As we understand it, there's no particular capital expenditure forecast for this access arrangement that has been taken into account in the determination of reference tariffs that relates to such extensions of the high pressure system.

What will happen at the end of the access arrangement is that if AlintaGas have made any such extensions to the system and they want that rolled into the capital base, then they will have to provide the information to the regulator substantiating their case. We've flagged in the draft decision that we'll be looking very closely at such capital expenditure to make sure it meets the requirements of 8.16 of the Code but to my knowledge or to my recollection no such expenditure has been taken into account at the moment.

DR MICHAEL: That hasn't probably answered your specific issue but I think the question is to what extent we address that concern through this particular decision process. It would seem, Ray, that we'd probably need to clarify some of the points you have made in our final decision, certainly in a preamble to it.

DR CHALLEN: Yes. In what is already I guess a fairly lengthy discussion, we'd be looking at public submissions to get some idea of the points of clarification needed there.

DR MICHAEL: Thank you for your comments, Phil. The mike is coming, Phil.

MR HARVEY: Perhaps, Ken, I could add something to that. In the preparation of the access arrangement, as I indicated in my brief presentation, we had to make decisions early on without being able to talk to the regulator, because you hadn't been appointed then. So, in our discussions with the steering committee, which involved the Office of Energy amongst others, we did recognise this as a unique problem.

The access Code was really designed primarily for isolated transmission pipelines and then almost towards the end of that process extended to cover distribution systems. I think the people who were preparing it never really envisaged at that time competition between two pipelines. So, we addressed in that steering committee the philosophical question without having the advantage of either guidance from the Code or the ability to talk

to the regulator.

The conclusion we came to is the one which we included in the access arrangement, that competition would be enhanced if distance was measured from the nearest pipeline. We think there are some good arguments for that and we believe that it will in fact promote competition between pipelines, rather than limit competition between pipelines.

DR MICHAEL: Thanks very much, Phil. Certainly, Phil, I guess with your people we'll probably raise that matter during the course of our discussions, just to clarify a couple of the points that have been raised. Are there any other comments? We've got two - one in the back.

MR LEWIS: Richard Lewis from McLennan Magasanik Associates. I'd just like to take that issue a little bit further about section 8.16 and ask whether either AlintaGas or OffGAR made any calculations about whether capital expenditure connecting new residential customers will actually meet the test of 8.16, given the fact that the tariffs are discounted and subject to the retail cap.

DR MICHAEL: Ray?

DR CHALLEN: Yes, we did look reasonably closely at AlintaGas's proposed capital expenditure, just to go through the process by which capital expenditure is accommodated within an access arrangement and within the determination of reference tariffs. At the end of the access arrangement period, the capital base will actually be reviewed and to what has been established now as the initial capital base, you will have some capital expenditure added on if that meets the requirements of section 8.16 and you will subtract depreciation that has occurred over the access arrangement period to arrive at the capital base for the commencement of the next period.

The code provides for a service provider to accommodate some capital expenditure that's going to occur over the access arrangement period into the determination of reference tariffs, so what you have in effect is that it's added to the capital base before the end of the access arrangement period.

For a service provider to be able to do that, they have to satisfy the regulator that it's reasonably likely given the way things currently stand that that capital expenditure will meet the requirements of 8.16 when you come to look at it in hindsight at the end of the access arrangement period.

What we were looking for in the information that was provided for assessment of the access arrangement was sufficient information to allow the regulator to reach that view, and that it's reasonably likely that the expenditure that has been proposed will meet those requirements.

We went through that. We took into account in that assessment that AlintaGas was still in the process of preparing detailed asset management plans and that perhaps there isn't

necessarily the information available at the moment to make as rigorous an assessment as we may like. I guess we had to use judgment to some extent on the likelihood of it meeting the requirements of section 8.16. We disallowed or wound back some capital expenditure because we thought there was a lack of substantiating information and in other instances we gave AlintaGas the benefit of the doubt for the time being.

However, even where we have given AlintaGas the benefit of the doubt so that some capital expenditure is incorporated into the determination of reference tariffs now, we still will be looking at that capital expenditure again when it comes to adjusting the capital base at the beginning of the next access arrangement period.

We certainly expect at that time for there to be far better information available to the regulator for assessing capital expenditure than there is at the moment for the purposes of assessing this access arrangement.

DR MICHAEL: Richard, did you want to add any more?

MR LEWIS: No. That answers the question.

DR MICHAEL: I think that answers the question, yes.

