



FINAL DECISION: ACCESS ARRANGEMENT MID-WEST AND SOUTH-WEST GAS DISTRIBUTION SYSTEMS

Submitted by

AlintaGas

Part B

Supporting Information

**INDEPENDENT GAS PIPELINES ACCESS REGULATOR
WESTERN AUSTRALIA**

30 June 2000



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GLOSSARY

Terms used in the Final Decision have the meanings ascribed to them under the *Gas Pipelines Access (Western Australia) Act 1998* or the Access Arrangement for the Mid-West and South-West Gas Distribution Systems. Readers should refer to these documents for definitions of specific terms. In order to assist understanding, summary definitions of several terms used widely in this Draft Decision are provided below.

Access Arrangement	A statement of policies and the basic terms and conditions that apply to third party access to a covered pipeline.
Access Arrangement Information	Additional and/or supplemental information pertaining to the Access Arrangement.
Access Request	A request for access to a Service made in accordance with the Access Arrangement.
Applications Procedure	A Prospective User wishing to obtain access to a service must submit an application in accordance with the AlintaGas Applications Procedure, as specified in clause 17 of the Access Arrangement.
Arbitrator	The Office of the Western Australian Gas Disputes Arbitrator established under section 62 of the <i>Gas Pipelines Access (WA) Act 1998</i> .
Bare Transfers	A transfer by a User of all or part of its contracted capacity on a pipeline not requiring the consent of the Service Provider and as it does not involve a change in the contractual arrangements between the User and the Service Provider.
Capacity	The potential of a pipeline, as currently configured and operated in a prudent manner consistent with good pipeline industry practice, to deliver a particular Service between a Receipt Point and a Delivery Point at a point in time.
Capacity Management Policy	A policy that is required to be in the Access Arrangement indicating whether the Covered Pipeline is to be administered as a Contract Carriage Pipeline or a Market Carriage Pipeline.
Capital Base	Has the meaning given to “Capital Base” in section 8.4 of the Code.
Capital Expenditure	Expenditure on a Covered Pipeline and associated regulated assets to be incorporated into the Capital Base of the pipeline.
Code	The <i>National Third Party Access Code for Natural Gas Pipeline Systems</i> .

Consent Transfers	A transfer by a User of all or part of its contracted capacity on a pipeline where the transfer is subject to the consent of the Service Provider.
Contract Carriage	A system of managing third party access whereby the Service Provider normally manages its ability to provide Services primarily by requiring Users to use no more than the quantity of service specified in a contract (defined in detail in the Code).
Contracted Capacity	The nominal quantity of gas transportation to be undertaken under a service agreement between a User and the Service Provider.
Contracted Peak Rate	Contracted Peak Rate in respect of a User entitled to take delivery of gas at a delivery point means the rate specified in the User's Haulage Contract as the highest instantaneous flow rate through the delivery point at which AlintaGas can be required to deliver gas.
Covered Pipeline	The whole or particular part of a pipeline which is regulated under the Code.
Curtailment	AlintaGas may curtail the delivery of a quantity of gas to a User where supply from an interconnected pipeline has been curtailed.
Delivery Point	A point of a pipeline at which the custody of gas is transferred from a Service Provider to a User.
Depreciated Actual Cost	The value that would result from taking the actual capital cost of the Covered Pipeline and subtracting the accumulated depreciation for those assets charged to Users (or thought to have been charged to Users) prior to the commencement of the Code.
Depreciated Optimised Replacement Cost	Is the depreciated minimum cost of replacing or replicating the service potential embodied in a pipeline with modern equipment and in the most efficient way practicable, from an engineering perspective, given the service requirements, the age and condition of the existing assets and replacement in the normal course of business.
Depreciation Schedule	The Depreciation Schedule is the set of depreciation schedules that is the basis upon which the assets that form part of the Capital Base are to be depreciated for the purposes of determining a Reference Tariff.
Designated Supplier	The supplier who has been notified to AlintaGas by a User for a specified quantity of gas.
Extensions/ Expansions Policy	A policy that is required to be in the Access Arrangement setting out a method for determining whether extension or expansion to the Covered Pipeline is or is not to be treated as part of the Covered Pipeline for the purposes of the Code.

Fixed Period	The period during which a Fixed Principle may not be changed.
Fixed Principle	An element of the Reference Tariff Policy that can not be changed without the agreement of the Service Provider.
Haulage Contract	An agreement entered into between a Pipeline Service Provider and a User under which the Pipeline Service Provider agrees to provide a Reference Service on terms and conditions as set out in an Access Arrangement.
High Pressure System	The system of pipelines owned and operated by AlintaGas operating at a nominal pressure of 300 kPa or more.
Incentive Mechanism	Incentive Mechanism has the meaning given to “Incentive Mechanism” in sections 8.44 and 10.8 of the Code.
Initial Capital Base	Initial Capital Base means the Capital Base at the commencement of the Access Arrangement period.
Interconnection Service	A service in respect of the interconnection between a sub-network and a pipeline which is, or is to become, an interconnected pipeline.
Interconnected Pipeline	A transmission pipeline, distribution pipeline or gas storage system from which gas is supplied to AlintaGas.
Listed Ancillary Service	Refers to any one of a Disconnection Service, A Reconnection Service, an Additional Meter Reading Service, or an Additional Meter Testing Service.
Market Carriage	A system of managing third party access whereby the Service Provider does not normally manage its ability to provide Services primarily by requiring Users to use no more than the quantity of Service specified in a contract (defined in more detail in the Code).
Market Variable Element	A factor that has a value assumed in the calculation of a Reference Tariff, where the value of that factor will vary with changing market conditions during the Access Arrangement Period or in future Access Arrangement Periods, and includes the sales or forecast sales of Services, any index used to estimate the general price level, real interest rates, Non-Capital Cost and any costs in the nature of Capital Costs.
Minister	Is the Western Australian Minister for Energy unless otherwise indicated.
Medium Pressure/ Low Pressure System	The system of pipelines owned and operated by AlintaGas operating at a nominal pressure of less than 300 kPa.
National Gas Pipelines Access Agreement	A national agreement to introduce a national gas pipelines access regime endorsed by CoAG and signed by all Australian Heads of State on 7 November 1997.

New Facilities Investment	An increase in the Capital Base of the pipeline after the commencement of a new Access Arrangement Period to reflect additional capital costs incurred in modifying or adding to existing assets for the purpose of providing services.
Non-Capital Costs	Non-Capital Costs has the meaning given to “Non-Capital Costs” in section 8.4 of the Code, which at the date of the publication of this decision was: “...the operating, maintenance and other Non-Capital Costs incurred in providing all Services provided by the Covered Pipeline”.
Non-Reference Service	A service other than a Reference Service.
Operating Expenditure	The Non-Capital Costs incurred by a Service Provider in operating, maintaining and delivering services.
Optimised Deprival Value	A valuation of an asset based on the cost that would be incurred by the owner of the asset if deprived of the asset. This may be calculated in several ways. For the purposes of this Final Decision, the Optimised Deprival Value is defined as the lesser of the depreciated cost of an asset and the valuation of the asset in terms of the expected net value of financial returns to the asset (on a cash flow basis).
Optimised Replacement Cost	Is the minimum cost of replacing or replicating the service potential of an asset with modern equipment in the most efficient way practicable, from an engineering perspective, given specified service requirements.
Prospective User	A person who seeks or who is reasonably likely to seek to enter into a Service Agreement with a Service Provider and includes a User who seeks or may seek to enter into a Service Agreement for an additional Service.
Queuing Policy	A policy that is required to be included in an Access Arrangement which defines the priority that a Prospective User has over another Prospective User to negotiate for specific Capacity.
Rate of Return	Rate of Return has the meaning given to “Rate of Return” in section 8.4 of the Code, which at the date of the publication of this decision was: “...a return (<i>Rate of Return</i>) on the value of the capital assets that form the Covered Pipeline (<i>Capital Base</i>).”
Receipt Point	A point of a pipeline at which the custody of gas is transferred to the Service Provider.
Reference Service	A Service that is specified as a Reference Service in an Access Arrangement.

Reference Tariff	A tariff specified in an Access Arrangement as corresponding to a Reference Service.
Regulator	The Independent Gas Pipelines Access Regulator in Western Australia established under section 27 of the <i>Gas Pipelines Access (WA) Act 1998</i> .
Residual Value	The value of the Capital Base at the end of the Access Arrangement Period after allowing for Capital Expenditure, Redundant Capital and Depreciation during the Period.
Revisions Commencement Date	A date upon which the next revisions to the Access Arrangement are intended to commence.
Revisions Submissions Date	A date upon which the Service Provider must submit revisions to the Access Arrangement.
Ring Fencing	A requirement on a Service Provider to establish arrangements to segregate or “ring fence” its business of providing Services using a covered pipeline from other business activities.
Scheme Participant	Scheme Participant means the State of Western Australia as defined in section 11 of the <i>Gas Pipelines Access (Western Australia) Act 1998</i> .
Service	A Reference Service or Non-Reference Service relating to the transportation of gas by a Service Provider, and in the case of a Service Agreement means the particular Reference Service or Non-Reference Service the subject of that Service Agreement.
Service Agreement	An agreement between a Service Provider and a User for the provision of a Service.
Services Policy	An Access Arrangement must include a policy on the Services to be offered, including a description of one or more Services. A Services Policy commits AlintaGas to making available Reference Services to Prospective Users, and for the provision of Non-Reference Services to Prospective Users.
Service Provider	In relation to a pipeline or proposed pipeline, means the person who is, or who is to be, the owner or operator of the whole or any part of the pipeline or proposed pipeline.
Standard Delivery Facilities	The standard delivery facility or facilities specified by AlintaGas, including a pressure regulator, sized to suit the applicable meter, and any ancillary pipes and equipment.

Structural Element	Any principle or methodology that is used in the calculation of a Reference Tariff where that principle or methodology is not a Market Variable Element and has been structured for Reference Tariff making purposes over a longer period than a single Access Arrangement Period.
Total Revenue	Total Revenue has the meaning given in section 8.2 of the Code, which says it is the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement period.
Trading Policy	A policy that is required to be in the Access Arrangement for a Contract Carriage Pipeline, as required by section 3.9 of the Code, regarding trading capacity and the rights of a User to trade its rights to obtain a Service to another person.
User	A person who has a current Service Agreement or an entitlement to a Service as a result of arbitration under Section 6 of the Code.
User Specific Delivery Facilities	The facility or facilities which are the most appropriate for a particular User as determined by AlintaGas, including a User-specific pressure regulator, any ancillary pipes and equipment, and a service pipe from the main to the delivery point.

ABBREVIATIONS

ACCC	Australian Competition and Consumer Commission
CAPM	Capital Asset Pricing Model
CCA	Current Cost Accounting
CMS	CMS Gas Transmission of Australia Pty Ltd
CoAG	Council of Australian Governments
CPI	Consumer Price Index
DAC	Depreciated Actual Cost
DBNGP	Dampier to Bunbury Natural Gas Pipeline
DORC	Depreciated Optimised Replacement Cost
GJ	Gigajoules (10^9 joules)
GST	Goods and Services Tax
HP	High Pressure
IPARC	Independent Pricing and Access Regulatory Commission (ACT)
IPART	Independent Pricing And Regulatory Tribunal (New South Wales)
IRR	Internal Rate of Return
kPa	Kilopascals
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
MAOP	Maximum Allowable Operating Pressure
MDQ	Maximum Daily Quantity
NCC	National Consumer Council
NPV	Net Present Value
OffGAR	Office of Gas Access Regulation
ORG	Office of the Regulator General (Victoria)

PJ	Petajoules (10^{15} joules)
TLPG	Tempered Liquefied Petroleum Gas
TJ	Terajoules (10^{12} joules)
WACC	Weighted Average Cost of Capital

1 INTRODUCTION

This Part B of the Final Decision provides background and supporting information to the Final Decision, outlined in Part A, on the Access Arrangement for the Mid-West and South-West Distribution Systems.

In preparing the Draft and Final Decisions, the Regulator assessed the Access Arrangement on the basis of three broad criteria:

- i. whether the Access Arrangement meets the requirements of sections 3.1 to 3.20 of the Code that explicitly state the matters that must be addressed in an Access Arrangement;
- ii. whether the proposed Reference Tariffs are consistent with the objectives of section 8 of the Code and were determined in accordance with the principles set out in section 8; and
- iii. for matters included in the Access Arrangement but are outside the scope of requirements set out in sections 3 or 8 of the Code, whether the inclusion and substance of these matters are reasonable having regard to the interests of the Service Provider, Users, Prospective Users and the general public as provided for in section 2.24 of the Code.

The supporting information set out in this part is generally organised such that matters relevant to assessment of the Access Arrangement are addressed in the same sequence as in the Code. There are, however, several areas of overlap and cross-reference between different parts of the Code that would cause adherence to this sequence resulting in excessive repetition. The supporting information is thus structured as follows.

- The process for assessment of an Access Arrangement, and in particular the Access Arrangement for the Mid-West and South-West Gas Distribution Systems.
- Assessment of matters addressed by the Access Arrangement other than those that relate to tariffs, fees and charges (non-tariff matters).
- Assessment of Reference Tariffs proposed by AlintaGas for the Mid-West and South-West Gas Distribution Systems.
- Assessment of fees and charges, other than Reference Tariffs, proposed by AlintaGas for the Mid-West and South-West Gas Distribution Systems.
- Responses to any additional matters that were raised in public submissions.

2 ASSESSMENT PROCESS

2.1 OVERVIEW

Where a pipeline is covered by the Code there is a requirement for a pipeline Service Provider to establish an Access Arrangement. The Regulator may approve an Access Arrangement only if it satisfies the minimum requirements set out in section 3 of the Code. The Regulator must not refuse to approve an Access Arrangement solely for the reason that the proposed Access Arrangement does not address a matter that section 3 does not require an Access Arrangement to address. Subject to this limitation, the Regulator has a broad discretion to refuse to accept an Access Arrangement.

An Access Arrangement submitted to the Regulator for approval must be accompanied by specified Access Arrangement Information, which should enable Users and Prospective Users to understand the derivation of the elements of the proposed Access Arrangement and form an opinion as to the compliance of the Access Arrangement with the Code.

The process by which an Access Arrangement is assessed and approved can be summarised as follows.

- The Service Provider submits a proposed Access Arrangement, together with the Access Arrangement Information, to the Regulator.
- The Regulator may require the Service Provider to amend and resubmit the Access Arrangement Information.
- The Regulator publishes a public notice and seeks submissions on the application.
- The Regulator considers the submissions, issues a Draft Decision and then, after considering any submissions received on the Draft Decision, makes a Final Decision which either:
 - approves the proposed Access Arrangement; or
 - does not approve the proposed Access Arrangement and states the revisions to the Access Arrangement which would be required before the Regulator would approve it; or approves a revised Access Arrangement submitted by the Service Provider which incorporates amendments specified by the Regulator in its Draft Decision.
- If the Regulator does not approve the Access Arrangement, the Service Provider may propose an amended Access Arrangement, which incorporates the revisions required by the Relevant Regulator.
- If the Regulator does not approve the Access Arrangement and the Service Provider does not propose an amended Access Arrangement, the Relevant Regulator can impose an Access Arrangement.

The *Gas Pipeline Access (WA) Law* provides a mechanism for the review of a decision by the Regulator to impose an Access Arrangement.

The particular components of the assessment process for the Access Arrangement submitted for the Mid-West and South-West Gas Distribution Systems are described below.

2.2 SUBMISSION OF THE ACCESS ARRANGEMENT AND SUPPORTING INFORMATION

Documentation submitted to the Regulator by AlintaGas was as follows.

- AlintaGas's Access Arrangement for the Mid-West and South-West Gas Distribution Systems (AlintaGas, 30 June 1999).
- AlintaGas's Access Arrangement Information for the Mid-West and South-West Gas Distribution Systems (AlintaGas, 30 June 1999).

2.3 FIRST-ROUND PUBLIC CONSULTATION

OffGAR undertook the following actions to provide public notification of receipt of the Access Arrangement and invite submissions from interested parties.

- Forwarding of notices to approximately 240 interested parties on 2 July 1999.
- Placing of the notice calling for submissions on the *OffGAR* web site.
- Placing of advertisements calling for public submissions in *The West Australian* and the *Australian* on 7 July 1999.

An issues paper was prepared by *OffGAR* and a notice was sent to interested parties. The issues paper was also available from the *OffGAR* office and the *OffGAR* web site. A closing date for receipt of public submissions was set at 4pm 5 August 1999. Two extensions to this closing date were subsequently made through notices distributed to interested parties and placed on the *OffGAR* web site, with extensions made to 4pm, 19 August 1999 and to 4pm, 2 September 1999.

Documentation on the proposed Access Arrangement was made available from the *OffGAR* office and on the *OffGAR* web site.

Submissions were received from the following parties.

- Apache Energy Ltd (2 September 1999).
- Australian Energy Advisors (5 August 1999).
- Chamber of Commerce and Industry (19 August 1999).
- Chamber of Minerals and Energy (two submissions: 19 August 1999 and 2 September 1999).
- CMS Gas Transmission of Australia (three submissions: 23 July 1999, 17 August 1999, 2 September 1999).
- Combustion Air Pty Ltd (23 July 1999).
- North West Shelf Gas (19 August 1999).

- Office of Energy (5 August 1999).
- Western Power (5 August 1999).

These submissions were made publicly available via the *OffGAR* web site. The contents of submissions as they relate to particular aspects of the Access Arrangement were taken into account by the Regulator in preparing the Draft Decision.

2.4 DRAFT DECISION

The Regulator issued a Draft Decision on the Access Arrangement on 14 March 2000. The Draft Decision was a result of an assessment by the Regulator of compliance of the Access Arrangement with requirements of the Code. The Draft Decision indicated 47 amendments that would be required to be made to the Access Arrangement (and Access Arrangement Information) before the Regulator will approve it.

The Draft Decision provides an opportunity for a Service Provider to make amendments to its Access Arrangement deemed necessary by the Regulator prior to a Final Decision on acceptance or rejection of the Access Arrangement. Publication of the Draft Decision also provides an opportunity for the Service Provider and other interested parties to comment on the Regulator's assessment of the Access Arrangement.

2.5 SECOND-ROUND PUBLIC CONSULTATION

Public submissions were invited on the Draft Decision. In accordance with the requirements of Section 2.14 of the Code, a copy of the Draft Decision was provided to all persons that made a submission as part of the first round of public consultation. Copies of the document were made available in from *OffGAR* and from the *OffGAR* web site. The closing date for receipt of submissions on the Draft Decision was 5 May 2000.

Submissions were received from the following parties.

- AGL Energy Sales & Marketing (5 May 2000)
- Apache Energy (by prior arrangement 9 May 2000)
- Arc Energy NL (5 May 2000)
- CMS Gas Transmission of Australia (three submissions all on 5 May 2000)
- Combustion Air Pty Ltd (5 May 2000)
- Empire Oil & Gas NL (5 May 2000)
- Office of Energy (5 May 2000)
- Origin Energy (by prior arrangement 9 May 2000)
- Phoenix Energy (5 May 2000)
- Western Power (5 May 2000 and 8 May 2000)

All of the above submissions have been placed, in full, on OffGAR's web site.

A submission was also made to the Regulator by AlintaGas which has also been made available on the OffGAR web site.

Public consultation also occurred through a public forum held by the Regulator on 2 May 2000.

2.6 FINAL DECISION

This final decision is issued in accordance with the requirements of section 2.16 of the Code. Section 2.16 requires the Regulator, after consideration of submissions on the Draft Decision, to issue a Final Decision which:

- (a) approves the Access Arrangement; or
- (b) does not approve the Access Arrangement and states the amendments (or nature of the amendments) which would have to be made to the Access Arrangement in order for the Regulator to approve it and the date by which a revised Access Arrangement must be resubmitted by the Service Provider; or
- (c) approves a revised Access Arrangement submitted by the Service Provider which the Relevant Regulator is satisfied incorporates the amendments specified by the Regulator in this Draft Decision.

The Final Decision of the Regulator on the Access Arrangement for the Mid-West and South-West Distribution Systems is described in this document. As already indicated, the decision of the Regulator was to not approve the Access Arrangement. The amendments to the Access Arrangement that are required before approval will be given are described in this document.

In accordance with requirements of section 2.17 of the Code, a copy of the Regulator's Final Decision will be provided to all persons that made a submission in respect of the Access Arrangement or Draft Decision, and copies will be made publicly available in hard-copy form and via OffGAR's web site. A copy will also be provided to the Code Registrar.

2.7 AMENDMENTS TO THE ACCESS ARRANGEMENT

If the Regulator does not approve the Access Arrangement and the Service Provider submits a revised Access Arrangement by the date specified by the Regulator under section 2.16(b) of the Code, which the Regulator is satisfied incorporates the amendments specified by the Relevant Regulator in its Final Decision, the Regulator will issue a further final decision that approves the revised Access Arrangement.

The Regulator has set a date of 14 July 2000 by which AlintaGas must submit a revised Access Arrangement that incorporates the amendments.

If the Regulator does not approve the Access Arrangement and the Service Provider does not submit a revised Access Arrangement by the date specified by the Regulator under section 2.16(b) of the Code or submits a revised Access Arrangement which does not, to the Regulator's satisfaction, incorporate the amendments specified by the Regulator in its Final Decision, the Regulator may draft and approve its own Access Arrangement. This would be

undertaken in accordance with requirements for public consultation set out in the Code in relation to the Regulator drafting and approving its own Access Arrangement.

3 NON-TARIFF MATTERS

3.1 INTRODUCTION

An Access Arrangement must, as a minimum, include the elements described in section 3 of the Code. Section 3 establishes the following requirements.

- Services Policy (sections 3.1 and 3.2).

An Access Arrangement must include a policy on the Services to be offered. The Services Policy must:

- include a description of one or more Services which are to be offered;
- where reasonable and practical, allow Prospective Users to obtain a Service that includes only those elements that the User wishes to be included in the Service; and
- where reasonable and practical, allow Prospective Users to obtain a separate tariff in regard to a separate element of a Service.

- Reference Tariffs and Reference Tariff Policy (sections 3.3 to 3.5).

An Access Arrangement must contain one or more Reference Tariffs. A Reference Tariff operates as a benchmark tariff for a specific Service, in effect giving the User a right of access to the specific Service at the Reference Tariff, and giving the Service Provider the right to levy the Reference Tariff for that Service.

- Terms and Conditions (section 3.6).

An Access Arrangement must include the terms and conditions on which the Service Provider will supply each Reference Service.

- Capacity Management Policy (sections 3.7 and 3.8).

An Access Arrangement must state whether the covered pipeline is a Contract Carriage Pipeline or a Market Carriage Pipeline.

- Trading Policy (sections 3.9 to 3.11).

An Access Arrangement for a Contract Carriage Pipeline must include a policy on the trading of capacity.

- Queuing Policy (sections 3.12 to 3.15).

An Access Arrangement must include a policy for defining the priority that Prospective Users have to negotiate for specific Capacity (a Queuing Policy).

- Extensions/Expansions Policy (section 3.16).

An Access Arrangement must include a policy setting out a method for determining whether an extension or expansion to the covered pipeline/distribution system is or is not to be treated as part of the covered pipeline for the purposes of the Code.

- Review Date (sections 3.17 to 3.20).

An Access Arrangement must include a date on or by which revisions to the Access Arrangement must be submitted and a date on which the revised Access Arrangement is intended to commence.

With the exception of the requirements for Reference Tariffs and a Reference Tariff Policy, the compliance of the Access Arrangement with the above requirements of the Code is addressed below. Reference Tariffs are addressed separately in section 4 of this report.

3.2 SERVICES POLICY

3.2.1 Access Code Requirements

Section 3.1 of the Code requires that an Access Arrangement include a policy on the Service or Services to be offered (a Services Policy). Section 3.2 of the Code requires that the Services Policy comply with the following principles.

- (a) The Access Arrangement must include a description of one or more Services that the Service Provider will make available to Users or Prospective Users, including:
 - (i) one or more Services that are likely to be sought by a significant part of the market; and
 - (ii) any Service or Services which in the Relevant Regulator's opinion should be included in the Services Policy.
- (b) To the extent practicable and reasonable, a User or Prospective User must be able to obtain a Service that includes only those elements that the User or Prospective User wishes to be included in the Service.
- (c) To the extent practicable and reasonable, a Service Provider must provide a separate Tariff for an element of a Service if this is requested by a User or Prospective User.

3.2.2 Access Arrangement Proposal

A Services Policy is provided in Division 1 of Chapter 2 of the Access Arrangement, which commits AlintaGas to making available Reference Services to Prospective Users, and negotiating in good faith for the provision of Non-Reference Services to Prospective Users.

Four types of Reference Services are specified in Division 1 of Chapter 2 and described in Schedules 4, 5 and 6 of the Access Arrangement. The principal features of the Reference Services are as follows.

- Reference Service A: delivery of gas to a delivery point on the high pressure system or medium/low pressure system, with an anticipated delivery of 35 TJ or more of gas each year with a contracted peak rate of 10 GJ or more per hour, and a contract duration of between two and five years.
- Reference Service B1: delivery of gas to a delivery point on the high pressure system or medium/low pressure system, with an anticipated delivery of less than 35 TJ of gas each year or a contracted peak rate of less than 10 GJ per hour, a contract duration of between two and five years, and a requirement of the User for User-specific delivery facilities.
- Reference Service B2: delivery of gas to a delivery point on the medium/low pressure system, using standard delivery facilities with a standard 12 m³/hr meter, and a contract duration of one year.
- Reference Service B3: delivery of gas to a delivery point on the medium/low pressure system, using standard delivery facilities with a standard 6 m³/hr meter, and a contract duration of one year.

A Haulage Contract for any Reference Service will specify one or more receipt points (where the User will receive gas into the AlintaGas network) and one or more delivery points (the point(s) on the AlintaGas network to which the gas will be transported).

Three types of Non-Reference Services are specified in Divisions 2, 3 and 4 of Chapter 2, respectively.

- Interconnection Service. The terms and conditions and prices upon which an Interconnection Service will be made available are to be negotiated by AlintaGas and the person to whom that service is provided.
- Elements of a Service. A Prospective User will be able to obtain an element of a Reference Service offered by AlintaGas under the Services Policy to the extent that it is practicable and reasonable to provide one.
- Listed Ancillary Services. Listed ancillary services will be offered to users of Reference Service B2 or B3 under standard terms and conditions and at a set tariff, whereas users of Reference Service A or B1 will negotiate with AlintaGas regarding the terms and conditions and prices of Ancillary Services.

3.2.3 Draft Decision

The Regulator considered that the services policy proposed by AlintaGas was generally consistent with the requirements of the Code, with the exception of the following matters.

- The contract period for Reference Services B2 and B3 proposed by AlintaGas of exactly one year was considered to be unreasonably restrictive and inconsistent with the contract periods offered for comparable services in Access Arrangements for other distribution systems in Australia.
- The Services Policy proposed by AlintaGas was considered to not contain sufficient service and technical information to enable interested parties to understand the services

offered by AlintaGas, and to not specify clearly the gas quality specification that would apply to gas entering and being transported through the AlintaGas network.

Required amendments to the Access Arrangement were as follows.

Draft Decision Amendment 1

The Access Arrangement should be amended to reference (for information purposes only) the standards and codes that will apply to the services specified in the Services Policy offered by AlintaGas.

Draft Decision Amendment 2

Clause 1 of schedule 6 of the Access Arrangement should be amended so that a Haulage Contract for Reference Service B2 or Reference Service B3 can have a duration of more than one year and is not constrained to a duration of exactly one year, as proposed by AlintaGas.

Draft Decision Amendment 3

Clause 20 of Chapter 2 of the Access Arrangement should be amended to clarify that, for each gas quality component listed, the most stringent specification contained in the *Gas Standards (Natural Gas) Regulations 1999* and the broadest specification as defined in the Access Arrangement and currently specified in the *Dampier to Bunbury Pipeline Regulations 1998* will prevail.

Draft Decision Amendment 4

Clause 19(1)(d) of Chapter 2 of the Access Arrangement should be amended to include a statement indicating that the minimum prudential and insurance requirements are to be reasonable.

Draft Decision Amendment 5

Clause 19(1)(b) of Chapter 2 of the Access Arrangement should be amended to state that AlintaGas will only enter into a service agreement if it would not deprive any person of a contractual right that existed prior to 30 June 1999, other than an exclusivity right which arose on or after 30 March 1995

3.2.4 Responses to Submissions on the Draft Decision

Reference to Standards

Draft Decision Amendment 1. The Access Arrangement should be amended to reference (for information purposes only) the standards and codes that will apply to the services specified in the Services Policy offered by AlintaGas.

- AlintaGas

AlintaGas objects to Draft Decision Amendment 1 and submits that the Regulator should not require such an amendment in the Final Decision. As a matter of principle AlintaGas does not believe that these are matters properly addressed in the terms of the Access Arrangement. As is stated in the Draft Decision, “the

duty placed on AlintaGas to meet the appropriate service and technical standards remains a legislative requirement rather than a contractual requirement.” AlintaGas considers that there is no benefit gained by a statement in the Access Arrangement that AlintaGas intends to comply with the law.

However, as AlintaGas does not consider this a material amendment it will agree to submit a compliant revision, provided that the reference to the standards and codes is contained in a “note” of the type contemplated by clause 67 of the Access Arrangement.

- **Combustion Air Pty Ltd**

Draft Decision Amendment 1, which requires reference to the standards and codes that will apply to the services specified in the Services Policy proffered by AlintaGas, is welcomed.

The requirement that the Access Arrangements should reference the appropriate standards and codes to be utilised by AlintaGas for the design, construction, operation and maintenance of their installations recognises AlintaGas’s obligation to ensure the safety of workers, the public and gas consumers. Many such standards and codes allow for exemptions, derogation or opting-out. For example, a prime code for AlintaGas’s gas distribution operations, the Australian Gas Association (AGA) document AG603 “Gas Distribution Code”, may be replaced by a safety case: an individual set of regulations or plans unique to a particular gas distribution network. One such set of plans and policies is outlined in AG606 “Code of Practice for the Preparation of a Safety and Operating Plan for Gas Networks”. Were the AGA AG606 code referenced in the Access Arrangement, Users and Prospective Users would be no further informed as to the applicable regulatory bench mark. An example appears at section 2.4 of AG606 which is headed “Operating Parameters” and states: *The operating parameters (of the gas distribution network) are to be sufficiently detailed to allow assessment of the risks from loss of supply and overpressure of supply. The details of the relevant operating parameters may be embodied in the description of the management systems.*

Use of a specific safety case, inspection plan and policy by a gas supplier, such as AlintaGas, will not satisfy Section 3.2 of the National Third Party Access Code (the Code) in respect to Services Policy, as Users and Prospective Users require specific information in order to fully understand the technical and service specifications offered by AlintaGas (Draft Decision p B29). Unless the specific safety case, inspection plan or policy is specified in the Access Arrangement, it cannot reference the applicable safety requirements. If the technical and service specifications of the Access Arrangement are based on risk management, Users and Prospective Users must be able to understand the risk. Criteria such as area risk and occupational risk coupled with AlintaGas’s nominated value of statistical life would assist Users in their cost benefit analysis.

We note that advice was sought from the Office of Energy, an agency of the Minister for Energy, in regard to technical safety issues related to the Access Arrangement. The independence of the Office of the Gas Access Regulator is a vital parameter in the process of evaluating access arrangements to ensure commercial neutrality and compliance with the Code.

In the draft decision the Regulator has recognised that Section 3.2 of the Code would be satisfied by amending the Access Arrangement to reference standards and codes relating to technical and service specifications. The Regulator may not appreciate that commercial advantage has already been conferred by the Minister for Energy and the Office of Energy, in granting exemptions with varying conditions to different gas suppliers, (e.g. exemptions granted by the Minister under sub-s. 13(2) of the Gas Standards Act 1972 (WA)).

At page B - 126 of the draft decision the Office of Energy advises the Regulator as follows:

AlintaGas has been issued with an exemption under the provision of section 13(2) of the Act [Gas Standards Act 1972 (WA)]. The terms and conditions of this exemption require AlintaGas to have an “Inspection Plan and Policy Statement” that is approved by the Director of Energy Safety of the Office of Energy, and to work to that plan at all times. Failure to do so is an offence under the Gas Standards Act 1972. The Office of Energy audits AlintaGas’s inspection practices on a regular basis.

The difficulty with such Ministerial exemption being granted to various gas suppliers on different terms can be seen by the Minister’s response to question 1625, reported in Hansard at page 9773 for Wednesday June 30, 1999:

Q. Is the “Inspection Plan and Policy” document available to the public and where can copies be obtained? If not, why not?

A. The gas suppliers are required to achieve the necessary outcomes consistent with their particular system of operation and therefore are unique to each gas supplier. There may be a competitive advantage in the methods chosen by a gas supplier to achieve the safety outcomes and the plan is therefore confidential.

The “competitive advantage” conferred by such secret safety and technical requirements described by the Minister is apparent in the marketplace. Further, AlintaGas's General Manager, Distribution Division raises these difficulties in his letter to Combustion Air dated April 4, 2000:

However, AlintaGas is concerned that consistency is maintained across industry, to ensure uniformity where possible between operators. It should not be possible for a competitor to gain an advantage through the application of an Inspection Plan. AlintaGas will be pursuing this issue with the Office of Energy.

Such “inspection plans and policy statements” do not equate to the existing statutory duty imposed by sub-section 13(1) of the Gas Standards Act 1972 (WA) (the Act). Exemptions granted by Ministerial fiat are not subject to public or Parliamentary scrutiny. Inspection plans and policy statements against which discretionary Ministerial instruments are granted remain secret. Regulation to which gas users, the public and industry are not privy is undemocratic and must on any analysis, threaten gas safety and gas access integrity. Recent recommendations by the Joint Standing Committee on Delegated Legislation have targeted this process and urged the Government to alter the practice, see Report No. 45 para 7.3(e) at p 35.

This company argues that it is technically and commercially unsafe for the Minister and/or his agency to grant secret competitive advantage to chosen gas suppliers via the use of Ministerial exemptions based on confidential conditions concerning the application, or non-application of regulations, standards and codes, especially when concerned with gas safety. Where exemptions to the Act have been made, they should be detailed in the Services' section of the Access Arrangement. Where derogations or variations to regulations, standards or codes have been negotiated by gas suppliers with the technical regulator, the details should be specified in the Service. Where standards or codes have been replaced or supplemented by safety cases, inspection plans and/or policies; the details should be specified in the Access Arrangement. Users and Potential Users require this information to adequately assess the Services offered. Any competitive advantage conferred by Ministerial exemption of a gas supplier by the approval of individual safety inspection plans and policies should be capable of assessment by a User to assess the risk and cost the benefit.

Advice provided by the Office of Energy, and relied upon by the Gas Access Regulator in making the draft decision includes ambiguous material, i.e. page B - 216:

AlintaGas has been issued with an exemption under the provision of section 13(2) of the Act. The terms and conditions of this exemption require AlintaGas to have an “Inspection Plan and Policy Statement” that is approved by the Director of Energy Safety of the Office of Energy, and to work to that plan at all times. Failure to do so is an offence under the Gas Standards Act 1972. The Office of Energy audits AlintaGas's inspection practices on a regular basis.

The provision for exemptions to undertakers and pipeline operators was introduced in recognition that the prime responsibility for ensuring that a consumer's gas installation is safe rests with the licensed gas fitter performing the work.

This advice appears to be erroneous in that compliance with the “Inspection Plans and Policy Statement”, against which AlintaGas has been granted Ministerial exemption under sub-section 13(2), does not, prima facie, invoke section 14 (offences) of the Act. The Office of Energy should be required to establish how compliance with such an “Inspection, Plan or Policy Statement” can be enforced under the Act.

The advice also appears to be factually incorrect. The provision for Ministerial exemptions to gas suppliers was introduced by section 89 of the Energy Corporations (Transitional and Consequential Provisions) Act 1994 (WA). Attempts to change the prime responsibility for ensuring that a consumers' gas installation is safe were made in the Gas Standards (Gasfitting and Consumers' Gas Installations) 1999, these regulations were disallowed by Parliament and repealed. A synopsis of the difficulties Parliament continues to have with these regulations can be seen from pages 6109 onward of Hansard on April 6, 2000. The Chair of the Joint Standing Committee on Delegated Legislation, in commending Report No. 49 to the House, the second report in relation to the Gas Standards (Gasfitting and Consumer Gas Installations) Regulations

1999, noted that the apparent shift of liability from gas suppliers and inspectors to gas fitters was bought about by these 1999 regulations.

Technical regulatory oversight by Government should enforce mandatory safety obligations stipulated by legislation. Such obligations are relied upon by gas users, the public and other government agencies and independent officers so that it is vital they be clear, certain and a matter of public record. Where mandatory obligations have been ameliorated by Ministerial exemption, or prescribed standards substituted for risk based inspections and policies, the de facto arrangements of calculated risk rates and specified VOSL's should be specified in the "Service" and funded via the "Tariff" in any access arrangement. Prudence and legislative compliance cannot be replaced by de facto risk management, secret competitive advantage entrenched via Ministerial exemption or a "lighthanded approach" to gas safety.

We argue that a change to Amendment 1 would give proper effect to the reasons published for the draft decision, by including the words "regulations, safety case, inspection plans and policy". Amendment 1 could then read: *The Access Arrangement should be amended to reference and identify (for information purposes only) the regulations, standards, codes, safety case, inspection plan and policy that will apply to the services specified in the Services Policy offered by AlintaGas. Derogations from standards and codes should be detailed.*

In the Draft Decision, the Regulator contended that it would be appropriate for the Access Arrangement to specify the technical and service standards that Users of services can expect. It was noted, however, that the obligation on AlintaGas to meet particular service and technical standards is imposed by legislation other than the Code, and hence it would not be appropriate for the Access Arrangement to be binding on AlintaGas in respect of meeting the standards. The Regulator therefore required that the Access Arrangement be amended to reference, *for reference purposes only*, the standards and codes that will apply to the services specified in the Service Policy.

The submission from Combustion Air Pty Ltd puts forward a view that the specification of standards, codes, etc. in the Access Arrangement should be more detailed than required by Draft Decision Amendment 1 and include details of derogations from standards and codes.

In addressing this submission, the Regulator sought legal advice on the extent to which the Code requires a Service Provider to include in an Access Arrangement details of any legal obligations which may apply to it in relation to its Services Policy, in the particular context of technical standards and codes applying to the delivery of services. On the basis of this advice, the Regulator is of the view that the Code (section 3.2) does not require inclusion in the Services Policy of information on the technical standards and codes that may apply to the delivery of services. As a consequence, the Regulator would not be able to refuse to approve the Access Arrangement solely for the reason that the Access Arrangement does not include such information.

Notwithstanding this, the Regulator may require such information to be provided to Prospective Users in the Information Package required to be made available by AlintaGas under section 5.1 of the Code, subject to the Regulator considering that the information will assist Prospective Users in deciding whether or not to seek services or to determine how to go about seeking services.

The Regulator will therefore not maintain the requirement for this amendment in the Final Decision. The Regulator will, however, address the possible requirement for such information to be included in the Information Package required to be made available to Prospective Users by AlintaGas under section 5.1 of the Code.

Duration of Reference-Service Contracts

Draft Decision Amendment 2. Clause 1 of schedule 6 of the Access Arrangement should be amended so that a Haulage Contract for Reference Service B2 or Reference Service B3 can have a duration of more than one year and is not constrained to a duration of exactly one year, as proposed by AlintaGas.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 2.

- Office of Energy

As part of the Draft Decision the Regulator required that Clause 1 of schedule 6 of the Access Arrangement be amended so that a Haulage Contract for Reference Service B2 or Reference Service B3 can have a duration of more than one year and is not constrained to a duration of exactly one year, as proposed by AlintaGas.

The Access Arrangement offers Reference Service A and B1 on the basis of a contract duration of no less than 2 and no longer than 5 years. In the light of the required amendment regarding the contract duration for Reference Service B2 or B3, it may be appropriate, in the interest of making services to users available on a more flexible basis, to also require that the contract duration for Reference Service A and B1 be amended to a minimum contract duration of one year instead of the two years proposed by AlintaGas. This will also be consistent with the duration of comparable Reference Services offered in the Access Arrangements for distribution networks submitted in other States (ref. page 30, Part B of the Draft Decision).

In the Draft Decision,¹ the Regulator indicated that in considering possible durations of contracts with the Service Provider, a balance should be sought between the potentially contrary interests of the Service Provider and Users in seeking security in a contract and risks of changing circumstances over a contract period. The Regulator indicated a view in the Draft decision that the limits on contract duration for Reference Services B2 and B3 was unreasonably restrictive, but that the proposed limits to duration of contracts for Reference Services A and B1 comprises an appropriate balance of interests.

The Regulator acknowledges that a shorter minimum contract duration for Reference Services A and B1 could be consistent with the interests of Users and Prospective Users through increasing contractual flexibility. It is noted that the two-year minimum contract duration is greater than the one year minimum periods for similar types of services proposed for the AGL Gas Networks distribution system in New South Wales,² and the South Australian distribution system.³ Furthermore, it is noted that both of these service providers have not imposed an upper bound on the contract duration for such services.

The Regulator considers that in view of practice of other Service Providers for distribution systems, there would appear to be no reason why AlintaGas should not offer a minimum contract duration of one year for Reference Services A and B1, nor remove any limit on the maximum term of contracts, both of which would be consistent with the interests of Users. The Regulator will require amendment of the Access Arrangement to this effect.

¹ Draft Decision, Part B page 30

² AGL Gas Networks Limited, January 1999. Access Arrangement for NSW Network, p10.

³ Envestra Limited, February 1999. Access Arrangement for the South Australian Distribution System, p13.

Gas Quality Specification

Draft Decision Amendment 3. Clause 20 of Chapter 2 of the Access Arrangement should be amended to clarify that, for each gas quality component listed, the most stringent specification contained in the Gas Standards (Natural Gas) Regulations 1999 and the broadest specification as defined in the Access Arrangement and currently specified in the Dampier to Bunbury Pipeline Regulations 1998 will prevail.

- **AlintaGas**

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 3.

In addition, further investigations have revealed that for the purposes of promoting the prospects of interconnection, it is appropriate to change the gas quality specification for the hydrocarbon dewpoint (hydrocarbon dewpoint over the pressure range 2.5 to 8.72 MPa absolute) from below 0 to an agreed value in the range of 0 to +10, provided that gas deliveries into the distribution system are made at temperatures exceeding the agreed value.

- **Origin Energy – Major Industry & Power**

The gas quality specifications would appear to be onerous in comparison to other network requirements throughout Australia and will significantly reduce potential competition. The higher gas quality specification contemplated will reduce the capacity of current small producers and significantly impact on the cost of development of future small gas fields. This would seem to be providing a significant marketing advantage to the gas delivered under contracts from the Northwest Shelf for no real benefit.

- **AGL Energy Sales & Marketing**

AGL Energy Sales & Marketing understands that gas specifications are required to ensure that the commercial interests, as well as the safety, of the end-users of the distribution network are protected. However, we feel that the proposed gas specifications are more stringent than they have to be, and we believe that this may prevent smaller producers from supplying gas into the AlintaGas gas distribution system.

- **Apache Energy Limited**

Apache is concerned about the comments made by Perth Basin producers at last week's public forum in regard to the gas specification issue. It is in everybody's interest (except for AlintaGas) that more gas rather than less gas is allowed access into the AlintaGas network. It is our understanding that mechanisms exist to track different gas quality deliveries to consumers. Further if there are appliances that need attention this is and remains an issue for AlintaGas, not for industry, to solve.

- **ARC Energy NL**

The gas specifications relating to the AlintaGas distribution network are covered by the *Gas Standards Act 1972* under regulations reviewed and subsequently issued in 1999. This Act was developed to cover natural gas supplied from the Perth Basin which was the sole supply source of natural gas into the AlintaGas gas distribution system until the completion of the DBNGP in the mid-1980's. As such, the suitability and safety of Perth Basin gas for use in the AlintaGas gas distribution system has long been established and proven.

The AlintaGas Access Arrangement now proposes to introduce more stringent gas specifications applicable to any third party wishing to transport gas through the AlintaGas system. This proposed change to the gas specifications, if accepted by OffGAR, will directly discriminate against Perth Basin gas as it would not be able to meet some of the more stringent proposed specifications.

ARC is extremely concerned about this proposed amendment as it would affect the marketability of our gas and, as a consequence, the viability and future of Perth Basin gas production and exploration.

Given the historic acceptability of Parmelia Pipeline gas under the existing gas quality specifications applicable to the AlintaGas network, we must strongly question the objectives and timing of AlintaGas proposing to narrow the gas specification and thereby exclude Perth Basin gas from its system.

Whilst AlintaGas and the Office of Energy have publicly stated their support for a reconnection of the Parmelia Pipeline to the AlintaGas network (and thereby facilitating the supply of Perth Basin gas into its system), the actual progress of this interconnection to date has been extremely slow, with the allowable gas volume also being very limited. Moreover, with the impending change of ownership of AlintaGas, its ongoing long-term support for the interconnection project may not be assured, especially if it can refuse Perth Basin gas on the basis of the proposed gas quality amendments.

It is also of significance that the current AlintaGas network gas quality specifications (i.e. as per the Gas Standards Act 1972) are comparable with those of other major Australian pipeline systems and, based on physical and historical evidence, do not pose any safety or quality problems for the AlintaGas distribution network.

We therefore see no reason for the requirement to narrow the gas quality specifications as proposed by AlintaGas other than to create a barrier to entry into the AlintaGas network for non-DBNGP gas.

We consider this proposal to be anti-competitive and, given AlintaGas's market power, it is considered to infringe on the relevant provisions of the Trade Practices Act.

In conclusion, we respectfully request OffGAR to reconsider its provisional support for this proposed gas quality specification amendment by AlintaGas and retain the specifications as per the *Gas Standards Act 1972*.

- CMS Gas Transmission of Australia Submission No. 1

CMS is opposed to OffGAR's decision to provisionally accept AlintaGas's proposed gas quality specification for gas entering and being transported through the AlintaGas Gas Distribution Systems as it is anti-competitive and hinders gas producers, gas retailers and gas transporters accessing the AlintaGas Gas Distribution System.

The proposed gas quality specification is more stringent than the requirements laid down in the *Gas Standards (Natural Gas) Regulations 1999* issued under the *Gas Standards Act 1972*.

CMS considers the proposed gas quality specification directly discriminates against gas from the Perth Basin from where the majority of gas is transported by the Parmelia Pipeline. AlintaGas's proposed gas quality specification incorporate the Dampier to Bunbury Natural Gas Pipeline (DBNGP) gas quality specification, which is more narrowly defined over a wider range of gas components.

The Parmelia Pipeline gas quality specification meets the gas quality specification laid down in the *Gas Standards (Natural Gas) Regulations 1999* issued under the *Gas Standards Act 1972*.

The decision by OffGAR to provisionally accept the more stringent gas quality specification can not be justified for the following reasons:

- i) safety issues
- ii) anti-competitive
- iii) value of AlintaGas

Each reason is discussed separately below:

- i) Safety

The gas flowing through the Parmelia Pipeline meets the gas quality specification under the *Gas Standards (Natural Gas) Regulations 1999*. These are based and refer to the *Gas Standards Act 1972*, which defined the gas specification for gas supplied to customers of the State Energy Commission of Western Australia for the period 1971 to 1984 prior to any gas production from the North West Shelf and transport via the DBNGP.

During this period, all natural gas supplied to the Perth region was produced in the Perth Basin and obviously complied with the *Gas Standards Act 1972*. This occurred without any safety issues or concerns in regard to gas quality.