MR BULT: Tim Bult from Wesfarmers Energy. Dr Michael, I was wondering if I could ask you a question with respect to the philosophy in maintaining minimum retail margins and in particular the relevance of that concept throughout the access period. If I have interpreted correctly the presentation today, the initial capital base has been derived on the presumption of minimum retail margin as it currently applies to tariffs to domestic customers in particular that are largely set by government policy, yet it strikes me that throughout the term of the access arrangement prices for domestic customers are going to become more and more set in fact by competitive pressures, rather than government policy.

Does that mean that there's a risk throughout the access period that the number that is chosen based on current arrangements becomes irrelevant and therefore that the initial capital base becomes a less relevant measure throughout the duration of the access period?

DR MICHAEL: I will get someone to answer that but when we struck a value we needed to come up with a value of the initial capital base and we chose a 2 percent margin. We assumed it to come up with a figure that we could use, because it is as you say quite variable in that respect and we needed something that we could use in order to determine what rate of return and what reference tariffs we would have. We had to balance it. We ran many models and many cases, as you can imagine, on that.

I'll leave it to Ray to talk about the retail margin itself but it's an attempt on our part to recognise that interested players wanting to enter the market at those particular reference points would have an opportunity to do so if there was a positive retail margin associated with that service. That essentially was the philosophy behind it. Ray, would you like to add to that?

DR CHALLEN: Just to go back a little and look at least at our interpretation of the methodology used by AlintaGas to determine their initial capital base. What AlintaGas did was to start with an a priori stream of retail revenue and then make numerous assumptions about retail costs, transmission costs, gas costs and so on, to deduct a range of costs from that retail revenue, to end up with a distribution revenue.

One of the costs they deducted was a retail margin and they assumed over the access arrangement period a declining retail margin, which they have argued in this presentation is due to competition and declining retail prices.

Our view when we assessed the access arrangement was that the reduction in retail margins was more than could be attributed to a declining retail price and therefore it represented a transfer of revenue, a somewhat arbitrary transfer of revenue, from the retail business to the distribution business which would have the effect of raising distribution tariffs.

We considered that to be unreasonable or certainly unsubstantiated in the information we were presented with and for the purposes of determining a target stream of distribution revenue and hence determining the initial capital base, we said, "Okay. We'll allow this transfer of revenue from the retail business to the distribution business but only up to a limit, given the lack of substantiating information" - that limit being some assumption about retail margins continuing to exist.

That's where that came from. We did look at what information was available as to what may comprise a reasonable retail margin and I'll be the first to admit that that information is rather scant but, nevertheless, we came to the conclusion that 2 percent wasn't a bad assumption for the purposes of the draft decision determining that target distribution revenue and therefore valuing the initial capital base.

MR BULT: I guess my issue is not so much whether the 2 percent is the right number but if I understand it correctly, you've said that the maximum distribution cost needs to be 2 percent less than the current delivered price and the current delivered price is set by government policy. My concern is the change in what your netting the retail margin off as the total delivered price and how that might move over time and therefore what current government policy is on delivered tariffs becomes a less relevant number and not the 2 percent or 1 and a half percent relevance as such.

DR CHALLEN: I mean, you may well have the situation arise where competition does result in retail tariffs that are below the regulated tariff, in which case even though we may have assumed a 2 percent margin what may result in practice is something less than a 2 percent margin. I guess that's something we'll have to consider in what is a reasonable figure to assume for the purposes of considering the current access arrangement and we'd still very much flag that that is still an open issue.

DR MICHAEL: Peter?

MR KOLF: If I may just comment on that a little bit further, I think the situation that needs to be understood is that the continuing minimum retail margin would apply to the B3 tariff. The 2 percent minimum retail margin in the derivation of the initial capital base was a once-only. If A tariff customers and perhaps B1 tariff customers are competitive, then there are no proposals to apply a minimum retail margin necessarily to those on a continuing basis. That was specifically for the purposes of deriving the initial capital base.

It's the B3 tariff that is a continuing concern and at this stage our understanding is that the Minister has made a statement as regards what he sees as the residential and small commercial market tariffs, as to how they would move over time, and it's really in relation to those that we're endeavouring to ensure that competition will be able to be sustained as the access arrangement period progresses.

DR MICHAEL: Tim, did you want to continue on with that point? These are the valid points that are coming out. If you'd like to make a comment, Phil, you certainly can. This is an issue that was clearly raised in Phil and Darren's submission and one we appreciate; hence we nominated it as one of the key issues that we need to resolve. Yes, Phil?