In fact, the current Parmelia Pipeline's gas quality specification is more stringent than that laid down in *Gas Standards Act 1972*.

ii) Anti-competitive

The *Gas Pipelines Access (Western Australia) Act 1998* legislates that AlintaGas must not engage in conduct for the express or inferred purpose of preventing or hindering the access of any person to a service provided by means of the AlintaGas gas distribution system.

The gas quality specification proposed by AlintaGas and provisionally accepted by OffGAR would mean that current and future gas sourced from Perth Basin producers would require additional processing. For some producers this might mean continued production is no longer viable. At the very least it would have the effect of increasing rather than decreasing costs and therefore lessening competition between gas producers and also between gas transporters.

CMS considers that the proposed gas quality specification will hinder gas producers, gas retailers and gas transporters in accessing the AlintaGas gas distribution system. Therefore, CMS believes that the proposed gas quality specification in the Access Arrangement infringes parts of section 13 of the *Gas Pipelines Access (Western Australia) Act 1998* that deals with preventing or hindering access.

Any barriers to entry to any market mitigate against competition, and the ability of end consumers of gas to exercise choice over gas supplier, retailer, or trader.

Furthermore, the *Trade Practices Act 1974* legislates that AlintaGas being a corporation that has a substantial degree of power in the market must not take advantage of that power for the purpose of preventing the entry of a person into that or any other market. CMS believes that the gas quality specification in the Access Arrangement infringes parts of section 46 of the *Trade Practices Act*.

CMS believes that OffGAR's decision to provisionally accept a more stringent gas quality specification is in direct conflict with the Operative Provisions Clause 2.1(c) of the Council of Australian Governments' Natural Gas Pipelines Access Agreement 1997 that the Western Australian Government agreed to. Clause 2.1(c) of the agreement states that:

"The objective of this agreement is to establish a uniform national framework for third party access to natural gas pipelines that ... promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders;"

iii) Value of AlintaGas

OffGAR must also be cognisant that the Western Australian Government intends to sell AlintaGas at a price that will maximise its proceeds. Furthermore, the new owners of AlintaGas will undoubtedly wish to implement strategies to diversify its sources of gas and gas transport arrangements.

The Parmelia Pipeline provides the new owners of AlintaGas with an opportunity to successfully implement such strategies due to its lower transportation costs, its interconnection with Mondarra Gas Storage and its ability to offer AlintaGas's customers with a greater choice of gas supply.

Therefore, the ability to use alternate sources of gas supply, including the Parmelia Pipeline, will increase the value of AlintaGas for potential bidders for the cornerstone shareholding in AlintaGas. Furthermore, having competitive sources of gas supply will foster industry development both in gas production and end use of gas.

CMS Proposal: OffGAR substitute the proposed gas quality specification with the gas quality specifications of the *Gas Standards Act 1972*.

- Office of Energy

As part of the Draft Decision the Regulator required that Clause 20 of Chapter 2 of the Access Arrangement be amended to clarify that, for each gas quality component listed, the most stringent specification contained in the *Gas Standards (Natural Gas) Regulations 1999* and the broadest specification as defined in the

Access Arrangement and currently specified in the *Dampier to Bunbury Pipeline Regulations 1998* will prevail.

The Regulator would be aware that the broadest specification currently specified in the *Dampier to Bunbury Gas Pipeline Regulations 1998* will cease to exist with the repeal of those Regulations, i.e. on the day the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline (DBNGP) is approved by the Regulator. As a consequence there will be no regulatory control over the DBNGP gas quality specification except as provided for under the DBNGP Access Arrangement. In contrast, the gas quality requirements contained in the *Gas Standards (Natural Gas) Regulations 1999* will continue to apply to gas distribution systems in Western Australia, including to AlintaGas's distribution systems subject to this Access Arrangement. Given that the latter are legal requirements it may be appropriate, for consistency reasons, for the Access Arrangement to specify that the specification contained in the *Gas Standards (Natural Gas) Regulations 1999* will prevail for the components specified in those Regulations. For the remaining components, not specified in the Regulations, AlintaGas may wish to propose, and the Regulator may wish to approve, the broadest specification as currently specified in the *Dampier to Bunbury Pipeline Regulations 1998*.

- Phoenix Energy

As the Regulator will be aware, the existing gas specifications relating to the AlintaGas distribution network are covered by the *Gas Standards Act 1972* under regulations reviewed and subsequently issued in 1999. This Act was developed to cover natural gas supplied from the Perth Basin which was the sole supply source of natural gas into the AlintaGas gas distribution system until the completion of the DBNGP in the mid-1980's. As such, the suitability and safety of Perth Basin gas for use in the AlintaGas gas distribution system has long been established and proven. Woodada was one of the original fields developed in the Perth Basin.

It is also of significance that the current AlintaGas network gas quality specifications (i.e. as per the *Gas Standards Act 1972*) are comparable with those of other major Australian pipeline systems and, based on physical and historical evidence, do not pose any safety or quality problems for the AlintaGas distribution network.

The AlintaGas Access Arrangement now proposes to introduce more stringent gas specifications applicable to any third party wishing to transport gas through the AlintaGas gas distribution system. This proposed change to the gas specifications, if accepted by OffGAR, will directly discriminate against Perth Basin gas as it would currently not be able to meet some of the proposed specifications.

Narrowing the gas quality specifications as proposed by AlintaGas will therefore create a barrier to entry into the AlintaGas network for non-DBNGP gas. In effect, this proposal is anti-competitive and, as such against the interests of Perth Basin producers supplying via the Parmelia Pipeline and gas consumers generally.

Phoenix Energy therefore respectfully request OffGAR to reconsider its provisional support for this proposed gas quality specification amendment by AlintaGas and retain the specifications as per the *Gas Standards Act 1972*.

Clause 20 of the Access Arrangement states that gas entering and being transported through the AlintaGas network must comply with the standards detailed in Regulation 4 of the *Gas Standards (Natural Gas) Regulations 1999*⁴ and the broadest specification requirements for Category B and Category C gas in the DBNGP.⁵ The Regulator regarded this clause as ambiguous to the extent that if there is a difference between these two specification in respect of a gas quality parameter, then it would not be clear to a User or Prospective User as to which gas quality parameter would apply. In Amendment 3 of the Draft Decision the

⁴ Subsequent to the issue of the Draft Decision, these regulations have been superseded by the *Gas Standards (Gas Supply and System Safety) Regulations 2000*.

⁵ Schedule 1 to the *Dampier to Bunbury Pipeline Regulations 1998*.

Regulator indicated a requirement that the Access Arrangement be amended to clarify that for each gas quality component listed, the most stringent specification would prevail.

The public submissions on the issue of gas quality related to two concerns in regard to the gas quality specification of the Access Arrangement and the Regulator's required amendment.

- i. Insofar as the broadest specification requirements for Category B and Category C gas in the DBNGP contain tighter specifications than the *Gas Standards (Natural Gas) Regulations 1999*, or provide specifications for parameters not addressed by the *Gas Standards (Natural Gas) Regulations 1999*, the Access Arrangement will impose a tighter gas quality specification than the *Gas Standards (Natural Gas) Regulations 1999*. Producers of gas from the Perth Basin may have difficulty meeting this gas quality specification which will restrict access to the AlintaGas network for gas from these producers.
- ii. The *Dampier to Bunbury Pipeline Regulations 1998* will be repealed once the Regulator has approved an Access Arrangement for the DBNGP. Consequently, a reference to these regulations in the Access Arrangement may become redundant.

AlintaGas has advised the Regulator that, subsequent to issue of the Draft Decision, AlintaGas and CMS Gas Transmission of Australia (owners of the Parmelia Pipeline) have reached a resolution on a mutually acceptable gas quality specification for gas supplied from the Perth Basin into the AlintaGas network. This resolution provides for a relaxation of gas quality specifications for maximum hydrogen sulphide, maximum water and hydrocarbon dew point from the specification contained in the Access Arrangement. AlintaGas has proposed that this revised specification be incorporated into the Access Arrangement with the effect of resolving both concerns raised by public submissions. The Regulator accepts this proposal and has altered Draft Decision Amendment 3 to require the revised specification to be incorporated into the Access Arrangement.

Minimum Prudential and Insurance Requirements

Draft Decision Amendment 4. Clause 19(1)(d) of Chapter 2 of the Access Arrangement should be amended to include a statement indicating that the minimum prudential and insurance requirements are to be reasonable.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 4.

In the absence of substantive submissions on Draft Decision Amendment 4, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Contractual Rights

Draft Decision Amendment 5. Clause 19(1)(b) of Chapter 2 of the Access Arrangement should be amended to state that AlintaGas will only enter into a service agreement if it would not deprive any person of a contractual right that existed prior to 30 June 1999, other than an exclusivity right which arose on or after 30 March 1995

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 5.

- Office of Energy

As part of the Draft Decision, the Regulator required that Clause 19(1)(b) of Chapter 2 of the Access Arrangement be amended to state that AlintaGas will only enter into a service agreement if it would not deprive any person of a contractual right that existed prior to 30 June 1999, other than an exclusivity right which arose on or after 30 March 1995.

It is understood that the amendment was required because under section 2.25 of the Code the Regulator must not approve an Access Arrangement which would deprive any person of a contractual right in existence prior to *the date the proposed Access Arrangement was submitted (or required to be submitted)*, other than an exclusivity right which arose on or after 30 March 1995.

Guidance in this respect is also provided under section 6.18 of the Code, which contains the restriction on the Arbitrator in making a decision in relation to an access dispute. Under that section the Arbitrator must not make a decision that would impede the existing right of a User to obtain Services or would deprive any person of a contractual right that existed prior to the notification of the dispute, other than an Exclusivity Right which arose on or after 30 March 1995.

It is therefore suggested that in practice AlintaGas would only enter into a service agreement if it would not deprive any person of a contractual right that existed prior to the date of entering that service agreement, other than an Exclusivity Right which arose on or after 30 March 1995.

The intent of Draft Decision Amendment 5 was to achieve consistency between the provisions of clauses 19(1)(b) of the Access Arrangement and section 2.25 of the Code. The Regulator concurs with the view expressed by the Office of Energy that the provisions of clause 19(1)(b) of the Access Arrangement are largely declaratory. Nevertheless, the Regulator maintains the view that there are benefits to consistency between the Access Arrangement and relevant provisions of the Code, and hence maintains that the Access Arrangement should be amended in accordance with the requirements of Draft Decision Amendment 5.

Interconnection Service as a Reference Service

- Office of Energy

In its first submission of 5 August 1999 on the proposed Access Arrangement, the Office of Energy considered that the Regulator should approve a set of standard terms and conditions, and prices of the Interconnection Service. Terms, conditions and prices, which are considered unreasonable for that service, would have the potential to hinder access to AlintaGas gas distribution systems.

The Regulator responded to that comment by stating that interconnection between AlintaGas's network and other transmission or distribution systems is likely to be sought relatively infrequently and will require some extremely complex technical issues to be resolved. Given this, and that interconnection is not offered as a Reference Service in other Access Arrangements for distribution systems in other States, the Regulator considered that interconnection is best offered on the basis of a negotiated service by AlintaGas and did not consider that an Interconnection Service should be a Reference Service for the purposes of the Access Arrangement.

Although the Office of Energy notes the Regulator's observation that interconnection is not an issue in some Eastern States, the Office of Energy does consider that the relevant concerns in Western Australia need to be addressed. The Office of Energy agrees with the Regulator's observation that in Western Australia, interconnection between AlintaGas's network and other distribution systems would require some complex technical issues to be resolved. Addressing such issues was the prime objective of the Office of Energy when late last year it convened a specific working group to deal with the issues related to interconnections with the AlintaGas gas distribution systems.

As the Western Australian gas industry opens up to competition, it is likely that new network owners will wish to set up discrete distribution networks that are adjacent to and potentially facilitated by connection to existing networks. As there is no legislation or code presently available in this State to provide guidelines on interconnection issues between networks owned by different parties, the Office of Energy convened the

above-mentioned working group which in February 2000 published guidelines on the matter. These guidelines have been developed to assist new network owners in planning, operating and obtaining a connection to an existing network.

The Office of Energy notes the Regulator's view that interconnection of third party distribution systems is likely to be sought relatively infrequently. However, it is suggested that the likelihood of such events would be able to be determined as the small use consumer end of the gas market opens to competition, which will take place during the Access Arrangement period. It would therefore be appropriate to revisit the issue at the end of this Access Arrangement Period.

It is also noted that connection between the AlintaGas system and the Parmelia pipeline is proceeding and connection is due to occur before the middle of the year at Harrow St. The Office of Energy has given an agreement to CMS for a 12 month trial based on a fixed gas mixing rate.

Under the provisions of clause 10 of the Access Arrangement, an interconnection service relates to an interconnection between a pipeline and the AlintaGas network for the purposes of supplying gas into the AlintaGas network. The Regulator notes that there are currently only two pipelines (the DBNGP and the Parmelia Pipeline) from which an interconnection may occur with the AlintaGas network. Interconnection arrangements are in place for the DBNGP and are understood to be in the final stages of negotiation for the Parmelia Pipeline. As such, the foreseeable demand for new interconnection services is very limited over the Access Arrangement period. Given this, and the likelihood that any interconnection service would have many "situation specific" requirements and characteristics, the Regulator maintains the view that it would not be appropriate at this time to require that an interconnection service be included in the Access Arrangement as a Reference Service. However, with the advent of competition at the retail level in July 2002, the Regulator concurs with the Office of Energy that it would be appropriate to revisit the issue at the end of this Access Arrangement Period.

Listed Ancillary Services

- Office of Energy

In its 5 August 1999 submission on the proposed Access Arrangement the Office of Energy considered that as the four listed ancillary services would be utilised by a significant part of the market, the prevailing standard terms and conditions for those listed ancillary services should be approved by the Regulator.

The Regulator responded to that comment by stating that the ancillary services are relatively simple in nature and are presently offered to Users without specific terms and conditions. The imposition of a requirement for terms and conditions to be available would impose an additional administrative burden, which would not necessarily provide additional benefits to Users. In the Draft Decision the Regulator therefore did not require AlintaGas to offer its listed ancillary services as Reference Services, or for terms and conditions for the provision of such services to be included in the Access Arrangement.

Under section 16 of proposed Access Arrangement, however, the terms and conditions upon which AlintaGas will make a listed ancillary service available to a User will be "the standard terms and conditions for that service as determined, amended or substituted by AlintaGas from time to time". AlintaGas will, when requested, make available a copy of its prevailing standard terms and conditions for a listed ancillary service.

The comment in the Office of Energy's 5 August 1999 submission reflected an expectation that the listed ancillary services are likely to be sought by all Users of the Reference Service B2 and Reference Service B3 and thus effectively form part of these Reference Services. As such, the comment also reflected a concern that the standard terms and conditions for the listed ancillary services were proposed by AlintaGas to be determined, amended or substituted by AlintaGas without the consent of the Regulator. The Office of Energy continues to consider that it is in the interest of Users that at least the tariffs for the listed ancillary services, together with an appropriate escalation mechanism, should continue to be approved by the Regulator.

It is noted that AGL Gas Networks' revisions to its Access Arrangement, which were based on IPART's Draft Decision and were submitted in February 2000, contain charges for five ancillary services as part of the Reference Tariffs proposed by AGL. Those charges include charges for: request for service; special meter readings; charge payable on transfer of delivery point from one User to another User (payable by the new User); disconnection fee; and charge payable for provision of end-user information as defined under the Code.

In order to facilitate the development of retail competition, the National Gas Pipelines Advisory Committee is considering recommending to Ministers that a new provision be included in the Code placing an obligation on Service Providers to disclose end-user information at the request of an end-user. It is relevant to note that it is also contemplated to allow the Service Provider to require the end-user to pay a fee to compensate the Service Provider for its reasonable costs of providing the end-user information, provided that fee has been approved in writing by the Regulator. Western Australia is supportive of these proposed inclusions in the Code. It is noted that in the above mentioned Access Arrangement AGL has proposed that the fee to provide end-user information be \$10 per request and AGL has included that service as part of its ancillary services.

The Regulator has noted the comments from the Office of Energy in respect of the suggestion that Ancillary Services be regarded as, or included in, Reference Services. The Regulator has also noted that such services are provided as Reference Services in the Victorian distribution systems, and are proposed to be provided as Reference Services in the South Australian distribution system.

The Regulator maintains the view, however, that this is not warranted at the current time given the relatively simple and discrete nature of the services, and a history of provision of such ancillary services without specific terms and conditions. Should the services not be provided at a reasonable quality and for a reasonable price, the option exists for a User or Prospective User to resort to arbitration in accordance with section 6 of the Code. Furthermore, full contestability in the retail gas market is not scheduled to be introduced until July 2002, which is only 21 months prior to time at which AlintaGas is required to submit revisions to the Access Arrangement. The Regulator will investigate whether there are any problems in the provision of Ancillary Services at the time of assessing revisions to the access Arrangement. In view of these factors, the Regulator does not consider it appropriate at the current time to require that Ancillary Services be Reference Services.

3.2.5 Required Amendments to the Access Arrangement

Amendment 1 [was Draft Decision Amendment 2]

Clause 1 of schedule 6 of the Access Arrangement should be amended so that a Haulage Contract for Reference Service B2 or Reference Service B3 can have a duration of more than one year and is not constrained to a duration of exactly one year, as proposed by AlintaGas.

Amendment 2

Clause 1 of schedule 4 of the Access Arrangement and Clause 1 of schedule 5 of the Access Arrangement should be amended to provide for minimum contract durations of one year for Reference Services A and B1, respectively, and to remove any upper limit on contract durations.

Amendment 3 [was Draft Decision Amendment 3]

Clause 20 of Chapter 2 of the Access Arrangement should be amended to indicate that gas entering and being transported through the AlintaGas network must, for each component of the following gas quality specifications, comply with the most stringent component of the following:

(a) the gas quality standards detailed in regulation 5 of the Gas Standards (Gas Supply and System Safety) Regulations 2000, including the requirement to odourise the gas detailed in regulation 6; and

(b) the specification detailed as follows:

Maximum carbon dioxide (mole%)	4.0
Maximum inert gases (mole%)	7.0
Minimum higher heating value (MJ/m ³)	35.1
Maximum higher heating value (MJ/m ³)	42.3
Minimum Wobbe Index (MJ/m ³)	46.0
Maximum Wobbe Index (MJ/m ³)	51.5
Maximum total sulphur including odorant (mg/m ³)	20
Maximum hydrogen sulphide (mg/m ³)	4.6
Maximum oxygen (mole%)	0.2
Maximum water (mg/m ³)	100
Hydrocarbon dewpoint over the pressure range 2.5 to 8.72 MPa absolute (°C)	Shall not exceed an agreed minimum delivery temperature between 0 to +10°C
Maximum radioactive components (Bq/m ³)	600

Amendment 4 [was Draft Decision Amendment 4]

Clause 19(1)(d) of Chapter 2 of the Access Arrangement should be amended to include a statement indicating that the minimum prudential and insurance requirements are to be reasonable.

Amendment 5 [was Draft Decision Amendment 5]

Clause 19(1)(b) of Chapter 2 of the Access Arrangement should be amended to state that AlintaGas will only enter into a service agreement if it would not deprive any person of a contractual right that existed prior to 30 June 1999, other than an exclusivity right which arose on or after 30 March 1995.

3.3 TERMS AND CONDITIONS**3.3.1 Access Code Requirements**

Section 3.6 of the Code requires that an Access Arrangement include the terms and conditions on which the Service Provider will supply each Reference Service. The terms and conditions included must, in the Regulator's opinion, be reasonable.

3.3.2 Access Arrangement Proposal

Terms and conditions specific to each Reference Service are set out in schedules 4, 5 and 6 of the Access Arrangement while general terms and conditions applicable to all Reference Services are set out in schedule 7 of the Access Arrangement.

3.3.3 Draft Decision

The Regulator considered the terms and conditions upon which Reference Services are to be offered to be reasonable with the exception of several terms and conditions in schedule 7 of the Access Arrangement which are considered as not being reasonable.

The required amendments to the Access Arrangement and Access Arrangement Information were as follows.

Draft Decision Amendment 6

Clause 47(2) of schedule 7 of the Access Arrangement should be amended to ensure that AlintaGas will make good, or pay compensation in respect of, damage caused by unreasonable acts of AlintaGas in the course of installing gas delivery facilities.

Draft Decision Amendment 7

Division 12 of schedule 7 of the Access Arrangement, which relates to interpretation, should be amended to insert a definition of confidential information that is applicable to clause 52, relating to confidentiality, in order to provide greater certainty as to the meaning of confidential information for the purposes of this clause.

Draft Decision Amendment 8

Clause 52(2)(e) of schedule 7 of the Access Arrangement should be amended to ensure that information of a confidential nature would only be disclosed in the course of any restructuring or sale of AlintaGas if it is the reasonable opinion of the disclosing party that the information is required to be disclosed.

Draft Decision Amendment 9

Schedules 4 and 5 of the Access Arrangement should be amended to specify the minimum frequency that AlintaGas will adopt to verify the accuracy of meters.

Draft Decision Amendment 10

Clause 7(a) of schedule 7 of the Access Arrangement should be amended to ensure that, if AlintaGas requires a User to provide security for the performance of its obligations under a Haulage Contract, the security must be the minimum amount necessary to protect AlintaGas's legitimate business interests.

Draft Decision Amendment 11

Division 12 of schedule 7 of the Access Arrangement should be amended to ensure that the general provision that “... in the event or circumstance not within a party’s control and which the party, by applying the standard of a reasonable and prudent person, is not able to prevent or overcome ...” clearly applies to each of the specific events listed as force majeure events.

Draft Decision Amendment 12

The Access Arrangement should be amended to provide for the waiving of fixed charges of a Reference Tariff for any period in which provision of a Reference Service is interrupted or reduced by a force majeure event.

Draft Decision Amendment 13

Clause 18 of schedule 7 of the Access Arrangement should be amended so that interest is accrued on underpayments or overpayments after a reasonable period has been given for a party to rectify the underpayment or overpayment, rather than from the actual date of underpayment or overpayment

Draft Decision Amendment 14

Clause 35(d) of schedule 7 of the Access Arrangement should be amended to ensure that a party cannot be declared in default under the Haulage Contract unless there is an adverse change in the business or financial condition of that party or an event occurs which could, in the reasonable opinion of the other party, materially affect the other party’s ability to meet its obligations under the Haulage Contract.

Draft Decision Amendment 15

Clause 38 of schedule 7 of the Access Arrangement should be amended to ensure that a party has at least 5 business days to remedy a payment default and 15 business days to remedy any other default, once it has received written notice from the other party, before the other party can terminate a Haulage Contract.

3.3.4 Responses to Submissions on the Draft Decision

Restitution for Damage Arising in Installation of Delivery Facilities

Draft Decision Amendment 6. Clause 47(2) of schedule 7 of the Access Arrangement should be amended to ensure that AlintaGas will make good, or pay compensation in respect of, damage caused by unreasonable acts of AlintaGas in the course of installing gas delivery facilities.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 6.

In the absence of substantive submissions on Draft Decision Amendment 6, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Confidentiality Requirements

Draft Decision Amendment 7. Division 12 of schedule 7 of the Access Arrangement, which relates to interpretation, should be amended to insert a definition of confidential information that is applicable to clause 52 of the Access Arrangement, relating to confidentiality, in order to provide greater certainty as to the meaning of confidential information for the purposes of this clause.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 7.

In the absence of substantive submissions on Draft Decision Amendment 7, the Regulator will maintain the requirement for these amendments of the Access Arrangement.

Draft Decision Amendment 8. Clause 52(2)(e) of schedule 7 of the Access Arrangement should be amended to ensure that information of a confidential nature would only be disclosed in the course of any restructuring or sale of AlintaGas if it is the reasonable opinion of the disclosing party that the information is required to be disclosed.

- AlintaGas

AlintaGas considers that this is implied in the existing provision. Nonetheless AlintaGas will submit a compliant revision in response to Draft Decision Amendment 8.

In the absence of substantive submissions on Draft Decision Amendment 8, the Regulator will maintain the requirement for these amendments of the Access Arrangement.

Verification of Accuracy of Meters

Draft Decision Amendment 9. Schedules 4 and 5 of the Access Arrangement should be amended to specify the minimum frequency that AlintaGas will adopt to verify the accuracy of meters.

- AlintaGas

AlintaGas objects to Draft Decision Amendment 9 and submits that the Regulator should not require such an amendment in the Final Decision.

Metering Standards are addressed in the draft *Gas Standards (Gas Supply and Supply Safety) Regulations 2000*. Both the level of accuracy and maximum replacement intervals are specified in the draft Regulations and AlintaGas submits that it is not appropriate that technical or operation and maintenance issues be addressed in the terms and conditions of Reference Services. This would be akin to specifying maintenance frequencies for pipe and other parts of the distribution network in each contract. These matters are correctly addressed in the relevant technical codes and standards associated with the operation and maintenance of the network.

In response to the submission by AlintaGas, the Regulator has reconsidered the requirement for minimum frequencies to be specified in the Access Arrangement for verifying the accuracy of meters. The Regulator's concerns in regard to verifying meter accuracy related to Reference Services A and B1, both of which involve delivery of large quantities of gas. The Regulator recognises that a reasonable time interval for testing of metering equipment would depend on the nature, age and condition of the equipment, and hence it may be difficult to specify verification frequencies in the Access Arrangement that would be appropriate for all circumstances. Nevertheless, as AlintaGas maintain ownership of

metering equipment and users have an obvious interest in the accuracy of this equipment, the Regulator considers it reasonable that the Access Arrangement make appropriate provision for verifying the accuracy of this equipment as part of the Reference Service.

In view of the above factors, the Regulator considers that the Access Arrangement should make provision for Reference Services A and B1 to incorporate the verification of accuracy of meters in accordance with “good industry practice and applicable laws”. “Good industry practice” provides a basis for resolution of any dispute between a User/Prospective User and AlintaGas as to an appropriate frequency for verification of meter accuracy.

The Regulator therefore alters Draft Decision Amendment 9 to require that schedules 4 and 5 of the Access Arrangement require AlintaGas to verify the accuracy of meters at a minimum frequency that is in accordance with good industry practice and applicable laws.

Provision of Security by Users

Draft Decision Amendment 10. Clause 7(a) of schedule 7 of the Access Arrangement should be amended to ensure that, if AlintaGas requires a User to provide security for the performance of its obligations under a Haulage Contract, the security must be the minimum amount necessary to protect AlintaGas’s legitimate business interests.

- AlintaGas

AlintaGas considers that the requirement of Draft Decision Amendment 10 is implied in the existing provision. Nonetheless AlintaGas will submit a compliant revision of the Access Arrangement.

In the absence of substantive submissions on Draft Decision Amendment 10, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Definition of Force Majeure Events

Draft Decision Amendment 11. Division 12 of schedule 7 of the Access Arrangement should be amended to ensure that the general provision that “... in the event or circumstance not within a party’s control and which the party, by applying the standard of a reasonable and prudent person, is not able to prevent or overcome ...” clearly applies to each of the specific events listed as force majeure events.

- AlintaGas

AlintaGas considers that this is implied in the existing provision. Nonetheless AlintaGas will submit a compliant revision in response to Draft Decision Amendment 11.

In the absence of substantive submissions on Draft Decision Amendment 11, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Waiving of Fixed Charges for Force Majeure Interruptions of Services

Draft Decision Amendment 12. The Access Arrangement should be amended to provide for the waiving of fixed charges of a Reference Tariff for any period in which provision of a Reference Service is interrupted or reduced by a force majeure event.

- AlintaGas

AlintaGas strongly objects to Amendment 12 and submits that the Regulator should not require such an amendment in the Final Decision.

The relevant provision in the Access Arrangement is schedule 7, clause 28. This provision is based on regulation 75 of the *Gas Distribution Regulations 1996* (WA) the regulation provides: “The demand price and the service price are to be payable even if for any reason (including the operation of force majeure on the corporation or the User) the User wholly or partially does not utilise gas distribution capacity.”

AlintaGas notes that the:

(a) The *Gas Distribution Regulations 1996* (WA);

(b) Epic Energy’s proposed terms and conditions for the use of the Dampier to Bunbury Natural Gas Pipeline;

(c) Goldfields Gas Transmission’s proposed terms and conditions for the use of the Goldfields Gas Transmission Pipeline; and

(d) CMS Energy’s proposed terms and conditions for the use of the Parmelia Pipeline;

all contain a similar provision to that proposed by AlintaGas.

This indicates that the distribution of risk effected by the proposed provision has been accepted by participants in the gas industry in Western Australia. The proposed provision has become standard industry practice in the State. It is, in consequence, “reasonable” and, given the Regulator’s acceptance of the provision in the case of the Parmelia Pipeline⁶, Amendment 12 should be removed from the Final Decision.

- Western Power Submission No. 1

Amendment 12 requires that for the duration of a force majeure event, Reference Tariff fixed charges relating to a Reference Service must be waived. This requirement could be considered to be unduly harsh and does not appear to recognise the nature of the Service Provider’s cost structure.

It is evident that the majority of costs, incurred by a Service Provider in supplying a given level of service capacity to meet Users’ requirements, are fixed. These costs must be met irrespective of the actual level of capacity utilisation. During a force majeure event, which by definition is outside of a party’s control, the level of capacity utilisation will tend to towards zero. However, there is no corresponding reduction in capacity costs – they must still be met by the Service Provider.

In force majeure circumstances where Reference Tariff fixed charges paid by Users are waived, there is a potential for a mismatch to occur between a Service Provider’s revenues and expenditures. In effect, under these conditions force majeure risk relating to the distribution networks has been allocated to the Service Provider, presumably on the basis that the Service Provider is better able to manage that risk. However, this assumption is difficult to sustain in practice and its intuitive underpinning is also open to debate.

Disallowing a Service Provider from recovering fixed charges during force majeure events also gives rise to questions of equity. On this basis, and in view of the issues raised above, there is an argument that distribution network force majeure risk should be allocated to Users as well as to the Service Provider. In terms of fixed costs recovery, this suggests that a percentage of the fixed charges inherent in a Reference Service should be paid by Users for the duration of a force majeure event. Ultimately, the quantum of the percentage is a matter of judgement. In Western Power's view, a percentage value of 50% is reasonable.

- Office of Energy

As part of the Draft Decision the Regulator required that the Access Arrangement be amended to provide for the waiving of the fixed charges of a Reference Tariff for any period in which provision of a Reference Service is interrupted or reduced by a force majeure event.

⁶ Draft Decision on the Parmelia Pipeline Access Arrangement Part B – Supporting Information, page 32.

This amendment will reverse AlintaGas's proposed allocation of risk between AlintaGas and Users. It may be more equitable to establish a mechanism whereby force majeure risks are shared between the parties to the Haulage Contract.

Provisions of the Access Arrangement, relating to the liability of a User for the fixed charges of Reference Tariffs when supply of a Reference Services is interrupted or reduced by a force majeure event, affect the identity of the parties that, in the first instance, bear the financial risk associated with this liability. In principle, the identity of the party that bears the risk in the first instance would be largely inconsequential, as there would be a compensating effect in the Reference Tariffs. Furthermore, the Regulator notes that the principle risk associated with a force majeure interruption to services would arise in relation the economic losses of end-users of gas, rather than any liability to pay the fixed charges of distribution tariffs.

In a practical sense, the Regulator's objective in determining an assignment of financial risk associated with force majeure events is to ensure that the party that bears the risk in the first instance is the party that is in the best position to manage the risk and to remedy any failure arising from a force majeure event. In particular, where the Service Provider is in the best position to manage the risks of force majeure, the Access Arrangement should ensure that it is the Service Provider that bears the financial risk of force majeure in the first instance. The current provisions of clause 28 of schedule 7 of the Access Arrangement assign the financial risk in most part to Users of the AlintaGas gas distribution systems regardless of whether it is AlintaGas or the User that would be in the best position to manage the risk of force majeure.

Since developing Draft Decision Amendment 12, the Regulator now more clearly recognises that the provisions of the Access Arrangement relating to force majeure also encompass events that affect the ability of Users to meet obligations under Haulage Contracts. As a consequence, Draft Decision Amendment 12 would not meet the Regulator's objectives in regard to the allocation of financial risk arising in relation to force majeure events, but rather would have the effect of assigning financial risk to AlintaGas even for force majeure events that a User may be in the best position to manage the risk of failing to meet obligations under a Haulage Contract.

The Regulator has reconsidered Draft Decision Amendment 12 in light of the above and concluded that the required amendment should be altered. Clause 28 of schedule 7 of the Access Arrangement should be changed to provide for the waiving of fixed charges of a Reference Tariff for any period in which provision of a Reference Service is interrupted or reduced by a failure of AlintaGas to carry out any of its obligations under a Haulage Contract for reasons of force majeure.

Accrual of Interest on Underpayments and Overpayments

Draft Decision Amendment 13. Clause 18 of schedule 7 of the Access Arrangement should be amended so that interest is accrued on underpayments or overpayments after a reasonable period has been given for a party to rectify the underpayment or overpayment, rather than from the actual date of underpayment or overpayment.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 13.

In the absence of substantive submissions on Draft Decision Amendment 13, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Declaration of Default of Contract

Draft Decision Amendment 14. Clause 35(d) of schedule 7 of the Access Arrangement should be amended to ensure that a party cannot be declared in default under the Haulage Contract unless there is an adverse change in the business or financial condition of that party or an event occurs which could, in the reasonable opinion of the other party, materially affect the other party's ability to meet its obligations under the Haulage Contract.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 14.

In the absence of substantive submissions on Draft Decision Amendment 14, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Periods for Remedy of Defaults

Draft Decision Amendment 15. Clause 38 of schedule 7 of the Access Arrangement should be amended to ensure that a party has at least 5 business days to remedy a payment default and 15 business days to remedy any other default, once it has received written notice from the other party, before the other party can terminate a Haulage Contract.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 15.

In the absence of substantive submissions on Draft Decision Amendment 15, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

3.3.5 Required Amendments to the Access Arrangement

Amendment 6 [was Draft Decision Amendment 6]

Clause 47(2) of schedule 7 of the Access Arrangement should be amended to ensure that AlintaGas will make good, or pay compensation in respect of, damage caused by unreasonable acts of AlintaGas in the course of installing gas delivery facilities.

Amendment 7 [was Draft Decision Amendment 7]

Division 12 of schedule 7 of the Access Arrangement, which relates to interpretation, should be amended to insert a definition of confidential information that is applicable to clause 52, relating to confidentiality, in order to provide greater certainty as to the meaning of confidential information for the purposes of this clause.

Amendment 8 [was Draft Decision Amendment 8]

Clause 52(2)(e) of schedule 7 of the Access Arrangement should be amended to ensure that information of a confidential nature would only be disclosed in the course of any restructuring or sale of AlintaGas if it is the reasonable opinion of the disclosing party that the information is required to be disclosed.

Amendment 9 [was Draft Decision Amendment 9]

Schedules 4 and 5 of the Access Arrangement should be amended to require AlintaGas to verify the accuracy of meters at a minimum frequency that is in accordance with good industry practice and applicable laws.

Amendment 10 [was Draft Decision Amendment 10]

Clause 7(a) of schedule 7 of the Access Arrangement should be amended to ensure that, if AlintaGas requires a User to provide security for the performance of its obligations under a Haulage Contract, the security must be the minimum amount necessary to protect AlintaGas's legitimate business interests.

Amendment 11 [was Draft Decision Amendment 11]

Division 12 of schedule 7 of the Access Arrangement should be amended to ensure that the general provision that "... in the event or circumstance not within a party's control and which the party, by applying the standard of a reasonable and prudent person, is not able to prevent or overcome ..." clearly applies to each of the specific events listed as force majeure events.

Amendment 12 [was Draft Decision Amendment 12]

The Access Arrangement should be amended to provide for the waiving of fixed charges of a Reference Tariff for any period in which provision of a Reference Service is interrupted or reduced by a failure of AlintaGas to carry out any of its obligations under a Haulage Contract for reasons of force majeure.

Amendment 13 [was Draft Decision Amendment 13]

Clause 18 of schedule 7 of the Access Arrangement should be amended so that interest is accrued on underpayments or overpayments after a reasonable period has been given for a party to rectify the underpayment or overpayment, rather than from the actual date of underpayment or overpayment.

Amendment 14 [was Draft Decision Amendment 14]

Clause 35(d) of schedule 7 of the Access Arrangement should be amended to ensure that a party cannot be declared in default under the Haulage Contract unless there is an adverse change in the business or financial condition of that party or an event occurs which could, in the reasonable opinion of the other party, materially affect the other party's ability to meet its obligations under the Haulage Contract.

Amendment 15 [was Draft Decision Amendment 15]

Clause 38 of schedule 7 of the Access Arrangement should be amended to ensure that a party has at least 5 business days to remedy a payment default and 15 business days to remedy any other default, once it has received written notice from the other party, before the other party can terminate a Haulage Contract.

3.4 CAPACITY MANAGEMENT POLICY

3.4.1 Access Code Requirements

Section 3.7 of the Code requires that an Access Arrangement include a statement (a Capacity Management Policy) that the covered pipeline is either:

- (a) a Contract Carriage pipeline; or
- (b) a Market Carriage pipeline.

Contract Carriage is a system of managing third party access whereby:

- (a) the Service Provider normally manages its ability to provide Services primarily by requiring Users to use no more than the quantity of Service specified in a contract;
- (b) Users normally are required to enter into a contract that specifies a quantity of Service;
- (c) charges for use of a service normally are based at least in part upon the quantity of Service specified in a contract; and
- (d) a User normally has the right to trade its right to obtain a service to another User.

Market Carriage is a system of managing third party access whereby:

- (a) the Service Provider does not normally manage its ability to provide Services primarily by requiring Users to use no more than the quantity of Service specified in a contract;
- (b) Users are not normally are required to enter into a contract that specifies a quantity of Service;
- (c) charges for use of Services are normally based on actual usage of Services; and
- (d) a User does not normally have the right to trade its right to obtain a service to another User.

Section 3.8 of the Code requires that the Relevant Regulator must not accept an Access Arrangement which states that the covered pipeline is a Market Carriage pipeline unless the Relevant Minister of each Scheme Participant in whose Jurisdictional Area the pipeline is wholly or partly located has given notice to the Relevant Regulator permitting the covered pipeline to be a Market Carriage pipeline.

3.4.2 Access Arrangement Proposal

In Chapter 4 of the Access Arrangement, AlintaGas proposes to manage the Mid-West and South-West Gas Distribution Systems as a Contract Carriage pipeline.

3.4.3 Draft Decision

The Regulator recognised that the Code requires no more than a statement in the Access Arrangement that the covered pipeline is a Contract Carriage or Market Carriage pipeline, subject to Ministerial permission for any proposal for the pipeline to be a Market Carriage pipeline. As the Access Arrangement proposes that the pipeline will be managed as a Contract Carriage pipeline, it is considered that the requirements of the Code are met.

3.4.4 Responses to Submissions on the Draft Decision

No public submissions were made on the Draft Decision in respect of the proposed Capacity Management Policy.

3.4.5 AlintaGas Submissions on the Draft Decision

The Draft Decision was to accept AlintaGas's proposed Capacity Management Policy. AlintaGas made no submission on the Draft Decision in this respect.

3.4.6 Required Amendments to the Access Arrangement

The Regulator considers that the requirements of the Code are met by the Access Arrangement in respect of a Capacity Management Policy.

3.5 TRADING POLICY

3.5.1 Access Code Requirements

Section 3.9 of the Code requires that an Access Arrangement for a covered pipeline which is described in the Access Arrangement as a Contract Carriage Pipeline must include a policy that explains the rights of a User to trade its right to obtain a Service to another person (a Trading Policy).

Section 3.10 of the Code requires that the Trading Policy must comply with the following principles.

- (a) A User must be permitted to transfer or assign all or part of its Contracted Capacity without the consent of the Service Provider concerned if:
 - (i) the User's obligations under the contract with the Service Provider remain in full force and effect after the transfer or assignment; and
 - (ii) the terms of the contract with the Service Provider are not altered as a result of the transfer or assignment (a Bare Transfer).

In these circumstances, the Trading Policy may require that the transferee notify the Service Provider prior to utilising the portion of the Contracted Capacity subject to the Bare Transfer and of the nature of the Contracted Capacity subject to the Bare Transfer, but the Trading Policy must not require any other details regarding the transaction to be provided to the Service Provider.

- (b) Where commercially and technically reasonable, a User must be permitted to transfer or assign all or part of its Contracted Capacity other than by way of a Bare Transfer with the prior consent of the Service Provider. The Service Provider may withhold its consent only on reasonable commercial or technical grounds and may make its consent subject to conditions only if they are reasonable on commercial and technical grounds. The Trading Policy may specify conditions in advance under which consent will or will not be given and conditions that must be adhered to as a condition of consent being given.
- (c) Where commercially and technically reasonable, a User must be permitted to change the Delivery Point or Receipt Point from that specified in any contract for the relevant Service with the prior written consent of the Service Provider. The Service Provider may withhold its consent only on reasonable commercial or technical grounds and may make its consent subject to conditions only if they are reasonable on commercial and technical grounds. The Trading Policy may specify conditions in advance under which consent will or will not be given and conditions that must be adhered to as a condition of consent being given.

Section 3.11 of the Code provides examples of matters that would be reasonable for the purposes of section 3.10(b) and (c):

- (a) the Service Provider refusing to agree to a User's request to change its Delivery Point where a reduction in the amount of the Service provided to the original Delivery Point will not result in a corresponding increase in the Service Provider's ability to provide that Service to the alternative Delivery Point; and
- (b) the Service Provider specifying that, as a condition of its agreement to a change in the Delivery Point or Receipt Point, the Service Provider must receive the same amount of revenue it would have received before the change.

3.5.2 Access Arrangement Proposal

A Trading Policy is provided by AlintaGas in Chapter 5 of the Access Arrangement document. Bare Transfers and Consent Transfers are provided for in Division 1 of Chapter 5.

With respect to Bare Transfers, the following information will be sought by AlintaGas from the transferee no more than three business days before the transferred or assigned contracted peak rate is utilised.

- The identity of the User which made the transfer or assignment, and the identity of the transferee or assignee.
- Information on the nature of the contracted peak rate which was transferred or assigned should include the amount transferred or assigned and the location of the relevant receipt point and delivery point.

- The duration of the transfer or assignment.

With respect to Consent Transfers, AlintaGas proposes to be able to withhold consent to the transfer or assignment on reasonable commercial or technical grounds. AlintaGas also proposes to be able to withhold consent if any or all of the pre-conditions to the provision of services specified in Division 5 of Chapter 2 (Services Policy) of the Access Arrangement are not satisfied.

The Trading Policy provides for the relocation of the receipt or delivery point in Division 2 of Chapter 5 of the Access Arrangement. AlintaGas proposes to be able to withhold consent to the relocation of the receipt or delivery point on reasonable commercial or technical grounds. AlintaGas also proposes to be able to withhold consent if any or all of the pre-conditions to the provision of services specified in clauses 19(1) and 19(2) of Chapter 2 (Services Policy) of the Access Arrangement are not satisfied. When the User notifies AlintaGas that it intends to relocate a receipt or delivery point, the Queuing Policy is to apply to this notice as if the notice was an application.

3.5.3 Draft Decision

The Trading Policy proposed by AlintaGas makes provision for Bare Transfers and Consent Transfers in a manner which is generally consistent with requirements of the Code. The Regulator did, however, have a concern that the transferee is required to notify AlintaGas at least three business days prior to the utilisation of capacity under a Bare Transfer, which may preclude such transfers at short notice. The required amendment to the Access Arrangement and Access Arrangement Information was as follows.

Draft Decision Amendment 16

Clause 43(3) of Chapter 5 should be amended to remove the requirement that a transferee must notify AlintaGas at least three business days prior to the utilisation of capacity under a Bare Transfer.

3.5.4 Responses to Submissions on the Draft Decision

Draft Decision Amendment 16. Clause 43(3) of Chapter 5 should be amended to remove the requirement that a transferee must notify AlintaGas at least three business days prior to the utilisation of capacity under a Bare Transfer.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 16.

In the absence of substantive submissions on Draft Decision Amendment 16, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

3.5.5 Required Amendments to the Access Arrangement

Amendment 16 [was Draft Decision Amendment 16]

Clause 43(3) of Chapter 5 of the Access Arrangement should be amended to remove the requirement that a transferee must notify AlintaGas at least three business days prior to the utilisation of capacity under a Bare Transfer.

3.6 QUEUING POLICY

3.6.1 Access Code Requirements

Section 3.12 of the Code requires that an Access Arrangement must include a policy for determining the priority that a Prospective User has, as against any other Prospective User, to obtain access to spare capacity and developable capacity (and to seek dispute resolution under section 6 of the Code) where the provision of the Service sought by that Prospective User may impede the ability of the Service Provider to provide a Service that is sought or which may be sought by another Prospective User (a Queuing Policy).

Section 3.13 of the Code requires that the Queuing Policy must:

- (a) set out sufficient detail to enable Users and Prospective Users to understand in advance how the Queuing Policy will operate;
- (b) accommodate, to the extent reasonably possible, the legitimate business interests of the Service Provider and of Users and Prospective Users; and
- (c) generate, to the extent reasonably possible, economically efficient outcomes.

Section 3.14 of the Code provides for the Relevant Regulator to require the Queuing Policy to deal with any other matter the Relevant Regulator thinks fit, taking into account the matters listed in section 2.24 of the Code:

- (a) the Service Provider's legitimate business interests and investment in the covered pipeline;
- (b) firm and binding contractual obligations of the Service Provider or other persons (or both) already using the covered pipeline;
- (c) the operational and technical requirements necessary for the safe and reliable operation of the covered pipeline;
- (d) the economically efficient operation of the covered pipeline;
- (e) the public interest, including the public interest in having competition in markets (whether or not in Australia);
- (f) the interests of Users and Prospective Users; and
- (g) any other matters that the Relevant Regulator considers are relevant.

3.6.2 Access Arrangement Proposal

A Queuing Policy is provided by AlintaGas in Chapter 6 of the Access Arrangement.

The Queuing Policy sets out the criteria for determining the priority of Prospective Users to obtain access to services, where two or more Prospective Users are competing for access to spare capacity and developable capacity. Provision is made for a single queue (the first come first served queue) for all Prospective Users, irrespective of whether the Prospective User is seeking to increase its contracted peak rate at a given delivery point within an existing service agreement or is seeking to enter into a new service agreement (i.e. not currently in an agreement).

A Prospective User's priority in respect of an application will be determined on a first come first served basis. However, AlintaGas seeks to depart from the first come first served principle if it believes it necessary to do so in order to:

- accommodate the legitimate business interests of AlintaGas, Users or Prospective Users;
- generate an economically efficient outcome; or
- deal with a vexatious application by a Prospective User.

AlintaGas proposes that if there is a departure from the first come first served principle, notice will be given of that action to all Prospective Users in the first come first served queue who are affected.

The position of a Prospective User's application in the first come first served queue is to be determined by reference to the time at which AlintaGas received the application. If more than one application is submitted by a Prospective User, or an amendment to an existing application is requested, then they are treated as separate applications. AlintaGas offers to process more than one application concurrently provided that there is no limitation on resources.

AlintaGas proposes to inform any Prospective User with an application in the first come, first served queue of the fact that another application exists and the position in the queue of the Prospective User who submitted that other application.

3.6.3 Draft Decision

The Regulator considered that the Queuing Policy proposed by AlintaGas does not meet the requirements of the Code as it does not, for all circumstances, provide sufficient information to enable Users and Prospective Users to understand in advance how priorities of access to spare capacity or developable capacity are to be determined at times when Access Requests exceed available spare capacity. Furthermore, the Queuing Policy was considered to be unreasonably contrary to the interests of Prospective Users through not making provision for advice to be provided to Prospective Users in relation to changes in the forecast timing of the availability of pipeline capacity.

The required amendments to the Access Arrangement were as follows.

Draft Decision Amendment 17

Clause 53 of the Access Arrangement should be amended to require AlintaGas to advise Prospective Users of an estimate of when capacity may become available, consistent with section 5.6 of the Code, and for AlintaGas to provide revised information to a Prospective User when the timing of the availability of the capacity changes.

Draft Decision Amendment 18

Chapter 6 of the Access Arrangement should be amended to describe how an application at the head of the queue is transformed into a service agreement when the spare or developable capacity sought becomes available, and how and when AlintaGas will inform the applicant.

Draft Decision Amendment 19

Chapter 6 of the Access Arrangement should be amended to describe what will happen to an application if the spare or developable capacity is not accepted by the applicant at the head of the queue.

Draft Decision Amendment 20

Chapter 6 of the Access Arrangement should be amended to describe what would happen to a Prospective User's priority where another Prospective User with an application in the first come first served queue seeks to reduce the capacity requested in its application.

Draft Decision Amendment 21

Chapter 6 of the Access Arrangement should be amended to clarify that an incumbent User, with an existing Haulage Contract that has an option to extend the contract, has priority over an application in the queue for the same capacity when the existing service agreement expires, if the User wishes to extend the duration of the Haulage Contract.

Draft Decision Amendment 22

Clause 49(1)(a) of Chapter 6 of the Access Arrangement should be amended to state that the Queuing Policy will operate on a first come first served principle, unless it is necessary to depart from this principle in order to accommodate, to the extent reasonably possible, the legitimate business interests of the Service Provider and of Users and Prospective Users (section 3.13(b) of the Code) and generate, to the extent reasonably possible, economically efficient outcomes (section 3.13(c) of the Code).

3.6.4 Responses to Submissions on the Draft Decision

Provision of Information to Prospective Users

Draft Decision Amendment 17. Clause 53 of the Access Arrangement should be amended to require AlintaGas to advise Prospective Users of an estimate of when capacity may become

available, consistent with section 5.6 of the Code, and for AlintaGas to provide revised information to a Prospective User when the timing of the availability of the capacity changes.

- AlintaGas

AlintaGas objects to Amendment 17 and submits that the Regulator should not require such an amendment in the Final Decision.

This matter is clearly addressed under section 5.6. AlintaGas submits that there is little use in repeating section 5.6 in the Access Arrangement.

AlintaGas further submits that section 2.24 prohibits the Regulator from requiring the inclusion of such a provision. Section 2.24 states that the Regulator must not refuse to approve a proposed access arrangement which does not address a matter that sections 3.1 to 3.20 do not require an access arrangement to address. The fact that sections 3.1 to 3.20 do not require such a provision is clear because sections 3.12 to 3.15 contain no such requirement and because it is a matter addressed by section 5.6.

In assessing AlintaGas's proposed Queuing Policy, the Regulator considered the provisions of section 3.14 of the Code that provide for the Regulator to require the Queuing Policy to deal with any matter the Regulator thinks fit, taking into account the matters for consideration listed in section 2.24 of the Code, including the economically efficient operation of the covered pipeline (section 2.24(d)) and the interests of Users and Prospective Users (section 2.24(f)). Amendment 17 was included in the Draft Decision in accordance with these two considerations and has two components:

- i. a requirement for AlintaGas to advise Prospective Users of an estimate of when capacity may become available, consistent with section 5.6 of the Code; and
- ii. a requirement for AlintaGas to provide revised information to a Prospective User when the timing of the availability of the capacity changes.

The Regulator acknowledges the first of these components is already covered by section 5.6 of the Code and, for the purposes of the Access Arrangement, would only be declaratory. The Regulator will alter the requirements of Draft Decision Amendment 17 to remove this component.

The Regulator considers that the power to require the second component of the amendment is provided by section 3.14 of the Code, and that this requirement is appropriate having regard to the matters set out in section 2.24 of the Code. The Regulator will therefore maintain the requirement for the Access Arrangement to be amended so as to oblige AlintaGas to advise a Prospective User with a queued access request of any envisaged change in the timing of when the capacity sought in the access request may be available.

Transformation of a Queued Application to a Service Agreement

Draft Decision Amendment 18. Chapter 6 of the Access Arrangement should be amended to describe how an application at the head of the queue is transformed into a service agreement when the spare or developable capacity sought becomes available, and how and when AlintaGas will inform the applicant.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 18.

In the absence of substantive submissions on Draft Decision Amendment 18, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Disposition of Queued Application upon Refusal of Offer of Capacity

Draft Decision Amendment 19. Chapter 6 of the Access Arrangement should be amended to describe what will happen to an application if the spare or developable capacity is not accepted by the applicant at the head of the queue.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 19.

In the absence of substantive submissions on Draft Decision Amendment 19, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Reduction in Requested Capacity for a Queued Application

Draft Decision Amendment 20. Chapter 6 of the Access Arrangement should be amended to describe what would happen to a Prospective User's priority where another Prospective User with an application in the first come first served queue seeks to reduce the capacity requested in its application.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Amendment 20.

In the absence of substantive submissions on Draft Decision Amendment 20, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Priority to Extend Existing Contracts

Draft Decision Amendment 21. Chapter 6 of the Access Arrangement should be amended to clarify that an incumbent User, with an existing Haulage Contract that has an option to extend the contract, has priority over an application in the queue for the same capacity when the existing service agreement expires, if the User wishes to extend the duration of the Haulage Contract.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 21.

In the absence of substantive submissions on Draft Decision Amendment 21, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Departure from First Come First Served Principle

Draft Decision Amendment 22. Clause 49(1)(a) of Chapter 6 of the Access Arrangement should be amended to state that the Queuing Policy will operate on a first come first served principle, unless it is necessary to depart from this principle in order to accommodate, to the extent reasonably possible, the legitimate business interests of the Service Provider and of Users and Prospective Users (section 3.13(b) of the Code) and generate, to the extent reasonably possible, economically efficient outcomes (section 3.13(c) of the Code).

- AlintaGas

AlintaGas does not believe that the required amendment will change the existing intended effect of the provision. AlintaGas will nonetheless submit a compliant revision in response to Amendment 22.

In the absence of substantive submissions on Draft Decision Amendment 22, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

3.6.5 Required Amendments to the Access Arrangement

Amendment 17 [was Draft Decision Amendment 17]

Clause 53 of the Access Arrangement should be amended to require AlintaGas to provide revised information to a Prospective User when there is a change in the expected timing of the requested capacity becoming available.

Amendment 18 [was Draft Decision Amendment 18]

Chapter 6 of the Access Arrangement should be amended to describe how an application at the head of the queue is transformed into a service agreement when the spare or developable capacity sought becomes available, and how and when AlintaGas will inform the applicant.

Amendment 19 [was Draft Decision Amendment 19]

Chapter 6 of the Access Arrangement should be amended to describe what will happen to an application if the spare or developable capacity is not accepted by the applicant at the head of the queue.

Amendment 20 [was Draft Decision Amendment 20]

Chapter 6 of the Access Arrangement should be amended to describe what would happen to a Prospective User's priority where another Prospective User with an application in the first come first served queue seeks to reduce the capacity requested in its application.

Amendment 21 [was Draft Decision Amendment 21]

Chapter 6 of the Access Arrangement should be amended to clarify that an incumbent User, with an existing Haulage Contract that has an option to extend the contract, has priority over an application in the queue for the same capacity when the existing service agreement expires, if the User wishes to extend the duration of the Haulage Contract.

Amendment 22 [was Draft Decision Amendment 22]

Clause 49(1)(a) of Chapter 6 of the Access Arrangement should be amended to state that the Queuing Policy will operate on a first come first served principle, unless it is necessary to depart from this principle in order to accommodate, to the extent reasonably possible, the legitimate business interests of the Service Provider and of Users and Prospective Users (section 3.13(b) of the Code) and generate, to the extent reasonably possible, economically efficient outcomes (section 3.13(c) of the Code).

3.7 EXTENSIONS/EXPANSIONS POLICY

3.7.1 Access Code Requirements

Section 3.16 of the Code requires that an Access Arrangement include a policy (an Extensions/Expansions Policy) which sets out:

- (a) the method to be applied to determine whether any extension to, or expansion of the Capacity of, the covered pipeline:
 - (i) should be treated as part of the covered pipeline for all purposes under the Code; or
 - (ii) should not be treated as part of the covered pipeline for any purpose under the Code;

(for example, the Extensions/Expansions Policy could provide that the Service Provider may, with the Relevant Regulator's consent, elect at some point in time whether or not an extension or expansion will be part of the covered pipeline or will not be part of the covered pipeline);
- (b) how any extension or expansion which is to be treated as part of the covered pipeline will affect Reference Tariffs (for example, the Extensions/Expansions Policy could:
 - (i) indicate that Reference Tariffs will remain unchanged but a surcharge may be levied on Incremental Users where permitted by sections 8.25 and 8.26 of the Code; or
 - (ii) specify that a review will be triggered and that the Service Provider must submit revisions to the Access Arrangement pursuant to section 2.28 of the Code);
- (c) if the Service Provider agrees to fund New Facilities if certain conditions are met, a description of those New Facilities and the conditions on which the Service Provider will fund the New Facilities.

The Relevant Regulator may not require the Extensions/Expansions Policy to state that the Service Provider will fund New Facilities, unless the Service Provider agrees.

3.7.2 Access Arrangement Proposal

An Extensions/Expansions Policy is provided by AlintaGas in Chapter 7 of the Access Arrangement. The Extensions/Expansions Policy details the method to be applied to determine whether any extension to, or expansion of the capacity of, the AlintaGas network should or should not be treated as part of the AlintaGas network for the purposes of the Code, and how that will affect the Reference Tariffs.

The general provisions of the Extensions/Expansions Policy are as follows.

- Any extension or expansion which is part of, or directly connected with, an existing sub-network will be treated as part of the AlintaGas network for all purposes under the Code unless AlintaGas, with the prior consent of the Regulator, declares that a proposed extension or expansion that would otherwise become part of the AlintaGas network is to be an excluded extension. (clauses 55 and 57 of the Access Arrangement).
- Any extension or expansion which is neither part of, nor directly connected with, an existing sub-network will not be treated as part of the AlintaGas network for any purpose under the Code, unless so determined by AlintaGas. Unless such a pipeline becomes a covered pipeline, access to it will be determined through negotiation between AlintaGas and the Prospective User. (clause 56(1)).
- An extension or expansion which is treated as part of the AlintaGas network will not affect Reference Tariffs for the remainder of the Access Arrangement period unless AlintaGas decides to trigger a review of the Access Arrangement at the time of the extension or expansion. (clause 58(1)).
- AlintaGas may from time to time impose a surcharge on, or seek a capital contribution from, users of the incremental capacity, where permitted by and subject to the Code. Where AlintaGas does not impose a surcharge or seek a capital contribution, users of the incremental capacity will pay the relevant Reference Tariff. (clauses 58(2) and 58(3)).
- AlintaGas may from time to time allocate new facilities investment to the speculative investment fund, where permitted by and subject to the Code. (clause 58(4)).

3.7.3 Draft Decision

In assessing the proposed Extensions/Expansions Policy, the Regulator gave consideration to the relationship between AlintaGas's proposed method of levying capital contributions for new customers and the Extensions/Expansions Policy. For Reference Services B2 and B3, AlintaGas has made allowance in Reference Tariffs for the recovery of costs associated with the meter and the first 20 metres of service pipe, both of which are extensions to the AlintaGas network. Consequently, the Extensions/Expansions Policy should preclude the levying of a surcharge for a meter and the first 20 metres of service pipe (in respect of B2 and B3 customers).

The required amendment to the Access Arrangement and Access Arrangement Information was as follows.

Draft Decision Amendment 23

Clause 58 of the Access Arrangement should be amended to specifically exclude the levying of surcharges in respect of costs associated with constructing the first 20 metres of service pipe and providing a meter for the purposes of delivering gas to an end-user under Reference Service B2 or B3.

3.7.4 Responses to Submissions on the Draft Decision

Surcharges

Draft Decision Amendment 23. Clause 58 of the Access Arrangement should be amended to specifically exclude the levying of surcharges in respect of costs associated with constructing the first 20 metres of service pipe and providing a meter for the purposes of delivering gas to an end-user under Reference Service B2 or B3.

- AlintaGas

AlintaGas intends to submit a compliant revision to Draft Decision Amendment 23. However, AlintaGas notes that the Amendment should specifically exclude the levying of surcharges in respect of “standard delivery facilities”, as that term is defined in clause 64(1) of the Access Arrangement.

In the absence of substantive submissions on Draft Decision Amendment 23, the Regulator will maintain the requirement for this amendment of the Access Arrangement. The Regulator has altered the required amendment to reflect AlintaGas’s suggested improvement in definition.

Excluded Extensions to the AlintaGas Network

- Office of Energy

An Extensions/Expansions Policy is provided by AlintaGas in Chapter 7 of the Access Arrangement. Under the general provisions of the Extensions/Expansions Policy any extension or expansion which is part of, or directly connected with, an existing sub-network will be treated as part of the AlintaGas network for all purposes under the Code unless AlintaGas, with the prior consent of the Regulator, declares that a proposed extension or expansion is to be an excluded extension. (Clauses 55 and 57 of the Access Arrangement). Unless an excluded extension becomes a Covered Pipeline under the Code, access to it will be a matter for negotiation between AlintaGas and the Prospective User.

The Government proposes to make retail tariff regulations under the Energy Coordination Act, which will have the effect of capping gas tariffs for all small use customers (using below 1 TJ/annum). The Regulations will apply in those areas of the State which are the subject of distribution licences granted to AlintaGas under the Energy Coordination Act. It is also likely that the approved distribution licence areas will extend beyond the current distribution systems of AlintaGas as defined in the Access Arrangement, although the extent of the areas is yet to be determined. The capping of gas retail tariffs within those areas would effectively mean that extensions to the current distribution system for the supply of gas to small use customers would only be viable if the relevant distribution tariffs allow sufficient retail margin below the cap. There may also be concern by users of the system (eg retailers supplying small use customers) that the ability of AlintaGas to exclude some of the extensions from the Access Arrangement could enable the AlintaGas distribution business to discriminate in favour of its trading business.

The Code requires that an Access Arrangement include an Extensions/Expansions Policy which sets out the method to be applied to determine whether any extension to, or expansion of the capacity of, a covered pipeline should or should not be treated as part of the covered pipeline for the purposes under the Code. It is arguable that even relatively minor low/medium pressure extensions would technically comprise extensions to the AlintaGas network. It is suggested however that given the Code was originally developed to cover only transmission pipelines, the ability to exclude minor extensions to established distribution systems may have not been intended by the creators of the Code. Related provisions in similar Access Arrangements covering distribution systems in the other States should also be noted. For example, under AGL’s Access Arrangement for the NSW distribution system any extension or expansion carried out by AGL will be part of the covered network and no extension or expansion will affect the respective Reference Tariff.

Notwithstanding the above, it is considered that should the Regulator approve the Extension/Expansion policy as proposed by AlintaGas, the Regulator’s consent for AlintaGas to declare a proposed extension as an excluded extension should be granted subject to a public consultation process, limited to the proposal,

being conducted prior to that consent. Public consultation is considered particularly appropriate in situations where the extension, which is proposed to be excluded, would be used, or would be part of interconnected system which would be used, to supply gas to small use customers.

Under clause 55 of the Access Arrangement, an extension or expansion to the AlintaGas network, that is directly connected to an existing sub-network, will be treated as part of the Covered Pipeline that is the AlintaGas Mid-West and South-West Gas Distribution Systems, unless AlintaGas determine the extension to be an “excluded extension” and obtain the Regulator’s consent for this to be so. The Office of Energy has suggested that in considering any application by AlintaGas to declare an extension or expansion of the network to be an excluded extension, the Regulator should undertake public consultation.

Section 3.16 of the Code provides some flexibility in the form an Extensions/Expansions Policy may take and indicates by way of example (section 3.16(a)) that “the Extensions/Expansions Policy could provide that the Service Provider may, with the Regulator’s consent, elect at some point in time whether or not an extension or expansion will be part of the Covered Pipeline or will not be part of the Covered Pipeline.”

By virtue of the example in section 3.16(a) of the Code, the potential role of the Regulator in consenting to or not consenting to an extension or expansion not being part of the Covered Pipeline may be a function of the Regulator under the Code. As a consequence, where an Access Arrangement includes an Extensions/Expansions Policy that makes provision for the Regulator’s approval in the manner contemplated by the example in section 3.16(a) of the Code, section 2.1 of the Code provides the Regulator with powers to hold public consultations concerning any application by the Service Provider for exclusion of an extension from the Covered Pipeline.

The Access Arrangement for the Mid-West and South-West Gas Distribution Systems provides for the Regulator to have an approval role in determining whether an extension to the AlintaGas network will be an excluded extension. In undertaking this role, the Regulator may exercise a power to hold public consultations. In determining whether to exercise this power, the Regulator would be likely to consider the materiality of the relevant extension and the envisaged level of public interest.

Regardless of any decision by the Regulator to undertake, or not undertake, public consultation, section 1 of the Code provides that any person may make an application to the National Competition Council requesting that a particular pipeline be covered. Thus an extension or expansion to the AlintaGas network that constitutes an excluded extension within the meaning of clause 57(1) of the Access Arrangement may become a covered pipeline in its own right. The National Competition Council is obliged to undertake public consultation on such an application in accordance with section 1.4 of the Code, unless the application is rejected on consideration that it has been made on trivial or vexatious grounds.

The Regulator therefore considers that there is currently adequate scope under the Access Arrangement and the Code for public consultation in respect of any proposal by AlintaGas to not include any extension of the AlintaGas network as part of the Covered Pipeline.

3.7.5 Required Amendments to the Access Arrangement

Amendment 23 [was Draft Decision Amendment 23]

Clause 58 of the Access Arrangement should be amended to exclude the levying of surcharges in respect of costs associated with providing “standard delivery facilities”, as that term is defined in clause 64(1) of the Access Arrangement.

3.8 REVIEW DATE

3.8.1 Access Code Requirements

Section 3.17 of the Code requires that an Access Arrangement include:

- (a) a date upon which the Service Provider must submit revisions to the Access Arrangement (a revisions submission date); and
- (b) a date upon which the next revisions to the Access Arrangement are intended to commence (a revisions commencement date).

In approving the revisions submission date and revisions commencement date, the Regulator must have regard to the objectives for Reference Tariffs and Reference Tariff Policy in section 8.1 of the Code, and may in making a decision on an Access Arrangement (or revisions to an Access Arrangement), if the Regulator considers it necessary having had regard to the objectives in section 8.1 of the Code:

- (i) require an earlier or later revisions submission date and revisions commencement date than proposed by the Service Provider in its proposed Access Arrangement; and
- (ii) require that specific major events be defined that trigger an obligation on the Service Provider to submit revisions prior to the revisions submission date.

Section 3.18 of the Code provides for an Access Arrangement Period to be of any length. However, if the Access Arrangement Period is more than five years, the Relevant Regulator must not approve the Access Arrangement without considering whether mechanisms should be included to address the risk of forecasts on which the terms of the Access Arrangement were based and approved proving incorrect. These mechanisms may include:

- (a) requiring the Service Provider to submit revisions to the Access Arrangement prior to the revisions submission date if certain events occur, for example:
 - (i) if a Service Provider's profits derived from a covered pipeline are outside a specified range or if the value of services reserved in contracts with Users are outside a specified range;
 - (ii) if the type or mix of services provided by means of a covered pipeline changes in a certain way; or
- (b) a Service Provider returning some or all revenue or profits in excess of a certain amount to Users, whether in the form of lower charges or some other form.

Where a mechanism is included in an Access Arrangement pursuant to section 3.18(a), the Relevant Regulator must investigate no less frequently than once every five years whether a review event identified in the mechanism has occurred.

3.8.2 Access Arrangement Proposal

Chapter 8 of the Access Arrangement specifies the date on which the Access Arrangement will commence and the date AlintaGas will submit revisions to the Regulator and the date AlintaGas intends those revisions to commence.

- AlintaGas proposes that the Access Arrangement commences on the later of 1 January 2000 or a date specified by the Regulator.
- AlintaGas will submit revisions to the Access Arrangement to the Regulator on or before 30 June 2004, with the revisions to commence on 1 January 2005.

3.8.3 Draft Decision

The Regulator considered two matters in respect of a revisions date: the timing of the revisions submission date, and trigger mechanisms for the Regulator to initiate a review of the Access Arrangement.

AlintaGas has proposed a revisions submission date of 30 June 2004, which is six months before the proposed revisions commencement date of 1 January 2005. In view of regulatory experience throughout Australia, the Regulator considered that a six-month period between submission of revisions and the implementation of the revisions to be inadequate. The Regulator therefore required that the revisions submission date be brought forward to allow a nine-month period between submission and implementation.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 24

Clause 60 of the Access Arrangement should be amended to provide for a revisions submission date of 31 March 2004.

The Regulator gave consideration to whether certain specific major events should be defined that would trigger an obligation on AlintaGas to submit revisions prior to the revisions submission date. The Regulator, having given regard to the objectives in section 8.1 of the Code, considered it appropriate to include certain trigger mechanisms in the Access Arrangement.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 25

Chapter 8 of the Access Arrangement (Review Date) should be amended to include trigger mechanisms enabling the Regulator, if the Regulator wishes, to initiate a review of the Access Arrangement in response to:

- submission to the Regulator by AlintaGas of a change statement entailing an increase in Reference Tariffs;
- changes to taxation arrangements affecting AlintaGas, including any change to the rates of the goods and services tax or corporate income tax;
- increases in quantities of gas distributed above forecast increases by an amount of more than 50 percent of the forecast increases; and
- a change in the provisions or administration of any Act or other law which, in the Regulator’s opinion, necessitates a review of the Access Arrangement.

3.8.4 Responses to Submissions on the Draft Decision

Revisions Submission Date

Draft Decision Amendment 24. Clause 60 of the Access Arrangement should be amended to provide for a revisions submission date of 31 March 2004.

- AlintaGas

The effect of Amendment 24 is to bring forward the revisions commencement date from the date of 30 June 2004 proposed by AlintaGas to 31 March 2004, thereby providing the Regulator with an extra 3 months, or 9 months in total, to assess revisions to the Access Arrangement submitted by AlintaGas. The Regulator indicated a requirement for a 9 month revisions assessment period because regulatory experience throughout Australia indicates that “...a six-month period is inadequate for assessment of a proposed Access Arrangement...”

AlintaGas intends to submit a compliant revision. However, AlintaGas expresses concern about the reasons underlying the Regulator’s decision to require Amendment 24. While AlintaGas believes that it is prudent to allow a realistic period of time for the assessment of revisions to an access arrangement, it submits that a period of 9 months is too long a period for the following reasons:

(a) The regulatory experience to which the Regulator refers is regulatory experience in relation to the assessment of proposed access arrangements. AlintaGas submits that the assessment of new access arrangements is a much larger and time consuming task than the assessment of revisions to an existing, and previously approved access arrangement. It follows, then, that the assessment of revisions should take significantly less time than 9 months.

(b) Prior to the introduction of the Code, there had been little experience in the independent regulatory assessment of third party access regimes in Australia. The submission and assessment of the first proposed access arrangements under the Code was, therefore, bound to take significant amounts of time as regulators established offices and infrastructure and developed experience and expertise. AlintaGas submits that as regulatory expertise develops the time taken to undertake assessments should correspondingly decrease. AlintaGas expects that the duration of assessments would ultimately contract to the period of 6 months specified in sections 2.21 and 2.43.

(c) Sections 2.21 and 2.43 provide a firm indication of the Parliament’s intention to restrict the time it should take to assess access arrangements and revisions to access arrangements to 6 months. While there is an ability to extend that period by one or more periods of up to 2 months, AlintaGas submits that the use of such extensions should be reserved for extraordinary events. In the normal course of events, particularly as

experience and expertise develops, regulators should strive to provide final decisions within the 6 month timeframe. The achievement of such an objective will provide to Service Providers greater certainty and will result in greater regulatory efficiency. Accordingly, although the Regulator desires a 9 month assessment period in the future, the Regulator should not believe that AlintaGas agrees that that is an acceptable timeframe for assessments.

The Regulator acknowledges that there are several matters to be addressed in the assessment of a proposed Access Arrangement that would not need to be assessed in regard to revisions to an Access Arrangement, most notably the value of the Initial Capital Base. However, the Regulator also notes that additional matters of assessment may arise in regard to the assessment of revisions that do not arise, or arise to a lesser degree, in assessment of a proposed Access Arrangement. These may include assessment of proposals to roll New Facilities Investment into the Capital Base, and more rigorous assessment and benchmarking of operating expenditure. Furthermore, with increasing numbers of participants and increasing competition in markets for natural gas, there may at the time of review be a greater interest in the Access Arrangement and hence greater requirements for public consultation.

In view of these matters, the Regulator is of the view that assessment of revisions will take at least the six months provided for in the Code. In addition, the Regulator considers it prudent to give the Service Provider a reasonable amount of time to implement the revisions to the Access Arrangement after their approval by the Regulator. This can be provided for by allowing a nine month period between AlintaGas's submission of revisions and the date for implementation of these revisions. The Regulator will therefore maintain the requirement for the Access Arrangement to be amended to provide for a Revisions Submission date of nine months prior to the Revisions Commencement Date.

Trigger Mechanisms

Draft Decision Amendment 25. Chapter 8 of the Access Arrangement (Review Date) should be amended to include trigger mechanisms enabling the Regulator, if the Regulator wishes, to initiate a review of the Access Arrangement in response to:

- submission to the Regulator by AlintaGas of a change statement entailing an increase in Reference Tariffs;*
- changes to taxation arrangements affecting AlintaGas, including any change to the rates of the goods and services tax or corporate income tax;*
- increases in quantities of gas distributed above forecast increases by an amount of more than 50 percent of the forecast increases; and*
- a change in the provisions or administration of any Act or other law which, in the Regulator's opinion, necessitates a review of the Access Arrangement.*

- **AlintaGas**

In the first paragraph of the reasons for Draft Decision Amendment 25 the Regulator indicates that the requirement for the amendment is based upon an exercise of the Regulators discretion under section 3.17. In the Draft Decision, section 3.17 is summarised in the following way:

“...section 3.17 of the Code does provide the Regulator with the ability to nominate in advance trigger mechanisms within the Access Arrangement, which can be used to initiate a review”.

The Regulator then proceeds to state that changes in company or general taxation arrangements, including changes to the rate of corporate income tax and the introduction of GST, are “appropriate trigger” events.

The Regulator also states that a trigger mechanism based on actual throughput is appropriate, provided that it does not have an adverse effect on AlintaGas's incentives to increase network usage.

AlintaGas strongly objects to Draft Decision Amendment 25 and submits that the Regulator should not require such an amendment in the Final Decision for the following reasons:

- (a) To the extent that Draft Decision Amendment 25 requires the inclusion in the Access Arrangement of a trigger mechanism that gives the Regulator discretion, upon the happening of certain events, about whether or not to conduct a review of the Access Arrangement, it exceeds the Regulator's power under section 3.17;
- (b) The reasons for decision disclose that the Regulator did not, as required by section 3.17, determine whether each of the defined trigger events was necessary having regard to the objectives of section 8.1;
- (c) The Regulator has exceeded powers under section 3.17 because the events specified in Draft Decision Amendment 25 are not "specific major events";
- (d) The approach to trigger mechanisms suggests that the Regulator has adopted an overly cautious and intrusive approach to regulation. Rather than having the confidence to allow AlintaGas to operate in the market for a 5 year period as proposed in the Access Arrangement, the Regulator has designed trigger mechanisms that will result in full regulatory reviews in the event that any outcome is not as the Regulator expects it to be. This is inappropriate and unreasonable. The reservation of increased discretion on the part of the Regulator results in decreased regulatory certainty for AlintaGas.
- (e) The occurrence of the defined trigger events does not justify the imposition of a requirement upon AlintaGas to submit revisions and for the Regulator to undertake a full review of the Access Arrangement under section 2.28.
- (f) The Regulator has failed to provide sufficient reasons for the Regulator's decision to include each trigger event, as required under section 7.7.

Full reasons for AlintaGas's response are as set out in Attachment C of AlintaGas's submission on the Draft Decision.

- Office of Energy

In the Draft Decision, the Regulator has required that Chapter 8 of the Access Arrangement (Review Date) be amended to include trigger mechanisms enabling the Regulator, if the Regulator wishes, to initiate a review of the Access Arrangement in response to, amongst other triggers, increases in quantities of gas distributed above forecast increases by an amount of more than 50 percent of the forecast increases.

The Regulator considered that the Access Arrangement should provide for a significant difference between forecast and actual values used in the determination of Reference Tariffs to trigger a review of the Access Arrangement. Given the implicit uncertainty involved in forecasting throughput over the Access Arrangement period, the Regulator considered that a trigger mechanism based on actual throughput is appropriate, provided the trigger mechanism does not have an adverse effect on AlintaGas's incentives to increase network usage.

In view of the significantly different markets serviced by the various Reference Services and the likelihood of forecast growth in gas quantities varying significantly between those Reference Services, it may be appropriate that in addition a review is triggered in response to increases in quantities for specific Reference Services. Given that the market growth for Reference Service B3 can reasonably be expected to be proportionately greater than other Reference Services, Reference Service B3 appears to be one service for which an individual trigger may be appropriate. It is considered, however, that the proposed trigger of 50% of the forecast increase could be easily achieved in the case of Reference Service B3, which may create a disincentive for AlintaGas to grow that part of the market. A trigger substantially higher than the general trigger may need to be set for the Reference Service B3 if this approach is accepted.

In addition the Regulator may wish to consider whether the general trigger - 50% of the forecast increase, is set at a level sufficiently high to retain AlintaGas's incentives to grow the throughput of the distribution system for the long-term benefits of its customers.

The Office of Energy notes that both the ACCC (in its Draft Decision on the Central West Pipeline (NSW)) and IPART (in its Draft Decision on the AGL's gas network (NSW)) have required trigger mechanisms based on throughput volumes. Both regulators have required the respective Access Arrangements to be

reviewed, if, in any one year, contract market volume forecasts on which Reference Tariffs are based proved to be more than 25% inaccurate. The IPART considers that this mechanism leaves sufficient incentive for AGL to grow the NSW gas market in the Access Arrangement period.

The Regulator has given further consideration to the specification of trigger mechanisms in the Access Arrangement in light of the submissions from AlintaGas and the Office of Energy. In particular, attention has been given to:

- whether or not the Regulator can reserve discretion as to whether a review of an Access Arrangement should proceed once a defined trigger event occurs; and
- the specification of specific major events within the meaning of section 3.17 of the Code that would trigger an obligation on AlintaGas to submit revisions to the Access Arrangement prior to the Revisions Submission Date.

The Regulator has received legal advice to the effect that section 3.17 of the Code does not expressly give the Regulator any discretion as to whether a review of an Access Arrangement is initiated following the occurrence of a defined event. Once certain events have been defined as ‘specific major events’ for the purposes of section 3.17, their occurrence will oblige the Service Provider to submit revisions to the Access Arrangement in accordance with section 2.28 of the Code and the Regulator to conduct a review in accordance with the requirements of Part 2 of the Code. In view of this advice, the Regulator will alter the requirement for amendment of the Access Arrangement as stated in Draft Decision Amendment 25 to remove the discretionary provision for the Regulator in respect of initiation of a review.

The Regulator has re-assessed the specification of events that would trigger a review of the Access Arrangement in consideration of the inability of the Regulator to reserve discretion about whether a review process is initiated once a defined event occurs, and the consequent need to define the events that would trigger a review in such a manner that a review is only triggered where it is justified by the potential benefits from a review. In addition, the Regulator has taken into account that Amendment 44 of this Final Decision will require a change to the Access Arrangement to remove provisions for pass through of taxation and regulatory changes. As a consequence, the only means by which Reference Tariffs could be changed in response to such events is by a review of the Access Arrangement at the initiative of AlintaGas or where a review is triggered in accordance with section 3.17 of the Code.

Having had regard to the objectives for design of Reference Tariffs and a Reference Tariff Policy as set out in section 8.1 of the Code, the Regulator considers that it is appropriate for ‘specific major events’ for the purpose of section 3.17 of the Code to include events relating to:

- realised quantities of gas throughput significantly exceeding quantities forecast for the purposes of determining Reference Tariffs;
- significant changes in taxation liabilities of AlintaGas arising from a change in law; and
- significant changes to costs to the AlintaGas distribution business arising from changes in the regulation affecting the provision of services.

In determining an appropriate difference between realised and forecast quantities of gas throughput for the triggering of a review of the Access Arrangement, the Regulator took

particular account of the objectives for a Reference Tariff of replicating the outcome of a competitive market and providing an incentive to the Service Provider to develop the market for Reference and other services (sections 8.1(b) and 8.1(f) of the Code).

In a competitive market, it is likely that reductions in unit costs for a service such as gas distribution would be passed on to consumers in lower unit prices. In itself, this would suggest that the Access Arrangement should be reviewed for any excess of realised throughput over forecast throughput. However, permitting a Service Provider to capture windfall gains from increasing throughput to levels greater than forecast during the Access Arrangement Period may provide an incentive for that Service Provider to increase throughput. The benefits from increased throughput (through lower unit costs) would be passed on to Users in the next Access Arrangement Period. The Regulator considers that an excess in realised throughput of 25 percent of forecast throughput would be an appropriate event to trigger a review, consistent with the stance taken by other Australian Regulators.^{7,8}

This trigger mechanism should relate to total realised throughput of this distribution systems, rather than just realised throughput for Reference Services. Provision of a trigger mechanism for review of the Access Arrangement forms part of an incentive mechanism for AlintaGas to increase the size of the market for gas distribution. That is, an incentive for AlintaGas to increase the sales of distribution services is provided by the ability to capture windfall profits from increases in quantities of gas distributed up to the level at which a review of the Access Arrangement is triggered. The design of such a mechanism should be consistent with the objectives for an incentive mechanism set out in section 8.46 of the Code, including that the incentive mechanism should provide the Service Provider with an incentive to increase the volume of sales of all Services, but to avoid providing an artificial incentive to favour the sale of one service over another Section 8.46(a). With a view to meeting this objectives, the Regulator notes that a trigger event based on total throughput through the distribution systems is required, rather than throughput under Reference Services alone. Otherwise, an incentive would be created for AlintaGas to provide Non-Reference Services rather than Reference Services so as to avoid a review of the Access Arrangement and a likely reduction in Reference Tariffs.

The Regulator notes that the underlying purpose of a trigger event based on realised throughput quantity is to ensure a sharing between the Service Provider and Users of the benefits of increased revenues and profits, above some threshold level. A trigger event on quantity may not completely capture the increases in revenues. For example, if increases in throughput quantity do not occur with the same proportional spread across services and tariff components as assumed for calculation of the Reference Tariffs, then a 25 percent increase in throughput could conceivably give rise to a greater or lower proportional rise in revenues. Given this, a trigger event based on revenue may be more appropriate. However, a trigger event based on quantity has the advantages of being more readily observable, and being observable at an earlier date. On this basis, the Regulator has decided to use a trigger event based on quantity for the current Access Arrangement Period, but will re-examine the appropriateness of this approach when the Access Arrangement is reviewed.

⁷ ACCC, September 1999. Draft Decision, Central West Pipeline (NSW).

⁸ IPART, October 1999, Draft Decision, AGL Gas Network (NSW).

In defining events to trigger a review in response to changes in taxation and changes in regulation, the Regulator took into account AlintaGas's initial proposals in schedule 3 of the Access Arrangement for pass through of changes in costs from such events, including the provision for the Regulator to require AlintaGas to initiate such a pass through of cost changes. A primary consideration of the Regulator was the objective set out in section 8.1(b) of the Code that Reference Tariffs should replicate the outcome of a competitive market, which would see any cost reductions from changes in taxation or regulation passed through to consumers in lower prices. However, the Regulator also took into account that as these changes in costs may only be passed through to changes in Reference Tariffs by way of a review of the Access Arrangement, the changes in costs to trigger a review must be of a sufficiently high magnitude that the benefits of review of the Access Arrangement, and reductions to Reference Tariffs should exceed the costs of a review. The Regulator concluded that an appropriate magnitude of a cost change would be 2.5 percent of forecast revenue, corresponding to approximately \$2.5 million.

The Regulator has altered the requirements for amendment of the Access Arrangement as outlined in Draft Decision Amendment 25 to take into account the absence of discretion of the Regulator in initiating a review of the Access Arrangement, and the specification of events that would trigger a review, as indicated above. The Regulator has also given attention to the time period allowed for AlintaGas to submit revisions to the Access Arrangement after a trigger event has occurred. In the view of the Regulator, a period of three months is appropriate, consistent with the requirement of section 2.2 of the Code for a Service Provider to submit an Access Arrangement to the relevant regulator within 90 days after the relevant pipeline has become covered under the Code.

3.8.5 Required Amendments to the Access Arrangement

Amendment 24 [was Draft Decision Amendment 24]
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Clause 60 of the Access Arrangement should be amended to provide for a revisions submission date of 31 March 2004.
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Amendment 25 [was Draft Decision Amendment 25]

Chapter 8 of the Access Arrangement (Review Date) should be amended to specify that AlintaGas will submit revisions of the Access Arrangement to the Regulator:

- by 31 March in any year of the Access Arrangement Period if the quantity of gas delivered into the distribution systems in the preceding calendar year, corrected for forecast losses of unaccounted for gas, exceeded the forecast delivered volume for that year by 25 percent or more;
- within three months of the day on which a change in regulation that arises from a change in law takes effect, or the day on which it becomes sufficiently certain that the change will take effect, whichever is earlier, that has the effect of reducing the costs that AlintaGas is required to pay, or is likely to be required to pay, in the subsequent calendar year of the Access Arrangement Period in relation to its supply of one or more services by an amount of 2.5 percent or more of the Total Revenue for that calendar year; and
- within three months of a change in taxation that arises from a change in law takes effect, or the day on which it becomes sufficiently certain that the change will take effect, whichever is earlier, that has the effect of reducing the costs that AlintaGas is required to pay, or is likely to be required to pay, in the subsequent calendar year of the Access Arrangement Period in relation to its supply of one or more services by an amount of 2.5 percent or more of the Total Revenue for that calendar year.

For the purposes of the trigger events relating to regulatory or taxation changes, the time at which it is sufficiently certain that a change will take effect is the time the change receives royal assent or otherwise has the force of law.

3.9 OTHER COMPONENTS OF THE ACCESS ARRANGEMENT

3.9.1 Access Code Requirements

Section 2.24 of the Code requires that an Access Arrangement contain the elements and satisfy the principles set out in sections 3.1 to 3.20 of the Code. An Access Arrangement may, however, address matters or provide information beyond the requirements of sections 3.1 to 3.20 of the Code.

The Regulator may not refuse to approve a proposed Access Arrangement solely for the reason that the proposed Access Arrangement does not address a matter that sections 3.1 to 3.20 do not require an Access Arrangement to address. However, should an Access Arrangement address matters in addition to the requirements of sections 3.1 to 3.20 of the Code, then the Regulator has broad discretion to refuse to accept the Access Arrangement if the additional matters are considered not reasonable. In assessing any additional matters included in an Access Arrangement, the Regulator may take into account the factors listed in section 2.24 of the Code:

- (a) the Service Provider's legitimate business interests and investment in the covered pipeline;

- (b) firm and binding contractual obligations of the Service Provider or other persons (or both) already using the covered pipeline;
- (c) the operational and technical requirements necessary for the safe and reliable operation of the covered pipeline;
- (d) the economically efficient operation of the covered pipeline;
- (e) the public interest, including the public interest in having competition in markets (whether or not in Australia);
- (f) the interests of Users and Prospective Users; and
- (a) any other matters that the Relevant Regulator considers are relevant.

3.9.2 Access Arrangement Proposals

Chapter 9 of the Access Arrangement deals with two technical issues necessary for the integration of third party access to the AlintaGas network with third party access to the pipeline or pipelines used to supply gas into the AlintaGas network. The first issue is the use of a single receipt point for each interconnection between such a pipeline and a sub-network, and the second is the requirement that each User have a designated supplier.

3.9.3 Draft Decision

The Regulator, taking into account the factors listed in section 2.24 of the Code, concluded that the Access Arrangement is not reasonable in its present form in respect of two matters addressed in Chapter 9.

The required amendments to the Access Arrangement were as follows.

Draft Decision Amendment 26

Clause 63(3) of Chapter 9 of the Access Arrangement should be amended to make provision for AlintaGas to provide reasonable advance warning of curtailment of supply from the AlintaGas network to an interconnected pipeline.

Draft Decision Amendment 27

Clause 63(2) of Chapter 9 of the Access Arrangement should be amended to ensure that the additional information that AlintaGas may require from a User in respect of designated suppliers of gas to the network should be reasonable and consistent with the information that a prudent operator of the network would require. The Access Arrangement should also provide examples of the type of additional information that AlintaGas may require.

3.9.4 Responses to Submissions on the Draft Decision

Advance Warning of Curtailment of Supply

Draft Decision Amendment 26. Clause 63(3) of Chapter 9 of the Access Arrangement should be amended to make provision for AlintaGas to provide reasonable advance warning of curtailment of supply from the AlintaGas network to an interconnected pipeline.

- AlintaGas

AlintaGas strongly objects to Draft Decision Amendment 26 and submits that the Regulator should not require such an amendment in the Final Decision. The reasons for AlintaGas's response are as set out below.

AlintaGas considers that the Regulator has misapprehended the meaning of the phrase "interconnected pipeline". An "interconnected pipeline" is one which delivers gas into the system: see clause 63(3) of the Access Arrangement. A pipeline that is connected to the distribution network and into which gas is delivered from the distribution system is not an "interconnected pipeline". The point at which such a pipeline is connected to the distribution system would be considered a delivery point and as such reasonable advance warning of curtailment would be covered by clause 22(2) of schedule 7 of the Access Arrangement.

Draft Decision Amendment 26 arose from the Regulator's consideration of a submission made on the Access Arrangement by CMS Gas Transmission of Australia. In view of the submission from AlintaGas on this amendment, the Regulator sought clarification from CMS as to the particular matters of concern. CMS indicated a desire to have AlintaGas obliged to notify the operator of a transmission pipeline delivering gas into the AlintaGas gas distribution systems on behalf of a User if AlintaGas is to curtail the supply of the relevant distribution service or services to the User.

After further consideration, the Regulator is of the view that it is not appropriate to require amendment of the Access Arrangement to impose such an obligation on AlintaGas. Such an obligation would relate to arrangements between AlintaGas and the operator of an interconnected transmission pipeline and would be expected to be addressed in a contract for an interconnection service, which is a Non-Reference Service under the proposed Access Arrangement. In view of this, and the submission from AlintaGas on the issue, the Regulator will remove the requirement for amendment of the Access Arrangement indicated as Draft Decision Amendment 26.

Requirements for Information on Designated Suppliers of Gas

Draft Decision Amendment 27. Clause 63(2) of Chapter 9 of the Access Arrangement should be amended to ensure that the additional information that AlintaGas may require from a User in respect of designated suppliers of gas to the network should be reasonable and consistent with the information that a prudent operator of the network would require. The Access Arrangement should also provide examples of the type of additional information that AlintaGas may require.

- AlintaGas

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 27.

In the absence of substantive submissions on Draft Decision Amendment 27, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

3.9.5 Required Amendments to the Access Arrangement

Amendment 26 [was Draft Decision Amendment 27]

Clause 63(2) of Chapter 9 of the Access Arrangement should be amended to ensure that the additional information that AlintaGas may require from a User in respect of designated suppliers of gas to the network should be reasonable and consistent with the information that a prudent operator of the network would require. The Access Arrangement should also provide examples of the type of additional information that AlintaGas may require.

4 REFERENCE TARIFFS

4.1 INTRODUCTION

Section 3.3 of the Code requires that an Access Arrangement include a Reference Tariff for:

- (a) at least one Service that is likely to be sought by a significant part of the market; and
- (b) each Service that is likely to be sought by a significant part of the market and for which the Relevant Regulator considers a Reference Tariff should be included.

The principles used to determine Reference Tariffs are to be stated as a Reference Tariff Policy. Both the Reference Tariff Policy and the Reference Tariffs should be designed with a view to achieving the objectives set out in section 8.1 of the Code:

- (a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service;
- (b) replicating the outcome of a competitive market;
- (c) ensuring the safe and reliable operation of the pipeline;
- (d) not distorting investment decisions in pipeline transportation systems or in upstream and downstream industries;
- (e) efficiency in the level and structure of the Reference Tariff; and
- (f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Relevant Regulator may determine the manner in which they can best be reconciled or which of them should prevail.

AlintaGas has proposed Reference Tariffs for the four Reference Services. In accordance with the principles established by the Code, AlintaGas used a price path methodology for the determination of Reference Tariffs. With this approach, Reference Tariffs are determined in advance for the Access Arrangement Period. The Reference Tariffs follow paths that are forecast to deliver a revenue stream sufficient to cover projected costs of providing the services.

The Code provides a general procedure for the application of the price path methodology to the determination of Reference Tariffs. The steps in this general procedure are:

- estimation of an Initial Capital Base;
- estimation of Capital Expenditure;
- estimation of Non-Capital Costs;

- estimation of an appropriate Rate of Return;
- specification of a Depreciation Schedule;
- determination of Total Revenue;
- determination of a cost/revenue allocation across services;
- determination of Reference Tariffs; and
- specification of Incentive Mechanisms.

The Regulator considered the Reference Tariffs proposed by AlintaGas in light of each of these steps.

4.2 METHODOLOGY USED TO DETERMINE REFERENCE TARIFFS

4.2.1 Access Code Requirements

Section 8.3 of the Code provides for the methodology for determination of Reference Tariffs to be at the discretion of the Service Provider, subject to the Regulator being satisfied that the methodology is consistent with the objectives contained in section 8.1 of the Code. Notwithstanding this, section 8.3 of the Code suggests that Reference Tariffs may be determined by:

- (a) a price path approach, whereby a series of Reference Tariffs are determined in advance for the Access Arrangement Period to follow a path that is forecast to deliver a revenue stream calculated consistently with the principles in section 8 of the Code, but is not adjusted to account for subsequent events until the commencement of the next Access Arrangement Period; or
- (b) a cost of service approach, whereby the Tariff is set on the basis of the anticipated costs of providing the Reference Service and is adjusted continuously in light of actual outcomes (such as sales volumes and actual costs) to ensure that the Tariff recovers the actual costs of providing the Service; or
- (c) variations or combinations of these approaches.

4.2.2 Access Arrangement Proposal

AlintaGas has adopted a “price path” approach for the determination of Reference Tariffs and the changes in Reference Tariffs across the Access Arrangement Period.

4.2.3 Draft Decision

The Regulator recognised in the Draft Decision that the Code provides a Service Provider with discretion in determining the methodology used to determine Reference Tariffs, subject to the chosen methodology being consistent with the objectives of Section 8.1 of the Code. The adoption by AlintaGas of a price path methodology was deemed to be consistent with these requirements.

4.2.4 Responses to Submissions on the Draft Decision

No submissions were made on the Draft Decision in respect of the general methodology used by AlintaGas to determine Reference Tariffs.

4.2.5 Required Amendments to the Access Arrangement

The Regulator considers that the general methodology used by AlintaGas to determine Reference Tariffs is consistent with the requirements of the Code and no amendments to the Access Arrangement are required in this respect.

4.3 INITIAL CAPITAL BASE

4.3.1 Access Code Requirements

As part of an assessment of the first Access Arrangement for an existing covered pipeline, the Regulator is required by the Code to approve a value of the assets making up the pipeline (an Initial Capital Base). The Initial Capital Base is then treated under the Code as an historical cost that is carried forward to future regulatory periods by adjusting for depreciation, new capital expenditure and, where appropriate, redundant assets.