MR HARVEY: Thanks, Ken. In a sense, there's an unhealthy focus on this particular issue. If we move away from the economic models and look at real life, currently we buy gas under three different contracts. They have different prices. Even within contracts we buy gas at a range of prices. That gas is then used to supply customers that range from very large customers to very small. They have different daily load factors; they have different annual load factors.

Somehow, out of all that somebody has to determine what the cost of gas is, even for a single AlintaGas type organisation to, say, residential customers. Clearly gas suppliers from the Perth Basin and gas being bought under other contracts will have a range of other prices, so there's a whole range of gas prices out there. That's the starting point. You then say, "Okay. That's what I buy gas for. How much does transmission cost me?" There's a submission to the regulator right now by Epic which says, "This is what we think transmission ought to cost" and we don't have an answer on that yet.

Then at the end of it all, there's a range of retail prices. In order to get a margin you really have to take the end price and subtract the initial gas purchase price, take off the transmission cost, take off the distribution cost, take off the retailers' costs and say there's a 2 percent margin. How anybody believes you can do that with accuracy where the margin is 2 percent - you're just kidding yourself. You absolutely can't.

We've had to make an attempt, and in our modelling that's what we did because we started with a monopoly situation. But, very clearly as we go down the track that will change. You could argue forever about whether average prices or marginal prices or the way the model has been set up is right or wrong. It was clear that if we used the DORC value of \$700 million we would have ended up with distribution charges that meant gas was too expensive, so we had to move from the DORC valuation of \$700 million down to some other number and we ended up, as you know, at about \$540 million.

I think anybody who believes they can get accurate to tens of millions of dollars in this area is just kidding themselves. I've got a fair bit of sympathy with Tim's view on that one.

DR MICHAEL: Thank you. Do we have any other comment on that from our own group? I suppose what I'd like to say - I accept the point you make about an unhealthy focus. We see it differently of course and we see it differently because we do see the opportunity. What we're trying to do is to make sure that there is a difference. In other words that there's not a negative margin in relation to the reference tariff that Peter was talking about, B3.

At the moment, I think there is a need for adjustment of the various tariffs and I think Darren alluded to some restructuring of those and we need to discuss them. The reason for us concentrating on that, and we make no secret of the fact that we don't know what the figure should be - we've simply assumed 2 percent to help us through the process. We're asking AlintaGas to come forward as a concept to demonstrate to us that the reference tariff, particularly B3, does show a positive margin to some extent in order to allow for competition and other users to have an opportunity.

I guess that's pretty well where we were coming from, so that's the other side of the equation I guess that I'm trying to put. I think that's the thing we have to discuss and resolve. If you take the \$700 million for the DORC, I could only say that in the one and a bit years that I've been involved, the Eastern States' people always take 75 percent of DORC and it just so happens that 75 percent of DORC is about 500-odd million. I mean, that's a hypothetical sort of approach and unfortunately the thing that I've struck in this whole exercise is that we are talking today about some real commercial businesses versus a methodology. You have to try and balance the two together.

The thing that struck me, being the regulator, is how you balance that out when methodologies have already been established through the Code and through other processes. Whether it's a WACC or whether it's the DORC or an ICB as a result or whether it's in fact the reference tariffs that arise from it, they are the three parameters that keep cropping up all the time that we need to get an understanding on.

In some instances, we have to make judgments and we can only make judgments, I might add - and this applies generally - on the value of the information that we have. That's what I think Ray is alluding to. If there's any better information available that will cause us to rethink what we've said, then please let us have it so that we can really do that. I think that's what I'm really saying to you, Phil. Are there any other comments or discussions?

MR WILKINSON: Andy Wilkinson, with CMS. Just sort of at the risk of harping on that, I have a brief couple of questions to Darren just to clarify a couple of points of confusion I had with his presentation. One relates to a discussion just then on establishing the capital base that I would just like to clarify in my mind.

The draft decision goes on at length about AlintaGas using a deprivation method of establishing the capital base which is a fundamentally different philosophy from using a DORC methodology and scaling that down because it comes up with a tariff that would be commercially unrealistic in actual application.

I was just wondering: what was AlintaGas's view on that? Did they see that they used a reverse engineering approach implied in a deprivation value methodology or did they use the DORC and is the DORC methodology adjusted for commercial reality?

The other question I had was regarding their objections to section 38 of the Act - not relating to that, but I'd get it out of the way now. This exposes my ignorance. My understanding of section 38 of the West Australian Gas Pipelines Act - and I could stand to be corrected on this - is that it is all about promoting competition. Superficially at least the objection seems to be that by imposing competition, that disadvantages AlintaGas - a fair enough statement, but I wonder if there's a little bit more to it than just that superficial view. I was just wondering; perhaps Darren can comment on those.