Sections 8.10 and 8.11 of the Code state the principles for establishing the Initial Capital Base. These principles apply to the Access Arrangement for the Mid-West and South-West Gas Distribution Systems.

Section 8.10 of the Code requires that a range of factors be considered in establishing the Initial Capital Base. These factors are described in more detail below, but relate generally to comparative analysis of different valuation techniques and the consideration of reasonable expectations of interested parties.

Section 8.11 of the Code states that the Initial Capital Base for covered pipelines that were in existence at the commencement of the Code normally should not fall outside the range bounded by the Depreciated Actual Cost (DAC)⁹ of pipeline assets and a Depreciated Optimised Replacement Cost (DORC) for the assets.

4.3.2 Access Arrangement Proposal

AlintaGas's determination of the Initial Capital Base of the distribution systems is described in section 3 of the Access Arrangement Information.

In deriving a value for the Capital Base, AlintaGas considered DAC and DORC values of distribution system assets.

A DAC value was estimated at \$299.7 million, being the book value of assets as at 30 June 1998. At the instigation of AlintaGas, this value was audited by the Western Australian

⁹ The term "Depreciated Actual Cost" is here given the meaning of section 8.10(a) of the Code as "the value that would result from taking the actual capital cost of the covered pipeline and subtracting the accumulated depreciation for those assets charged to Users (or thought to have been charged to Users) prior to the commencement of the Code".

Auditor General with the conclusion that it presents fairly the written down historical value of the assets.

The value derived by a DORC methodology was estimated as \$707 million as at 31 December 1998. This value was based on:

- an estimated Optimised Replacement Cost of network assets as at 30 June 1998 of \$1,001.4 million and a DORC of \$685.4 million derived by straight line depreciation of network assets over the technical lives of the assets;
- a valuation of non-network assets as at 30 June 1998 of \$22.7 million;
- Capital Expenditure in the period 1 July 1998 to 31 December 1998 of \$12.1 million; and
- depreciation for the period 1 July 1998 to 31 December 1998 of \$13.2 million.

In proposing an Initial Capital Base, AlintaGas claims that a DORC value has in-principle advantages of:

- providing “correct” signals for new facilities investment;
- enabling the effects of technological change, and of asset redundancy as a result of changes in gas demand, to be reflected in asset values and Reference Tariffs; and
- reducing the likelihood of economically inefficient investment decisions in upstream and downstream industries through basing Reference Tariffs on the “economic cost” of providing gas transportation services.

Notwithstanding the claimed advantages of a DORC valuation of the Capital Base, AlintaGas indicated that a DORC valuation is inappropriate as it would result in Reference Tariffs that exceed the current gas transportation costs that are implicit in AlintaGas’s current retail prices for gas, and hence potentially give rise to increased prices for gas delivered via the AlintaGas network.

AlintaGas proposed that an acceptable Initial Capital Base would be one that is based nominally on the DORC values of different asset categories, but with reductions in these values such that the resulting Reference Tariffs would be consistent with an acceptable Reference Tariff outcome for consumers of gas via the AlintaGas network. The criterion of “acceptability” was taken to be a requirement that the Reference Tariffs resulting from a valuation of the Initial Capital Base should be consistent with retail gas prices expected to prevail in the market during the Access Arrangement Period.

To derive an Initial Capital Base, AlintaGas therefore reduced DORC values of each category of assets to levels that purportedly return the same retail prices for gas as are expected to prevail over the Access Arrangement Period. This valuation is inextricably linked to the methodology used to determine a schedule of Reference Tariffs and the associated assumptions as to the rate of return, and allocation of costs across services. Furthermore, the valuation is dependent upon the assumptions as to costs and margins, other than the costs of gas distribution, that underlie retail gas prices.

The methodology used by AlintaGas to derive an Initial Capital Base is not described in detail in the Access Arrangement Information. Modelling by the Regulator indicates the methodology used by AlintaGas is approximately consistent with the following steps.

- Develop forecasts over the four-year period 2000 to 2003 for sales volumes and average retail prices for gas supplied from the AlintaGas network for each of the classes of customers corresponding to each Reference Service, and calculate forecasts of gross retail revenues for each Reference Service.
- Develop forecasts over the period 2000 to 2003 for the cost of gas, gas transmission costs, retail costs and retail margins for each of the classes of customers corresponding to each Reference Service, and subtract these costs and margins from the gross retail revenues to leave residual amounts that are the implicit distribution revenues for each Reference Service.
- Calculate the present value of the distribution revenues for each service over the period 2000 to 2003.
- Determine an Initial Capital Base (and values of the various asset classes) that will return the same present value for the target Total Revenue for each service, taking into account assumptions as to Non-Capital Costs, Capital Expenditure, method of depreciation and rate of return on capital.

The total value of the Initial Capital Base derived by AlintaGas is \$530.3 million as at 31 December 1998 and is referred to by AlintaGas as a deprival value on the basis that this is the Initial Capital Base that is necessary to maintain forecast revenue. The corresponding current cost accounting value of the Initial Capital Base as at 31 December 1999, taking into account forecast Capital Expenditure and depreciation in 1999, is \$539.4 million. The values proposed by AlintaGas for particular asset categories are indicated below, together with DORC values and the percentage of the DORC value of each category of assets.

In order to meet the criterion that the values ascribed to particular classes of assets must return a schedule of Reference Tariffs that would be consistent with retail gas prices expected to prevail in the market during the Access Arrangement Period, the reductions in DORC values were not uniform across asset classes. Relatively larger reductions were applied to classes of assets used predominantly to deliver gas to residential and small business consumers. The greatest proportional reduction occurred with “meters and service pipes”, “medium/low pressure mains” and “low pressure mains”. These assets are used predominantly to service residential and small-business consumers of gas and the reductions were undertaken to avoid increases in the cost of gas to these consumers.

AlintaGas proposed Initial Capital Base

Asset Class	DORC^a (\$million)	Proposed Regulatory Value (\$million at 30 December 1998)	Percent of DORC^b Value
Mains:			
High pressure	152.2	142.7	93.8
Medium pressure	206.6	169.8	82.2
Medium low pressure	118.4	96.8	81.8
Low pressure	34.6	28.0	80.9
Secondary gate stations	2.2	2.0	90.9
Regulators	9.0	8.9	98.9
Meters and service pipes	160.2	60.8	38.0
Telemetry and monitoring systems	1.1	1.0	90.9
Non network assets	22.7	20.3	89.4
Total	707.0	530.3	75.0

a. Non-network assets were not valued at DORC, but rather a range of valuation methodologies were used as described in the Access Arrangement Information (pp 22,23).

b. Calculated percentage reductions are approximate as no account is taken of distribution of depreciation and capital expenditure across classes of assets in the period 1 July 1998 to 31 December 1998. The error is, however, negligible as the values of depreciation and capital expenditure were small relative to the total asset values.

4.3.3 Draft Decision

In assessing the value of the Initial Capital Base proposed by AlintaGas, the Regulator considered several alternative valuation methodologies, the valuations that arise from these methodologies, and the advantages and disadvantages of each methodology and valuation in the context of the distribution systems.

In determining the most appropriate Initial Capital Base for the AlintaGas gas distribution systems, the Regulator considered a balance of interests between AlintaGas, Users and Prospective Users. In accordance with the proposal by AlintaGas, the Regulator accepted that AlintaGas's proposal to set the Initial Capital Base to be consistent with retail gas prices expected to prevail in the gas market during the Access Arrangement Period would provide a reasonable balance of interests between the relevant parties. The Regulator did, however, revise AlintaGas's proposed Initial Capital Base in accordance with revisions to assumptions used in the estimation of projected distribution revenues and assumptions as to distribution costs that underlie the revenue requirement for the distribution business.

In the Draft Decision, the Regulator concluded that AlintaGas's Initial Capital Base for the Mid-West and South-West Gas Distribution Systems should be \$510.4 million as at 31 December 1999.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 28

The Access Arrangement and Access Arrangement Information should be amended to reflect an Initial Capital Base of \$510.4 million as at 31 December 1999.

4.3.4 Responses to Submissions on the Draft Decision

DORC Valuation of Assets

- AlintaGas

The potential estimated valuation uncertainty in the DORC valuation in the order of \$200 million, as highlighted in the Draft Decision, is incorrect.

As noted above, the Regulator identified several areas of technical concern about the DORC valuation. The Regulator indicated that the concerns affected the reliance that could be placed on the estimated DORC value.

AlintaGas believes that the DORC valuation by GHD can be relied upon and provides a reasonable and accurate estimate of the DORC value of the AlintaGas distribution network. AlintaGas's comments on issues raised by the Regulator's consultants, Connell Wagner Pty Ltd¹⁰, are:

(a) The capacities of the low and medium- low pressure networks are on the whole at, or below, the actual requirements for gas distribution. There is essentially no opportunity for capacity optimisation in these areas.

In carrying out the valuation low-pressure systems were, however, replaced by medium pressure systems during the optimisation phase. The network configuration is also constrained by the locations of the existing customers.

As mentioned in the GHD report, the adopted optimisation was based on a system built using modern engineering equivalent assets and complying with industry best practice standards, including standards for security of supply. GHD has confirmed that the standards used for the design and construction of the distribution assets within AlintaGas are appropriate, comply with the relevant Australian standards, and are similar to standards used by all other gas businesses in Australia.

Therefore, the prime focus for the optimisation was the sizing of mains, the lengths required and the number of regulators needed to provide optimum pressures. AlintaGas and GHD consider this to be appropriate practice in this case.

(b) The asset list included low-pressure systems only for the purpose of identifying the existing systems. As described in the GHD report, all low-pressure system networks were optimised to operate at medium pressure. Also, as discussed above all low and low medium pressure systems are currently operating at capacity and there are limited opportunities for further optimisation in these systems.

(c) The five year growth projection was based on Ministry of Planning data and historical usage records from AlintaGas's Retail Marketing & Sales division. The growth projection was the same as that adopted by AlintaGas's marketing department for the purpose of retail marketing strategies.

(d) The unit rates adopted were generally comparable to those adopted by other utilities after taking into consideration locational and geographical factors.

(e) The unit rates for "brown-field" replacement of domestic services and meters used in the valuation, were appropriate and compatible with rates applied elsewhere in Australia. The unit rates used for capital expenditure budgeting purposes were generally appropriate for those works in the newer subdivision areas, where the majority of new connections occur. Those rates are not generally representative of brown-field conditions that affect the installation of new assets, as used in the DORC valuation.

¹⁰ Draft Decision Part B pp 77,78.

(f) The diversified consumption figures for residential and small commercial customers were derived from a 1999 load survey conducted for the distribution system, using results evaluated from flow and pressure data logging equipment located in the surveyed network areas. The field results corresponded closely with the diversified figures used in AlintaGas's computer modelling of the system and also with surveys conducted in previous years.

In AlintaGas's opinion, the consumption figures closely reflected the diversified load within AlintaGas's distribution system and were based on accepted gas industry methodology and sound engineering judgement.

In addition, some of the comments made in the reasons for decision seem to indicate that the distribution system was assessed by Connell Wagner as though it was a transmission system. Such an approach is incorrect as the two types of systems are very different and subject to different operating standards. The following comments highlight this point:

Temperature variation generally has more significant impact on transmission pressure systems than on distribution systems and has relatively minor impact in a distribution system. The temperature variance between gas flowing in distribution pipelines and the surrounding soil is relatively small throughout the year and has very little impact on the capacity (and optimisation) of distribution systems. Distribution pipelines have smaller pipe diameters and operate at significantly lower pressures than transmission systems. The temperature used in system optimisation closely corresponds to recent field survey results.

Linepack is considered irrelevant as it has limited application in distribution systems when compared to that which can be achieved with transmission systems. It is accepted industry practice to ignore line pack in distribution systems due to lower pressures, smaller pipe sizes and the interconnectivity of pipes in the network. Its impact on capacity through modelling of the distribution network is, therefore, considered insignificant for the reasons stated above. It is also insignificant because the network is currently operating close to its maximum allowable pressure and a significant portion of it is under capacity.

Due to the complexity in carrying out dynamic modelling and the limitations of the existing model capabilities, it was not practicable to carry out dynamic modelling to support valuation for AlintaGas's distribution system. Enquiries and knowledge of modelling for other gas distributors in Australia by GHD reinforces the belief that a static steady state model provides adequate optimisation support.

In addition, although no specific instructions were provided to GHD on the inclusion or exclusion of user-specific assets, the assets form part of the covered pipeline and should for the purposes of the DORC valuation be included to provide a guide as to the overall value of the network. They were appropriately excluded for tariff setting purposes.

AlintaGas, therefore, submits that the potential estimated valuation uncertainty in the order of \$200 million, as highlighted in the draft decision, is incorrect.

In assessing the estimate of the optimised replacement cost put forward by AlintaGas, the Regulator took advice from AlintaGas as to potential uncertainties in the valuation, given the information put forward in support of that valuation. The Regulator's initial assessment was that the optimised replacement cost may have been overestimated by up to \$200 million. The additional information provided by AlintaGas in its submission on the Draft Decision may go some way to removing this uncertainty as to the valuation. The Regulator notes, however, that given the methodology used by AlintaGas to value the Initial Capital Base, the estimated optimised replacement cost and DORC values of the distribution system assets are largely inconsequential other than providing an indication of an upper bound on the regulatory value of assets. AlintaGas's proposed Initial Capital Base of \$517 million as at 31 December 1998 would be close to lower bound estimate the DORC value, taking into account the \$200 million uncertainty in the estimated optimised replacement cost. The Regulator therefore did not seek to arrive at an agreed estimate of the optimised replacement cost of assets for the purposes of this Final Decision.

Initial Capital Base Value of less than DORC

- Western Power Submission 2

The massive asset write-down (from approximately \$700m to \$510m) taken by AlintaGas is of some concern. The fact that the initial asset base value has been set to allow a positive retail margin for the current retail tariffs suggests that retail tariffs are unsustainably low.

Unless the asset base is written down to the same extent at each full regulatory review, it is difficult to see how the access prices can continue to trend down in real terms. If assets are perpetually written down then the Service Provider will not be able to afford to replace the existing assets. This appears to be a significant risk to the Service Provider.

Whilst Western Power understands that the current Regulator is unable to bind future Regulators or decisions (except through Fixed Principles), Western Power considers it would be appropriate for the Regulator to state in the Final Decision that:

- the large initial asset write down is made for specific retail profitability outcomes and does not represent the optimal long run asset base nor equitable nor efficient pricing outcome for the Service Provider; and
- future asset write-downs are appropriate only when the new investment fails to pass technical or economic efficiency tests.

The Regulator interprets the submission from Western Power as indicating a concern over the regulatory treatment of new capital investment.

The Regulator notes that a valuation of assets at less than the DORC value does not necessarily constitute a “write down” in the value of the assets, nor necessarily result in an under-recovery of capital investment. Rather, it can be interpreted as the value within the range of possible values that has been assigned to the Service Provider’s existing assets, having regard to the factors prescribed in section 8.10 of the Code.

It is important to note, however, that it is only with respect to the Service Provider’s *existing assets* that the Regulator is required to set a reasonable value within a range, having regard to fairly broad criteria. The Code requires *new investment* to be valued at the actual cost (section 8.15), unless the investment is imprudent (section 8.16(a)) or fails to pass one of the roll-in tests (section 8.16(b)). In addition, once new investment is included in the Capital Base, it can only be “removed” or “written down” if the redundant capital provisions of the Code are invoked (sections 8.27 to 8.29), which include a number of safeguards for the Service Provider. Accordingly, the Code provides a degree of certainty over the valuation of new investment.

Deprival Value Methodology for Valuation of the Initial Capital Base

- CMS Gas Transmission of Australia Submission No. 2

CMS questions the appropriateness of AlintaGas’s methodology to calculate the Initial Capital Base. In the Draft Decision, OffGAR have treated it as if it were an application of Optimised Deprival Value. However, it is neither a Deprival Value Methodology nor has it been adequately justified in the AlintaGas Access Arrangement Information in any other acceptable manner.

Consistently throughout the Draft Decision OffGAR detail their concern about the methodology used by AlintaGas to calculate the Initial Capital Base but despite highlighting the lack of valid argument, inexplicably support it.

In any event, the argument for deprival value as a valuation of the Initial Capital Base breaks down in application to this situation of regulated tariffs. If the deprival value is determined as the net present value

of expected future returns, then there is a circular argument in an industry where tariffs are regulated. This arises where regulated tariffs provide for a reasonable rate of return to an Initial Capital Base valued as a net present value of future returns, but the net present value of future returns depends upon the regulated tariffs.

CMS Proposal: OffGAR direct AlintaGas to provide a more detailed explanation of how the Initial Capital Base was calculated so that the public can determine whether the deprival value approach taken by AlintaGas is reasonable.

The Regulator noted in the Draft Decision that the “deprival value” methodology used by AlintaGas to value the Initial Capital Base is inconsistent with generally accepted methodologies for determining deprival values that are based upon the net present value of expected future cash flows.¹¹ However, the Regulator noted that there was a general conceptual similarity in the methodology used by AlintaGas and more conventional methodologies, and that the AlintaGas methodology was accepted in the Draft Decision by the Regulator as producing a value that is generally indicative of a deprival value.

The methodology used by AlintaGas for valuation of the Initial Capital Base was also considered by the Regulator to be consistent with the approach typically taken by gas pipeline regulators in Australia, which is to contemplate a value of the Initial Capital Base that is consistent with tariffs for gas transmission/distribution that are not higher than existing charges.¹² Largely on this basis, the Regulator accepted the general methodology used by AlintaGas as being appropriate. It is noted that imposing a constraint on future prices breaks the circularity referred to by CMS. The Regulator’s revision in the Draft Decision of the value ascribed to the Initial Capital Base arose from differences from AlintaGas in the assumptions made in applying that methodology.

Cross Subsidies Implicit in Valuation of the Initial Capital Base

- CMS Gas Transmission of Australia Submission No. 2

AlintaGas has proposed that an acceptable Initial Capital Base would be one that is based nominally on the DORC values of different asset categories. AlintaGas has allocated these DORC values and scaled them such that the resulting Reference Tariffs would be consistent with retail gas prices expected to prevail in the market during the Access Arrangement Period.

CMS questions the validity of AlintaGas's disproportionate reallocation of the asset base that results in a cross-subsidy from large customers to smaller customers. CMS views this calculation as an attempt by AlintaGas to artificially protect its customer base by keeping large contestable customers’ distribution tariffs high whilst lowering tariffs to smaller customers that are not yet contestable.

The Regulator does not consider that the differential reduction of asset values from DORC values constitutes cross subsidisation of services or Users.

Concerns about cross subsidies arising though the methodology used by AlintaGas for valuation of the Initial Capital Base were addressed in the Draft Decision in response to a previous public submission.¹³ It was noted that the allocation of sunk capital costs does not have any bearing on cross subsidies between services or Users. Rather, tests of the existence of cross subsidies relate to whether a User may be paying more than the stand alone cost of providing a service to that User, in which case that User is arguably subsidising other Users,

¹¹ Draft Decision, Part B p79.

¹² Draft Decision, Part B p90.

¹³ Draft Decision, Part B pp73,74.

and whether a User is being charged less than the avoidable cost of the service they are receiving, in which case the User is arguably receiving a cross subsidy. There was no evidence of either of these situations occurring in respect of the Reference Tariffs proposed by AlintaGas.

The Regulator is of the view that there is no evidence for an adverse effect of the allocation of Capital Costs on potential competition in provision of gas to end-users under Reference Services A and B1. This matter will, however, be examined in light of experience at the time of review of the Access Arrangement.

Assumption of a Retail Margin for the Purposes of Valuation of the Initial Capital Base

- AlintaGas

AlintaGas objects to Draft Decision Amendment 28 and submits that the Regulator should not require such an amendment in the Final Decision.

AlintaGas objects to Draft Decision Amendment 28 for the following reasons.

(a) It is not necessary for the Regulator to require a 2 percent net retail margin for each Reference Service in each year of the Access Arrangement Period.

(b) As section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* (“section 38”) is not capable of being applied and could not be taken into account in assessing the value of the Initial Capital Base.

(c) Even if section 38 were capable of being applied and could have been taken into account in assessing the value of the Initial Capital Base:

i. The Regulator failed to comply with an obligation to give reasons under section 7.7 because no explanation was given of the Regulator’s interpretation of section 38 of the *Gas Pipelines Access (Western Australia) Act*.

ii. Reference Tariffs B2 and B3 and the Initial Capital Base should be accepted as they were proposed because they are consistent with the purpose of section 38, which is to require the Regulator to consider fixing distribution and transmission tariffs that are reasonably uniform so as to enable the maintenance of reasonably uniform retail tariffs across the Mid-West and South-West areas of the State.

iii. The Regulator’s interpretation of section 38 as requiring the provision of a 2 percent net retail margin for each Reference Service is incorrect because it goes beyond the intent of section 38.

iv. Even if the Regulator’s interpretation of section 38 were correct, nothing in section 38 requires that the Regulator provide a 2 percent net retail margin for each Reference Service.

v. Even if the Regulator’s interpretation of section 38 were correct, it is unnecessary to provide for a 2 percent net retail margin by reducing the Initial Capital Base. Reducing the Initial Capital Base is only one way of achieving the objective of section 38, and an overall retail margin will provide sufficient incentive for retailers to compete for the custom of small business and retail consumers.

vi. If the Regulator’s interpretation of section 38 were correct, in determining the Initial Capital Base the Regulator should take into account the fact that there are other ways in which the AlintaGas retail business can achieve a 2 percent net retail margin for each Reference Service, including reducing the costs of retail operations and negotiating more favourable prices for gas purchase and gas transmission.

vii. If the Regulator’s interpretation of section 38 is correct, any consideration of extending competition in the supply of gas to small business and residential consumers must be undertaken by reference to the gas purchase, gas transmission and retail costs that would be incurred by a new market entrant – not by the costs of AlintaGas’s retail business.

viii. The Regulator has unreasonably attached too much weight to the factors that the Regulator is required to consider under section 38. As a consequence, the Regulator has failed to give appropriate weight to other factors that the Regulator is required to consider under section 2.24. The Regulator should give other factors, including the legitimate business interests of AlintaGas, greater weight than was given in deciding

to include Amendment 28 in the Draft Decision, with the result that the Regulator does not require that Reference Tariff B3 provide a 2 percent net retail margin.

ix. The Regulator did not reasonably balance the interests of AlintaGas and other participants in the gas market that are in a position to contribute to the achievement of a 2 percent margin. This has unreasonably subordinated AlintaGas's interests to the interests of other participants in the gas market.

x. The Regulator may have erred in relation to comments in the Draft Decision on a shift in revenue from AlintaGas's retail business to AlintaGas's distribution business.

Detail of AlintaGas's reasoning in regard to each of the above arguments is provided in Attachment D of AlintaGas's submission to the Regulator on the Draft Decision.

AlintaGas's principal objection to the analysis presented in the Draft Decision appears to be that the Regulator's assumption of a two percent net retail margin for each Reference Service was unreasonable for the purpose of determining the Initial Capital Base.

AlintaGas has also objected to the Regulator's view that section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* requires the Regulator to take account of the extension of effective competition to the supply of gas to residential and small business customers when assessing Reference Tariffs, including the valuation of the Initial Capital Base.

Section 38 of the Gas Pipelines Access (Western Australia) Act applies where:

- (a) the Regulator is assessing a proposed Access Arrangement to determine whether it should be approved under the Code; and
- (b) for that purpose is required by the Code to take the public interest into account.

Where section 38 applies, the Regulator, in the fixing of appropriate charges for gas transmission and distribution, is to take into account the extension of effective competition in the supply of natural gas to residential and small business customers. The Reference to appropriate charges is to charges for the use of a pipeline to transport small quantities of natural gas that will enable suppliers to compete for the custom of residential and small business consumers. For section 38 to operate, a "small quantity" of gas must be defined through being prescribed by the Minister by order published in the Gazette.

On the basis of legal advice, the Regulator is of the view that the impact of AlintaGas's assumptions as to retail margins on potential competition in the retail market for gas delivered under Reference Services B2 and B3 is a relevant consideration under section 38 of the *Gas Pipelines Access (Western Australia) Act 1998*, subject to the Minister having prescribed the quantity of gas that is a small quantity for the purposes of section 38. An order by the Minister was published in the Government Gazette on 28 June 2000 prescribing a small quantity of gas to be a quantity that is less than one terajoule in any period of 12 consecutive months.¹⁴

The Regulator has given further consideration to the assumptions that should be made about retail margins for the purpose of applying AlintaGas's asset valuation methodology. Subsequent to its submission on the Draft Decision, AlintaGas indicated that the assumptions it made about the cost of gas retailing for the purpose of calculating the implied net retail margin associated with the different tariff classes may not reflect an efficient retailing cost. If

¹⁴ Government Gazette, WA, 28 June 2000 p3814.

the cost incurred by a new entrant retailer was lower than that assumed by AlintaGas (for example, if the new entrant could realise synergies with other retailing activities), then the implied net retail margin for that retailer would be correspondingly higher.

In light of AlintaGas's comments, the Regulator has accepted that, for the purpose of making an assumption about the required retail margin (which is necessary to apply AlintaGas's methodology for determining the Initial Capital Base), it would be more appropriate to make an assumption about the *gross retail margin* rather than the *net retail margin*. Focussing on the gross retail margins will ensure that the cost of gas retailing, as well as the profit element, is benchmarked against other retailers.

As noted in the Draft Decision, there are few benchmarks of retail margins on which to draw conclusions as to the adequacy of the retail margins assumed by AlintaGas for competition in retail gas markets. IPART has proposed a gross retail margin of 6.6 percent of sales turnover for franchise electricity retailers in NSW, corresponding to absolute gross retail margins of approximately \$60 per customer in 1997/98.¹⁵ A similar gross retail margin of \$61 per customer was approved by IPARC for retail electricity supply in the ACT, including metering costs.¹⁶ These gross margins are consistent with observed average gross retail margins, including metering costs, of \$A50 for 14 electricity retailers in the United Kingdom.¹⁷

For the retail sale of gas, IPART has observed a gross retail margin of 4.6 percent in one regional market, including retail costs of \$17 per tariff market customer and net retail margins of 2 to 3 percent.¹⁸ IPART has estimated gross retail margins for tariff customers of the NSW gas retailer AGL Retail and Energy Limited to be 9.9 percent of tariff revenue, or \$46 per tariff customer, in 1998/99.¹⁹ These margins do not include metering costs, which are borne by the gas distributor.

The average gross retail margins implicit in AlintaGas's forecast distribution range between \$44 and \$51 per customer for different years of the Access Arrangement Period (14.7 to 17.0 percent of retail revenue) for Reference Service B3, and \$61 to \$85 per customer (11.5 to 15.1 percent of retail revenue) for all Reference Services in total. While there may be some differences in definitions of retail margins underlying the AlintaGas retail margins and those of other businesses, the margins assumed by AlintaGas appear consistent with margins that may occur in competitive retail markets. Assumed gross retail margins for Reference Services A, B1 and B2 do not appear inconsistent with those that may occur in a competitive retail market. On this basis, the Regulator is prepared to accept AlintaGas's proposed Initial Capital Base of \$517.6 million (excluding user-specific assets) as at 31 December 1998.

¹⁵ IPART, June 1999. *Pricing for Electricity Networks and Retail Supply*. Note that it is not clear from the IPART report whether metering costs are met from the gross retail margin, in which case this margin would have to be reduced to be comparable with gross retail margins in the retail market for gas.

¹⁶ Independent Pricing and Regulatory Commission, *ACTEW's electricity, water and sewerage charges for 1999/2000 to 2003/4, Price Direction*, cited in IPART, June 1999. *Pricing for Electricity Networks and Retail Supply*.

¹⁷ IPART, May 2000. *Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW*, Draft Report, p25.

¹⁸ IPART, October 1999, Draft Decision Review of the Delivered Price of Natural Gas in Wagga Wagga and Albury.

¹⁹ IPART, May 2000. *Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW*, Draft Report, p26.

The Regulator will, however, require that the Initial Capital Base be established at a value as of 31 December 1999. To determine this value, the Regulator has escalated the Capital Base value from 31 December 1998 to 31 December 1999 taking into account AlintaGas's forecast capital expenditure in 1999, depreciation in 1999, and the actual inflation rate in 1999 of 1.8 percent. The resulting value of the Initial Capital Base as at 31 December 1999 is \$535.9 million.

4.3.5 Required Amendments to the Access Arrangement

Amendment 27 [was Draft Decision Amendment 28]

The Access Arrangement and Access Arrangement Information should be amended to reflect an Initial Capital Base of \$535.9 million as at 31 December 1999 with a breakdown as follows:

Asset Class	Asset Value at 31 December 1999
High pressure mains	\$149.1 million
Medium pressure mains	\$177.0 million
Medium low pressure mains	\$96.2 million
Low pressure mains	\$27.8 million
Meters	\$52.8 million
Regulators	\$9.7 million
Gate Stations	\$2.0 million
Buildings	\$1.7 million
Equipment and vehicles (SCADA) & telemetry systems	\$15.1 million
Land	\$4.5 million
Total	\$535.9 million

4.4 CAPITAL EXPENDITURE

4.4.1 Access Code Requirements

Sections 8.15 to 8.21 of the Code provide for Capital Expenditure on a covered pipeline and associated regulated assets to be incorporated into the Capital Base of the pipeline, and for forecast Capital Expenditure to be considered in determination of Reference Tariffs.

The Capital Base of a covered pipeline may be increased from the commencement of a new Access Arrangement Period to recognise additional capital costs incurred in constructing New Facilities for the purpose of providing services, subject to the New Facilities Investment meeting certain criteria.

Section 8.16 of the Code sets out criteria that must be met by any New Facilities Investment if the actual capital cost of that investment is to be added to the Capital Base. These criteria are:

- (a) the amount of the capital cost does not exceed the amount that would be invested by a prudent Service Provider acting efficiently, in accordance with accepted good industry practice, and to achieve the lowest sustainable cost of delivering services; and

(b) one of the following conditions is satisfied –

- i. the Anticipated Incremental Revenue generated by the New Facility exceeds the New Facilities Investment; or
- ii. the Service Provider and/or Users satisfy the Relevant Regulator that the New Facility has system-wide benefits that, in the Relevant Regulator's opinion, justify the approval of a higher Reference Tariff for all Users; or
- iii. the New Facility is necessary to maintain the safety, integrity or contracted capacity of services.

Section 8.17 of the Code sets out two factors that the Regulator must consider in determining whether Capital Expenditure meets the criteria set out in section 8.16:

- (a) whether the New Facility exhibits economies of scale or scope and the increments in which capacity can be added; and
- (b) whether the lowest sustainable cost of delivering Services over a reasonable time frame may require the installation of a New Facility with capacity sufficient to meet forecast sales of services over that time frame.

Section 8.18 of the Code allows for a Reference Tariff Policy to state that the Service Provider will undertake New Facilities Investment that does not satisfy the requirements of section 8.16, and for the Capital Base to be increased by that part of such investment which does satisfy section 8.16 (the Recoverable Portion). Section 8.19 of the Code allows for an amount of the balance of the investment to be assigned to a Speculative Investment Fund, and to be added to the Capital Base at some future time if the criteria of section 8.16 come to be met. Section 8.19 also sets out the manner in which the value of the Speculative Investment Fund is determined at any time.

Section 8.20 of the Code provides for Reference Tariffs to be determined on the basis of New Facilities Investment that is forecast to occur within the Access Arrangement Period provided that the investment is reasonably expected to pass the requirements in section 8.16 when the investment is forecast to occur. This does not, however, mean that the forecast New Facilities Investment will automatically be added to the Capital Base after it has occurred (section 8.21). Rather, the Regulator will assess whether the investment meets the criteria of section 8.16 of the Code either at the time of review of the Access Arrangement or, if asked to do so by the Service Provider, at the time at which the investment takes place.

Section 8.22 of the Code requires that either the Reference Tariff Policy should describe, or the Regulator shall determine, how the New Facilities Investment is to be determined for the purposes of additions to the Capital Base at the commencement of the subsequent Access Arrangement Period. This includes whether (and how) the Capital Base at the commencement of the next Access Arrangement Period should be adjusted if the actual New Facilities Investment is different from the forecast New Facilities Investment.

Sections 8.23 to 8.25 of the code set out provisions for New Facilities Investment to be financed in whole or in part of capital contributions from Users, or from surcharges over and above Reference Tariffs to be levied on Users.

4.4.2 Access Arrangement Proposal

AlintaGas provided details of planned Capital Expenditure in sections 3.5 and 3.6 of the Access Arrangement Information. Further information on Capital Expenditure, including a more detailed breakdown, was made available to the Regulator. The forecast Capital Expenditure is summarised as follows.

Forecast Capital Expenditure (nominal \$million; year ending 31 December)

Type of investment	2000	2001	2002	2003	2004	Total
High pressure mains	4.0	3.6	3.0	2.6	2.0	15.2
Medium/low pressure mains:						
Infill	1.1	0.5	0.0	0.0	0.0	1.6
Re-laying program	2.2	2.5	2.5	2.7	2.8	12.7
Capacity reinforcement	0.3	0.1	0.2	0.2	0.1	0.9
Mains extensions	4.0	4.2	4.5	4.6	4.7	22.0
Meters and service pipes	8.2	7.8	7.8	7.6	7.5	38.9
Telemetry and monitoring systems	0.1	0.1	0.1	0.3	0.1	0.7
Equipment and vehicles:						
Information systems	3.8	1.4	0.5	1.6	0.6	7.9
Vehicles, plant and equipment	3.0	1.1	0.8	1.1	0.7	6.8
Buildings	0.1	0.1	0.1	0.1	0.1	0.5
Total	26.8	21.4	19.5	20.9	18.5	107.2

4.4.3 Draft Decision

The Regulator made an assessment of the forecast Capital Expenditure on the basis of a breakdown of expenditure and additional supporting information provided by AlintaGas on a confidential basis.

In general, the Regulator considered that the forecast of Capital Expenditure is insufficiently substantiated in terms of the requirements set out in section 8.16 of the Code. Furthermore, the Regulator noted that for some items of Capital Expenditure, the forecast unit rates underlying the forecasts were in excess of rates that may be regarded as consistent with efficient costs.

Notwithstanding the insufficient justification for Capital Expenditure forecasts, the Regulator accepted that New Facilities Investment of the types proposed by AlintaGas may meet the requirements of section 8.16(b) of the Code in respect of net benefits accruing from that investment. The Regulator therefore accepted AlintaGas's proposed New Facilities Investment for the purposes of determining Reference Tariffs subject to two revisions:

- i. downwards adjustment of the forecast expenditure on high pressure mains and medium/low pressure mains to reflect unit rates that are consistent with historical unit rates; and
- ii. removal from the capital expenditure forecast of expenditure on the galvanised steel medium/low pressure mains relaying program, on the basis that this program had not been approved by the AlintaGas Board as of the date of issue of the Draft Decision and no justification was provided for the expenditure in terms of the requirements of section 8.16 of the Code.

The revised schedule of Capital Expenditure is as follows.

Revised Capital Expenditure (nominal \$million; year ending 31 December)

Type of investment	2000	2001	2002	2003	2004	Total
High pressure mains	3.8	3.5	3.0	2.6	2.0	14.9
Medium/low pressure mains:						
Capacity reinforcement	0.3	0.1	0.2	0.2	0.1	0.9
Infill	0.5	0.2	0.0	0.0	0.0	0.8
Re-laying program	2.2	2.5	1.12	0.0	0.0	5.9
Mains extensions	3.5	3.7	4.0	4.1	4.2	19.4
Meters and service pipes	8.2	7.8	7.8	7.6	7.5	38.9
Telemetry and monitoring systems	0.1	0.1	0.1	0.3	0.1	0.7
Equipment and vehicles:						
Information systems	3.8	1.4	0.5	1.6	0.6	7.9
Vehicles, plant and equipment	3.0	1.1	0.8	1.1	0.7	6.8
Buildings	0.1	0.1	0.1	0.1	0.1	0.5
Total	25.5	20.5	17.7	17.7	15.3	96.6
Total proposed by AlintaGas	26.8	21.4	19.5	20.9	18.5	107.2

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 29

The Access Arrangement and Access Arrangement Information should be amended to reflect Capital Expenditure of \$96.6 million over the Access Arrangement Period, as described in this Draft Decision and reflecting reductions in forecast unit rates for New Facilities Investment.

The Regulator noted in the Draft Decision that acceptance of a revised forecast of Capital Expenditure does not mean that the associated New Facilities Investment will automatically be added to the Capital Base after it has occurred. Rather, the Regulator will assess whether

the investment meets the criteria of section 8.16 of the Code either at the time of review of the Access Arrangement or, if asked to do so by AlintaGas, at the time at which the investment takes place. In assessing any proposed additions to the Capital Base, the Regulator will require more rigorous demonstration that the investment meets the requirements of section 8.16 of the Code than was provided in the documentation for the Access Arrangement.

4.4.4 Responses to Submissions on the Draft Decision

- AlintaGas

AlintaGas acknowledges that the assessment of forecast new facilities investment for compliance with sections 8.16 and 8.20 requires that judgments be made about a wide range of matters. As a result, AlintaGas accepts that it is open for the Regulator to reach conclusions about forecast new facilities investment that are inconsistent with AlintaGas's views about forecast new facilities investment.

AlintaGas does not, however, accept that the Regulator's conclusions are reasonable. AlintaGas did not put forward an "ambit claim" with respect to forecast new facilities investment and submits that its proposal was reasonable and arrived at on a reasonable basis.

Comments on the Regulator's revisions to Capital Expenditure are as follows.

- Reduction in re-laying programme expenditure by \$6.8 million over the period of the Access Arrangement Period.

AlintaGas submits that this is unreasonable and that the re-laying program represents forecast investment that would be incurred by a prudent Service Provider, acting efficiently and in accordance with good industry practice. It meets the test of 8.16 in that it is necessary to maintain the safety and integrity of the distribution system.

AlintaGas believes that it has provided sufficient justification for the program, the main justifications being:

(a) AlintaGas considers that the relaying or replacement of ageing parts of the network is in accordance with good industry practice and is a normal part of a prudent Service Provider's ongoing capital works program;

(b) The program is considered essential for minimising gas losses, and thereby minimising the environmental impact of the network, improving the overall integrity of the network and ensuring public safety;

(c) The redundant parts of the network are generally operated at low pressures to minimise losses and the relaying program allows the upgrading of these systems to medium pressure and for the connection of more customers. Without such a program further customer connections to these parts of the network would not be possible; and

(d) The current cast iron relay program was extended to 2008 after subsequent investigations indicated that it was prudent to include the replacement of galvanised and unprotected steel mains and services that were considered to be in poor condition.

(e) AlintaGas has reasonably forecast the ongoing replacement of ageing parts of the system and strongly objects to the \$6.8 million reduction of New Facilities Investment in relation to the relaying program.

- Revision of expenditure on mains extensions for new customers to reflect historic unit rates.

The Draft Decision states that the Regulator does not consider that AlintaGas has adequately demonstrated that the proposed unit rate is consistent with efficient costs. The Regulator has adjusted the proposed rates by taking the historic unit rates and adjusting them for inflation.

The Regulator states that the difference between the historical average cost and that proposed in the Access Arrangement is significantly greater than that which could be attributed to inflation.

AlintaGas does not agree with the Regulator's methodology. Firstly, it is AlintaGas's view that the approach is inappropriate as it is based on historic rates which do not always serve well as a guide to future costs. AlintaGas submits that the Regulator should not rely solely on historic rates. The fact that certain unit rates may have been incurred in the past does not mean that they will be incurred in the future. For that reason, in accordance with sound financial practice, AlintaGas did not rely solely on historic unit rates in determining forecast new facilities investment.

AlintaGas has already provided information to Ofgas to support medium/low pressure unit rates. That information indicated that historical rates for medium/low pressure mains laying are not good indicators of future laying rates. It also clearly shows that laying rates vary considerably.

AlintaGas did not estimate the cost of new medium/low pressure mains construction on the basis of average laying rates. Rather, AlintaGas took into account the many factors that influence laying rates, including but not limited to:

ground conditions;

location (that is, rural versus urban);

laying technique (that is, whether common trenching is used)

the mix of anticipated work between periods; and

contingency for increases in unit rates.

The mix of anticipated extension activity between periods can vary significantly. Factors that determine that mix include, but are not limited to, the number of ad-hoc mains extensions, the amount of infill work and the number and scale of new subdivisions. These factors render comparisons between periods difficult and suggest that the use of simple historical averages to predict future costs is not always appropriate.

AlintaGas also contends that CPI is not the only factor to affect the cost of laying the pipes. For example, recent increases in the price of raw materials has resulted in increases in prices for PVC and PE pipe and fittings ranging from 20% to 54%, and rates for laying of mains by common trenching contractors are yet to be finalised, as rate increases requested by the contractors are yet to be negotiated.

AlintaGas submits that these are two recent examples of prices being very much market driven and open to influence from a number of factors. The Service Provider must reasonably be allowed to include some contingency component in estimates, or all the risk and uncertainty associated with estimates will be borne by the Service Provider. It is AlintaGas's view that these examples further support the appropriateness of AlintaGas's approach.

AlintaGas submits that the Regulator's approach of basing medium/low pressure mains new facilities investment on an historic unit rate is not appropriate. A prudent Service Provider acting in accordance with the requirements of the efficiency test under section 8.16 would base its proposed investment on the factors considered by AlintaGas. The Regulator should, therefore, accept the proposed new facilities investment for medium/low pressure mains proposed by AlintaGas.

In light of the above, AlintaGas believes that it is proper and necessary for the Regulator to consider the comments set out in Attachment E of its submission on the Draft Decision. Given AlintaGas's ODV methodology for valuation of the Initial Capital Base, AlintaGas would propose to discuss with the Regulator the impact of forecast new facilities investment prior to the issue of the Final Decision.

The decision the Regulator has to make at this time in respect of New Facilities Investment is the level of capital expenditure that should be *assumed* for the purpose of establishing price controls for AlintaGas's regulated distribution activities. The Regulator is not approving or disapproving individual projects, nor will AlintaGas be required to spend the New Facilities Investment the Regulator has assumed for the purposes of determining the price controls. The question of whether or not to invest in a particular project, and the priorities that are attached to individual projects, will be matters for AlintaGas to determine. An important objective of the regulatory regime is then to create an environment within which AlintaGas

has the incentive to make efficient investment decisions to ensure that only efficient investment ultimately is included in the Capital Base.²⁰

In general, the Regulator has adopted a conservative approach when assessing whether the benchmark for capital expenditure proposed by AlintaGas reflects a reasonable forecast of expenditure over the Access Arrangement Period which is likely to meet the requirements of section 8.16 of the Code. This position reflects, amongst other things, the fact that modest changes to the forecast of capital expenditure over the regulatory period do not have a significant effect on price levels, and that a more important objective is to provide incentives for actual expenditure to be efficient. In the Draft Decision, however, the Regulator considered (on the basis of engineering advice) that two changes to AlintaGas's proposed benchmark for capital expenditure were justified:

- to revise downwards the assumption that is made about future unit costs for mains extensions for new customer connections to reflect AlintaGas's historically incurred unit costs; and
- to remove from consideration the forecast expenditure for relaying the galvanised steel medium/low pressure mains given the absence of justification for the program and, in particular, any analysis of the relative merits of insertion of techniques).

The Regulator has not been convinced that the benchmark adopted for future capital expenditure in the Draft Decision was unreasonable.

Regarding the assumption that is adopted about future unit costs, a common theme in AlintaGas's submission was the level of uncertainty associated with unit costs for main extensions. In addition, the Regulator is also mindful of the information asymmetry that exists between the Regulator and AlintaGas over the trends in factors that may affect future unit costs, and the level of supportive information that has been provided by AlintaGas. Given these factors, the Regulator remains unconvinced that the use of historically incurred unit costs are likely to provide an unbiased forecast of future unit costs.

Equally, the Regulator has not been convinced that the benchmark for capital expenditure should include an assumption about expenditure on the mains relaying program. In particular, while AlintaGas's submission included a number of assertions about the relative merits of the program, it did not address the specific issues that were raised in the Draft Decision (in particular, a quantitative assessment of the relative merits of the program compared to insertion techniques, a quantitative assessment of the cost of the program against the benefits associated with UAFG reduction, and other matters relevant to section 8.16). As discussed above, however, AlintaGas is responsible for determining the level and priority of capital expenditure (subject to its obligations with respect to service delivery). If AlintaGas considers the mains relaying program to be the most appropriate way of providing the outputs it has identified, it is free to undertake the project.

²⁰ As noted above, the Regulator is required to assess New Facilities Investment undertaken during the Access Arrangement Period against section 8.16 of the Code when re-determining the Capital Base. However, in administering this provision, the Regulator is encouraged to draw appropriate inferences from the operation of incentive mechanisms (sections 8.44-8.46 and 8.49 of the Code).

The Regulator will therefore maintain the requirement for revision of the benchmark that is adopted for Capital Expenditure over the Access Arrangement Period as indicated in the Draft Decision.

4.4.5 Required Amendments to the Access Arrangement

Amendment 28 [was Draft Decision Amendment 29]

The Access Arrangement and Access Arrangement Information should be amended to reflect Capital Expenditure of \$96.6 million over the Access Arrangement Period, as follows:

	2000	2001	2002	2003	2004	Total
High pressure mains	3.8	3.5	3.0	2.6	2.0	14.9
Medium/low pressure mains						
Capacity reinforcement	0.3	0.1	0.2	0.2	0.1	0.9
Infill	0.5	0.2	0.0	0.0	0.0	0.8
Re-laying program	2.2	2.5	1.1	0.0	0.0	5.9
Mains extensions	3.5	3.7	4.0	4.1	4.2	19.5
Meters and service pipes	8.2	7.8	7.8	7.6	7.5	38.9
Telemetry and monitoring systems	0.1	0.1	0.1	0.3	0.1	0.7
Equipment and vehicles						
Information systems	3.8	1.4	0.5	1.6	0.6	7.9
Vehicles, plant and equipment	3.0	1.1	0.8	1.2	0.7	6.8
Buildings	0.1	0.1	0.1	0.1	0.1	0.5
Total	25.5	20.5	17.7	17.7	15.3	96.6

4.5 NON-CAPITAL COSTS

4.5.1 Access Code Requirements

Section 8.36 of the Code defines Non-Capital Costs as the operating, maintenance and other costs incurred in the delivery of a Reference Service.

Section 8.37 of the Code provides for a Reference Tariff to recover all Non-Capital Costs (or forecast Non-Capital Costs, as relevant) except for any such costs that would not be incurred by a prudent Service Provider, acting efficiently, in accordance with accepted and good industry practice, and to achieve the lowest sustainable cost of delivering the Reference Service.

4.5.2 Access Arrangement Proposal

AlintaGas provided details of expected Non-Capital Costs in section 4 of the Access Arrangement Information, summarised as follows.

AlintaGas forecast Non-Capital Costs
(nominal \$million; year ending 31 December)

Category	2000	2001	2002	2003	2004	Total
Wages and salaries	12.1	12.4	12.8	13.2	13.5	64.0
Materials and supply	14.4	14.0	14.4	14.4	15.1	72.3
Outsourced services	1.5	1.5	1.5	1.6	1.6	7.7
Property taxes	0.2	0.2	0.2	0.2	0.2	1.0
Marketing	1.3	1.4	1.4	1.4	1.5	7.0
Corporate overheads	4.2	3.4	2.9	2.9	2.9	16.3
Unaccounted for gas	3.3	3.3	3.4	3.5	3.5	17.0
Total	37.0	36.2	36.6	37.2	38.3	185.3

The cost of providing listed ancillary services and other services are not included in the forecast Non-Capital Costs shown above. The forecast cost of providing these services is as follows.

Non-Capital Costs forecast for the provision of listed ancillary and other services
(nominal \$million; year ending 31 December)

Category	2000	2001	2002	2003	2004	Total
Listed ancillary services	0.6	0.6	0.6	0.7	0.7	3.2
Other services	0.8	0.8	0.8	0.8	0.8	4.0
Total	1.4	1.4	1.4	1.5	1.5	7.2

The forecast Non-Capital Costs included the costs of unaccounted for gas. Unaccounted for gas is defined as the difference between the measurement of the quantity of gas delivered into the AlintaGas network in a given period, and the measurement of the quantity of gas delivered from the AlintaGas network during that period. AlintaGas identified the main contributors to unaccounted for gas as measurement errors associated with more than 416,000 meters at delivery points, and operational losses. AlintaGas has indicated that unaccounted for gas on the AlintaGas network is approximately 3 percent of the volume of gas delivered from the network.

4.5.3 Draft Decision

The Regulator made an assessment of the forecast Non-Capital Costs on the basis of a breakdown of expenditure and additional supporting information provided by AlintaGas on a confidential basis. In considering the Non-Capital Costs proposed by AlintaGas, the Regulator assessed whether these costs may meet the requirements of section 8.37 of the Code. That is, whether the proposed costs are consistent with the costs that would be incurred by a prudent Service Provider, acting efficiently, in accordance with accepted and

good industry practice, and to achieve the lowest sustainable cost of delivering the Reference Services. In undertaking the assessment, the Regulator noted that the forecasts of Non-Capital Costs do not limit or constrain AlintaGas as to the level or composition of Non-Capital Costs actually realised over the Access Arrangement Period. For this reason, the Regulator gave attention to both the total level of Non-Capital Costs that will be recognised in the derivation of Reference Tariffs, and the individual components of the forecasts.

The Regulator considered that AlintaGas's forecast of Non-Capital Costs was not well justified in the Access Arrangement Information and in other information separately made available for the purposes of assessment. For some Non-Capital Cost items, the forecasts did not appear to make adequate allowance for reasonable efficiency gains and cost reductions over the Access Arrangement Period. This particularly applied to timetables for projected efficiency gains in maintenance activity and to levels and costs of unaccounted for gas.

Notwithstanding the absence of adequate justification for the cost forecasts, the costs appeared reasonable in comparison with Non-Capital Costs of other distribution systems. Furthermore, the time trend of Non-Capital Costs is for these costs to remain approximately constant in real terms over the Access Arrangement Period despite expansions to the distribution network and increases in customer numbers.

In view of the above, the Regulator accepted the forecast Non-Capital Costs subject to amendments to reflect implementation of efficiency improvements proposed by AlintaGas over three rather than five years, and a reduction in unaccounted for gas from the level of 3 percent proposed by AlintaGas to 2.5 percent by 2004.

The revised schedule of Non-Capital Costs was as follows.

Revised Non-Capital Costs
(nominal \$million; year ending 31 December)

Category	2000	2001	2002	2003	2004	Total
Wages and salaries	11.9	11.9	12.2	12.8	13.5	62.4
Materials and supply	14.4	13.9	14.2	14.3	15.1	71.9
Outsourced services	1.5	1.5	1.5	1.6	1.6	7.7
Property taxes	0.2	0.2	0.2	0.2	0.2	1.0
Marketing	1.3	1.4	1.4	1.4	1.5	7.0
Corporate overheads	4.2	3.4	2.9	2.9	2.9	16.3
Unaccounted for gas	3.0	3.0	2.9	3.0	2.9	14.8
Total	36.4	35.2	35.4	36.3	37.7	181.1
AlintaGas proposed total Non-Capital Costs	37.0	36.2	36.6	37.2	38.3	185.3

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 30

The Access Arrangement and Access Arrangement Information should be amended to reflect Non-Capital Costs of \$181.1 million over the Access Arrangement Period, as described in this Draft Decision and reflecting more rapid implementation of efficiency gains and lower levels of unaccounted for gas.

4.5.4 Responses to Submissions on the Draft Decision

- AlintaGas

AlintaGas acknowledges that the assessment of forecast Non-Capital Costs for compliance with section 8.37 requires that judgments be made about a wide range of matters. As a result, AlintaGas accepts that it is open for the Regulator to reach conclusions about forecast Non-Capital Costs that are inconsistent with AlintaGas's views about forecast Non-Capital Costs.

AlintaGas does not, however, accept that the Regulator's conclusions are reasonable or have been arrived at on a reasonable basis. AlintaGas did not put forward an "ambit claim" with respect to forecast Non-Capital Costs and submits that its proposal was reasonable, arrived at on a reasonable basis and satisfies the requirements of section 8.37.

Comments on the Regulator's revisions to Non-Capital Costs are as follows.

- Productivity/efficiency gains highlighted in the PA Business Efficiency Review

The reasons for decision refer to a *Business Efficiency Review* report written by PA Consulting Group. The report identified the potential for reductions in the level of Non-Capital Costs in AlintaGas's distribution business. In the reasons for decision the Regulator noted that AlintaGas had incorporated those reductions into its determination of proposed Reference Tariffs.

In the report, PA Consulting Group made recommendations about the implementation of certain efficiency improvements over a three year period. The recommendations, including those in respect to timing, were necessarily "high-level", as the report was a review of the whole business of AlintaGas. They were also based on high-level assumptions and were not supported by detailed implementation plans or robust calculations.

Following the original review on which its *Business Efficiency Review* report was based, PA Consulting undertook a detailed independent review of the distribution business's Non-Capital Costs. The results of that review were recorded in a further report, entitled *Review of Operating and Maintenance Costs*, in which PA Consulting subsequently recommended the following timetable for cost reductions as a result of the efficiency initiatives:

	Year 1	Year 2	Year 3	Year 4	Year 5
Asset Management	0%	1%	4%	7%	10%
Maintenance Efficiency	2.5%	5%	7.5%	10%	15%

In this subsequent, more detailed report into the distribution business' Non-Capital Costs, PA consulting clearly contemplated that efficiency gains would be implemented over a 5 year, rather than 3 year period. Accordingly, AlintaGas strongly objects to the Regulator's requirement to implement the identified efficiency gains over a 3 year period, rather than a 5 year period proposed by AlintaGas.

AlintaGas requests that the Regulator recognise that AlintaGas, of its own volition, agreed to implement the reductions proposed by PA Consulting Group. In doing so, AlintaGas effectively agreed to introduce aggressive efficiency measures in respect of activities that generate Non-Capital Costs over the period of the Access Arrangement. These efficiency measures will result in reductions in costs, including corporate overheads and direct distribution business operating costs. Reductions in Non-Capital Costs and the introduction of associated efficiency measures are a significant matter.

Since the inception of AlintaGas in January 1995, AlintaGas's distribution business has been the subject of a number of major efficiency reviews. The reviews required distribution management to consider carefully the activities undertaken, the resources it uses and how the business uses those resources. In none of these reviews have any major activities ever been considered superfluous to what would be seen as appropriate for a prudent and efficient Service Provider. It is important to note that the PA Consulting Group efficiency gains are in addition to the gains achieved as the result of those earlier reviews.

The level and timing of the savings attributable to the implementation of efficiency gains was identified and discussed by PA Consulting in its independent expert report entitled *Review of Operating And Maintenance Costs* (Dated 29 March 1999, at Appendix D). PA Consulting signed off on the report by concluding that it believed that the forecast Non-Capital Costs proposed by AlintaGas in the Access Arrangement (including the implementation of the proposed reductions identified in the Business Efficiency Review report over a five year period) met the requirements of section 8.37 of the Code.

AlintaGas believes that the Regulator's proposal to implement the PA Consulting gains in 3, rather than 5 years, is unreasonable. The Regulator appears to have ignored PA Consulting Group's independent Review of Operating and Maintenance Costs even though it was based on a more detailed review of Non-Capital Costs than the Business Efficiency Review. AlintaGas submits that the Regulator should have regard to, and accept, the findings of the later and more detailed report and require that the efficiency gains be implemented over 5, rather than 3, years.

– Open access management

There is currently only one User of the distribution network and only one interconnected pipeline. Therefore, requirements for balancing, settlement, associated metering and contractual arrangements have been very simple.

With a greater number of users and interconnected pipelines these processes will become more complex and the additional areas of expenditure highlighted under the "Open Access" heading have endeavoured to capture the anticipated associated costs. Two areas in particular which will require substantial resources are billing and customer profiling.

– Billing and customer profiling

Based on the reasons for decision it is not clear that the Regulator has appreciated the reason as to why AlintaGas will need to incur "billing and customer profiling" Non-Capital costs. It is also clear that the Regulator has not understood the likely magnitude of these costs.

When the gas market is completely deregulated, there will be a requirement to determine the total gas flows into the distribution network and to allocate them amongst Users on a daily basis. This information will be required by transmission pipeline operators to determine gate station allocations.

To undertake this daily settlement procedure, an estimate of consumption for each end-use gas customer for each gas day will have to be made. For large use end customers it is cost effective to have metering on site capable of doing this. However, this is not the case for the 400,000 small use residential and commercial customer sites. A series of customer profiles will, therefore, need to be developed. This exercise will be complex, demand expert assistance, be time consuming and entail a long lead-time to ensure the procedures adopted are workable. There are no "off the shelf" or standard industry software packages available. It is noted that this exercise is currently being undertaken in the eastern states.

Customer profiles will be developed for end-use customers, but the daily quantities calculated for each site will then be required to be aggregated for each User. This information will clearly need to be automated and made available to affected stakeholders.

It is interesting to note that the current *Gas Distribution Regulations 1996* ("GDRs") do not contemplate this situation, largely because it was designed for large use customers that have the type of metering on site which can provide the relevant data. The process adopted under the GDRs relies on AlintaGas's Trading business being responsible for the residual amount of gas at a gate station which has not been allocated to a third party User. This is not an equitable long term solution in a fully deregulated market.

The costs associated with identifying a solution to the issues of settlement and balancing are not easy to estimate. AlintaGas is in the best position to determine a reasonable estimate of likely costs and has done so.

– Unaccounted for gas

In the Draft Decision the Regulator stated that the benchmark of 3% for Unaccounted For Gas (“UAFG”) is inconsistent with AlintaGas’s historic averages for UAFG which suggest a rate of 2.4 to 2.7%. The Regulator stated that the AlintaGas benchmark should be reduced to 2.7% in 2000, decreasing to 2.5% by 2004.

AlintaGas’s UAFG benchmark has been established taking account of not only its historical performance, but also other factors such as increases resulting from pressure upgrades, increasing uncertainty in HHV measurements and the resulting uncertainty of UAFG calculations. The increasing variations in HHV are a result of variations in the HHV of gas delivered into the DBNGP (which has also increased the UAFG level on the DBNGP). These HHV variations and their consequences will become more significant with the imminent interconnection with the Parmelia pipeline.

There has been an upward trend in UAFG since 1995. AlintaGas is obviously concerned with the trend and is working at reducing it, however, any benchmark needs to consider the reality of this trend. Although a considerable effort has been made to reduce leakage through programs such as the re-laying program, other factors are obviously contributing to the increase in UAFG.

The reason for this increase in UAFG cannot be attributed to one factor and could be the result of any, all or a combination of the following:

Replacement of the cast iron system enables AlintaGas to increase capacity by upgrading areas to medium pressure. Such upgrades are required to provide additional capacity to cater for urban infill (unit developments, subdivision of blocks, etc.) as well as the general increases in per household gas consumption. As a result of the increased pressure, the leakage rate will increase in the remaining areas of the network.

It should be appreciated that there is a significant uncertainty in both the calculation of UAFG and the factors driving it. Whilst the published figures may seem fairly constant there are large variations in UAFG on a month to month basis and this is a good indication that the calculation has a high uncertainty, possibly in the range of +/- 10-20 %.

One significant factor not in AlintaGas’s control is fluctuations in HHV. This is due to the proliferation of gas suppliers and field sources experienced in recent years, widening of gas quality limits, increased flows for the new entrants and the commissioning of new gas sources for the established players. This has completely changed the previous picture of almost constant gas quality and has had a significant impact on DBNGP measurement uncertainties and UAFG. This is likely to deteriorate further in the near future with the commissioning of the interconnection with the Parmelia Pipeline which introduces a new gas supply with a significantly differing HHV and is likely to further increase measurement uncertainty.

AlintaGas believes that the 3% benchmark included in its Access Arrangement is a level commensurate with the exposure it faces as a prudent and reasonable operator. While a more aggressive benchmark may seem appropriate when looking at past levels of UAFG, it ignores the real risks and future uncertainty faced by AlintaGas. Whilst the result may be pleasing to Users, it unfairly weights the risk of UAFG entirely with the Service Provider and fails to recognise that there will be an impact on UAFG from issues such as the interconnection of the Parmelia Pipeline.

When the 3% UAFG target is converted to a loss in GJ/km terms using the forecast throughput and construction figures that underline the economics of the Access Arrangement it is in fact a declining value:

Year ending 31 December	2000	2001	2002	2003	2004
Forecast kilometres mains	10536	10729	10915	11101	11283
Total system throughput [TJ]	27825	27784	28077	28723	29208
3 % UAFG [TJ]	835	834	842	862	876
UAFG [GJ/km]	79.2	77.7	77.2	77.6	77.7

AlintaGas's UAFG, in terms of GJ lost per km of mains, is substantially lower than that experienced by other Australian utilities:

State	SA	Vic	NSW	Qld	AlintaGas ²¹		
Year	1997	1997	1997	1997	1996	1997	1998 ²²
UAFG [GJ/km]	241	188	150	287	64.4	69.0	71.8

This shows that AlintaGas has a significantly lower UAFG level per kilometre of pipe when compared to other Australian networks, despite AlintaGas's UAFG in percentage terms being similar. This reflects the higher levels of sales per kilometre of piping due to the higher level of customers per km of piping (~ 60 in Victoria, compared to 40 in WA), the difference in network age, as well as climatic factors.

AlintaGas believes that the benchmark of 3% is more than reasonable given these circumstances and satisfies the requirements of section 8.37.

– Additional costs

Since the forecasts of Non-Capital Costs were prepared, a number of additional costs have become apparent which will be borne by AlintaGas's distribution business and which are clearly associated with the delivery of Reference Services. None of these costs were included in the Access Arrangement forecasts of Non-Capital Costs.

The more significant of these costs include:

GST implementation costs;

costs associated with the development of the current Access Arrangement;

costs for interconnection of other distribution or transmission systems; and

settlement and system issues.

These costs should be taken into consideration when the Regulator recommends reductions in Non-Capital Costs or the imposition of even further efficiency improvements.

AlintaGas believes that it is proper and necessary for the Regulator to consider the above comments in relation to AlintaGas's proposed Non Capital Costs. Given AlintaGas's optimised deprival value methodology for valuation of the Initial Capital Base, AlintaGas would propose to discuss with the Regulator, the impact of forecast Non-Capital Costs prior to the issue of the Final Decision.

In the Draft Decision, the Regulator indicated a requirement for a downwards revision to the forecast of Non-Capital Costs to reflect:

- implementation of efficiency gains in operations over three years rather than five years as proposed by AlintaGas; and
- a reduction in the forecast level of unaccounted for gas from the three percent proposed by AlintaGas to 2.7 percent in 2000 and decreasing to 2.5 percent by 2004.

The Regulator also noted that other line items of expenditure were not well justified in terms of the requirements of section 8.37 of the Code, in particular the forecast costs for open access management, business development and ring fencing, and computing and information technology services. The Regulator did not, however, require revisions to these costs on the basis that the total Non-Capital Costs appeared reasonable in comparison with the Non-Capital Costs of other Australian gas distribution systems, and the time trend for the total

²¹ Based on mains lengths of 9,586, 9795 and 10,125 kilometres respectively.

²² Data for the financial year 1997 - 1998 as data for the calendar year 1998 cannot yet be calculated

Non-Capital Costs is for these costs to remain approximately constant in real terms over the Access Arrangement Period despite planned expansions to the distribution network and increases in customer numbers.

The Regulator has noted the argument made by AlintaGas in respect of the time period for implementation of efficiency gains and examined the report by PA Consulting referred to by AlintaGas that relates specifically to the prospects for efficiency gains in the distribution business of AlintaGas.²³ The PA Consulting report provides an opinion that AlintaGas's forecast of Non-Capital Costs meets the requirements of section 8.37 of the Code. This opinion is based on:

- a view that the forecast is based on service standards that are in accordance with good industry practice;
- a view that the forecasts are based on a robust budget process;
- a view that the forecasts adequately account for planned efficiency gains and cost reductions in maintenance activity and IT expenditure; and
- comparisons of Non-Capital Costs and cost ratios between AlintaGas and other Australian gas distributors.

The PA Consulting report does not specifically address the time period for implementation of efficiency gains in maintenance activity, nor addresses the discrepancy between the five year period of implementation proposed by AlintaGas, and the three year period suggested by PA Consulting in an earlier review of the entire AlintaGas Business.²⁴ Contrary to AlintaGas's submission on the Draft Decision, PA Consulting did not explicitly recommend a five-year timetable for cost reductions as a result of the efficiency initiatives, but rather only noted the proposal by AlintaGas for implementation over a five year period.

The Regulator notes that in neither information provided by AlintaGas, nor in advice obtained by the Regulator is there a convincing case for either three-year or five-year periods for implementation of efficiency gains in maintenance activities. In principle, the appropriate question is whether there is any reason as to why planned efficiency improvements could not be made *immediately*, as would be the outcome for a firm that is subject to the discipline of effective competition. That said, however, the Regulator has decided to accept the time path for the efficiency improvements proposed by AlintaGas (i.e. over the five year period) given that there is uncertainty associated with determining a benchmark forecast of Non-Capital Costs for AlintaGas's distribution business on a stand-alone basis, that total Non-Capital Costs compare favourably with costs of other Australian gas distributors, and that the forecast embodies a real reduction in Non-Capital Costs over the Access Arrangement Period.

In regard to unaccounted for gas, the Regulator has noted the arguments presented by AlintaGas in its submission on the Draft Decision, but does not consider there to be reason to move from the requirement indicated in the Draft Decision for downward revision of the unaccounted-for-gas costs. One of AlintaGas's primary arguments for proposing a higher allowance for "unaccounted for gas" than implied by its historical losses was that there are a

²³ PA Consulting Group, 1999. AlintaGas Distribution: Review of Operating and Maintenance Costs.

²⁴ PA Consulting Group, 1998. AlintaGas Business Efficiency Review.

number of factors that will increase the level of uncertainty of measurement and other issues that will imply more uncertainty in unaccounted for gas. The important issue, however, is whether the *expected* level of unaccounted for gas is likely to rise as a result of these events, or whether the events are just likely to increase the *variation* in unaccounted for gas. Expressed in another way, the factors that were identified by AlintaGas would only justify a higher allowance for unaccounted for gas if the factors predominantly acted to increase the level of unaccounted for gas, rather than just increasing the uncertainty associated with unaccounted for gas. The Regulator has not been convinced that the factors identified by AlintaGas, taken as a whole, would lead to an increase in expected levels of unaccounted for gas.

4.5.5 Required Amendments to the Access Arrangement

Amendment 29 [was Draft Decision Amendment 30]

The Access Arrangement and Access Arrangement Information should be amended to reflect Non-Capital Costs of \$183.1 million over the Access Arrangement Period, as follows (in nominal \$million).

	2000	2001	2002	2003	2004	Total
Non-Capital Costs	36.7	35.8	36.1	36.7	37.8	183.1

4.6 RATE OF RETURN

4.6.1 Access Code Requirements

Sections 8.30 and 8.31 of the Code set out the principles for establishing the Rate of Return for an existing covered pipeline when a Reference Tariff is first proposed for a Reference Service. These principles apply to the proposed Access Arrangement for the AlintaGas gas distribution systems.

Section 8.30 of the Code requires that the Rate of Return used in determining a Reference Tariff should provide a return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service (as reflected in the terms and conditions on which the Reference Service is offered and any other risk associated with delivering the Reference Service).

Section 8.31 states that, by way of example, the Rate of Return may be set on the basis of a weighted average of the return applicable to each source of funds (equity, debt and any other relevant source of funds). Such returns may be determined on the basis of a well accepted financial model, such as the Capital Asset Pricing Model. In general, the weighted average of the return on funds should be calculated by reference to a financing structure that reflects standard industry structures for a going concern and best practice. However, other approaches may be adopted where the Regulator is satisfied that to do so would be consistent with the objectives contained in section 8.1 of the Code, as listed in section 5.1 of this Draft Decision.

Overall, the Regulator is required to ensure that the Rate of Return used in determining Reference Tariffs should be at a level that would be sufficient to motivate the Service Provider's investment in the pipeline assets, but which is not unduly in excess of this level.

4.6.2 Access Arrangement Proposal

For the purposes of determining Total Revenue, AlintaGas calculated the return on each group of assets that form the AlintaGas network by applying a pre-tax real rate of return to the current cost accounting value of that group of assets at the beginning of each year.

The rate of return was calculated as a weighted average of the returns (weighted average cost of capital or WACC) applicable to the assumed levels of equity and debt used to finance the assets which form the AlintaGas network. AlintaGas's calculation of the WACC is described in sections 3.7 to 3.11 of the Access Arrangement Information.

Capital Asset Pricing Model (CAPM) theory was used to derive the WACC. The parameter values used by AlintaGas in its calculation of the WACC are presented in the table below. On the basis of these input assumptions, AlintaGas proposed a real pre-tax WACC of 8 percent.

AlintaGas estimation of the Rate of Return

Capital asset pricing model parameter	Value used by AlintaGas
Risk free rate (Nominal)	5.65%
Risk free rate (Real)	3.07%
Market risk premium	6.50%
Equity beta	0.85
Debt beta	0.235
Cost of debt margin	1.53%
Corporate tax rate	36%
Franking credit value	30%
Debt to total assets ratio	55%
Equity to total assets ratio	45%
Expected inflation	2.5%

4.6.3 Draft Decision

In assessing the derivation of the WACC by AlintaGas, the Regulator obtained advice from the Allen Consulting Group (ACG). This advice comprised:

- a review of the methodologies employed by AlintaGas and the reasonableness of the values adopted for specific variables, and suggestion of alternative values of variables where appropriate; and

- re-calculation of the cost of capital applicable to the AlintaGas distribution business based on values of input variables determined to be appropriate.

On the basis of the advice provided by ACG, the Regulator drew conclusions on appropriate values of input variables and the value of the WACC. A comparison of the values of input variables used by AlintaGas and the revised values of the Regulator is as follows.

Estimation of the rate of return

Parameter	Parameter symbol	Value used by AlintaGas	Value proposed by the Regulator
Risk Free Rate (Nominal)	R_f	5.65%	6.85%
Risk Free Rate (Real)	R_f	3.07%	3.65%
Market Risk Premium	—	6.50%	6.0%
Equity Beta	b_e	0.85	1.05
Debt Beta	b_d	0.235	0.22
Cost of Debt Margin		1.53%	1.30%
Corporate Tax Rate	T	36%	36%
Franking credit value	g	30%	50%
Debt to total assets ratio	D/V	55%	60%
Equity to total assets ratio	E/V	45%	40%
Expected inflation	p_e	2.5%	3.09%

The WACC values for the AlintaGas distribution business generated by the *forward* and *reverse* transformations were 8.0 and 6.3 percent, respectively. The Regulator considered that a real pre-tax WACC somewhere towards the upper end of the range is reasonable. On the basis of financial advice, the Regulator considered a real pre-tax WACC of 7.9 percent and a nominal pre-tax WACC of 11.2 percent to be appropriate for the AlintaGas distribution business.

Implicit in these WACC values are the following rates of return on equity.

Returns on equity implicit in WACC values

Nominal post-tax return on equity	13.2 percent
Real post-tax return on equity	9.8 percent
Nominal pre tax return on equity	15.9 percent
Real pre-tax return on equity	12.4 percent

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 31

The Access Arrangement and Access Arrangement Information should be amended to reflect a pre-tax real rate of return of 7.9 percent, and a pre-tax nominal rate of return of 11.2 percent.

4.6.4 Responses to Submissions on the Draft Decision

Beta Estimate

- CMS Gas Transmission of Australia Submission No. 2

CMS disputes the validity of OffGAR's decision in regard to AlintaGas having an equity beta of 1.05 based on OffGAR's opinion that AlintaGas faces greater risks to what the Victorian distribution businesses encounter.

It is difficult to understand OffGAR's treatment of the AlintaGas equity beta given OffGAR's own evaluation of the riskiness of AlintaGas compared to other distribution systems. OffGAR states that AlintaGas faces a higher risk than other gas distribution businesses. However, OffGAR mandated a value of an equity beta for AlintaGas that was lower than that prescribed for the Victorian distribution systems and inconsistent with other pipeline equity betas.

CMS believes that this inconsistency contravenes the requirements of section 8.1(b) of the Code.

CMS Proposal: OffGAR should amend the equity beta to be consistent with those set by the Office of the Regulator General for the Victorian distribution businesses.

Regarding the beta assumption that has been adopted by the Regulator, it is noted that the *asset* beta (rather than the *equity* beta) is the more relevant measure for comparing the assumed relative risk of two assets.

For the purposes of estimating the cost of capital associated with AlintaGas's regulated activities, the Regulator had regard to empirical estimates of asset betas for relevant entities in Australia and overseas, as well as the asset betas that other regulators have used for similar purposes. On the basis of this information, the Regulator determined that an appropriate range for the asset beta for an Australian distribution business to be between 0.45 to 0.60. The Regulator considered that there were several factors that may predispose the AlintaGas distribution business to a higher risk (and hence higher beta values) than the Victorian distribution businesses, including far lower average gas consumption in Western Australia by residential end-users, a higher average price for gas in Western Australia resulting in more competition from other energy sources, and a greater proportional reliance of AlintaGas upon revenue from industrial end-users of gas. However, the Regulator also considered that the relative risk of the AlintaGas distribution business may be lower than eastern states gas distributors given the absence of reforms in the Western Australian electricity market that have occurred in the eastern states, and hence a lower level of competition from the electricity sector.

Having regard to all of these factors, on balance, the Regulator considered that an asset beta of 0.55 is appropriate for the purpose of estimating the cost of capital associated with AlintaGas's regulated activities. This is at the upper end of the range of asset betas observed from comparable entities and adopted by other Australian regulators. Using the Regulator's

preferred approach for leveraging and de-levering (which is the same as that proposed by AlintaGas), this equates to an equity beta of 1.05.

Since the release of the Draft Decision, the Victorian Office of the Regulator-General has released updated information on empirical estimates of asset betas for comparable Australian and overseas utilities. This information supports the range for the asset beta that was adopted in the Draft Decision.²⁵

Accordingly, the Regulator will maintain this stance for the purposes of the Final Decision.

Rate of Return

- AlintaGas

AlintaGas agrees to submit a compliant revision in response to Draft Decision Amendment 31. However AlintaGas does have some comments in relation to the calculation of the Weighted Average Cost of Capital (“WACC”) in the Draft Decision.

The rate of return methodology adopted in the Draft Decision and the approach the Regulator used in establishing a feasible range for the rate of return, are consistent with the methodology and approach that have been used in other regulatory decisions in Australia. With the exception of the transformation methodology and the method used to select a point estimate, the methodology and approach the Regulator used is also similar to that adopted by AlintaGas.

The rate of return proposed by AlintaGas in the Access Arrangement is based on the forward transformation methodology, and the point estimate selected reflects the midpoint of the low-high results achieved. The forward transformation methodology was retained by AlintaGas on the basis of advice from KPMG Corporate Finance that the forward transformation methodology produced results that were closer to the theoretically correct results.

The Regulator’s comments that:

- (a) AlintaGas has calculated its cost of debt by inserting an assumed debt beta into the CAPM equation; and
 - (b) the approach used by AlintaGas to estimate the debt beta is “unconventional”,
- are both incorrect.

Firstly, the cost of debt was calculated by reference to an estimated debt margin that took into consideration the risk margin likely to be required by banks, as well as annualised “upfront” fees.

Secondly, the approach adopted by AlintaGas to derive the debt beta is precisely the same as that suggested by the Regulator, that is, by observing the market cost of debt and then back-calculating using the CAPM equation.

Regarding the assumption that is made about the cost of tax, the Regulator has adopted the *forward transformation* methodology in the Final Decision, which is the same as that adopted by AlintaGas. The Regulator’s use of the *forward transformation* reflects a view that the announced changes to the company taxation regime in Australia are likely to narrow the gap between the statutory and effective tax rates for infrastructure firms in Australia. It is noted, however, that there is no consistent approach to the issue amongst the other Australian regulators, and that an after-tax WACC has been adopted in a number of recent decisions in Australia, with a benchmark allowance for taxation included explicitly in the revenue benchmark.

²⁵ Office of the Regulator General (2000), 2001 Electricity Distribution Price Review, Chapter 8.

Regarding the method used to derive the benchmark cost of debt, and after receipt of further information from AlintaGas on the methodology used to determine the WACC, it is acknowledged that AlintaGas adopted the more conventional approach, as described above. The comments made in the Draft Decision pertained to the explanation provided in the publicly available Access Arrangement Information.

The Regulator has maintained the same assumptions as those used in the Draft Decision for the other inputs required to estimate the WACC associated with AlintaGas's regulated activities, with the following exceptions:

- changing the cost of debt margin from 1.3 percent to 1.2 percent to be consistent with approaches taken in other regulatory decisions, with a consequential change in the equity beta from 1.05 to 1.08;
- incorporating more recent information on bond yields, as they relate to interest rates; and
- incorporating changes to the statutory rate of corporate taxation.

Consistent with the Draft Decision, a recent average of the yield to maturity on the 10 year Commonwealth Government Capital indexed Treasury Bonds has been used for the proxy for the real risk free rate, and a recent average of the yield to maturity on 10 year Commonwealth Government Treasury Bonds has been taken as the proxy for the nominal risk free rate. The difference between the two bond rates has been used to obtain a forecast of inflation forecast over the relevant period (calculated using the Fisher equation).

The observed yield for the relevant bonds has been taken as the average of the last 20 trading days to 15 June 2000, indicating a forecast real risk free rate of 3.40 percent, nominal risk free rate of 6.27 percent, and forecast inflation rate of 2.78 percent.

The corporate taxation rate was assumed equal to the legislated average corporate taxation rate over the Access Arrangement Period, which is a corporate tax rate of 36 percent for January to June 2000, 34 percent for July 2000 to June 2001, and 30 percent for July 2001 to December 2004. Accordingly, the average rate of corporate taxation over the period is 31.4 percent.

The revised parameters used by the Regulator in estimating the WACC are as follows.

Estimation of the rate of return

Parameter	Parameter symbol	Value used by AlintaGas	Value used by the Regulator
Risk Free Rate (Nominal)	R_f	5.65%	6.27%
Risk Free Rate (Real)	R_f	3.07%	3.40%
Market Risk Premium	–	6.50%	6.0%
Asset Beta	b_a	–	0.55
Equity Beta	b_e	0.85	1.08
Debt Beta	b_d	0.235	0.20
Cost of Debt Margin		1.53%	1.20%
Corporate Tax Rate	T	36%	31.4%
Franking credit value	g	30%	50%
Debt to total assets ratio	D/V	55%	60%
Equity to total assets ratio	E/V	45%	40%
Expected inflation	p_e	2.5%	2.78%

These parameter values give the following revised estimates of the WACC.

Revised WACC

Estimated WACCs	Nominal	Real
Post-tax (Vanilla)	9.6%	6.6%
Post-Tax (Officer)	7.2%	4.3%
Pre-tax (forward transformation)	10.5%	7.5%
Pre-tax (reverse transformation)	9.7%	6.7%

As stated above, for the purpose of the Final Decision, the Regulator has used the forward transformation to derive the implied allowance for corporate taxation. Accordingly, on the basis of financial advice, the Regulator has adopted a real pre-tax WACC of 7.5 percent for the purpose of assessing AlintaGas's proposed Reference Tariffs. The implied nominal pre tax WACC is 10.5 percent.

The returns to equity that are implied by this WACC estimate are as follows.

Returns on equity implicit in revised WACC values

Nominal post-tax return on equity	12.7 percent
Real post-tax return on equity	9.7 percent
Nominal pre tax return on equity	15.1 percent
Real pre-tax return on equity	12.0 percent

The Regulator will require the Access Arrangement and Access Arrangement Information to be amended to reflect the revised Rate of Return.

4.6.5 Required Amendments to the Access Arrangement

Amendment 30 [was Draft Decision Amendment 31]

The Access Arrangement and Access Arrangement Information should be amended to reflect a pre-tax real rate of return of 7.5 percent, and a pre-tax nominal rate of return of 10.5 percent.

4.7 DEPRECIATION SCHEDULE**4.7.1 Access Code Requirements**

Sections 8.32 to 8.34 of the Code specify rules for depreciation of assets that form part of the Capital Base, for the purposes of determining a Reference Tariff.

Section 8.32 defines a Depreciation Schedule as the set of depreciation schedules (one of which may correspond to each asset or group of assets that form part of the covered pipeline) that is the basis upon which the assets that form part of the Capital Base are to be depreciated for the purposes of determining a Reference Tariff (the Depreciation Schedule).

Section 8.33 requires that the Depreciation Schedule be designed:

- (a) so as to result in the Reference Tariff changing over time in a manner that is consistent with the efficient growth of the market for the Services provided by the pipeline (and which may involve a substantial portion of the depreciation taking place in future periods, particularly where the calculation of the Reference Tariffs has assumed significant market growth and the pipeline has been sized accordingly);
- (b) so that each asset or group of assets that form part of the covered pipeline is depreciated over the economic life of that asset or group of assets;
- (c) so that, to the maximum extent that is reasonable, the depreciation schedule for each asset or group of assets that form part of the covered pipeline is adjusted over the life of that asset or group of assets to reflect changes in the expected economic life of that asset or group of assets; and

- (d) subject to provisions for capital redundancy in section 8.27 of the Code, so that an asset is depreciated only once (that is, so that the sum of the Depreciation that is attributable to any asset or group of assets over the life of those assets is equivalent to the value of that asset or group of assets at the time at which the value of that asset or group of assets was first included in the Capital Base).

Section 8.34 provides for the application of depreciation principles in the determination of Total Revenue using IRR or NPV methodologies. If the IRR or NPV methodology is used, then the notional depreciation over the Access Arrangement Period for each asset or group of assets that form part of the covered pipeline is:

- (a) for an asset that was in existence at the commencement of the Access Arrangement Period, the difference between the value of that asset in the Capital Base at the commencement of the Access Arrangement Period and the value of that asset that is reflected in the Residual Value; and
- (b) for a New Facility installed during the Access Arrangement Period, the difference between the actual cost or forecast cost of the Facility (whichever is relevant) and the value of that asset that is reflected in the Residual Value,

and, to comply with section 8.33:

- (c) the Residual Value of the covered pipeline should reflect notional depreciation that meets the principles of section 8.33; and
- (d) the Reference Tariff should change over the Access Arrangement Period in a manner that is consistent with the efficient growth of the market for the Services provided by the pipeline (and which may involve a substantial portion of the depreciation taking place towards the end of the Access Arrangement Period, particularly where the calculation of the Reference Tariffs has assumed significant market growth and the pipeline has been sized accordingly).

4.7.2 Access Arrangement Proposal

The Depreciation Schedule proposed by AlintaGas is described in section 3 of the Access Arrangement Information.

AlintaGas determined a Depreciation Schedule for each group of assets that form the AlintaGas network. The set of Depreciation Schedules establishes the depreciation to be used for the purpose of determining Reference Tariffs.

Depreciation for each group of assets that form the AlintaGas network was calculated using the Current Cost Accounting (CCA) method. In applying this method, regulatory asset values were adjusted each year to take into account new facilities investment, and the depreciation of existing and new facilities, during the year. Depreciation was calculated on a straight line basis on the adjusted regulatory asset values. Assets in each group were depreciated over the assumed economic life. The resulting depreciation was then further adjusted for the change in nominal asset values during the year caused by inflation.

The economic lives and average remaining lives of the assets forming the AlintaGas network, as used in the Depreciation Schedule, are set out in the table below.

Economic lives of assets (at 30 June 1998)

Category of asset	Economic Life (years)	Average remaining life (years)
Mains:		
High pressure	120	97
Medium pressure	60	50
Medium low pressure	60	41
Low pressure	60	41
Secondary gate stations	40	26
Regulators	40	40
Meters:		
Residential	25	10
Commercial and industrial	25	14
Telemetry and monitoring systems	10	5
Equipment and vehicles	10	5
Buildings	40	25

The depreciation costs by type of asset, as used by AlintaGas in the determination of Reference Tariffs, is presented in the table below.

AlintaGas proposed depreciation costs (nominal \$million; year ending 31 December)

Asset Group	1999	2000	2001	2002	2003	2004	Total
Mains:							
High pressure	1.4	1.5	1.5	1.6	1.7	1.7	9.4
Medium pressure	3.5	3.7	3.8	4.0	4.2	4.4	23.6
Medium low pressure	2.4	2.5	2.5	2.6	2.7	2.7	15.4
Low pressure	0.9	0.9	1.0	1.0	1.1	1.2	6.1
Secondary gate stations	0.1	0.1	0.1	0.1	0.1	0.1	0.6
Regulators	0.3	0.4	0.4	0.4	0.4	0.4	2.3
Meters and service pipes	4.6	5.0	5.6	6.1	6.5	7.0	34.8
Equipment and vehicles	2.7	3.2	3.8	4.1	4.4	4.8	23.0
Buildings	0.1	0.1	0.1	0.1	0.1	0.1	0.6
Total	16.0	17.4	18.8	20.0	21.2	22.4	115.8

4.7.3 Draft Decision

In assessing AlintaGas's proposed Depreciation Schedule, the Regulator considered the assumptions as to asset lives and AlintaGas's application of the CCA methodology in calculating depreciation allowances.

The Regulator considered AlintaGas's assumptions as to asset lives to be reasonable.

The Regulator assessed AlintaGas's Depreciation Schedule against accounting standards described in the Statement of Accounting Practice No. 1: Current Cost Accounting.²⁶ An inconsistency was observed between AlintaGas's methodology and the accounting standard in regard to the relative timing of depreciation and asset inflation for Capital Expenditure. The Regulator also revised the Depreciation Schedule according to revisions made to the Initial Capital Base and Capital Expenditure. The revised depreciation costs were as follows.

Draft Decision revised depreciation costs (nominal \$million; year ending 31 December)

Asset Group	2000	2001	2002	2003	2004	Total
Mains:						
High pressure	1.4	1.5	1.5	1.6	1.6	7.6
Medium pressure	3.5	3.6	3.8	3.9	4.0	18.8
Medium low pressure	2.3	2.4	2.5	2.5	2.6	12.3
Low pressure	0.9	0.9	1.0	1.1	1.1	5.0
Secondary gate stations	0.1	0.1	0.1	0.1	0.1	0.5
Regulators	0.3	0.4	0.4	0.4	0.4	1.9
Meters and service pipes	4.8	5.3	5.7	6.2	6.7	28.8
Equipment and vehicles	3.1	3.7	4.0	4.3	4.6	19.6
Buildings	0.1	0.1	0.1	0.1	0.1	0.4
Total	16.5	17.9	19.0	20.1	21.3	94.8
AlintaGas proposed total depreciation	17.4	18.8	20.0	21.2	22.4	99.8

The required amendment to the Access Arrangement was as follows.

²⁶ Australian Society of Accountants and Institute of Chartered Accountants in Australia, 1989, Statement of Accounting Practice "Current Cost Accounting" (SAP 1). Australian Society of Accountants and Institute of Chartered Accountants in Australia, 1989, Statement of Accounting Practice SAP 1 Guidance Notes. Australian Accounting Research Foundation, 1984. Working Guide for Statement of Accounting Practice SAP 1 Current Cost Accounting.

Draft Decision Amendment 32

The Access Arrangement and Access Arrangement Information should be amended to reflect depreciation costs over the Access Arrangement Period of \$94.8 million, as described in this Draft Decision.

4.7.4 Responses to Submissions on the Draft Decision

- AlintaGas

AlintaGas objects to Draft Decision Amendment 32 and submits that the Regulator should not require such an amendment in the Final Decision.

AlintaGas considers that the Regulator's approach to the timing of capital expenditures for the purpose of establishing the Depreciation Schedule is somewhat unorthodox. AlintaGas also notes that the effect of the Regulator's proposed "correction" is not material.

However, major differences in depreciation as determined by AlintaGas, and as determined by the Regulator and set out in the reasons supporting Amendment 32 in the Draft Decision, result from differences in the Initial Capital Base.

AlintaGas has objected to the reduction of the Initial Capital Base as required by Amendment 28, and has submitted that the Final Decision should not require such an amendment. If Amendment 28 is not required, the depreciation costs will not be those referred to in Amendment 32. Accordingly, the Regulator should not require Amendment 32 in the Final Decision.

AlintaGas's objections to Draft Decision Amendment 32 appear to relate to the asset values underlying the calculation of depreciation rather than the standard method of calculation used by the Regulator. For the purposes of this Final Decision, the Regulator has maintained the same calculation methodology, although the allowed depreciation costs have varied in accordance with a change made to the Initial Capital Base. The revised depreciation schedule is as follows.

Revised depreciation costs (nominal \$million; year ending 31 December)

Asset Group	2000	2001	2002	2003	2004	Total
Mains:						
High pressure	1.5	1.5	1.6	1.7	1.7	7.9
Medium pressure	3.6	3.8	3.9	4.1	4.2	19.7
Medium low pressure	2.5	2.5	2.6	2.7	2.7	13.0
Low pressure	0.9	1.0	1.0	1.1	1.2	5.2
Secondary gate stations	0.1	0.1	0.1	0.1	0.1	0.5
Regulators	0.4	0.4	0.4	0.4	0.4	2.0
Meters and service pipes	5.1	5.5	6.0	6.5	6.9	30.0
Equipment and vehicles	3.2	3.8	4.1	4.4	4.8	20.3
Buildings	0.1	0.1	0.1	0.1	0.1	0.4
Total	17.3	18.7	19.8	21.0	22.1	98.9
AlintaGas proposed total depreciation	17.4	18.8	20.0	21.2	22.4	99.8

4.7.5 Required Amendments to the Access Arrangement

Amendment 31 [was Draft Decision Amendment 32]

The Access Arrangement and Access Arrangement Information should be amended to reflect depreciation costs over the Access Arrangement Period of \$98.9 million, as follows (in nominal \$million).

Asset Group	2000	2001	2002	2003	2004	Total
Mains:						
High pressure	1.5	1.5	1.6	1.7	1.7	7.9
Medium pressure	3.6	3.8	3.9	4.1	4.2	19.7
Medium low pressure	2.5	2.5	2.6	2.7	2.7	13.0
Low pressure	0.9	1.0	1.0	1.1	1.2	5.2
Secondary gate stations	0.1	0.1	0.1	0.1	0.1	0.5
Regulators	0.4	0.4	0.4	0.4	0.4	2.0
Meters and service pipes	5.1	5.5	6.0	6.5	6.9	30.0
Equipment and vehicles	3.2	3.8	4.1	4.4	4.8	20.3
Buildings	0.1	0.1	0.1	0.1	0.1	0.4
Total	17.3	18.7	19.8	21.0	22.1	98.9

4.8 TOTAL REVENUE

4.8.1 Access Code Requirements

Sections 8.4 and 8.5 of the Code require that the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period (the Total Revenue) be determined, or be able to be expressed in terms of, one of three methodologies.

- **Cost of Service:** the Total Revenue is equal to the cost of providing all Services (some of which may be the forecast of such costs), and with this cost to be calculated on the basis of:
 - (a) a return (Rate of Return) on the value of the capital assets that form the covered pipeline (Capital Base);
 - (b) depreciation of the Capital Base (Depreciation); and
 - (c) the operating, maintenance and other Non-Capital Costs incurred in providing all Services provided by the covered pipeline (Non-Capital Costs).
- **Internal Rate of Return (IRR):** the Total Revenue will provide a forecast IRR for the covered pipeline that is consistent with the principles in sections 8.30 and 8.31 of the Code. The IRR should be calculated on the basis of a forecast of all costs to be incurred in providing such Services (including capital costs) during the Access Arrangement Period. The initial value of the covered pipeline in the IRR calculation is to be given by the Capital Base at the commencement of the Access Arrangement Period and the assumed residual value of the covered pipeline at the end of the Access Arrangement Period (Residual Value) should be calculated consistently with the principles in section 8 of the Code.
- **Net Present Value (NPV):** the Total Revenue will provide a forecast NPV for the covered pipeline equal to zero. The NPV should be calculated on the basis of a forecast of all costs to be incurred in providing such Services (including capital costs) during the Access Arrangement Period, and using a discount rate that would provide the Service Provider with a return consistent with the principles in sections 8.30 and 8.31 of the Code.

The initial value of the covered pipeline in the NPV calculation is to be given by the Capital Base at the commencement of the Access Arrangement Period and the assumed Residual Value at the end of the Access Arrangement Period should be calculated consistently with the principles in section 8 of the Code.

The methodology used to calculate the Cost of Service, an IRR or NPV should be in accordance with generally accepted industry practice.

4.8.2 Access Arrangement Proposal

AlintaGas used a cost of service methodology to determine a Total Revenue requirement for the distribution systems. Total Revenue for each year of the Access Arrangement Period was calculated as the sum of:

- a return on the Capital Base;

- depreciation of the Capital Base;
- a return on working capital; and
- Non-Capital Costs.

The return on the capital base proposed by AlintaGas and derived using the CCA methodology is as follows.

Current cost accounting return on capital (nominal \$million; year ending 31 December)

	1999	2000	2001	2002	2003	2004
CCA value of initial assets	530.5	543.8	557.4	571.3	585.6	600.2
CCA depreciation accumulated to start of year		16.0	32.8	50.5	69.0	88.4
CCA cost base	530.5	527.8	524.6	520.8	516.6	511.8
Additions to CCA value of assets	12.6	26.6	38.3	49.2	61.2	72.2
CCA depreciation accumulated to start of year		0.4	1.5	3.0	4.9	7.4
Additions to cost base	12.6	26.2	36.8	46.2	56.3	64.8
CCA return on:						
CCA cost base	42.4	42.2	42.0	41.7	41.3	40.9
Additions to cost base	1.0	3.1	5.0	6.6	8.2	9.6
Return on capital base	43.4	45.3	47.0	48.3	49.5	50.7

An allowance for a return on the working capital employed in providing Reference Services was included in the forecast total cost from which the Reference Tariffs have been determined. This allowance was determined by applying the pre-tax nominal WACC to an estimated working capital requirement of \$13.0 million in the first year of the Access Arrangement, and to values of working capital in subsequent years escalated annually at a rate of one plus the inflation rate. In the final year, the return was calculated on half of the value of the working capital, representing the average value of working capital for the year.

Return on working capital (nominal \$million; year ending 31 December)

	2000	2001	2002	2003	2004
Value of working capital	13.0	13.3	13.7	14.0	14.4
Return on working capital:	1.4	1.4	1.5	1.5	0.8

The proposed Total Revenue indicated in section 2.4 of the Access Arrangement Information was as follows.

AlintaGas proposed Total Revenue (nominal \$million; year ending 31 December)

	2000	2001	2002	2003	2004
Return on Capital	45.3	47.0	48.3	49.5	50.7
Depreciation	17.4	18.8	20.0	21.2	22.4
Return on Working Capital	1.4	1.4	1.5	1.5	0.8
Non-Capital Costs	37.0	36.1	36.6	37.1	38.3
Total Revenue	101.1	103.4	106.4	109.4	112.2

4.8.3 Draft Decision

On the basis of analysis of the information provided by AlintaGas, the Regulator considered the Total Revenue proposed by AlintaGas needed to be revised to reflect revisions to Capital Expenditure, Non-Capital Costs, the Rate of Return and depreciation. The Regulator also revised the Total Revenue to correct for a systematic bias in AlintaGas's CCA calculation of capital costs, and to reflect amendments to the working capital requirement and the methodology used to calculate a return on working capital.