DR MICHAEL: Darren, would you like to comment? Thank you, Darren Grondal.

MR GRONDAL: We'd like to answer the second of those questions. The first question in relation to the asset valuation methodology is extremely complex and we're going to leave that to the submission that we make on Friday.

In relation to section 38, I only have brief comments to make. Yes, I understand that you have read the Act and that it does state that the regulator is to take into account the fixing of distribution tariffs as a means of extending effective competition in the market. AlintaGas doesn't object - that section exists.

What we do have a difficulty with is in relation to the interpretation of the section, particularly in the light of the second reading speech of the Minister for Energy.

We also have a major problem with the weighting that has been given to section 38. Section 38 is one factor that should be taken into account in the assessment of an access arrangement. The point at which section 38 becomes relevant is where the regulator is assessing whether or not to approve and is required to take into account the public interest.

The public interest is one of six factors that the regulator is required to take into account and as Ken himself stressed at the beginning of his presentation, he is seeking to achieve a balance of interests. What we are saying is that section 38 has been inappropriately weighted and that has resulted in an unreasonable outcome for AlintaGas.

The detailed arguments as to why we have a particular view on the interpretation of section 38 will be set out in some detail in our response. I don't think it's particularly helpful to go through that right now.

DR MICHAEL: Thank you, and I thank you for making those comments, Darren. Does

any of the group from the office - I think we'll leave those on the table. I accept the points that are being made. I would like to just add that in all our discussions there hasn't been any objection to the competitive element. It's more a question I think from AlintaGas's point of view as to how we've used it.

I would argue that we have not given it undue weighting. We've looked at the total code, as I invariably try to do. However, a competitive environment is one of the key outcomes of all this process; otherwise we're in a position of status quo and I don't think that's what we're talking about at this stage. We're looking for opportunities. If the status quo is very competitive, then so be it.

We're suggesting that there are means by which that can be improved and we've highlighted what they are and obviously there's a disagreement on the extent of that. I think that's something where we have to sit down with AlintaGas, with their submissions, and go through it. Anybody else who has any comments in relation to that, we'd be delighted to have. Are there any other comments or discussions? No? We've worn you all out.

We are actually just about nearly on half past 12 and we had extra time, which was excellent. If there are no pressing comments, I will give Phil and his team the opportunity, if you want, to make any final comment. Are you happy with that?

Our team up here - it's not meant to be on the one side and on the other. It is done this way because it is the Office of Gas Access Regulation's decision that is being put on the table and it is the Office of Gas Access Regulation that I believe has to respond to the queries that are being raised.

DR MICHAEL: Could I just in closing advise you again that at the end of this week we're having the closure of submissions for the draft decision so those who have been busily working on it, following today hopefully you're in a better position to tidy that up and send it in to us. We'd certainly like to hear from you.

We very much appreciate all the comments we've received from the floor and I'd like to thank Phil and his team for coming forward and giving the presentation. This process is a bit more difficult than normal, in fact so much so that this is the second one. David King has been through this previously.

What I'd like to do - and our office doesn't know this yet; I'm about to let them know. What we'll do - we have your names and hopefully contacts. We'll be in touch with you. We might just ask you a few questions about the nature of the public forum and some feedback you might like to give us so that with the next one we run, if there are any improvements we can make we certainly will. I'm not looking for a score. I'm simply looking for ways in which we might do that. If you want to volunteer those, that's fine but we will get to you.

The next step of course is to take all these comments on board and certainly sit down with AlintaGas in particular and go through all the points that have been raised and

come out with a final decision, hopefully by the end of June which is our target. That's 12 months. As Phil says, it's a long process. It's 2 years from his perspective. It's 12 months from our perspective.

I've gone again on record as saying that it's difficult to do it under 12 months under the current process, especially for the first ones. We're learning a lot from these processes and I'm hopeful, as I've consistently said, that we can come out with some suggestions that will streamline this process so that it's seen as a partnering type exercise which Phil would like to see, rather than one that seems to create a bit of adversity here and there.

The other thing I'd like to just do very quickly - a number of points were raised. I won't go through them. I won't summarise them. I think there were a number of issues that were raised which will be on record. I do have them listed here and we'll need to take those on board in company with any comments we receive from yourselves and from AlintaGas in discussions with them, to hopefully come up with a final decision that does reflect the situation appropriately and to the benefit of all players. That's what it's all about.

Finally I would just thank Julie and the staff for organising today's forum and getting it all organised. I trust that it was helpful to you and I look forward to speaking with some of you again and hearing from you. Many thanks for your attendance.