The systematic bias in the calculation of capital costs arose from an implicit assumption made by AlintaGas that capital costs (depreciation plus return on capital) are incurred (on average) about 6 months before revenue is received, whereas these occur at similar rates over each year.

The Regulator considered that the level of working capital should be determined on the basis of the number of days, on average, that expenses are due prior to revenue being received – the “net lag”. By reference to other distribution businesses in Australia, the Regulator considers a net lag of 100 days to be a reasonable value for the AlintaGas distribution business, corresponding to a working capital requirement of \$10.0 million in 2000.

AlintaGas has proposed escalating the value of working capital each year by a factor of one plus the rate of change in the CPI, and calculating a return on working capital by multiplying by the nominal pre-tax rate of return. However, the Regulator considered it inappropriate to escalate the working capital requirement for inflation.

The Regulator revised the Total Revenue requirement for the distribution systems according to revisions made to the Initial Capital Base, Capital Expenditure, Non-Capital Costs and working capital, and corrections to the calculation of the return on capital and the return on working capital. The revised Total Revenue was as follows.

Draft Decision revised Total Revenue (nominal \$million)

	2000	2001	2002	2003	2004
Return on Capital	41.2	42.7	43.8	44.7	45.5
Depreciation	16.5	17.9	19.0	20.1	21.3
Return on Working Capital	1.1	1.1	1.1	1.1	0.6
Non-Capital Costs	36.4	35.2	35.4	36.3	37.7
Total Revenue	95.2	96.9	99.3	102.3	105.1
AlintaGas proposed Total Revenue	101.1	103.4	106.4	109.4	112.2

The required amendments to the Access Arrangement were as follows.

Draft Decision Amendment 33

The Access Arrangement and Access Arrangement Information should be amended to reflect a working capital requirement of \$10.0 million in each year of the Access Arrangement Period and a return on working capital determined by multiplication of the level of working capital by the nominal pre-tax rate of return.

Draft Decision Amendment 34

The Access Arrangement and Access Arrangement Information should be amended to reflect a Total Revenue requirement as follows:

Year	2000	2001	2002	2003	2004
Revenue (\$million)	95.2	96.9	99.3	102.3	105.1

4.8.4 Responses to Submissions on the Draft Decision***Working Capital***

Draft Decision Amendment 33. The Access Arrangement and Access Arrangement Information should be amended to reflect a working capital requirement of \$10.0 million in each year of the Access Arrangement Period and a return on working capital determined by multiplication of the level of working capital by the nominal pre-tax rate of return.

- AlintaGas

While AlintaGas believes its forecasts are a better indication of the amount of required working capital, the forecasts proposed by the Regulator are not significantly different to those proposed by AlintaGas.

AlintaGas intends to submit a compliant revision in response to Draft Decision Amendment 33.

In the absence of substantive objections to the position adopted by the Regulator on working capital as indicated by Draft Decision Amendment 33, the Regulator will maintain the requirement for this amendment of the Access Arrangement.

Total Revenue

Draft Decision Amendment 34. The Access Arrangement and Access Arrangement Information should be amended to reflect a Total Revenue requirement as follows.

Year	2000	2001	2002	2003	2004
Revenue (\$million)	95.2	96.9	99.3	102.3	105.1

- AlintaGas

AlintaGas objects to Draft Decision Amendment 34 and submits that the Regulator should not require such an amendment in the Final Decision for the following reasons:

(a) The major differences in return on capital and depreciation, as determined by the Regulator and as determined by AlintaGas result from differences in the Initial Capital Base; and

(b) As AlintaGas has objected to the reduction in Initial Capital Base contained in Draft Decision Amendment 28, the flow-on effect of this is that Draft Decision Amendment 34 should also be removed from the Final Decision.

The Total Revenue requirements for the period 2000 to 2004 specified in Amendment 34 are, for each year, determined as the sum of four components: return on capital, depreciation, return on working capital, and Non-Capital Costs.

The major differences in return on capital as determined by AlintaGas, and as determined by the Regulator and set out on page 156 of Part B the Draft Decision, result from differences in the Initial Capital Base.

For the reasons given above in relation to Amendment 28 AlintaGas objects to the reduction of the Initial Capital Base as required by Draft Decision Amendment 28, and submits that the Final Decision should not require such an amendment. If Draft Decision Amendment 28 is not required in the Final Decision, the return on capital in each year of the access arrangement period will not be the figure shown on page 156 of the Draft Decision. In addition, it will not be the figure included in the sum of components of Total Revenue set out in Draft Decision Amendment 34. Accordingly the Regulator should not require Amendment 34 in the Final Decision.

As noted in relation to Draft Decision Amendment 32, the major differences in depreciation as determined by AlintaGas, and as determined by the Regulator (and set out in the reasons supporting Draft Decision Amendment 32), also result from differences in the level of the Initial Capital Base.

For the reasons given in relation to Draft Decision Amendment 28, AlintaGas objects to the reduction of the Initial Capital Base, and submits that the Final Decision should not require such an amendment.

The Regulator notes that AlintaGas's objections to Draft Decision Amendment 34 relate to amendments required in respect of determination of some components of the Total Revenue calculation rather than corrections to calculation methodologies. These objections are addressed in other sections of this Final Decision and changes made, where justified, to the components of Total Revenue.

After further consideration of the various components of the Total Revenue, the Regulator will still require a change in Total Revenue from that proposed by AlintaGas. This reflects differences from the AlintaGas proposal in respect of the Initial Capital Base, Capital Expenditure, Non-Capital Costs and the Rate of Return. As per the Draft Decision, the Regulator also revised the Total Revenue to correct for the systematic bias in AlintaGas's CCA calculation of capital costs, and to reflect changes to the working capital requirement and the methodology used to calculate a return on working capital.

The Total Revenue the Regulator has calculated for the purpose of determining AlintaGas's Reference Tariffs is as follows.

Revised Total Revenue (nominal \$million)

	2000	2001	2002	2003	2004
Return on Capital	41.0	42.4	43.4	44.3	45.0
Depreciation	17.3	18.7	19.8	21.0	22.1
Return on Working Capital	1.1	1.1	1.1	1.1	1.1
Non-Capital Costs	36.7	35.8	36.2	36.7	37.7
Total Revenue	96.0	97.9	100.5	103.1	106.0
AlintaGas proposed Total Revenue	101.1	103.4	106.4	109.4	112.2

4.8.5 Required Amendments to the Access Arrangement

Amendment 32 [was Draft Decision Amendment 33]

The Access Arrangement and Access Arrangement Information should be amended to reflect a working capital requirement of \$10.0 million in each year of the Access Arrangement Period and a return on working capital determined by multiplication of the level of working capital by the nominal pre-tax rate of return.

Amendment 33 [was Draft Decision Amendment 34]

The Access Arrangement and Access Arrangement Information should be amended to reflect a Total Revenue as follows.

Year	2000	2001	2002	2003	2004
Revenue (nominal \$million)	96.0	97.9	100.5	103.1	106.0

4.9 REVENUE ALLOCATION**4.9.1 Access Code Requirements**

In determining Reference Tariffs, a Service Provider must determine (explicitly or implicitly) the costs or share of costs of pipeline operation that will be recovered through each Reference Service, and from each User. Rules for the allocation of costs/revenues between services and Users are provided in sections 8.38 to 8.43 of the Code.

Allocation of Costs/Revenue Between Services

Section 8.38 of the Code requires that Reference Tariffs should be designed to only recover that portion of Total Revenue which includes:

- (a) all of the Total Revenue that reflects costs incurred (including capital costs) that are directly attributable to the Reference Service; and
- (b) a share of the Total Revenue that reflects costs incurred (including capital costs) that are attributable to providing the Reference Service jointly with other Services, with this share to be determined in accordance with a methodology that meets the objectives in section 8.1 of the Code and is otherwise fair and reasonable.

Section 8.39 of the Code provides for the Regulator to require a different methodology to be used for cost/revenue allocation than may have been proposed by a Service Provider in an Access Arrangement pursuant to section 8.38 of the Code. However, if such a requirement is proposed, the Regulator must provide a detailed explanation of the methodology that is required to be used.

Section 8.40 of the Code addresses the allocation of Total Revenue between Reference Services and Rebatable Services. A Rebatable Service is defined in the Code as a Service where:

- (a) there is substantial uncertainty regarding expected future revenue from sales of that Service due to the nature of the Service and/or the market for that Service; and
- (b) the nature of the Service and the market for that Service is substantially different to any Reference Service and the market for that Reference Service.

If a Reference Service is provided jointly with a Rebatable Service, then all or part of the Total Revenue that would have been recovered from the Rebatable Service under section 8.38 of the Code (if that Service was a Reference Service) may be recovered from the Reference Service provided that an appropriate portion of any revenue realised from sales of any such Rebatable Service is rebated to Users of the Reference Service (either through a reduction in the Reference Tariff or through a direct rebate to the relevant User or Users). The structure of such a rebate mechanism should be determined having regard to certain objectives:

- (a) providing the Service Provider with an incentive to promote the efficient use of Capacity, including through the sale of Rebatable Services; and
- (b) Users of the Reference Service sharing in the gains from additional sales of Services, including from sales of Rebatable Services.

Section 8.41 provides a Service Provider with discretion to adopt alternative approaches to cost/revenue allocation subject to any approach adopted having substantially the same effect as the approach outlined in section 8.38 and 8.40 of the Code.

Allocation of Costs/Revenue Between Users

Section 8.42 relates to the allocation of Total Revenue between Users and requires that, subject to provisions for prudent discounts in section 8.43 of the Code, Reference Tariffs be designed such that the proportion of Total Revenue recovered from actual or forecast sales of a Reference Service to a particular User of that Service is consistent with the principles described in section 8.38 of the Code.

Prudent Discounts

Section 8.43 of the Code provides for a Service Provider to give prudent discounts on Reference Tariffs, or equivalent tariffs for Non Reference Services, in particular circumstances. A User receiving a discount would be paying a proportion of Total Revenue that is less than the proportion that would be paid by the User under the principles of sections 8.38 and 8.40 of the Code. Section 8.43 of the Code provides for such a discount to be given to a User if:

- (a) the nature of the market in which a User or Prospective User of a Reference Service or some other Service operates, or the price of alternative fuels available to such a User or Prospective User, is such that the Service, if priced at the nearest Reference Tariff (or, if the Service is not a Reference Service, at the equivalent tariff) would not be used by that User or Prospective User; and
- (b) a Reference Tariff (or equivalent tariff) calculated without regard to revenues from that User or Prospective User would be greater than the Reference Tariff (or equivalent tariff) if calculated having regard to revenues received from that User or Prospective User on the basis that it is served at a price less than the Reference Tariff (or equivalent tariff).

Condition (b) effectively requires that the discounted tariff must return a revenue that is in excess of the avoidable cost of providing the service to the User. That is, the User receiving the discount must still pay a price for the service that covers the incremental costs of providing that service as well as making some contribution to common costs that are met jointly by all Users. By virtue of the contribution to common costs, the Reference Tariffs for all other Users would be lower than if the User eligible for the discount did not purchase the service.

The proportion of Total Revenue that comprises the discount may be recovered from other users of the Reference Service or some other service or services in a manner that the Regulator is satisfied is fair and reasonable.

4.9.2 Access Arrangement Proposal

The methodology used by AlintaGas to allocate Total Revenue across services is described in section 2.5 of the Access Arrangement Information. The allocation methodology had the following principal steps.

- i. Costs were allocated into three “cost baskets”:
 - asset costs, comprising the return on the capital base and depreciation costs;
 - operating and maintenance costs; and
 - other costs, comprising the return on working capital, marketing costs and corporate overhead costs.
- ii. Costs from the asset cost basket and the operating and maintenance cost basket were allocated into cost pools broadly relating to three categories of assets making up the distribution network:

- the high pressure system;
- the medium/low pressure system; and
- metering.

The allocation of asset costs into three cost pools was undertaken according to the proportions of total capital costs attributable to individual classes of assets (AlintaGas Allocator 2).

The allocation of operating and maintenance costs to cost pools was undertaken according to ratios of the replacement costs of assets in each cost pool to the total replacement cost of distribution system assets (AlintaGas Allocator 1).

- iii. Costs from the “other costs” basket and from each cost pool were allocated to two groups of Reference Services:

- Reference Service A; and
- Reference Services B1, B2 and B3.

Costs in the high pressure system cost pool were allocated to the service groups according to estimated contributions of services in each category to system peak flows (AlintaGas Allocator 3).

Costs in the medium/low pressure system cost pool were allocated to the service groups according to estimated contributions of services in each category to forecast gas volumes delivered for each category, weighted according to load factors for each service (AlintaGas Allocator 6).

Costs in the metering cost pool were allocated entirely to the service group comprising Reference Services B1, B2 and B3.

Costs in the “other costs” basket were allocated to the service groups according to two criteria. 20 percent of the “other costs” were allocated to the service groups on the basis of proportions of forecast gas volumes delivered for each service group (AlintaGas Allocator 4). The remaining 80 percent of the “other costs” were allocated on the basis of proportions of the forecast numbers of delivery points for each service group (AlintaGas Allocator 7).

- iv. For the service group comprising Reference Services B1, B2 and B3, costs derived from the “other costs” basket and each cost pool were allocated to the individual services.

Costs derived from the high pressure system cost pool were allocated to each service in proportion to the estimated contributions of each service to forecast total gas volume delivered (AlintaGas Allocator 5).

Costs derived from the medium/low pressure system cost pool were allocated to each service in proportion to estimated contributions of each service to forecast gas volumes delivered for each category, weighted according to load factors for each service (AlintaGas Allocator 6).

Costs derived from the metering cost pool were allocated to services B2 and B3 in proportion to the cost-weighted number of delivery points for each service (meters for service B2 are larger and more expensive than for service B3) (AlintaGas Allocator 8).

Costs derived from the “other costs” basket were allocated to each service according to two criteria. 20 percent of the “other costs” were allocated to each service on the basis of proportions of forecast gas volumes delivered for each service category (AlintaGas Allocator 4). The remaining 80 percent of the “other costs” were allocated on the basis of proportions of the forecast numbers of delivery points for each service category (AlintaGas Allocator 7).

The allocation of Total Revenue across services effectively determines the average tariff for gas distribution for each service. The revenue allocation proposed by AlintaGas and the average distribution tariffs for each service are indicated as follows.

AlintaGas proposed allocation of Total Revenue across services (2000)

Reference Service	Revenue Allocation	Average Distribution Tariff
A	8.3 million	\$0.54/GJ
B1	16.2 million	\$4.40/GJ
B2	5.3 million	\$5.98/GJ
B3	71.3 million	\$9.06/GJ
Total	101.1 million	\$3.63/GJ

4.9.3 Draft Decision

While in the Draft decision the Regulator accepted AlintaGas’s methodology for allocation of Total Revenue, the allocation of revenue across services varied from that proposed by AlintaGas as a result of revisions to underlying cost parameters. The revised revenue allocation indicated in the Draft Decision is shown below.

AlintaGas proposed allocation of Total Revenue across services (2000)

Reference Service	AlintaGas Proposed Allocation		Revised Allocation	
	Revenue Allocation	Average Distribution Tariff	Revenue Allocation	Average Distribution Tariff
A	8.3 million	\$0.54/GJ	7.8 million	\$0.51/GJ
B1	16.2 million	\$4.40/GJ	15.2 million	\$4.13/GJ
B2	5.3 million	\$5.98/GJ	5.0 million	\$5.63/GJ
B3	71.3 million	\$9.06/GJ	67.2 million	\$8.54/GJ
Total	101.1 million	\$3.63/GJ	95.2 million	\$3.42/GJ

4.9.4 Responses to Submissions on the Draft Decision

No submissions were made on the Draft Decision in respect of the allocation of Total Revenue to Reference Services.

4.9.5 Required Amendments to the Access Arrangement

The Regulator maintains the view expressed in the Draft Decision that AlintaGas's proposed methodology for allocation of Total Revenue meets the requirements of the Code. No specific amendments to the Access Arrangement are necessary in this regard. The actual allocation of revenue will, however, vary from that proposed by AlintaGas due to revisions made in this Final Decision to Total Revenue. The revised revenue allocation is as follows.

Revised allocation of Total Revenue across services (2000)

Reference Service	AlintaGas Proposed Allocation		Revised Allocation	
	Revenue Allocation	Average Distribution Tariff	Revenue Allocation	Average Distribution Tariff
A	8.3 million	\$0.54/GJ	7.9 million	\$0.51/GJ
B1	16.2 million	\$4.40/GJ	15.2 million	\$4.12/GJ
B2	5.3 million	\$5.98/GJ	5.0 million	\$5.66/GJ
B3	71.3 million	\$9.06/GJ	67.8 million	\$8.63/GJ
Total	101.1 million	\$3.63/GJ	96.0 million	\$3.45/GJ

Over the Access Arrangement Period, the reduction in revenues required by the Regulator corresponds to a reduction in the discounted weighted average tariff of approximately four percent²⁷ from that proposed by AlintaGas.

4.10 REFERENCE TARIFFS

4.10.1 Access Code Requirements

The final stage of cost allocation is the allocation of target revenue for each Reference Service to the various charges that make up each Reference Tariff. The Code does not establish explicit rules or guidelines for the structuring of Reference Tariffs. However, in setting out the general objectives for Reference Tariffs and a Reference Tariff policy, section 8.1 of the Code states that a Reference Tariff and Reference Tariff Policy should be designed with a view to achieving efficiency in the level and structure of the Reference Tariff.

²⁷ Excluding pass through of the goods and services tax.

In addition to the requirements of the Code, further requirements in respect of the setting of Reference Tariffs are imposed by the *Gas Pipelines Access (Western Australia) Act 1998* on the Regulator. Section 38 of the Act requires the Regulator to take into account the fixing of appropriate charges as a means of extending effective competition in the supply of natural gas to residential and small business consumers. “Appropriate charges” refers to charges for the use of the pipeline to transport small quantities of natural gas that will enable suppliers to compete for the custom of residential and small business consumers. “Small quantities” refers to a quantity of gas that is less than a quantity prescribed by the Minister, but is in any case a quantity of less than one terajoule in any period of 12 consecutive months that is transported to a single metered connection. In respect of the AlintaGas gas distribution systems, this would correspond to supply of gas under Reference Services B2 and B3.

4.10.2 Access Arrangement Proposal

AlintaGas structured Reference Tariffs to recover the target revenue allocated to each service on the basis of standing charges that would apply uniformly to all Users of a Service and demand and/or usage charges that vary for each User in proportion to their level of use of a service.

Revenue allocated to Reference Service A is allocated to standing, demand and usage charges in proportions of 30 percent, 35 percent and 35 percent respectively. Demand and usage charges are segregated into distance-related tariffs based on the minimum straight-line distance of the delivery point from the nearest transmission pipeline (either the Dampier to Bunbury Natural Gas Pipeline or the Parmelia Pipeline). Different rates apply to the first 10 km distance and to any distance in excess of 10 km.

Revenue allocated to the Reference Services B1, B2 and B3 is allocated to standing and usage charges. For Reference Services B2 and B3, the usage charges comprise a block structure for different levels of gas use. No information was provided by AlintaGas as to the basis for the proportions of revenue intended to be recovered from the different components of each tariff.

In addition to the standing, demand and usage components of Reference Tariffs, the Access Arrangement makes provision in the specification of Reference Tariffs for user-specific charges to be levied on Users of Reference Service A and B1. The user-specific charges are to reflect the costs to AlintaGas of providing the user-specific delivery facilities under a haulage contract. The costs of the user-specific delivery facilities have not been included in the Total Revenue that is intended to be recovered from Reference Tariffs.

The Reference Tariffs proposed by AlintaGas are indicated below. Tariffs have been set only for the first year of the Access Arrangement Period. AlintaGas has proposed that tariffs in subsequent years are able to be varied in accordance with a “revenue yield” regime. The variation of Reference Tariffs is discussed in section 4.11, below.

AlintaGas's proposed Reference Tariffs

Reference Service	Standing Charge	Block Structure	Demand Charge	Usage Charge
	(\$/annum)		(\$/GJ–km/year)	(\$/GJ–km)
A	50,000.00	First 10 km	179.29	0.04675
		> 10 km	89.64	0.02337
				(\$/GJ)
B1	500.00	–	–	4.35
B2	200.00	First 100 GJ	–	5.46
		> 100 GJ	–	4.91
B3	25.00	First 15 GJ	–	8.72
		Next 30 GJ	–	6.54
		Next 55 GJ	–	5.67
		>100 GJ	–	5.23

In addition to the above charges, the Access Arrangement makes provision for the Reference Tariffs for Reference Services A and B1 to include user-specific charges for user-specific delivery facilities.

The Regulator considered that the structure of Reference Tariffs should be a matter of commercial discretion for the Service Provider, subject to any proposed tariff structure not being inconsistent with broad criteria of efficiency and equity.

Public submissions on the Access Arrangement raised concerns in relation to the proposed determination of charges for user-specific charges and the proposed tariff structure for Reference Service A.

AlintaGas indicated to the Regulator that the user-specific charge would comprise an amortised cost of the user-specific delivery facilities over a cost recovery period determined on the basis of the characteristics and circumstances of individual Users.

The Regulator accepted that it is reasonable for user-specific charges to be determined on a case by case basis for individual Users of Reference Services A and B1. However, the Regulator considered that Users and Prospective Users can reasonably expect that the Access Arrangement should indicate the general methodology to be used in calculating the user-specific delivery charges and the rate of return implicit in amortisation of costs of user-specific delivery facilities.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 35

The Access Arrangement should be amended to include a statement of general methodology for the determination of user-specific delivery charges, and to indicate the rate of return implicit in amortisation of costs of user-specific delivery facilities.

Several public submissions on the Access Arrangement raised concerns about the proposed tariff structure for Reference Service A. In particular, submissions addressed:

- the setting of demand and usage charges on the basis of distance from the nearest transmission pipeline regardless of which transmission pipeline the gas is actually sourced for the particular User; and
- the block structure of the tariff for Reference Service A that provides for different demand and usage charges for the first 10 km distance of a User from a transmission pipeline and any distance in excess of 10 km.

The Regulator considered that the general structure of the tariff for Reference Service A is consistent, in principle, with efficiency and equity considerations. However, the Regulator had concerns with regard to AlintaGas's argued basis for differences in distance-based charges. The Regulator was also concerned about the possibility that the proposed tariff structure may give rise to abrupt large changes in gas distribution costs relative to those that would be incurred under the current regulatory regime (charges set under the *Gas Distribution Regulations 1996* – the “GDR Tariffs”).

Other concerns related to the proposed tariff structures for Reference Services A and B1 and the potential for these tariff structures to motivate inefficient use of gas. Where gas is delivered to a User at quantities close to 35 TJ of gas per year and at a contracted peak rate of close to 10 TJ/hour, there may be no material practical difference in the nature of the delivery service provided to the User, regardless of whether this service is provided as Reference Service A or Reference Service B1. However, by virtue of the different tariff structures for Reference Service A and Reference Service B1, the User may face substantially different costs of gas distribution depending upon the service which the User is eligible to receive. The differences in cost may motivate the User (or the end-user of the gas) to alter the level or rate of gas use solely for the purpose of becoming eligible for a distribution service with a lower average tariff. This may result in the inefficient use of gas resources.

The required amendments to the Access Arrangement were as follows.

Draft Decision Amendment 36

Should AlintaGas wish to maintain differences in demand and usage charges for Reference Service A on the basis of differences in pipeline construction costs, these charges (clause 21 of the Access Arrangement) should be amended to reflect available information on cost differentials.

Draft Decision Amendment 37

Clause 21 of the Access Arrangement should be amended to provide a tariff structure for Reference Service A (or a succession of tariff structures for each year of the Access Arrangement Period) that accommodates a reasonable transition to the Reference Service A tariff from distribution tariffs that would have occurred for Users under the *Gas Distribution Regulations 1996*.

Draft Decision Amendment 38

Clauses 21 and 22 of the Access Arrangement should be amended to provide tariff structures for Reference Services A and B1 that allow for a reasonably seamless transition in gas distribution charges between these two services.

In regard to tariff structures for Reference Services B2 and B3, the Regulator assessed whether the levels and structures of distribution tariffs for Reference Services B2 and B3 are consistent with retail margins in the supply of gas that are sufficiently large to enable gas traders to enter the market for gas supply to small-business and residential customers.

By virtue of the proposed block structures of retail and distribution tariffs, retail margins for individual customers of Reference Services B2 and B3 will differ for different gas-quantity blocks. The Regulator noted that the proposed tariff structure for Reference Service B3 provides for very low or negative retail margins for some gas quantity blocks. This could impede the development and continuation of effective competition in the supply of natural gas to these customers. The Regulator considered that the tariff structure for Reference Service B3 should make provision for reasonable retail margins.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 39

Clause 24 of the Access Arrangement should be amended to provide a tariff structure for Reference Service B3 that makes provision for reasonable retail margins for a User providing gas to residential end-users of gas, both in total for any residential end-user and for any gas-quantity block.

4.10.3 Responses to Submissions on the Draft Decision

Quantity Forecasts

- Office of Energy

In its 5 August 1999 submission on the Access Arrangement the Office of Energy considered that the Regulator would need to be satisfied as to the validity of the volume forecasts. It may be that the decrease in volume indicates customers being lost to by-pass. One reason for this happening could lie in inefficient distribution pricing.

The Draft Decision states that the Regulator did not undertake a detailed review of quantity forecasts. While the absence of growth for the services may arise from practices of distribution pricing and consequent by-pass, the Regulator regarded this to be a commercial matter for AlintaGas and not of direct relevance to the assessment of the Access Arrangement.

In relation to this matter the Office of Energy draws the Regulator's attention some of the factors that the Regulator needs to consider in assessing a proposed Access Arrangement. Firstly, one of the factors about

which the Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff Policy is that any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis. Secondly, one of the factors that should be considered in establishing the Initial Capital Base for a pipeline is the comparability with the cost structure of new pipelines that may compete with the pipeline in question (for example, a pipeline that may by-pass some or all of the pipeline in question). In addition, for example, the Code requires that the Depreciation Schedule should be designed so as to result in the Reference Tariff changing over time in a manner that is consistent with the efficient growth of the market for the Services provided by the pipeline. It is requested that the Regulator give further consideration to the matter of volume forecasts and efficient distribution pricing in respect of Reference Services A and B1.

In assessing the quantity forecasts put forward by AlintaGas, the Regulator considered the consistency of these forecasts with recent (1996 to 1999) growth in AlintaGas's gas markets and a review of the AlintaGas's quantity forecasts undertaken for AlintaGas for the purposes of the Access Arrangement.²⁸

The Regulator noted that distribution forecasts for gas delivery to residential and small commercial end-users of gas (Reference Services B2 and B3) comprised increases in quantities consistent with recent historical rates of increase, and consistent with independent forecasts of numbers of potential new residential and small business connections. On this basis the Regulator accepted the quantity forecasts for Reference Services B2 and B3.

Distribution forecasts for gas delivery to larger commercial end-users of gas (Reference Services A and B1) were noted to comprise rates of increase in distributed quantity that were substantially less than recent historical rates of increase in customer numbers. This was attributed to a combination of expectations of limited increases in demand from large end-users of gas over the Access Arrangement Period, and increased competition from operators of gas transmission pipelines for delivery of gas to such end-users by by-passing the distribution system. The Regulator notes that there is still a projected growth in gas distribution for these sectors of the gas market, albeit at a reduced rate.

While the structure of distribution tariffs may influence the decision by a potential User of the AlintaGas gas distribution system to either utilise the distribution or opt for a bypass of the distribution systems directly from a transmission pipeline, there is no evidence to suggest that the proposed tariffs for Reference Services A or B1 would unduly influence a bypass decision. Furthermore, the Regulator is of the view that AlintaGas would have no commercial incentive to structure distribution tariffs in such a way as to motivate bypass of the distribution systems.

Reference Service A and B1 – User Specific Delivery Charges

Draft Decision Amendment 35. The Access Arrangement should be amended to include a statement of general methodology for the determination of user-specific delivery charges, and to indicate the rate of return implicit in amortisation of costs of user-specific delivery facilities.

- AlintaGas

AlintaGas accepts that the Access Arrangement should contain a statement of general methodology with regard to user-specific charges. AlintaGas proposes to include a statement to the effect that "user-specific charges will be calculated by amortising the value of user-specific facilities over an appropriate capital recovery period, using the Nominal Weighted Average Cost of Capital Before Tax."

²⁸ Economics Consulting Services, April 1999. Report to AlintaGas: Distribution Network Forecast.

In the absence of substantive submissions on Draft Decision Amendment 35, the Regulator will maintain the requirement for this amendment of the Access Arrangement. The Regulator also notes that the changes to the Access Arrangement proposed by AlintaGas in this regard would meet the requirements of the Draft Decision Amendment 35.

Reference Tariffs A and B1 – Magnitude

- CMS Gas Transmission of Australia Submission No. 3

Under the current Gas Distribution Regulations 1996 (GDR) regulatory regime, Gas Retailers have to a limited extent been able to compete against AlintaGas in the competitive gas market and this has established a market delivered gas price for contestable customers.

AlintaGas Trading's sales equate to a market share of 90% compared to third parties market share of 10%. CMS's share of the retail market is 0.3%.

The proposed Reference Tariffs will make competition near on impossible as it has raised the cost to a level above the current market delivered gas price which would require competitors to AlintaGas to be left with negative margins. It is apparent that under the proposed Access Arrangement:

- i). the distribution costs as a proportion of the total delivered gas price would be increased substantially; and
- ii) the delivered gas price would substantially exceed the market delivered gas price of \$3.00/GJ that has been reported in the press.

This provides AlintaGas with the opportunity to use arbitrary internal transfer pricing which can keep competition out but have no effect on AlintaGas's consolidated distribution and trading revenue.

Further proof that Gas Retailers will not be able to compete against AlintaGas in the competitive gas market for customers consuming 35 TJ/a lies in the tariffs for Reference Service A and B1 proposed in the AlintaGas Access Arrangement being generally substantially higher than those currently prevailing under the Gas Distribution Regulations.

How can a Gas Retailer compete if its costs under the proposed Access Arrangement will be higher than the market price established under the existing Gas Distribution Regulations which have been in operation since deregulation of the AlintaGas gas distribution system started in 1997?

CMS considers that these proposed tariff structures would deny competitors access to a gas market, which amounts to gas sales revenue of about \$250 million (AlintaGas Annual Report 1999 and CMS Estimate). This revenue equates to the total market that Gas Retailers will be able to compete for (i.e. it excludes all long term gas supply contracts supplied directly off DBNGP such as Alcoa, Worsley, CSBP).

These proposed AlintaGas Access Arrangement provisions would allow AlintaGas to maintain its monopoly and hold out CMS and other competitors for at least five years (i.e., Access Arrangement Period). Furthermore, the proposed tariff structures would stifle any Gas Retailer competition and this has the potential to reduce revenue on the Parmelia Pipeline and for Perth Basin Gas Producers.

Finally, if these tariff structures are approved then the benefits that would arise from increased competition will not be realised.

In view of concerns expressed in submissions that the proposed gas distribution costs under Reference Tariff A would substantially exceed what the costs may have been under the *Gas Distribution Regulations* (the "GDR Tariff") the Regulator undertook a comparison of relative distribution charges using data provided by AlintaGas on the current end-users of gas that would, under the proposed Access Arrangement, receive gas under Reference Service A. The data provided by AlintaGas comprised aggregated data for each pair of end-users of gas that take gas from the AlintaGas high pressure system (and hence would qualify for the GDR Tariff) and would also qualify for delivery of gas under Reference Service A, in order of increasing distance from the closest gas transmission pipeline. The data included usage and

location parameters that are the determinants of gas distribution charges under the two tariff structures.

For the purposes of this comparison, the Regulator based the calculation of gas distribution costs on the GDR Tariff established for 1998/99, and Reference Tariff A as it would be after revision of the Access Arrangement as required by this Final Decision. These tariffs are as follows.

Gas Distribution Regulations 1998/99 Tariff			
Demand Price	Energy Price		
(\$/GJ of MHQ/km/year)	(\$/GJ/km)		
120.888	0.0198		
Revised Reference Tariff A			
Standing Charge	Block Structure	Demand Charge	Usage Charge
(\$/annum)		(\$/GJ of MHQ/km/year)	(\$/GJ/km)
44,000.00	First 10 km	181.64	0.04426
	> 10 km	90.82	0.02213

The conclusions of the analysis were as follows.

- The change in tariff structure was estimated to imply an increase in gas distribution charges for 15 out of the 19 “customer pairs”. For most of the pairs, the projected increase was by a factor of up to about 2.5 times, but with increases for some pairs of four to five times. However, the *relative* change in distribution charges for Reference Tariff A customers is likely to overstate the impact on users given the relatively small share of distribution charges in the total gas cost for many of these customers.
- The proportionate reduction in charges to the remaining four customer pairs ranged between about 5% and 40%.
- There is no simple correlation between the change in charges with distance from a transmission pipeline or the quantity of gas delivered.

The Regulator notes the argument put forward by AlintaGas that, in the absence of the advent of regulation under the Code, the GDR Tariffs may have been increased by about 19 percent for 1999/2000. This would imply that a comparison of distribution charges under Reference Tariff A with the 1998/99 GDR Tariff would exaggerate any increase in charges that would result from the change in tariff structure.²⁹ However, given that the 1998/99 tariffs are the last set of tariffs that have been published and made available to third party access seekers, the Regulator considers that these provide the more appropriate basis for comparison.

²⁹ See below under “Reference Tariff A – Transition from GDR Tariff”. AlintaGas proposed that the GDR Tariff would have been increased by 19 percent for 1999/2000.

Accordingly, the Regulator accepts the restructuring of charges that AlintaGas has proposed will imply a differentiated impact across users.

However, it is not accepted that the change in the level and structure of distribution charges is likely to create impediments to competition in the supply of gas. In particular, while charges for gas distribution may increase under the Reference Tariff relative to the possible level of charges under the GDR Tariff, this does not necessarily decrease the potential retail margins for gas traders entering the market. Rather, as there is no regulated retail price for gas that would be delivered under Reference Service A, the price paid by end-users could rise to accommodate higher distribution costs if these occur.

The submission from CMS also addressed the potential for an increase in gas distribution charges under Reference Tariff B1, relative to what these charges may have been under the GDR Tariff. The Regulator notes that the GDR Tariff did not apply to such deliveries of gas as may be expected to occur under Reference Service B1, and hence any such comparison between the two tariff structures is invalid.

Reference Service A Tariff – Standing Charge

- Origin Energy – Major Industry & Power

The standing charge for the Reference Service A appears to be excessive and will be a significant disadvantage to small customers. We believe the charge requires further review as to its appropriateness and level of application.

- AGL Energy Sales & Marketing

We accept that a standing charge may be required to ensure a sufficient capital recovery from the construction and maintenance of the AlintaGas distribution network. However, we have not seen information that justifies a \$50,000 per annum standing charge for the proposed Reference Service A. We therefore ask the Regulator to request further information from AlintaGas so that this charge can be adequately assessed. We also ask the Regulator to give consideration to the impact a charge of this order may have on the delivered cost of gas for a small Reference Service A tariff customer.

- Apache Energy Limited

Reference Service A tariffs for gas delivered into the Geraldton region are very high and will result in customers in that area receiving little benefit from the Access Arrangement. Exactly the same argument holds for customers south of the Clifton Road Gate Station. In each case the distribution tariff exceeds the associated transmission charge in bringing the gas to the entry point to the distribution system. While AlintaGas has indicated that it is prepared to negotiate tariffs, it is hard to see this happening while there is common ownership of the AlintaGas retail and distribution businesses. These laterals are transmission laterals and should be tarified as such. They were acquired by AlintaGas from its former transmission business.

As far as Apache is aware there has not been one grant of access to the distribution system under the terms and conditions of the *Gas Distribution Regulations 1996*. The proposed Reference Service A tariff, with its high standing charge, will in many cases be much higher than existing charges. Whilst it will be argued that the new tariffs reflect the application of the Code and the Regulator is seeking a reasonable transition from the old to the new charges, the result is significantly higher transport costs to larger customers, and revenues to AlintaGas Distribution clearly much increased from the old regime.

- ARC Energy NL

We note that the proposed \$50,000 per annum standing charge pursuant to Reference Tariff A has already come under strong criticism from other key industry stakeholders as it is highly excessive and, on face value, will substantially increase the distribution system cost component for those small to medium sized commercial gas customers that already are and will become contestable over the next two years.

It would appear that this proposed tariff structure by AlintaGas is a clear attempt to retain its existing customer base in the small to medium commercial sector and to make it very difficult, if not impossible, for third parties to compete in an effective manner. The assertion by AlintaGas in the public forum on the Regulator's Draft Decision, that any customer who may be affected by this increase to any great extent, may be looked after by AlintaGas through a lower negotiated non-Reference Tariff so as to not suffer economic hardship, is further indication of their underlying objective. In other words, if AlintaGas does accept that many of its contestable commercial customers will be subject to substantial distribution network cost increases due to the proposed standing charge and, at the same time, is genuine about promoting fair competition amongst gas producers, traders and retailers, Reference Tariff A should have been structured to reflect a fair and reasonable charge for those customers in the relevant gas consumption brackets rather than levying an excessive fixed charge in the first place.

As has already been demonstrated in other previous industry submissions on this particular issue, the proposed \$50,000 standing charge will result in more than 1000% increases in the distribution cost component for many gas customers. It should come as no surprise that the customers most affected by this increase are those that have recently become contestable and those that will shortly be negotiating for a renewal of their contracts prior to becoming contestable on 1 January 2002.

Any tariff increases by a monopoly of this size and nature raise serious concerns as such increases can surely not be justified by AlintaGas on the basis of increased costs. Instead, AlintaGas has chosen to reallocate its costs in such a way that its most recently contestable customer base will be most affected. The underlying objectives and implications of this cost reallocation for market competition would seem more than obvious.

Whilst AlintaGas may argue that any "tariff anomalies" may be overcome through a negotiation process, it is our experience that the negotiation of Non-Reference Tariffs with a monopoly Service Provider will be one-sided and is certainly not conducive to achieving a fair competitive market environment, especially where prospective network users will continue to compete with AlintaGas's trading/retailing arm. Despite OffGAR's assurances that it will monitor any AlintaGas "inhouse" discounting/cross-subsidisation arrangements not offered to other third party users, we strongly doubt the transparency and, hence, the effectiveness of this negotiation process.

It simply can not be in the best interest of promoting/creating a competitive environment to initially set an artificially high fixed charge for a certain consumer group, and then invite Prospective Users of the distribution network to negotiate a "better deal" with a monopoly Service Provider that has competing interests.

In summary, ARC considers the proposed standing charge pursuant to Reference Tariff A to constitute a substantial barrier to entry for any competitors of AlintaGas and we do not consider it cost reflective nor conducive to promoting an efficient competitive environment.

ARC therefore respectfully requests that OffGAR reconsiders its draft decision in relation to Reference Tariff A in order to remove the anti-competitive, high-cost element from that structure.

- CMS Gas Transmission of Australia Submission No. 1³⁰

CMS considers that the standing charge of \$50,000 for Reference Service A has been specifically set at a high level by AlintaGas to ensure that third parties find it difficult to capture any AlintaGas's customers if they have to supply gas via the AlintaGas Gas Distribution System.

This provision protects the AlintaGas trading business, which can use the diversity of its customer base to maintain supply to customers under competitive threat, i.e., it can use its residential market to cross subsidise its industrial market. In fact, this provision will allow AlintaGas to maintain its monopoly and hold out competitors for at least five years (i.e. the Access Arrangement Period).

The impact of the proposed standing charge results in the tariffs for Reference Service A proposed in the Access Arrangement generally being substantially higher than those currently prevailing under the Gas

³⁰ Some sections of this submission by CMS were also included in the submission by Empire Oil & Gas NL. For the purposes of avoiding repetition, only the CMS submission is described and addressed here.

Distribution Regulations. A comparison of regulatory regime tariffs for varying gas usage and distance is as follows.

Comparison: Gas Distribution Regulations and Access Arrangement Reference Service A Tariffs (\$/GJ)

Annual Quantity TJ/year	Tariff regime	Distance (km) from nearest gate station					
		0.1	1	2	5	10	20
35	GDR (old)	0.0043	0.0434	0.0869	0.2172	0.4344	0.8688
	AA (new)	1.4000	1.4900	1.5800	1.8800	2.3700	2.8600
100	GDR (old)	0.0043	0.0434	0.0869	0.2172	0.4344	0.8688
	AA (new)	0.5100	0.6000	0.7000	0.9900	1.4800	1.9700
250	GDR (old)	0.0043	0.0434	0.0869	0.2172	0.4344	0.8688
	AA (new)	0.2100	0.3000	0.4000	0.6900	1.1800	1.6700

The following table highlights the extent of the difference in percentage terms.

Percentage Increase: Access Arrangement Reference Service A over Gas Distribution Regulations

Annual Quantity TJ/year	Distance (km) from nearest gate station					
	0.1	1	2	5	10	20
35	32228%	3430%	1819%	866%	546%	329%
100	11740%	1381%	806%	456%	341%	227%
250	4834%	691%	460%	318%	272%	192%

The imposition of a \$50,000 per year standing charge constitutes a substantial barrier to entry for third party producers, retailers and traders alike. For an AlintaGas competitor to secure gas supply to a 100 terajoules per year customer who became contestable on 1 January 2000, just under half of the transport tariff paid by that AlintaGas competitor would be paid to AlintaGas to simply gain access to the market.

One of the stated objectives of the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) is the promotion of a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders.

Any barriers to entry to any market mitigate against competition, and the ability of end consumers of gas to exercise choice over gas supplier, retailer, or trader. The fixed charge incorporated in Reference Tariff A constitutes a substantial barrier to entry for competitors of AlintaGas.

Therefore, it may be seen that the tariff structure applicable to Reference Service A as currently proposed does not comply with the intent of the Code.

Whether it is intended, or unintended this provision hinders competition and therefore infringes Clause 13 of the Gas Pipelines Access (WA) Act. Furthermore, CMS considers that the standing charge will have the effect of preventing CMS and other parties engaging in competitive conduct. Therefore, CMS believes that this provision infringes parts of section 46 of the Trade Practices Act.

Overall CMS' contention is that the standing charge is either designed to block, or has the effect of blocking, access for third party producers, retailers and traders to the AlintaGas market.

CMS note that the submission by Apache Energy Ltd came to the same conclusion as CMS. Furthermore, the submissions by the Chamber of Minerals & Energy and Chamber of Commerce & Industry (respectively) question the standing charge in terms of not being cost reflective or promoting an efficient market.

CMS contend that the Draft Decision of the Regulator does not address the concerns that have been raised in the above submissions.

CMS Proposal: OffGAR mandates that AlintaGas withdraws the currently proposed tariff structure for Reference Service A and puts in its place a structure which is fair and reasonable, and is in accordance with the intent of the Code.

- Phoenix Energy

Phoenix has concerns about the standing charge for Reference Service A. Whilst we believe they have been addressed comprehensively by other parties making submissions, in particular CMS, we would welcome an opportunity to discuss them further with *OffGAR* and lend our weight to the arguments.

As indicated above under the heading “Reference Tariff A – Magnitude”, the Regulator undertook a comparison of potential distribution charges under the 1998/99 GDR Tariff and the Reference Service A Tariff using data provided by AlintaGas on the current end-users of gas that would, under the proposed Access Arrangement, receive gas under Reference Service A. The analysis of the data provided by AlintaGas indicated that gas distribution charges generally increase in a change from the GDR Tariff to Reference Tariff A, although some decreases may also occur. The analysis indicated that the change in tariff structure would typically increase gas distribution charges, most commonly by up to about 2.5 times but with some increases of four to five times, and the decreases ranged from about 5% to 40%. It was also noted, however, that the relative change in distribution charges may overstate the impact on large Users given the small share of distribution charges in the total cost for these Users.

The comparative distribution costs presented in the submission by CMS appears to greatly overstate the potential increase in gas distribution costs under Reference Tariff A compared to the 1998/99 GDR Tariff.

The Regulator is of the view that the standing charge proposed under Reference Tariff A would not in itself constitute a barrier to entry of new gas traders to the market for gas sales to large end-users. Rather, any disincentive to enter the market would arise in relation to the *total distribution charge* rather than any particular tariff component. Furthermore, a tariff structure that seeks to recover some of the fixed costs of service provision through a standing charge may have some efficiency advantages, in so far as it allows a usage charge to be closer to the marginal costs of service provision. Accordingly, the Regulator has not been convinced that AlintaGas’s proposal to include a standing charge component as part of Reference Tariff A is unreasonable and should be precluded.

It should be noted that with revisions to the Access Arrangement as required by this Final Decision, the standing charge will be \$44,000 rather than \$50,000 as initially proposed.

In relation to the specific concerns raised by Apache Energy limited in relation to gas distribution costs from the Geraldton lateral, there is some difficulty in addressing this issue as the decision that the Geraldton lateral is part of the distribution system is one that has already been taken outside of the Regulator’s jurisdiction. While it may be possible for this lateral to be regulated at sometime in the future as a transmission pipeline, it not clear, however, that gas transportation costs through this lateral would be lower as a result.

Reference Tariff A – Interconnection Distance

- ARC Energy NL

We note that in its Access Arrangement AlintaGas proposes to change the distance calculation for Reference Tariff A customers to ensure that such customers will not be supplied directly from another pipeline which may be in closer proximity to the customer’s site than the DBNGP. AlintaGas justifies this new approach on the basis of mitigating against the risk of inefficient by-pass of the AlintaGas network.

ARC is extremely concerned by OffGAR's support for this change as it not only further enhances AlintaGas's monopoly position but also directly discriminates against non-DBNGP gas which may be able to be provided to a customer directly from another pipeline in a more cost effective manner.

The amendment's objective is to remove a key incentive for AlintaGas customers to negotiate with non-DBNGP gas suppliers where cost savings can be obtained via a direct hook-up to another pipeline (in this case, the Parmelia Pipeline). Whilst the customer itself will be offered the lower tariff and will therefore be satisfied, AlintaGas's unrecouped distribution cost for supplying that customer through its network at a lower tariff will be subsidised by AlintaGas's other customers (eg. through the excessive \$50,000 standing charge).

In ARC's view, this extremely contentious amendment aimed directly at Perth Basin suppliers can not be supported or justified on economic and efficiency grounds and it reflects yet another anti-competitive measure to be introduced by AlintaGas with a view to retain its monopoly position and preventing other parties from engaging in competitive conduct.

ARC therefore respectfully requests an amendment to be required to the relevant provision of the Access Arrangement which would remove this anti-competitive measure.

- CMS Gas Transmission of Australia Submission No. 1³¹

The basis for calculation of the interconnection distance is defined in Chapter 10 of the Access Arrangement and is as follows:

".... a distance measured along the straight line which represents the shortest distance between the delivery point and the nearest pipeline or storage system from which gas is (or would be if an Interconnection Contract were entered into and necessary physical gate points and associated facilities were constructed) supplied into the AlintaGas Network;"

This means that Reference Tariff A is to be calculated on the basis of the straight line distance from a User's delivery point to either the Parmelia Pipeline or the DBNGP, whichever is closest.

OffGAR and AlintaGas justify this approach as quoted from the AlintaGas Access Arrangement Information (section 2.2.1) on the basis that:

"Use of distance to the nearest transmission pipeline as the measure of distance in the demand charge of Reference Tariff A is intended to mitigate the risk of inefficient by-pass of the AlintaGas Network."

Although the intent of the language is clear, the effect of the language, if taken literally, will be anti-competitive to Parmelia Pipeline in favour of the DBNGP.

CMS has been negotiating with AlintaGas to interconnect the Parmelia Pipeline to the AlintaGas gas distribution system. A proposal document jointly produced by CMS and AlintaGas to allow blending of Perth Basin gas with DBNGP gas in the AlintaGas gas distribution system was accepted by the Office of Energy. However, the negotiation process with AlintaGas has been going on for nearly two years with a number of issues still to be resolved before interconnection can proceed.

A pricing mechanism that has the intentional or unintentional effect of holding out competitors is clearly anti-competitive. The Trade Practices Act legislates that AlintaGas being a corporation that has a substantial degree of power in the market must not take advantage of that power for the purpose of deterring or preventing any person (eg. CMS) from engaging in competitive conduct in that or any other market.

CMS considers that the basis for calculating the interconnection distance as proposed in the Access Arrangement will have the effect of preventing CMS and other parties engaging in competitive conduct. In fact, this provision will allow AlintaGas to maintain its monopoly and hold out competitors for at least five years (i.e., Access Arrangement Period). Therefore, CMS believes that this provision infringes parts of section 46 of the Trade Practices Act.

³¹ Some sections of this submission by CMS were also included in the submission by Empire Oil & Gas NL. For the purposes of avoiding repetition, only the CMS submission is described and addressed here.

Furthermore, CMS considers that this provision does not meet the principles outlined in Section 8 of the Code. The Code indicates that a Reference Tariff should be designed to:

- replicate the outcome of a competitive market; and
- not distort investment decisions in pipeline transportation systems or any upstream/downstream industries.

CMS Proposal: OffGAR amend the definition for interconnection distance to: *"interconnection distance means a distance measured along the straight line which represents the shortest distance between the delivery point and the nearest pipeline or storage system that supplies gas to that delivery point from which a User takes gas."*

- Phoenix Energy

Phoenix has concerns about the interconnection distance basis for calculating distribution charges under Reference Service A. Whilst we believe they have been addressed comprehensively by other parties making submissions, in particular CMS, we would welcome an opportunity to discuss them further with OffGAR and lend our weight to the arguments.

Efficiency considerations for examining the tariff structure for Reference Service A include the criteria that the resultant gas charges should recover at least the incremental costs of servicing a User, and that the charge should be less than the stand-alone (i.e. by-pass) costs of servicing that User. For existing customers, and particularly where capacity constraints are not expected for a long time into the future, the upper and lower bands may be a long way apart, and so there may be a wide range of tariff structures that would meet these efficiency criteria. Accordingly, setting distribution charges on the basis of the distance to the nearest transmission pipeline may be just one means, amongst many, that may fit within these criteria. No evidence has been produced that either of these different forms of charging are likely to result in charges outside of the efficiency criteria, and so none of these measures necessarily has any efficiency advantage over another. Consequently, the proposed distance-based charges cannot be deemed unreasonable solely as a result of being calculated on the basis of distance to the nearest transmission pipeline rather than distance to the transmission pipeline from which gas is sourced, as suggested by some submissions on the Draft Decision.

The interconnection distance proposed to be used by AlintaGas in determining charges under Reference Tariff A has the potential advantage of encouraging the efficient expansion of gas distribution networks by discouraging inefficient by-pass. It is clearly unreasonable that a user that is already connected to the distribution system be made to pay a tariff that exceeds the optimised replacement cost of a new connection. The 'distance to the nearest transmission pipeline' approach does, however, place an obligation on the Regulator to ensure that AlintaGas does not cross-subsidise new Tariff A customers. The difficulty arises where, in competing for a new connection, AlintaGas offers a tariff based on the 'distance to the nearest transmission pipeline' approach, but incurs new expenditure by extending the distribution system over a distance greater than that to the nearest pipeline which in this case is a competitive pipeline. Recognising this difficulty, the Regulator reviewed AlintaGas's proposed capital expenditure and is satisfied that no provision has been made by AlintaGas that would constitute inefficient expenditure to connect Reference Tariff A customers. Furthermore, the Regulator will ensure that any new expenditure proposed for the purposes of servicing new connections for Reference Service A customers meets the requirements of section 8.16(b)(i) of the Code.

In the Draft Decision, the Regulator indicated that it had no reason to reject AlintaGas's proposed structure for Reference Tariff A, subject to the monitoring of Capital Expenditure to ensure that the charges levied on a new User of Reference Service A cover at least the

incremental costs of providing the service, especially any associated extensions to the AlintaGas network. The Regulator maintains this view.

Reference Service A Tariff – Declining Block Structure for Distance Based Tariffs

Draft Decision Amendment 36. Should AlintaGas wish to maintain differences in demand and usage charges for Reference Service A on the basis of differences in pipeline construction costs, these charges (clause 21 of the Access Arrangement) should be amended to reflect available information on cost differentials.

- AlintaGas

AlintaGas objects to Amendment 36 and submits that the Regulator should not require such an amendment in the Final Decision for the following reasons:

(a) as the price difference is only applied for each kilometre greater than 10km, on an incremental basis, it does not produce a ratio of 2:1 in terms of overall price; and

(b) the price ratio for an average customer who is greater than 10km from the transmission line is in the order of 0.7, which is within the range recommended by Connell Wagner.

The objective of adopting a declining block structure with two distance based blocks was to provide better cost reflectivity in the tariff. It was estimated that delivery points that are greater than 10km from the nearest transmission pipeline are usually delivery points in urban fringe and rural areas, where the costs of laying pipelines is significantly cheaper than pipe laying in more densely populated areas.

The cost differential of 0.5 (or a ratio of 2:1), was arrived at after mainly considering the differential in construction costs. However, AlintaGas believes that prices are fairly weighted and give an overall result which is acceptable.

The block weighting provides some difference in price for Users who are greater than 10 km from the nearest transmission line to reflect the construction costs difference. However, the difference in price is only applied on a marginal basis (that is, for each km greater than 10km). Users greater than 10km pay the <10km price for the first 10 km and then a reduced price thereafter. The result of this is that it does not produce a 2:1 ratio in terms of overall price.

The table below provides a comparison of charges (excluding standing charges) for notional Tariff A customers with the same volume and maximum hourly quantity ("MHQ"), at distances of 10, 20 and 25 km from the nearest transmission line. The average distance from a transmission line for delivery points located greater than 10km from a transmission line is approximately 25km.

Price per \$/GJ (Demand & Usage only) for Users at 10, 20 & 25km; Volume 100GJ/pa; and MHQ, 35GJ/hr.

	10km	20km	25km
\$/GJ	.877	1.315	1.534
Distance Ratio (to 10km)	N/a	2:1	2.5:1
Price Ratio (to 10km)	N/a	1.5:1	1.75:1
Distance Ratio/Price Ratio		1.33:1(.75)	1.43:1(.70)

The above table applies the 0.5 (or 2:1) price ratio between less than 10 km and greater than 10 km for Users 20 km and 25 km from the transmission line. The table demonstrates that due to the marginal operation of the charge, an actual price ratio of 0.75 (1.33:1) or 0.7 (or 1.43:1) results. This figure is within the range of appropriate ratios suggested by Connell Wagner.

AlintaGas therefore submits that the price differential proposed in the Access Arrangement achieves the desired outcome of the tariffs being more cost reflective, and should therefore remain unchanged.

The Regulator has noted the submission and clarifying information. The Regulator is aware that the structure of the Tariff and associated recovery costs of providing the service is just one of many possible allocations of costs that result in charges between avoidable cost and

stand alone cost, and that a supposedly “cost reflective” block structure may not necessarily have any advantages (in terms of efficient pricing) over an alternative structure. On this basis, the Regulator will remove the requirement for revision of the Access Arrangement as indicated in Draft Decision Amendment 36.

Reference Tariff A – Transition from GDR Tariff

Draft Decision Amendment 37. Clause 21 of the Access Arrangement should be amended to provide a tariff structure for Reference Service A (or a succession of tariff structures for each year of the Access Arrangement Period) that accommodates a reasonable transition to the Reference Service A tariff from distribution tariffs that would have occurred for Users under the Gas Distribution Regulations 1996.

- AlintaGas

AlintaGas believes that Reference Tariff A will not have an effect on the current delivered price of gas to customers supplied by users of Reference Service A. However, AlintaGas acknowledges that the prices payable by Users for gas haulage under Reference Tariff A may, in some cases, be higher than prices that those Users would have anticipated paying had prices under the GDR prices continued in existence.³²

AlintaGas previously provided information to the Regulator in relation to the validity of comparing GDR haulage prices with haulage prices determined in accordance with the Code. In providing that information AlintaGas argued that there are compelling policy reasons as to why the Regulator should not undertake such comparisons. In addition, AlintaGas expressed the opinion that it did not believe that the introduction of Reference Tariff A haulage prices would have an effect on current delivered gas prices.

AlintaGas believes that the arguments previously put before the Regulator are correct and that the Regulator should not be concerned about the transition from GDR pricing to Reference Tariff A prices. As such, the Regulator should not require Draft Decision Amendment 37.

However, to the extent that it is reasonably possible, AlintaGas also believes that it is important to address perceived issues of equity for users in relation to the transition from GDR prices to Reference Tariff A. Therefore, while AlintaGas does not resile from its position as to the correctness of its arguments in relation to this matter, and indeed reserves its rights in this regard, it is prepared to explore the development and implementation of a reasonable transitional arrangement.

AlintaGas’s views as to the key elements of a reasonable transitional arrangement are set out below.

- Reference Tariff A Charges

AlintaGas acknowledges that the charges calculated under Reference Tariff A may, in some cases, be higher than those calculated under the GDRs. Whether this means that end consumers would pay more for delivered gas is an open question - however, it is AlintaGas’s view that they would not.

The higher distribution charges obtained by applying the Reference Tariff principles of the Code are more cost reflective than the tariffs under the GDRs. AlintaGas has previously provided detailed information to OffGAR in relation to this issue.

The Reference Tariffs of the Access Arrangement have been structured to provide a rational basis for recovery of all distribution system costs. In this respect, they are unlike the existing retail tariffs which (as AlintaGas has previously described to OffGAR) are not reflective of AlintaGas’s cost structure. Furthermore, the Reference Tariffs are not, unlike the GDR tariffs, directed at cost recovery for only a part of the distribution system. The Reference Tariffs have been designed to recover the costs of all parts of the system. AlintaGas would, therefore, caution against undue focus on one particular Reference Tariff – Reference Tariff A – and the components of that tariff.

³² The Gas Distribution Regulations will be repealed upon the commencement of the Access Arrangement: Schedule 3 of the *Gas Pipelines Access (Western Australia) Act 1998*.

– 1998/99 GDR Prices

In comparing the Reference Tariff A prices to the last published GDR price, it must be pointed out, that the GDR prices used in the comparison related to the 1998/99 year. The last price re-determination undertaken under the GDR regime occurred in July 1998.

It is relevant to point out that a subsequent GDR price re-determination was not undertaken due to the impending implementation of the Access Arrangement. The decision to not undertake a re-determination balanced the interests of users and AlintaGas and was intended to minimise costs, avoid dedication of resources to a regime which was to be superseded and avoid confusing Prospective Users by publishing GDR prices which were different than those contained in the Access Arrangement.

Whilst AlintaGas accepted the 1998/99 prices would apply for an extended period, it was an interim arrangement which was to be formalised in the making of regulations to amend the *Gas Distribution Regulations*. AlintaGas understands that the Office of Energy is close to finalising the amending regulations.

AlintaGas submits that this was a practical approach, which generally achieved the outcomes proposed. However, it should not compromise any comparison to the proposed Reference Tariff A prices. AlintaGas has continued to invest capital in the high pressure network and this should be factored in to any comparison.

In support of the comparison, AlintaGas has undertaken a preliminary price re-determination to establish the GDR prices that it believes would be applicable for 2000/2001. It indicates that GDR prices would have conservatively increased by approximately 19 percent from 1998/1999 to 2000/2001.

AlintaGas, therefore, submits that the revised prices should be used in any comparison.

– Expectations of Prospective Users

As highlighted above, the last GDR price re-determination was published in August 1998. As AlintaGas's proposed Access Arrangement was submitted and made publicly available in July 1999, it provided Prospective Users with a clear indication of future access prices. This should have affected expectations about the continuation of future GDR prices.

AlintaGas submits that the practical approach adopted in relation to the GDR price re-determinations clearly avoided heightening price expectations. The proposed prices have now been in the public domain for some 10 months. In addition, the majority of users should be well aware of the adoption of the Code and the principles contained therein. AlintaGas believes that Prospective Users would have been aware of the substantial differences in the pricing regimes and that User expectations should have been based on the Access Arrangement prices.

AlintaGas's propose the following key elements of a reasonable transitional arrangement.

(a) It would apply for a 2 year period.

(b) Standing charges for Reference Tariff A would be discounted by 100% in year 1, 50% in year 2 and be fully applied for year 3 and thereafter.

(c) The discount in standing charges would be applied only to the extent that the price payable by a User under Reference Tariff A is greater than the estimated 2000/2001 GDR price. In instances where users are within close proximity of a transmission line a 100 percent waiver of the standing charge would result in Reference Tariff A being below the GDR price.

(d) The "discount" to Reference Tariff A would be a discount on the published Reference Tariff A and, although not revenue neutral to AlintaGas, would not result in a reduced Initial Capital Base.

(e) The discount would apply only to delivery points from which contestable customers are supplied with gas on the date of the commencement of the Access Arrangement. "Contestable customer" has the meaning given to it in section 92 of the *Gas Pipelines Access (Western Australia) Act 1998*.

- CMS Gas Transmission of Australia Submission No. 1³³

CMS notes that OffGAR has proposed that:

"Clause 21 of the Access Arrangement should be amended to provide a tariff structure for Reference Service A (or a succession of tariff structures for each year of the Access Arrangement Period) that accommodates a reasonable transition to the Reference Service A tariff from distribution tariffs that would have occurred for Users under the Gas Distribution Regulations 1996."

However, it should be noted that this only provides for a transition and so Users will eventually incur the proposed standing charge of \$50,000 and therefore be much worse off than they would have been on the distribution tariffs that would have occurred under the current Gas Distribution Regulations 1996.

In view of the potential increases in gas distribution costs under Reference Tariff A relative to what these costs may have been under the GDR Tariff, the Regulator will maintain the requirement for a transitional arrangement between the two tariffs, as indicated in Draft Decision Amendment 37. The Regulator has noted the transition arrangement proposed by AlintaGas in its submission on the Draft Decision and considers that such an arrangement would fulfil the required amendment.

Transition from Reference Tariff B1 to Reference Tariff A

Draft Decision Amendment 38. Clauses 21 and 22 of the Access Arrangement should be amended to provide tariff structures for Reference Services A and B1 that allow for a reasonably seamless transition in gas distribution charges between these two services.

- AlintaGas

AlintaGas acknowledges the potential for the inefficient use of gas arising from the difference between Reference Tariff A and Reference Tariff B1 by users taking delivery of between 25 and 35 TJ per year. AlintaGas has undertaken some preliminary investigations as to how a "reasonably seamless transition" could be achieved, and proposes further discussions with the Regulator to address this issue.

As a practical matter, the number of users with gas consumption in this range is expected to be less than 20, and the effect is likely to be small.

Establishing relativities between the Reference Tariffs of the AlintaGas Access Arrangement is an extremely difficult task. Reference tariffs determined by a Service Provider in accordance with the Code are to be reflective of the costs incurred in providing the corresponding Reference Services. Proposed caps on retail gas prices in Western Australia, which appear to have been set without consideration being given to the structure of costs in the gas market, make fully cost reflective distribution charges difficult, if not impossible to achieve. AlintaGas appreciates the Regulator's recognition of this issue in requiring that the transition be "reasonably" seamless. AlintaGas's work to date indicates that an approximate outcome is all that can be secured. Given the constraints imposed on Reference Tariff determination, a continuous transition from Reference Tariff B1 to Reference Tariff A cannot be achieved without introducing distortions into other parts of the tariff structure.

The Requirement for Draft Decision Amendment 38 arose from the substantially lower average cost of gas distribution under Reference Tariff A than under Reference Tariff B and levels of gas use close to the 35 TJ/year threshold between the two Reference Services. This difference would potentially give rise to an incentive for an end-user of gas delivered under Reference Service B1 to utilise more gas and secure a lower distribution cost and lower average gas cost, and hence motivate inefficient use of gas in order to qualify for Reference Service A. The Regulator will maintain the requirement for amendment of the Access

³³ Some sections of this submission by CMS were also included in the submission by Empire Oil & Gas NL. For the purposes of avoiding repetition, only the CMS submission is described and addressed here.

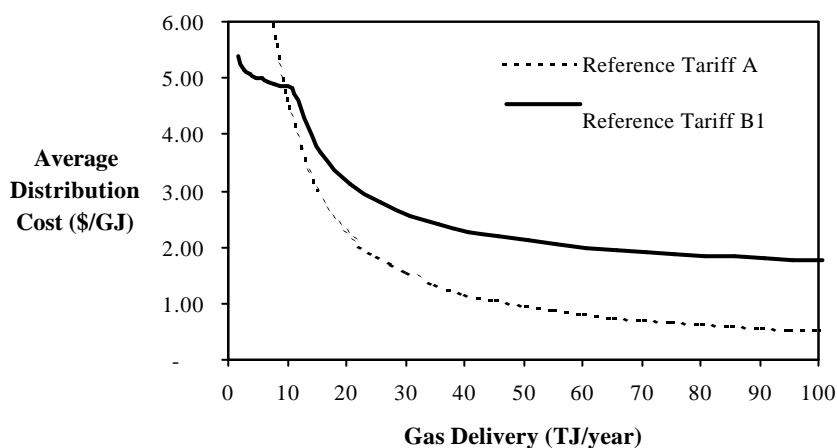
Arrangement to achieve a reasonably seamless transition between Reference Tariff B1 and Reference Tariff A.

Subsequent to the submission on the Draft Decision, AlintaGas put forward a proposal to the Regulator indicating an alternative tariff structure for Reference Tariff B1. When revised further to be consistent with changes to the Initial Capital Base and costs as required by this Final Decision, the revised tariff structure in the first year of the Access Arrangement Period (2000) is as follows.

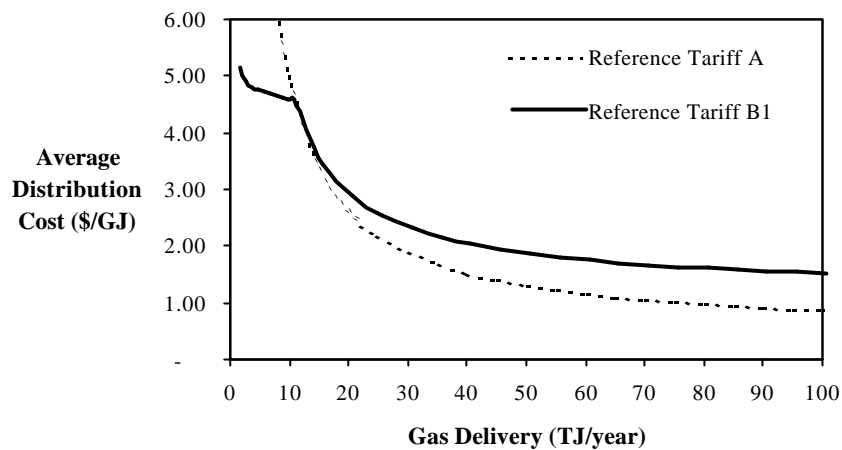
Revised Reference Tariff B1

Standing Charge (\$/annum)	Block Structure	Usage Charge (\$/GJ)
500.00	First 5 TJ/year	4.61
	5 – 10 TJ/year	4.38
	>10 TJ/year	1.15

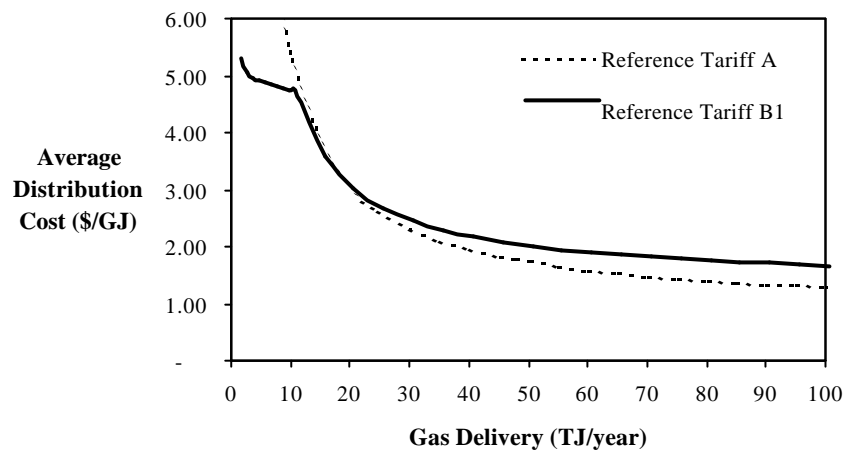
The Regulator compared average costs of gas distribution that would apply to a User under the revised tariffs for Reference Services A and B1. Comparisons of average gas distribution costs are shown below for distances of delivery points from the closest transmission pipeline of 1, 5, 10 and 20 km.



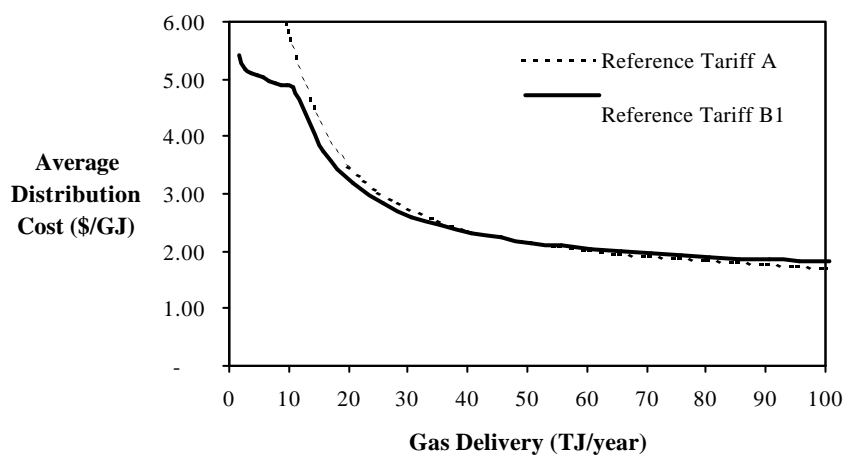
(a) Average gas distribution costs for Reference Services A and B1 with distance from delivery point to transmission pipeline of 1 km



(b) Average gas distribution costs for Reference Services A and B1 with distance from delivery point to transmission pipeline of 5 km



(c) Average gas distribution costs for Reference Services A and B1 with distance from delivery point to transmission pipeline of 10 km



(d) Average gas distribution costs for Reference Services A and B1 with distance from delivery point to transmission pipeline of 20 km

The comparisons of average gas distribution costs under the revised Reference Tariffs indicate that average gas costs under the tariffs are reasonably close at quantities of gas delivered close to 35 TJ/year. The Regulator is satisfied that the revised tariffs would sufficiently reduce or remove the differential in average gas distribution costs between the two services at levels of gas use close to 35 TJ/day, and hence remove the incentive for inefficient use of gas.

Reference Service B2 and B3 Tariffs

Draft Decision Amendment 39

Clause 24 of the Access Arrangement should be amended to provide a tariff structure for Reference Service B3 that makes provision for reasonable retail margins for a User providing gas to residential end-users of gas, both in total for any residential end-user and for any gas-quantity block.

- Apache Energy Limited

Apache supports the Regulator's position aiming to ensure that the tariff structures applicable to Reference Services B2 and B3, given the current regulated retail prices, are consistent with retail margins which will encourage competition in this sector of the market.

- Office of Energy

As part of the Draft Decision the Regulator required that Clause 24 of the Access Arrangement be amended to provide a tariff structure for Reference Service B3 that makes provision for reasonable retail margins for a User providing gas to residential end-users of gas, both in total for any residential end-user and for any gas-quantity block. The Regulator also noted that whilst regulated retail prices for gas remain in force, the retail margins and consequences for contestability and competition in the retail gas markets will be an ongoing matter of concern in the regulation of distribution tariffs, and in any reviews of the Access Arrangement.

It is understood that the Regulator required that the above amendment be based on the consideration that the low and/or negative retail margins for certain gas-quantity blocks in the supply of gas to residential customers under Reference Service B3 would impede the development and continuation of effective competition in the supply of natural gas to these customers, particularly for large residential customers consuming more than 45 GJ/year.

The Draft Decision discussed retail margins in terms of net and gross retail margins, defined as follows:

Gross retail margin – the margin on gas sales before interest, tax and retail costs, but after all other costs.

Net retail margin – the margin on gas sales before interest and tax, but after all other costs (including retail costs) have been accounted for.

It is noted from the Draft Decision that while [gross] retail margins are relatively high for the first 15 GJ per annum delivered to a Reference Service B3 customer (gross retail margin of 22 percent), lower [gross] retail margins apply to subsequent gas quantity blocks. The total gross retail margin for a customer declines with increasing gas consumption by that customer, becoming negative for gas consumption of greater than 100 GJ/year.

The analysis presented in the Draft Decision in respect of the gross retail margins may be relevant in providing a useful indication whether retail margins for the customers consuming a reasonable quantity of gas per annum are reasonable. However, it is considered that the analysis does not sufficiently address the reasonableness of the retail margins for customers with a relatively low annual gas consumption. An analysis conducted by the Office of Energy indicates that while gross retail margins are relatively high for this group of customers, net retail margins are negative for customers using less than around 11 GJ per

annum. The Office of Energy analysis assumed fixed annual retail costs of \$50 per customer, which is considered conservative compared with the \$80 for such costs quoted elsewhere in relation to utilities similar to AlintaGas. The retail costs would need to be as low as \$25 per customer in order for the net retail margin for 5 GJ per annum customers to be zero and not negative.

In the light of the above analysis it may not be practicable to restructure the Reference Tariff B3 in a way that provides for the very low usage customers to have positive net retail margins.

However, the Office of Energy supports the creation of positive net retail margins for, and making viable retail competition to, as many Reference Service B3 customers as is practicable. It is expected that AlintaGas should be able to restructure its Reference Tariff B3 in a manner which produces equitable and reasonable retail margins for as wide a group of such customers as is practicable. This should be able to be achieved without further affecting the financial position of AlintaGas, i.e. in a manner which has a neutral effect on AlintaGas's Initial Capital Base or total distribution revenue.

- **AlintaGas**

AlintaGas strongly objects to Amendment 39 and submits that the Regulator should not require such an amendment in the Final Decision. The reasons for AlintaGas's response, which are based on its understanding of the reasons for decision, are set out below. If AlintaGas's understanding of the reasons for decision is incorrect, AlintaGas's response to Amendment 39 may change.

AlintaGas objects to Amendment 39 for the following reasons:

(a) Amendment 39 is uncertain because it does not state with sufficient specificity the amendment (or the nature of the amendment) that the Regulator requires and, therefore, does not satisfy the requirements of section 2.13(b). The uncertainty arises in the following respects:

- i. Amendment 39 refers to "reasonable retail margins" without indicating what the Regulator considers to be reasonable; and
- ii. Amendment 39 refers to "reasonable retail margins" but does not specify whether the Regulator means "gross retail margins" or "net retail margins", or both, as those terms are defined in the reasons for decision.

(b) For the reasons set out in its response to Amendment 28 in relation to section 38, AlintaGas submits that the Regulator should not require that AlintaGas amend Reference Tariff B3 to provide for a positive gross or net retail margin.

(c) Whereas section 38 is concerned with the class of consumers known as small business and residential consumers, the Regulator applies section 38 in relation to particular residential consumers and particular gas quantities.

(d) It is unreasonable for the Regulator to require that AlintaGas amend Reference Tariff B3 to provide a positive retail margin for every residential customer, regardless of the level of gas that the customer consumes.

(e) The Regulator should take into account the fact that there are other ways in which AlintaGas's retail business can contribute to the achievement of the perceived objective of a positive retail margin for every residential customer, regardless of the amount of gas consumed by that customer, before determining that it is necessary to fix distribution tariffs.

(f) Any consideration of the extension of competition in the supply of gas to small business and residential consumers must be undertaken by reference to the costs of new retailers, not by reference to the costs of AlintaGas's retail business.

(g) The emphasis the Regulator has placed upon section 38 indicates that the Regulator has unreasonably attached too much weight to the fixing of Reference Tariff B3 in order to provide a retail margin for every residential customer regardless of the amount of gas consumed by that customer. As a consequence, the Regulator has failed to give appropriate weight to other factors that the Regulator is required to consider under section 2.24.

(h) The emphasis that the Regulator has placed upon section 38 also indicates that the Regulator has attached insufficient weight to the interests of AlintaGas as against the interests of other participants in the gas market, particularly retailers.

Details of AlintaGas's reasoning in respect of each of these arguments is provided in Attachment K of AlintaGas's submission to the Regulator on the Draft Decision.

AlintaGas has objected to Draft Decision Amendment 39 on the following principal grounds:

- it is not possible to apply section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* to the consideration of retail margins;
- it is unreasonable to require a positive retail margin for every residential customer, regardless of the level of gas that the customer consumes; and
- any consideration of the extension of competition in the supply of gas to small business and residential consumers should be based on the costs faced by new retailers rather than costs of AlintaGas's retail business.

The submission by the Office of Energy also raised the concern that it is unreasonable to require a positive retail margin for every residential customer, regardless of the level of gas that the customer consumes.

The Regulator's considerations as to applicability of section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* to consider potential retail margins in the delivery of gas to residential and small business end-users of gas were discussed in section 4.3.4 of this Final Decision, in relation to the determination of the Initial Capital Base. On the basis of legal advice, the Regulator determined that consideration of potential retail margins in supply of gas to residential and small-business end-users of gas was a relevant consideration under section 38 of the Act, subject to the Minister having prescribed the quantity of gas that is a small quantity for the purposes of section 38. An order by the Minister was published in the Government Gazette on 28 June 2000 prescribing a small quantity of gas to be a quantity that is less than one terajoule in any period of 12 consecutive months.³⁴

In regard to the specific issue of Reference Tariffs B2 and B3, the intent of the Regulator with Draft Decision Amendment 39 was to ensure that any gas retailer faced with similar costs of gas and gas transmission as AlintaGas would have an incentive to provide a retail service to the predominant end-users of these services, being residential and small business end-users. The Regulator's concern with the proposed Reference Tariff B3 was the existence of a negative margin of the maximum regulated retail price of gas over the costs of gas, gas transmission and gas distribution for the gas quantity block of greater than 45 GJ per annum. Given this negative margin, there would be a consequent disincentive for any gas retailer to provide gas to an end-user in excess of 45 GJ/year.

The intent of Draft Decision Amendment 39 was for AlintaGas to revise the proposed tariff structure for Reference Service B3, such that for any additional unit of gas supplied to an end-user there would be a positive margin of the maximum retail price over the costs of gas, gas transmission and gas distribution. The Regulator will maintain the requirement for the Access Arrangement to be amended to this effect, but will revise the required amendment to

³⁴ Government Gazette, WA, 28 June 2000 p3814.

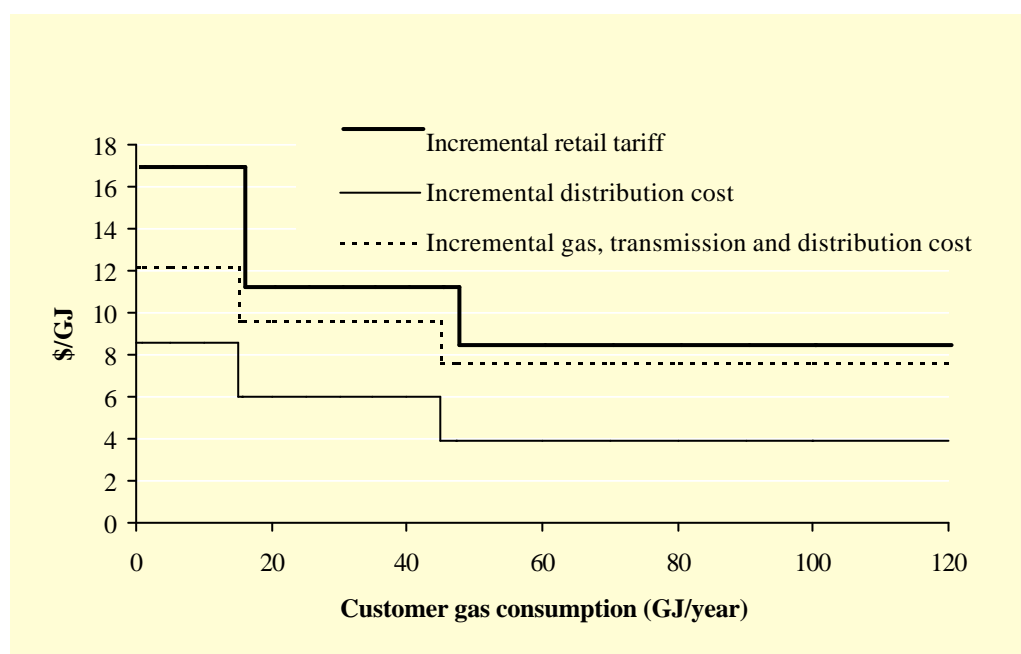
address the concerns raised by AlintaGas and the Office of Energy in regard to the potential inability to ensure a positive retail margin in total for any gas consumer.

Subsequent to the submission on the Draft Decision, AlintaGas put forward a proposal to the Regulator indicating a revised tariff structure for Reference Tariff B3. When revised further to be consistent with changes to the Initial Capital Base and costs as required by this Final Decision, the revised tariff structure in the first year of the Access Arrangement Period (2000) is as follows.

Revised Reference Tariff B3

Standing Charge	Block Structure	Usage Charge
(\$/annum)		(\$/GJ)
25.00	First 15 GJ/year	8.55
	15 – 45 GJ/year	5.98
	>45 GJ/year	3.93

The differences between regulated maximum retail tariffs and assumed supply costs under the revised tariff structure³⁵ are shown below.



Block structures of maximum retail tariffs for residential gas customers and supply costs for delivery of gas under Reference Service B3

³⁵ Supply costs comprise the distribution tariffs proposed by AlintaGas, and the Regulator's assumed gas cost of \$2.18/GJ and gas transmission cost of \$1.50/GJ.

The revised tariff structure is consistent with a minimum two percent retail margin for any incremental unit of gas supplied to an end-user under Reference Service B3, given the Regulators assumptions of gas cost at \$2.18/GJ and transmission cost at \$1.50/GJ. The Regulator is therefore satisfied that this revised tariff structure would meet the requirements for a positive retail margin for any incremental unit of gas supply.

It is noted that no specific amendment of the Access Arrangement has been required in respect of Reference Tariff B2. Nevertheless, Reference Tariff B2 will alter in accordance with amendments required by this Final Decision to the Initial Capital Base and to projected costs for the distribution systems. The revised tariff is as follows.

Revised Reference Tariff B2

Standing Charge	Block Structure	Usage Charge
(\$/annum)		(\$/GJ)
200.00	First 100 GJ/year	5.10
	> 100 GJ/year	4.59

4.10.4 Required Amendments to the Access Arrangement

Amendment 34 [was Draft Decision Amendment 35]

The Access Arrangement should be amended to include a statement of general methodology for the determination of user-specific delivery charges, and to indicate the Rate of Return implicit in amortisation of costs of user-specific delivery facilities.

The Regulator will require tariff structures to be revised to address the following concerns.

- The proposed Reference Tariff A may, in some circumstances of Users, give rise to gas distribution costs that are greater than the costs that may be incurred under the tariffs currently set under the *Gas Distribution Regulations 1996* (the “GDR Tariff”). The Regulator considers that it is reasonable that the Access Arrangement make provision for transitional arrangements between the two tariff structures.
- The proposed Reference Tariff A and Reference Tariff B1 may give rise to a large discrepancy in gas distribution costs at close to the threshold level of gas use that determines eligibility for the two services. The potential difference in distribution costs, and consequent difference in total gas cost to an end-user of gas, may give rise to incentives for an inefficiently high use of gas so as to secure lower distribution costs and a lower average total cost for gas.
- The proposed Reference Tariff B3 includes a block structure of distribution charges that may, under reasonable assumptions as to costs of gas and gas transmission, give rise to negative retail margins in delivery of incremental units of gas to certain residential end-users. This tariff structure may therefore provide a disincentive for a retailer to meet the service requirements of these end-users.

Subsequent to its submission on the Draft Decision, AlintaGas has proposed alternative structures to the Regulator that will meet the Regulator's requirements in this regard, and the Regulator will require the Access Arrangement to be amended to include these structures.

The Regulator also notes that AlintaGas has proposed to the Regulator that the goods and services tax be passed through to Reference Tariffs at a rate of 9.3 percent of the goods-and-services-tax exclusive price. The Regulator is of the view that it is appropriate to accommodate the pass through of the goods and services tax in the Reference Tariffs as they will be set out in the revised Access Arrangement.

Amendment 35 [was Draft Decision Amendment 37]

Clause 21 of the Access Arrangement should be amended to provide for the following tariff structure for Reference Service A in the first year of the Access Arrangement Period:

From 1 January 2000 to 30 June 2000

Standing Charge: \$44,000/year;

Demand Charge: \$181.64/GJ/km/year for the first 10 km of interconnection distance, and \$90.82/GJ/km/year for any part of the interconnection distance in excess of 10 km;

Usage Charge: \$0.04426/GJ/km for the first 10 km of interconnection distance, and \$0.02213/GJ/km for any part of the interconnection distance in excess of 10 km.

From 1 July 2000 to 31 December 2000

Standing Charge: \$48,092/year;

Demand Charge: \$198.53/GJ/km/year for the first 10 km of interconnection distance, and \$99.27/GJ/km/year for any part of the interconnection distance in excess of 10 km;

Usage Charge: \$0.04838/GJ/km for the first 10 km of interconnection distance, and \$0.02419/GJ/km for any part of the interconnection distance in excess of 10 km.

The Access Arrangement should be further amended to provide for a transitional arrangement from the tariff structure under the *Gas Distribution Regulations 1996* to Reference Tariff A, where this transitional arrangement has the following key elements.

(a) It would apply for a 2 year period.

(b) Standing charges for Reference Tariff A would be discounted by 100 percent in year 1, 50 percent in year 2 and be fully applied for year 3 and thereafter.

(c) The discount in standing charges would be applied only to the extent that the price payable by a User under Reference Tariff A is greater than the estimated 2000/2001 GDR Tariff, estimated and independently audited in accordance with the process described in the AlintaGas Publication *Gas Distribution Access Pricing Methods* (25 June 1997).

(d) The discount would apply only to delivery points from which contestable customers are supplied with gas on the date of the commencement of the Access Arrangement. "Contestable customer" has the meaning given to it in section 92 of the *Gas Pipelines Access (Western Australia) Act 1998*.

Amendment 36 [was Draft Decision Amendment 38]

Clause 22 of the Access Arrangement should be amended to provide for the following tariff structure for Reference Service B1 in the first year of the Access Arrangement Period:

From 1 January 2000 to 30 June 2000

Standing Charge \$500.00/year;
 Usage Charge \$4.61/GJ for the first 5 TJ of gas delivered to the User per year;
 \$4.38/GJ for gas delivered to the User in excess of 5 TJ per year and up to 10 TJ/year; and
 \$1.15/GJ for gas delivered to the User in excess of 10 TJ per year.

From 1 July 2000 to 31 December 2000

Standing Charge \$546.50/year;
 Usage Charge \$5.04/GJ for the first 5 TJ of gas delivered to the User per year;
 \$4.79/GJ for gas delivered to the User in excess of 5 TJ per year and up to 10 TJ/year; and
 \$1.26/GJ for gas delivered to the User in excess of 10 TJ per year.

Amendment 37

Clause 23 of the Access Arrangement should be amended to provide for the following tariff structure for Reference Service B2 in the first year of the Access Arrangement Period:

From 1 January 2000 to 30 June 2000

Standing Charge \$200.00/year;
 Usage Charge \$5.10/GJ for the first 100 GJ of gas delivered to the User per year; and
 \$4.59/GJ for gas delivered to the User in excess of 100 GJ per year.

From 1 July 2000 to 31 December 2000

Standing Charge \$218.60/year;
 Usage Charge \$5.57/GJ for the first 100 GJ of gas delivered to the User per year; and
 \$5.02/GJ for gas delivered to the User in excess of 100 GJ per year.

Amendment 38 [was Draft Decision Amendment 39]

Clause 24 of the Access Arrangement should be amended to provide for the following tariff structure for Reference Service B3 in the first year of the Access Arrangement Period:

From 1 January 2000 to 30 June 2000

Standing Charge \$25.00/year;
 Usage Charge \$8.55/GJ for the first 15 GJ of gas delivered to the User per year;
 \$5.98/GJ for gas delivered to the User in excess of 15 GJ per year and up to 45 GJ/year; and
 \$3.93/GJ for gas delivered to the User in excess of 45 GJ per year.

From 1 July 2000 to 31 December 2000

Standing Charge \$27.32/year;
 Usage Charge \$9.35/GJ for the first 15 GJ of gas delivered to the User per year;
 \$6.54/GJ for gas delivered to the User in excess of 15 GJ per year and up to 45 GJ/year; and
 \$4.30/GJ for gas delivered to the User in excess of 45 GJ per year.

4.11 REFERENCE TARIFF VARIATION AND INCENTIVE MECHANISMS

4.11.1 Access Code Requirements

The Code addresses variation in Reference Tariffs over the Access Arrangement Period in terms of two general matters:

- i. variation in Reference Tariffs at the discretion of the Service Provider and according to principles such as a predetermined price path or realised cost and sales outcomes for the Service Provider; and
- ii. within the scope of (i), variation of Reference Tariffs according to principles of an Incentive Mechanism.

The provisions of the Code relating to these matters are outlined as follows.

Variation in Reference Tariffs at the Discretion of the Service Provider

Section 8.3 of the Code provides for the Service Provider to have discretion as to the manner in which Reference Tariffs vary across an Access Arrangement Period, subject to the Regulator being satisfied that such variation is consistent with the objectives for Reference Tariffs contained in section 8.1 of the Code. Section 8.3 of the Code goes on to indicate that, for example, a Reference Tariff may be varied across the Access Arrangement Period by means of:

- (a) a price path approach, whereby a series of Reference Tariffs are determined in advance for the Access Arrangement Period to follow a path that is forecast to deliver a revenue stream calculated consistently with the principles in section 8 of the Code, but is not adjusted to account for subsequent events until the commencement of the next Access Arrangement Period;
- (b) a cost of service approach, whereby the Tariff is set on the basis of the anticipated costs of providing the Reference Service and is adjusted continuously in light of actual outcomes (such as sales volumes and actual costs) to ensure that the Tariff recovers the actual costs of providing the Service; or
- (c) variations or combinations of these approaches.

Incentive Mechanism

Sections 8.44 to 8.46 of the Code state the principles for establishing an Incentive Mechanism within the Reference Tariff Policy and the objectives which the Incentive Mechanism should seek to meet.

Section 8.44 of the Code requires that the Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism that permits the Service Provider to retain all, or a share of, any returns to the Service Provider from the sale of a Reference Service during an Access Arrangement Period that exceeds the level of returns expected at the beginning of the Access Arrangement Period (an Incentive Mechanism), particularly where the additional returns are attributable (at least in part) to the efforts of the

Service Provider. Such additional returns may result, amongst other things, from lower Non-Capital Costs or greater sales of Services than forecast.

Section 8.45 states that an Incentive Mechanism may include (but is not limited to) the following:

- (a) specifying the Reference Tariff that will apply during each year of the Access Arrangement Period based on forecasts of all relevant variables (and which may assume that the Service Provider can achieve defined efficiency gains) regardless of the realised values for those variables;
- (b) specifying a target for revenue from the sale of all Services provided by means of the covered pipeline, and specifying that a certain proportion of any revenue received in excess of that target shall be retained by the Service Provider and that the remainder must be used to reduce the Tariffs for all Services provided by means of the covered pipeline (or to provide a rebate to Users of the covered pipeline); and
- (c) a rebate mechanism for Rebatable Services pursuant to section 8.40 that provides for less than a full rebate of revenues from the Rebatable Services to the Users of the Reference Service.

Section 8.46 states that an Incentive Mechanism should be designed with a view to achieving the following objectives:

- (a) to provide the Service Provider with an incentive to increase the volume of sales of all Services, but to avoid providing an artificial incentive to favour the sale of one Service over another;
- (b) to provide the Service Provider with an incentive to minimise the overall costs attributable to providing those Services, consistent with the safe and reliable provision of such Services;
- (c) to provide the Service Provider with an incentive to develop new Services in response to the needs of the market for Services;
- (d) to provide the Service Provider with an incentive to undertake only prudent New Facilities Investment and to incur only prudent Non-Capital Costs, and for this incentive to be taken into account when determining the prudence of New Facilities Investment and Non-Capital Costs for the purposes of sections 8.16 and 8.37; and
- (e) to ensure that Users and Prospective Users gain from increased efficiency, innovation and volume of sales (but not necessarily in the Access Arrangement Period during which such increased efficiency, innovation or volume of sales occur).

4.11.2 Access Arrangement Proposal

Chapter 3 and schedules 2 and 3 of the Access Arrangement make provision for changes to Reference Tariffs over the Access Arrangement Period. AlintaGas has proposed that changes may be made to Reference Tariffs in two ways:

- i. annual revision of Reference Tariffs and components of Reference Tariffs in accordance with an “average revenue” or “revenue yield” control mechanism; and
- ii. pass through of changes in costs arising from changes in taxes and regulation.

Revenue Yield Mechanism of Tariff Control

AlintaGas has proposed that Reference Tariffs be set for the first year of the Access Arrangement Period and subsequently varied on an annual basis in accordance with a combined price-path and cost-of-service approach. The provisions for tariff variation comprise an “average revenue” or “revenue yield” approach to tariff variation wherein tariffs may be varied subject to a constraint that the forecast average revenue (per gigajoule of gas delivered) for the year in which tariffs will apply (the review year) does not exceed a specified maximum allowed average revenue for that year.

The revenue yield mechanism proposed by AlintaGas allows AlintaGas to vary Reference Tariffs at its discretion subject to two constraints:

- i. a limit on changes to Reference Tariffs such that the forecast average revenue for any year does not exceed a maximum allowed average revenue determined in accordance with a “CPI-X” formula, and with adjustment reflecting differences between forecast and realised sales for each Reference Service in previous years; and
- ii. a limit on changes to Reference Tariffs such that the change to any particular Reference Tariff component in any year does not exceed the maximum allowed value for that tariff determined in accordance with a “CPI+Y” formula.

Part A of schedule 2 of the Access Arrangement proposes a procedure for assessment by the Regulator of proposed changes to Reference Tariffs. AlintaGas has proposed that a statement of proposed changes to Reference Tariffs and supporting information (a variation proposal) be provided to the Regulator before the commencement of the review year. It is proposed that the Regulator must approve the proposed Reference Tariffs in a variation proposal if:

- the proposed Reference Tariffs and proposed tariff components comply with the principles and formulas set in part B of schedule 2 of the Access Arrangement; and
- all of the forecasts included in the variation proposal are satisfactory to the Regulator.

Furthermore, it is proposed that if the Regulator does not provide notification of approval or non-approval of the proposed Reference Tariffs within 20 days of receiving the variation proposal, then the variation proposal is deemed to have been approved by the Regulator.

The Access Arrangement proposes that if the Regulator does not approve the proposed Reference Tariffs in a variation proposal, and does not approve a subsequently revised variation proposal, then AlintaGas may seek review of the Regulator’s decision as though it was a decision to which section 38 of schedule 1 to the *Gas Pipelines Access (Western Australia) Act 1998* applies.³⁶

³⁶ Section 38 of schedule 1 to the *Gas Pipelines Access (Western Australia) Act 1998* relates to appeals against a decision:

(a) that a pipeline or proposed pipeline is, or is not, or ceases to be, or does not cease to be, a Code pipeline;

Pass Through of Taxes and Regulatory Changes

The Access Arrangement provides for Reference Tariffs to be changed as a result of pass through of taxation and regulatory changes, including pass through of variation in taxes, charges, levies, imposts and fees, or costs arising from a change in the regulatory environment.

The provisions for regulatory approval of changes to Reference Tariffs arising from pass through of taxes and regulatory changes are similar to those described above for variations to Reference Tariffs. The Access Arrangement proposes that the Regulator is required to notify AlintaGas of approval or non-approval of changes to Reference Tariffs within 30 days of submission by AlintaGas of the relevant “change statement”. If the Regulator does not provide notification of approval or non-approval of the proposed changes to Reference Tariffs within 30 days, then the change statement is deemed to have been approved by the Regulator. AlintaGas may seek review of any decision by the Regulator on a “change statement” as though it was a decision to which section 38 of schedule 1 to the *Gas Pipelines Access (Western Australia) Act 1998* applies.

4.11.3 Draft Decision

In assessing the proposed provisions for changes to Reference Tariffs, the Regulator had concerns in regard to:

- obligations imposed on the Regulator in regard to the process for approval or non-approval of the proposed tariff variations;
- provisions for review of any decision by the Regulator to not approve a change in Reference Tariffs;
- inappropriate incentives in the revenue-yield methodology for variations in Reference Tariffs; and
- the determination by AlintaGas of the X factor used in the CPI-X annual adjustments to maximum allowed average revenue.

The determinations of the Regulator on these matters are indicated below.

Approval of Variation Proposals and Change Statements

In regard to approval of changes to Reference Tariffs, the Access Arrangement seeks to establish:

- the processes by which the Regulator would be advised of the proposed changes to Reference Tariffs;

(b) to add to, or to waive, the requirement under the Code that a Service Provider be a body corporate or statutory authority or not be a producer, purchaser or seller of natural gas or relating to the separation of certain activities of a Service Provider;

(c) not to approve a contract, arrangement or understanding between a Service Provider and an associate of a Service Provider;

(d) relating to any other matter that, under the Code, is a decision to which this section applies.

- conditions under which the Regulator must approve the proposed changes;
- time limits for the Regulator to notify AlintaGas of a decision to approve or not approve proposed changes, before the proposed changes are deemed to have been approved;
- obligations of the Regulator in respect of providing reasons to AlintaGas for not approving a proposal to change Reference Tariffs; and
- provision for AlintaGas to seek review of any decision by the Regulator to not approve a proposal to change tariffs as if the decision was a decision to which section 38 of schedule 1 of the *Gas Pipelines Access (WA) Act 1998* applies.

While the Regulator accepted that some certainty with respect to the approval of tariffs is desirable, it was also noted that provisions that remove any flexibility on the part of the Regulator reduce the ability of the Regulator to audit proposed changes to ensure compliance with the Access Arrangement. This was of particular concern with the proposed revenue yield formula for variation of Reference Tariffs, for which the Regulator would be under some obligation to audit volume forecasts and tariff calculations, and for the pass through of changes in taxation and regulation that may be complex. Furthermore, for pass through of changes in taxation and regulation, it may be appropriate for public consultation prior to the Regulator arriving at a decision on changes to Reference Tariffs. For these reasons, the Regulator considered that changes to Reference Tariffs should be subject to the approval of the Regulator.

The Regulator also considered that it is not acceptable for a Service Provider to impose obligations upon the Regulator within an Access Arrangement. The proposed process for the Regulator to be advised of and to make a decision on proposed variations to Reference Tariffs or pass through of changes in taxation or regulation should therefore not impose any such obligations.

The required amendments to the Access Arrangement were as follows.

Draft Decision Amendment 40

Clause 1 of schedule 2 and clause 2 of schedule 3 of the Access Arrangement should be amended to make variations to Reference Tariffs and the pass through of changes in taxation and regulation subject to the approval of the Regulator.

Draft Decision Amendment 41

Clause 1 of schedule 2 and clause 2 of schedule 3 of the Access Arrangement should be amended so as to not impose obligations on the Regulator in respect of decisions by the Regulator to approve or not approve proposed variations to Reference Tariffs or pass through of changes in taxation and regulation, other than as provided for by the Code in respect of a review of an Access Arrangement.

Review of Decisions of the Regulator

In regard to review of any decision by the Regulator to not approve a proposed change to Reference Tariffs, the Access Arrangement seeks to make such a decision a matter that can be reviewed by the Western Australian Gas Review Board. Under section 38(1) of

schedule 1 to the *Gas Pipelines Access (WA) Act 1998*, a person's right to apply to the Western Australian Gas Review Board for a review of a decision of the Regulator depends on whether or not the decision is of a type mentioned in section 38(13) of schedule 1. Section 38(13) of schedule 1 does not make reference to decisions on changes to Reference Tariffs. As a consequence, the proposal by AlintaGas effectively seeks to extend the provisions of the Act by conferring rights to appeal in regard to changes to Reference Tariffs. The Regulator does not consider it appropriate for an Access Arrangement to seek to extend the provisions of the Act by conferring rights to appeal in regard to changes to Reference Tariffs.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 42

Clauses 1(6) of schedule 2 and 2(4) of schedule 3 of the Access Arrangement should be amended to remove provisions for AlintaGas to seek a review of a decision by the Regulator to not approve changes to Reference Tariffs as though such a decision was a decision to which section 38 of schedule 1 of the *Gas Pipelines Access (WA) Act 1998* applies.

Revenue-Yield Form of Price Control

The revenue yield from of price control would allow AlintaGas to raise tariffs over the Access Arrangement Period subject to the CPI-X constraint on average revenue, and to "re-balance tariffs (i.e. to alter cost allocations across Reference Services) subject to a CPI+Y constraint that limits the extent that any one tariff may change in a given year.

In principle, the Regulator agreed that it may be desirable for AlintaGas to have the ability to re-balance Reference Tariffs during the Access Arrangement Period. Furthermore, the Regulator acknowledged that the revenue yield form of price control proposed by AlintaGas creates many of the incentive properties that are described in the Access Arrangement Information, for example the incentive to minimise costs. However, it was noted that there are also several well documented problems with this particular form of price control. The Regulator had concerns as to the implications of this form of price control for efficiency in pricing of services, competition in the retail gas market and costs of regulation. These concerns related to:

- incentives for inefficient pricing resulting in the tariffs for particular services, or components of tariffs, not reflecting the costs associated with provision of the service or particular components of services;
- incentives for strategic pricing of distribution services that may impede the introduction and maintenance of competition into the retail gas market; and
- high levels of complexity and potential expense in regulating and administering variations in Reference Tariffs.

For AlintaGas, the Regulator considered that the revenue yield form of price control has insufficient merits to compensate for the concomitant incentives for inefficient pricing of certain services and the potentially high administrative complexity and regulatory costs. While an alternative form of price control such as a "tariff basket" control would negate some

of the problems of the revenue yield approach, problems would remain as a result of AlintaGas having common ownership of both distribution and retail businesses.

The Regulator thus concluded that the provisions for tariff re-balancing should be removed from the Access Arrangement and that a “price cap” form of price control be implemented. The price cap form of price control does not negate the possibility for AlintaGas to re-balance Reference Tariffs over the Access Arrangement Period, but would require any such re-balancing to be undertaken as a revision of the Access Arrangement in accordance with relevant provisions of part 2 of the Code. In view of the potential implications of tariff re-balancing for competition in the retail gas market, the Regulator considered that the public scrutiny provided for in a revision of the Access Arrangement is appropriate for any re-balancing of Reference Tariffs.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 43

Schedule 2 of the Access Arrangement should be amended to remove provisions for re-balancing of Reference Tariffs and to implement a price-cap mechanism for the variation of Reference Tariffs.

Determination of the X Factor

The methodology that AlintaGas used to determine the value of the X factor in the CPI-X constraint on revenue adjustment would lead to a systematic upward bias of Reference Tariffs and revenue after CPI-X adjustments.

The Regulator re-calculated the X factor using a methodology that corrects for this bias, and also corrects for changes to other costs underlying the Total Revenue requirement for the Access Arrangement period. The resultant value of X was 2.62.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 44

Clause 15 of schedule 2 of the Access Arrangement should be amended such that the “X” value in a CPI-X price cap mechanism is not less than 2.62 percent.

The Regulator noted that AlintaGas proposed using the All-Groups CPI measure for Perth to escalate Reference Tariffs. The general regulatory approach in Australia to allow for inflation is to use a measure of economy-wide inflation, such as the Eight Capital City, All-Groups CPI measure as published by the Australian Bureau of Statistics. Furthermore, the CPI measure used for inflation adjustment of tariffs should exclude effects of the goods and services tax. The Regulator supported this approach.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 45

Clause 14 of schedule 2 of the Access Arrangement should be amended such that the Consumer Price Index (CPI) refers to the Eight Capital City, All-Groups CPI measure, exclusive of the impact of the goods and services tax, as published by the Australian Bureau of Statistics.

4.11.4 Responses to Submissions on the Draft Decision***Process for Approval or Non-Approval of Changes to Reference Tariffs***

Draft Decision Amendment 40. Clause 1 of schedule 2 and clause 2 of schedule 3 of the Access Arrangement should be amended to make variations to Reference Tariffs and the pass through of changes in taxation and regulation subject to the approval of the Regulator.

Draft Decision Amendment 41. Clause 1 of schedule 2 and clause 2 of schedule 3 of the Access Arrangement should be amended so as to not impose obligations on the Regulator in respect of decisions by the Regulator to approve or not approve proposed variations to Reference Tariffs or pass through of changes in taxation and regulation, other than as provided for by the Code in respect of a review of an Access Arrangement.

Draft Decision Amendment 42. Clauses 1(6) of schedule 2 and 2(4) of schedule 3 of the Access Arrangement should be amended to remove provisions for AlintaGas to seek a review of a decision by the Regulator to not approve changes to Reference Tariffs as though such a decision was a decision to which section 38 of schedule 1 of the Gas Pipelines Access (WA) Act 1998 applies.

- Office of Energy

As part of the Draft Decision, the Regulator required that Clause 1 of schedule 2 and Clause 2 of schedule 3 of the Access Arrangement be amended to make variations to Reference Tariffs and the pass through of changes in taxation and regulation subject to the approval of the Regulator.

Consistent with related comments in the Office of Energy's 5 August 1999 submission, the Office of Energy agrees that variations to Reference Tariffs (or "re-balancing" of Reference Tariffs) and the pass through of changes in taxation and regulation should be subject to the approval of the Regulator. The Office of Energy also considers that the required amendment is consistent with the intent of the Code.

When read in isolation the above amendment may be taken to read that Regulator's approval would also need to be obtained before each annual CPI-X change of Reference Tariffs. It is suggested that the above amendment should be read in conjunction with Amendment 43 in the Draft Decision removing provisions in the Access Arrangement for re-balancing of Reference Tariffs and implementing a price-cap mechanism for the variation of Reference Tariffs.

A concern with Amendment 40 may be that it could give the Regulator considerable discretion to trigger a full review of the Access Arrangement and bring the current Access Arrangement Period to a premature end. The currently proposed Access Arrangement Period of approximately 5 years appears to balance the interests of AlintaGas in regulatory and business certainty with the interests of users in ensuring appropriate regulatory oversight.

It is noted however that the Regulator considered that schedule 3 should make provision for the Regulator to seek public submissions on any proposed change statement submitted by AlintaGas, where the Regulator believes it is necessary to do so. The Office of Energy considers that it is possible to conduct limited reviews (with limited public consultation) of the Access Arrangement solely for the purpose of variations to Reference Tariffs or the pass through of changes in taxation and regulation. Restricting the reviews to those specific matters would reduce regulatory risk and increase business certainty. It would also help restrain regulatory cost to an efficient level.

- AlintaGas

AlintaGas objects to Amendments 40, 41 and 42 and submits that the Regulator should not require such amendments in the Final Decision. The reasons for AlintaGas's response, which are based on its interpretation of the reasons for decision is incorrect, are set out below. If AlintaGas's understanding of the reasons for decision is incorrect, AlintaGas's response to the amendments may change.

AlintaGas objects to Amendments 40, 41 and 42 for the following reasons:

- (a) The reasons for decision are deficient.
- (b) The effect of Amendments of 40, 41 and 42 will be to significantly undermine regulatory certainty and increase associated regulatory costs for AlintaGas, contrary to its legitimate business interests.
- (c) In relation to Amendments 40, 41 and 42, the Regulator has not reasonably or correctly considered AlintaGas's legitimate business interests in respect of Reference Tariff variations.
- (d) AlintaGas proposed schedules 2 and 3 in the exercise of its discretion under section 8.3 and in this regard:
 - i. Schedules 2 & 3 comply with the elements of section 8.3 and are consistent with the objectives of section 8.1;
 - ii. Pursuant to section 8.3 it is at AlintaGas's discretion to include schedules 2 and 3 in the Reference Tariff policy within the Access Arrangement;
 - iii. The Regulator may not refuse to approve the Access Arrangement for the reasons the Regulator has given in relation to section 8.3; and
 - iv. The issues of the imposition of obligations, approval and appeal do not appear to be relevant to a consideration of the objectives of section 8.1.
- (e) AlintaGas submits that the Regulator's decision to not allow the Access Arrangement to impose obligations upon the Regulator is ill-founded. It is entirely proper and within the ambit of section 8.3 for a Service Provider to specify the manner in which Reference Tariffs are to vary.
- (f) If implemented, Amendments 40, 41 and 42 will make it impossible for AlintaGas to realise its objectives in relation to schedules 2 and 3. If the Regulator is not prepared to move from the views set out in the reasons for decision, AlintaGas suggests replacing all references to "the Regulator" in schedules 2 and 3 with the words "an independent auditor appointed by AlintaGas".
- (g) Amendment 42 is incorrect in so far as it is based on a judgement that schedules 2 and 3 seek to "extend" section 38 of schedule 1 of the *Gas Pipelines Access (Western Australia) Act*.

Details of AlintaGas's reasoning behind each of these arguments is provided in Attachment L of AlintaGas's submission to the Regulator on the Draft Decision.

In considering the submissions from the Office of Energy and AlintaGas, the Regulator took advice on provisions under the Code for the changing of Reference Tariffs during an Access Arrangement Period, and the corresponding the role and powers of the Regulator in respect of the approval of such changes.

It is noted that section 10.8 of the Code defines a tariff as the criteria that, when applied to a User's characteristics and requirements, determine a charge payable by that User to the Service Provider for a particular service. A Reference Tariff means a tariff specified in an Access Arrangement as corresponding to a Reference Service. A Reference Tariff Policy is defined in section 3.5 of the Code as the principles that are to be used to determine a Reference Tariff.

Section 8.3 of the Code gives a Service Provider broad discretion in the form of Reference Tariff Policy it may choose to apply, ranging from a fixed price-path approach to a continuously variable approach, or a variation or combination of these approaches.

Section 8.1 of the Code imposes some limits on the parameters of design of a Reference Tariff Policy. Whether the policy nominated by a Service Provider may be approved depends on the Regulator being satisfied about the factors listed in section 8.2. It is noted, however, that once a Reference Tariff Policy and Reference Tariff are approved as part of an Access Arrangement, the Code does not provide for a change in either the Reference Tariff Policy or Reference Tariff except by a review of the Access Arrangement in accordance with section 2.28 to 2.48 of the Code, or in accordance with provisions for change included in the Reference Tariff Policy and allowed for under section 8.3 of the Code. Section 8.3 of the Code allows for a Reference Tariff to be adjusted in light of “actual outcomes”, examples of which are sales volumes and actual costs.

The provision for adjustment of a Reference Tariff under Section 8.3 of the Code is potentially contradictory to the requirement in section 2.49 of the Code that provides for an Access Arrangement only to be changed in accordance with section 2 of the Code, i.e. by following the public consultation and regulatory approval process for an Access Arrangement review. While the extent and impact of any conflict between the two parts of the Code is not entirely clear, it would appear that there is not a conflict in the case of an automatic variation to a Reference Tariff such as a CPI-X escalation where the change is an automatic variation without the need for any regulatory action. However, there is uncertainty as to whether the Code would accommodate variations to Reference Tariffs that do not occur by an automatic adjustment and where actual amendments to the Access Arrangement documentation would be required to implement any new Reference Tariff. This would be the case for a revenue yield approach to variation of Reference Tariffs, for which the variation involves discretion on the part of the Service Provider rather than occurring automatically by a predetermined formula.

The Regulator is also of the view that the Code does not in itself provide for the Regulator to have an ongoing supervisory role during the Access Arrangement Period, nor any administrative role in relation to variation of Reference Tariffs outside of a review of the Access Arrangement. This is because the Code itself only provides for the Regulator to be involved in approving proposed Access Arrangements and revisions to existing Access Arrangements. However, due to flexibility inherent in section 8.3 of the Code, the Regulator may have such a role where that is proposed by the Service Provider, subject to such a role being consistent with the requirements for a Reference Tariff Policy listed in chapter 8 and section 2.24 of the Code.

In view of the above, the Regulator is of the view that changes to Reference Tariffs in respect of:

- the revenue yield form of price control as proposed under schedule 2 of the Access Arrangement, and
- the pass through of changes in costs arising from taxation or regulatory changes as proposed under schedule 3 of the Access Arrangement,

are not permitted under the Code.

In addition, the Regulator maintains the concern expressed in the Draft Decision that the regulatory regime might provide AlintaGas with perverse incentives with respect to the re-balancing of charges. A revenue yield can provide the incentive for the regulated entity to subsidise demand (and which ultimately would lead to a rise in average prices). Furthermore,

as regulated retail prices will be set independently of distribution charges, AlintaGas would have the opportunity to re-balance charges in order to increase the profits of its associated retailer prior to contestability, and then to structure charges to exclude competitor retailers after competition has been extended to all customers. These issues are addressed in more detail in the response to Western Power's comments below.

The Regulator will therefore require the Access Arrangement to be amended to remove provisions for changes to Reference Tariffs through either a revenue yield mechanism or pass through of changes in costs arising from changes in taxation or regulation. As variation to Reference Tariffs in accordance with a CPI-X escalation for inflation does appear to be permitted under the Code, a price-cap form of price control may be included in the Access Arrangement.

Revenue Yield Form of Price Control

Draft Decision Amendment 43. Schedule 2 of the Access Arrangement should be amended to remove provisions for re-balancing of Reference Tariffs and to implement a price-cap mechanism for the variation of Reference Tariffs.

Draft Decision Amendment 44. Clause 15 of schedule 2 of the Access Arrangement should be amended such that the "X" value in a CPI-X price cap mechanism is not less than 2.62 percent.

Draft Decision Amendment 45. Clause 14 of schedule 2 of the Access Arrangement should be amended such that the Consumer Price Index (CPI) refers to the Eight Capital City, All-Groups CPI measure, exclusive of the impact of the goods and services tax, as published by the Australian Bureau of Statistics.

- Western Power Submission No. 1

Tariff Re-balancing

The Draft Decision acknowledges the benefits of Average Revenue Yield regulation. It also concludes, on balance, that these benefits are outweighed by the potential for AlintaGas to pursue strategic pricing (i.e. "game") of distribution services that may impede the introduction and maintenance of competition into the retail gas market.

Opportunities to engage in strategic pricing can occur either when distribution tariffs are determined at the start of the regulatory period or annually through the tariff re-balancing process.

In Western Power's view, the ability to game the initial tariffs has been effectively prevented by the Draft Decision requirement to set distribution Reference Tariffs to allow for a 2% retail margin in all customer classes across all consumption blocks. Further, the capacity to game tariffs through annual tariff re-balancing is limited by the side constraints on price movements (i.e. Y control), threat of bypass and asset write-downs. Moreover, the side constraints can be set to allow any desired level of flexibility in this re-balancing.

In the Draft Decision, it is suggested that the opportunity to engage in tariff gaming would be reduced by dropping Average Revenue Yield regulation in favour of Tariff Basket/Price Cap regulation. Under the latter regulatory regime, the Regulator would oversee any tariff re-balancing. However, the significant benefits of Average Revenue Yield regulation would be lost.

In Western Power's view, the most important feature of Average Revenue Yield regulation is the incentive to improve network utilisation resulting in the long-term benefit of lower network prices for all customers. Further, it is suggested that the issue of tariff re-balancing, and the extent to which it is desirable, can be separated from the question of which regulatory approach delivers the best outcomes for all industry

participants. For example, an Average Revenue Yield regime could be implemented with no re-balancing (by setting Y equal to negative X) or unlimited re-balancing (Y uncapped) or anything in between.

However, if there is a resolute view that the Service Provider may engage in gaming and set inefficient prices, then there is scope to retain Average Revenue Yield regulation by restricting the application of the re-balancing mechanism or removing it altogether. This could include the requirement, as suggested in the Draft Decision, that any tariff re-balancing be fully scrutinised by the Regulator. This option would allow some of the benefits of Average Revenue Regulation to be retained, while meeting the Regulator's concerns regarding tariff re-balancing.

Overall, in Western Power's view there does not appear to be a strong case, based on tariff re-balancing considerations, that would favour Price Cap/Tariff Basket over Average Revenue Yield.

Advantages of Average Revenue Yield

Western Power submits that the key distinguishing feature of Average Revenue Yield, as opposed to Tariff Basket/Price Cap, is the incentive for the Service Provider to improve returns to the business through the efficient use and growth of the distribution network (and not the ability to re-balance tariffs without regulatory oversight). For example, under Price Cap/Tariff Basket, incremental revenue is related to the average cost of supply of each tariff class whereas, under Average Revenue Yield, incremental revenue is related to the average cost of supply for all tariff classes. This means that in comparison with Price Cap/Tariff Basket, Average Revenue Yield incorporates a stronger incentive to grow off-peak throughput and a weaker incentive to grow peak load.

More specifically, Price Cap/Tariff Basket provides a relatively homogenous incentive to grow load across all tariff classes that will likely result in the Service Provider adding more capacity to meet peak load growth. In contrast, Average Revenue Yield encourages the Service Provider to develop alternative and innovative solutions to meet peak load growth. In effect, under Revenue Yield, Service Providers have stronger incentives to improve asset utilisation.

Another concern about Price Cap/Tariff Basket regulation relates to the requirement for setting efficient incentive levels on a tariff basis. In Western Power's view, because network business costs are characterised by a high degree of common costs it is difficult to determine the actual cost of supply of a tariff class. It follows that it would also be difficult to assess what level incentives are efficient and equitable for each tariff class. This issue does not arise under Average Revenue Yield regulation.

Western Power urges the Regulator to reconsider the decision to drop Average Revenue Yield in favour of Price Cap/Tariff Basket. Western Power believes that Average Revenue Yield provides simple, well understood (by Service Provider, Regulator and Government) incentives, namely to maximise off-peak throughput and so improve asset utilisation which will benefit all customers through lower prices in the longer term.

X Factor Efficiency Gains

The Draft Decision notes that the X factor calculation methodology, used by AlintaGas, reflects efficiency gains and falling unit costs that are already incorporated into the cost forecasts underpinning the tariff calculations. It is also stated that the Regulator, prior to issuing the Final Decision on the AlintaGas Access Arrangement, will consider whether an additional incentive for efficiency gains is warranted.

In order to objectively assess the potential for efficiency improvements in the distribution networks, Western Power suggests that there may be merit in benchmarking performance levels. In particular, it may be useful to review recent trends in productivity performance levels and establish the current level of productivity for the distribution networks. This data could then be matched up with an assessment of best practice productivity levels to determine the potential for efficiency improvement, given the characteristics of the AlintaGas distribution networks.

One way to assess productivity performance is through undertaking a review of total factor productivity for the distribution networks. Data Envelope Analysis, based on performance data for networks with reasonably similar characteristics, could be used to establish best practice levels.

In Western Power's view, this type of information would provide both a rigorous and defensible basis on which to consider the quantum of any additional efficiency incentives that could be included in setting the X factor.

- Western Power Submission No. 2

Average Revenue Yield Regulation and Tariff Re-balancing

The Regulator argues that Average Revenue Yield regulation provides the Service Provider with an incentive to “game” tariffs to limit the ability of competitive retailers to compete within certain segments of the market.

It appears that the Regulator recognises the benefits of Average Revenue Yield regulation but, on balance, considers that these benefits are outweighed by the potential for AlintaGas to manipulate tariffs to benefit their own retailer. Manipulation of tariffs can occur either:

- at the outset, when tariffs are set for the start of the regulatory period, or
- at the annual re-setting of tariffs under the guise of re-balancing.

The ability to “game” initial tariffs has been effectively prevented by the requirement to set network Reference Tariffs to allow for a 2% retail margin in all cases.

The ability to “game” tariffs as part of the annual tariff re-set is limited by the side constraints on price movements (Y control), threat of bypass and asset write-downs. The side constraints can be set to allow any desired level of flexibility in this re-balancing.

The Regulator has suggested that the way to prevent tariff gaming is to move away from Average Revenue Yield regulation to Tariff Basket / Price Cap regulation. Any tariff re-balancing would be done under the oversight of the Regulator. The problem with this outcome is that the potential benefits of revenue yield regulation are lost.

Western Power submits that incentives, rather than re-balancing, is the characteristic feature of Average Revenue Yield. The benefits of Average Revenue Yield regulation, over Tariff Basket / Price Cap regulation, are centred on the creation of incentives for the Service Provider to find ways to improve the utilisation of the network with the long-term benefit of lower network prices for all customers.

The Regulator’s decision regarding the appropriate amount of re-balancing can be treated independently from the form of regulation (Average Revenue Yield, Tariff Basket / Price Cap, Revenue Cap or other). An Average Revenue Yield regime can be implemented with no re-balancing (by setting Y equal to -X) or unlimited re-balancing (Y infinite) or anything in between. Re-balancing could also be allowed under Tariff Basket / Price Cap.

Strategic re-balancing of access prices to maximise the value of the Service Provider’s retail business is a real problem but it applies to both Tariff Basket / Price Cap and Average Revenue Yield and can be relatively easily handled within either regime.

If the Regulator believes there is a risk that the Service Provider may set inefficient prices, the Regulator could retain Average Revenue Yield regulation and limit or completely remove the ability to re-balance tariffs. This could include the requirement, as suggested by the Regulator, that any tariff re-balancing be fully scrutinised by the Regulator. This option would allow some of the benefits of Average Revenue Regulation to be retained, while meeting the Regulator’s concerns regarding tariff re-balancing. Western Power does not consider it appropriate to choose Tariff Basket / Price Cap over Average Revenue Yield on the basis of re-balancing restrictions.

Advantages of Average Revenue Yield

Western Power submits that the major difference between Average Revenue Yield and Price Cap / Tariff Basket is the incentives the regimes provide to the Service Provider (not the ability to re-balance tariffs).

Because there are not usually significant elasticity differences between classes, it is possible to overstate the efficiency differences between the regimes and to understate the incentives differences of the regimes.

Under Price Cap / Tariff Basket, the Service Provider’s incremental revenue is related to the average cost of supply for that tariff class. Under Average Revenue Yield, the Service Provider’s incremental revenue is related to the average cost of supply for all tariff classes. That is, compared to Price Cap / Tariff Basket, Average Revenue Yield provides higher incentives to grow off-peak throughput and lower incentives to grow peak load. In practice this means:

- Because Price Cap / Tariff Basket, provides a relatively homogenous incentive to grow load across tariff classes, the Service Provider is happy to add more capacity to meet peak load growth. By comparison, Average Revenue Yield provides greater incentives to provide alternative and innovative solutions to meet peak load growth.
- Under Revenue Yield, Service Providers have strong incentives to improve asset utilisation.

Under Price Cap / Tariff Basket, the incentive to grow a particular tariff class depends on the difference between the specific tariff level and the incremental cost of supply for that tariff class. The incremental cost of supply is difficult for the Regulator to assess – therefore it is difficult to determine exactly what incentives have been provided to the Service Provider. The Regulator is relatively uncertain which tariff classes are most attractive to the Service Provider and therefore whether the incentives are desirable or efficient.

Compared to the Price Cap / Tariff Basket, Average Revenue Yield provides simple, well understood (by Service Provider, Regulator and Government) incentives, namely sell more (particularly off-peak) service and improve asset utilisation (flatten load profile).

Western Power concludes that the practical, simple incentives of Average Revenue Yield outweigh the theoretical efficiency advantages of Price Cap / Tariff Basket.

Tariff Re-Balancing and Efficiency

In the previous sections we have argued that:

- allowing tariff re-balancing is an independent decision to the choice of regulatory control (Average Revenue Yield or Tariff Basket / Price Cap); and
- even without re-balancing, Average Revenue Yield provides superior incentives for the Service Provider (and therefore lower prices for customers in the long run).

This section argues that, if re-balancing is allowed, Average Revenue Yield is likely to facilitate efficient tariff re-balancing.

The Regulator argues that Average Revenue Yield regulation provides the Service Provider with an incentive to reduce prices, for some segments of the market, below economically efficient levels (i.e. below the long run avoidable cost of providing the services), in order to increase overall throughput (as more throughput increases revenue and profit).

Whilst this is a theoretical outcome of Average Revenue Yield regulation, Western Power does not consider that it is a practical problem.

To arrive at an undesirable re-balancing outcome, two initial conditions must be met:

- the Service Provider must identify classes of consumer with very different elasticities of demand; and
- prices must already be efficient in level and structure.

Neither of these conditions is usually met by allocated average cost of service pricing methodologies.

If the first condition is not met, then there is no practical problem – the Service Provider cannot increase throughput by re-balancing tariffs.

If the first condition is met, then the re-balancing ability will generally increase efficiency. Because prices are initially set based on an average allocation of the cost of service and, in AlintaGas's case, retail tariff level and structure, the initial access prices are likely to be inefficient. By decreasing the price to highly elastic classes and increasing the price to relatively inelastic classes, the Service Provider will both increase revenue and efficiency.

It is only in the extreme, where the price is reduced to a level below the marginal cost of supply for that class, that prices become inefficient. However, there are several factors limiting the extent of this game including:

- CPI+Y re-balancing constraint makes it difficult to develop cross subsidies during a single Access Arrangement;

- the threat of asset bypass for the cross-subsidising class limits the amount of cross subsidy available; and
- the potential write down of assets supplying a low charge class at next regulatory review (when a new cost of service assessment is conducted) reduces the incentive for the Service Provider to charge less than the long run avoidable cost for use of assets.

Western Power concludes that, if tariff re-balancing was allowed under an Average Revenue Yield regime, the resulting tariff changes are likely to be efficient.

Administrative Complexity

The Regulator argues that the proposed Average Revenue Yield regime introduces significant regulatory complexity because the Regulator will be required to devote resources to:

- verify whether quantity forecasts are reasonable (the Regulator argues that the Service Provider has an incentive to strategically bias forecasts); and
- audit K-factor correction mechanism.

Western Power submits that it is possible to remove forecast quantities from the Average Revenue Yield regime by using historic service mix to weight forecast sales between tariff classes.

In general, in any regime, higher administration costs must be weighed against superior incentives for Service Providers and outcomes for customers.

Historically, Western Australia operated gas and electricity businesses without a regulator. The recent addition of an independent regulator increases administration cost to government and industry. However, we assume that the introduction of the Western Australian Gas Regulator improves outcomes for customers.

The goal should be to optimise the regulatory activities and scrutiny rather than minimise the Regulator's workload. For example, it may be more appropriate to rely on targeted audits rather than detailed analysis of every proposal.

Determination of the X Factor

Determination of the X factor should be consistent with the method of regulation.

The Regulator has indicated the possibility of applying a premium to the X factor to force additional efficiencies beyond those incorporated in the forecast capital and operating budgets for the regulatory period. The Regulator has indicated that the forecast capital and operating expenditures will be reduced to levels that may be regarded as consistent with efficient costs. This action has imposed a requirement on AlintaGas to reduce its capital and operating costs to levels below those forecast just to meet its forecast profitability.

A further increase in the X factor will make it more difficult for AlintaGas to achieve efficiencies that would be rewarded under an incentive regime. Remembering that the essence of incentive regulation is that the greater the incentives, the greater the long-term savings and the greater the customer benefits. On this basis, an additional premium on the X factor appears counter productive.

Western Power has made a number of comments about the advantages of the revenue yield form of price control and a tariff basket form of price control.³⁷ As explained above, the Regulator has, for reasons associated with the powers of the Regulator provided by the Code, decided to require a price cap on each of the individual tariff components rather than to accept either a revenue yield or tariff basket for the first Access Arrangement Period for AlintaGas. Notwithstanding, the comments made by Western Power warrant comment.

³⁷ As discussed in the Draft Decision, under a tariff basket form of price control, the weighted average price from year to year is constrained to not rise by more than CPI-X, where the quantities of the relevant charging components in a previous period are used as the weights.

Amongst others, Western Power appears to have made the following points to support the revenue yield approach over a tariff basket approach.

- The revenue yield approach provides an incentive to implement innovative approaches to meet peak load growth, whereas the tariff basket approach will encourage the regulated entity to add more capacity to meet this growth.
- A revenue yield approach will provide a greater incentive to encourage growth in off-peak usage of the network and a weaker incentive to encourage peak usage. In contrast, the tariff basket approach will provide the same incentive to encourage growth in different parts of the market, and so will result in poorer utilisation of assets.
- The tariff basket approach requires the Regulator to determine the level of incentive that is “efficient and equitable” for each tariff class, whereas this question does not arise with the revenue yield approach.

These matters are discussed in turn. However, at the outset it needs to be noted that an understanding of the relative merits of the different forms of price control³⁸ requires a detailed analysis of the incentives created for the regulated entity. The precise incentives are often far from obvious.

Incentives to Implement Innovative Solutions to Meet Demand Growth

Under any form of price control – revenue yield, tariff basket, hybrid form of control, or even a revenue cap – the regulated entity will have the same incentive to implement innovative (lower cost) solutions to meet demand growth.

One defining feature of incentive compatible regulation is that the regulated entity is permitted to retain the benefit associated with the efficiency gains for a defined period, which in turn is intended to induce the entity to make efficiency gains. The retention of part of this efficiency benefit is achieved by setting the price control for a defined regulatory period irrespective of the actual costs incurred over that period (and so if costs fall, profits rise), possibly supplemented by permitting some of this benefit to be carried over into the next regulatory period.³⁹ Importantly, this incentive to reduce costs is not affected by the incremental revenue the regulated entity receives from the additional units of growth, and so is not affected by the form of price control that is adopted.

Incentives to Increase Asset Utilisation

At the outset it needs to be noted that the more appropriate objective for any regulatory regime is that the *efficient* growth of the market be encouraged, rather than growth *per se*.

³⁸ The *revenue yield* and *tariff basket* forms of price controls were mentioned by Western Power and so are discussed here. There are other forms of price control, as discussed in: Office of the Regulator-General (1999), *Electricity Distribution Price Review Consultation Paper No. 3: Form of Price Control*.

³⁹ The rationale for permitting benefit to be carried over into the next regulatory period is to reduce the incentive the entity may have to defer making further efficiency gains towards the end of the period. This issue is analysed in depth by the Office of the Regulator-General in: Office of the Regulator-General (2000), *2001 Electricity Distribution Price Review: Draft Decision*, chapter 6. That discussion presents a more refined version for the efficiency carry-over mechanism than that previously discussed in Australia.

As noted in the Draft Decision, one problem of the revenue yield is that, because the incremental revenue that a regulated entity receives from sale of an additional unit of a service (i.e. the average revenue across all services) is independent of the price charged to the customer, it may have the incentive to reduce prices to below efficient levels for the customers whose demand can be met at low incremental cost.⁴⁰ Western Power has suggested that the potential for this form of inefficiency is low given the low price responsiveness of gas (and electricity) demand. It is clear, however, that some areas of the market, such as industrial usage, the demand is responsive to price. Moreover, utilities also have a number of non-price means for encouraging usage. For example, a utility (or its associated retailer if the utility is ring fenced) could provide subsidised appliances to customers, such as heaters for gas utilities or air conditioners for electricity utilities. The incentive that exists for an associated retailer to subsidise demand (in order for its associated distribution company to earn additional revenue under the revenue yield price control) is also likely to bias the playing field as competition is introduced as, in effect, the revenue yield approach encourages predatory pricing.

Note, however, that the reverse problem may also exist with the revenue yield form of control. That is, as the incremental revenue is tied to an average cost for the system, the regulated entity may have little incentive to meet demand growth where this occurs in higher unit-cost areas, such as for demand at peak times or in sparsely populated areas, regardless of the price the customers are prepared to pay.

In analysing the impact of the tariff basket form of control, the *dynamic incentives* that this form of price control establishes for the regulated entity's pricing policies need to be understood. Under a tariff basket control, the regulated entity has the incentive to continually refine its pricing structure towards a more efficient structure. That is, one whereby each customer contributes at least the avoidable (or incremental) cost it causes on the system, and where the joint (fixed) costs are recovered in the least distorting manner.⁴¹

It follows that, where the system is close to a constraint (and so avoidable costs are high), the entity would have the incentive to set peak charges that discourage peak usage. Likewise, the regulated entity would also have the incentive to set lower charges for off-peak usage (given the negligible avoidable cost), and thus enhance asset utilisation. Moreover, to the extent that there is a rise in peak usage, these customers will be paying at least the incremental costs they cause, thus the growth will be efficient and prices to the existing customers will not rise.

Under the revenue yield form of control, the regulated entity may have an incentive to set higher prices for peak usage in order to reduce demand and so permit an augmentation to be deferred. However, whether the regulated entity has the incentive to discourage or encourage peak usage will depend entirely upon the size of the revenue yield for peak usage that is

⁴⁰ Inefficient growth refers to the situation whereby the benefit received by the customer from the additional unit of output is less than the incremental cost of producing that output. In competitive markets prices reflect marginal cost. Thus, if a customer *chooses* to purchase an item, the consumption will be efficient.

⁴¹ The properties here relate to the strict form of the tariff basket, which is where the weights that are used to determine the weighted average price remain fixed during the regulatory period. Where updated weights are used to determine the weighted average price (such as the actual quantities that were sold in a recent year), the regulated entity faces a trade-off. On the one hand, the entity has the long run incentive to set efficient prices, but on the other hand, it has the short run incentives to try to influence the quantities that are sold in a given year in order to manipulate the weights. In general, however, using quantities from further in the past reduces the pay-off from this short run strategy.

determined by the regulator.⁴² If peak usage is unprofitable for the regulated entity, it will have the incentive to set high (in fact, prohibitively high) charges to discourage peak use of the system. However, it would have no incentive to augment the system even if customers are prepared to pay the high prices. Thus, efficient use of the system may be discouraged. In contrast, if peak usage is profitable for the regulated entity, it will have the incentive to encourage peak usage, regardless of whether customers are prepared to pay the costs associated with peak usage. That is, under a revenue yield approach, the regulated entity has no incentive to set efficient prices and permit customers to respond to these signals. In contrast, under a tariff basket control, the regulated entity has the incentive to set prices that reflect the cost of augmenting the system, and thus permitting customers to choose when and how much to consume.

These arguably theoretical concerns with the revenue yield approach are supported by practical experience in Australia. Although the experience is relatively short, the actual performance of revenue yield forms of price control in Australia does not provide much encouragement for the proposition that this form of control will lead to improved asset utilisation. The longest running revenue yield form of control in Australia is the one applying to the Victorian electricity distribution businesses.⁴³ That control has separate sub-yields for peak and off-peak usage, and has yields on peak usage that are significantly higher than the yields for off-peak usage. Over the period of its operation, it is understood that the share of peak usage in overall usage has increased substantially (particularly for domestic customers, who are mostly responsible for the system peaks).

Need for a Regulator to Determine the “Efficient” and “Equitable” Incentives

As implied by the above discussion and in contrast to Western Power’s suggestion, a virtue of the tariff basket form of control is that a regulator does not have to determine the appropriate level of incentive for the different tariff classes. Rather, under the tariff basket form of control, the regulated entity has the *dynamic incentive* to refine its charging practices to determine more efficient prices, and which in turn provides the entity with an appropriate incentive with respect to demand growth. In contrast, under revenue yield forms of controls, a regulator has to determine the incremental revenue the regulated entity receives from growth in different tariff classes, which in turn determines its incentives with respect to growth.

Re-Balancing in the Presence of Retail Price regulation

A further matter than needs to be taken into account when assessing the incentives provided for re-balancing is the effect of independent regulation of retail prices. For gas in Western Australia (as with electricity), the Government has announced that it will regulate the delivered price of gas to small gas users. In addition, it has determined the delivered price

⁴² Most revenue yield forms of price control (and that proposed by AlintaGas) have a number of “sub-yields” for different parts of the market. The overall maximum average charge (or revenue yield) is then determined as the weighted-average of these sub-yields. The change in revenue associated with a change in quantities in a given year is determined by the overall revenue yield (i.e. the weighted average) in that year, but the expected change in revenue is more likely to reflect the “sub-yields” in the subsequent years.

⁴³ The control is given effect in the *Victorian Electricity Industry Tariff Order 1995*. The Victorian Regulator-General has just announced his intention to replace the revenue yield control with a tariff basket for the period commencing 1 January 2001: Office of the Regulator-General (2000), *2001 Electricity Distribution Price Review: Draft Decision*, chapter 11.

independently of distribution charges. This structure of regulated retail prices provides two perverse incentives for AlintaGas. Importantly, these incentives would exist for *any* form of price control that permits re-balancing (i.e. whether it be a revenue yield, tariff basket, hybrid or other approach)

First, prior to small customers becoming contestable, the Service Provider would have the incentive to reallocate costs towards contestable (large) customers (thus increasing the price they pay) and away from small customers. This would not change the revenue (and hence profit) for the distribution business as its revenue would be unchanged. However, as the retail prices would not fall in line with the distribution charges, the profit earned by AlintaGas's associated retail business would increase.

Secondly, after competition is extended to all customers, AlintaGas could have the incentive to increase the distribution charges for small customers, or to change the structure of these charges in order to exclude retail competitors for these customers. This would arise because the competitor's retail margin would depend upon (amongst other things) the difference between the regulated retail price and the distribution charge. As re-balancing would provide AlintaGas with the scope to manipulate the latter charge, it would have the ability to affect this margin.

As well as encouraging gaming and anti-competitive behaviour, there is no reason to expect that the re-balancing of charges that would be consistent with these incentives would improve the efficiency of charging for the use of distribution services.

Other Relevant Matters – Risk

A further disadvantage of the revenue yield form of control is that, as the regulated entity's revenue is independent of how it sets its charges, the entity is precluded from setting charges that reduce its risk exposure. In the revenue yield controls currently in operation in Australia (and proposed by AlintaGas), the averaging parameter generally is energy throughput – gigajoules of gas or kilowatt hours of electricity transported. As a result, even where the regulated entity sets charges based upon more cost-reflective factors such as maximum demand, the revenue the entity is permitted to retain will be related to energy throughput.

It is not clear that having the regulated entity bear this risk reflects an efficient allocation of risk. For the most part, energy flows do not affect the regulated entity's costs – it needs the capacity in place to meet maximum demand, regardless of energy throughput. Hence, the acceptance of this risk is unlikely to provide the incentive to reduce costs. In addition, the regulated entity will often have no ability to affect the level of energy throughput, as factors such as weather are likely to be more significant. It has been suggested elsewhere⁴⁴ that, as regulated entities have to finance significant amounts of investment, long term average prices (including the cost of financing) are likely to be lower if the risks associated with exogenous factors – such as weather – are passed through to customers.

⁴⁴ Office of the Regulator-General (1998), *Electricity Distribution Price Review Consultation Paper No.2: Efficiency Measurement and Benefit Sharing*; and Office of the Regulator-General (1999), *Electricity Distribution Price Review Consultation Paper No. 4: Cost of Capital Financing*.

- AlintaGas

AlintaGas objects to Amendments 43, 44 and 45 and submits that the Regulator should not require these amendments in the Final Decision for the following reasons:

(a) In relation to Amendment 43 the Regulator has taken into account only one of the factors the Regulator is required to take into account under section 2.24 and the Regulator has failed to give consideration to any of the objectives of section 8.1 for the design of a Reference Tariff and a Reference Tariff policy.

(b) In relation to Amendment 43, the Regulator:

- i. interpreted section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* in an unreasonable and, therefore, inappropriate way; and
- ii. failed to take into account facts which, if they had been properly taken into account, would have led the Regulator to not proposing Amendment 43.

(c) In relation to Amendment 43, the Regulator's reasons for rejecting the revenue yield form of incentive mechanism proposed by AlintaGas in schedule 2 of the Access Arrangement appear to be without foundation, and their use in supporting the amendment does not appear to have a clear rationale.

(d) In relation to Amendment 43, the Regulator's assertion that the revenue yield form of incentive mechanism proposed by AlintaGas, in schedule 2 of the Access Arrangement, is complex and potentially expensive to regulate and administer is largely unsubstantiated.

(e) In relation to Amendment 44, AlintaGas notes that the Regulator's method of calculating the value of "X" in the CPI-X formula flows from Amendment 43. As AlintaGas objects to the imposition of simple price caps as proposed by Amendment 43, it also opposes Amendment 44.

(f) In relation to Amendment 45:

- i. The CPI measure proposed by AlintaGas is the appropriate measure of inflation to be used in the Access Arrangement;
- ii. Amendment 45 has been based on irrelevant considerations; and
- iii. As a Western Australian regulator, appointed to ensure that appropriate consideration is given to local issues, the Regulator should examine the merits of AlintaGas's use of the All Groups Perth CPI within the scope of sections 2.24 and 8.24 of the Code and not propose a change only because that change achieves consistency with the decisions of regulators in other jurisdictions.

AlintaGas notes the comment made in the reasons for decision supporting Amendment 45 to the effect that the Regulator is considering an efficiency requirement in addition to that provided by the X factor in the CPI-X mechanism. AlintaGas would strongly object to such an additional requirement on the grounds that:

(a) it can see no basis for the Regulator's assertion that the proposed price control is comparatively lenient; and

(b) there is no scope under the Code for imposition of arbitrary incentives for unachievable levels of efficiency improvement.

Details of AlintaGas's reasoning behind these arguments are presented in Attachment M of AlintaGas's submission to the Regulator on the Draft Decision.

The submission from AlintaGas addresses three matters:

- the Regulator's rejection of AlintaGas's proposed revenue yield approach to variation of reference tariffs over the Access Arrangement Period;
- the Regulator's revision to the value of "X" in the CPI-X constraint on the variation of Reference Tariffs within the Access Arrangement Period; and

- the Regulator's requirement for a national rather than Western Australian CPI measure to be used as the basis for variation of Reference Tariffs within the Access Arrangement Period.

AlintaGas's arguments in respect of the proposed revenue yield approach to variation of Reference Tariffs are noted. However, after giving further consideration to the form of regulation, the Regulator has determined that the approach proposed by AlintaGas is not permissible under the Code and is therefore rejected on this basis. Notwithstanding this, the Regulator would maintain strong reservations as to the approval of this approach even if it were permitted under the Code for the reasons outlined in the Draft Decision.

In regard to the value of X in the CPI-X constraint on tariff variation, the Regulator maintains the stance taken in the Draft Decision on the corrections to the methodology proposed by AlintaGas for the determination of this value. The requirement for amendment of the X value will be maintained. The Regulator has, however, re-calculated the value of X to reflect changes to cost parameters underlying the determination of Reference Tariffs and will require the Access Arrangement to be amended to define the value of X as 2.55 percent.

Under the methodology proposed by AlintaGas for determination of X, the prices for the first year of the period (year 2000) are calculated to ensure that the expected revenue from distribution charges in the year 2000 is equal to the cost of providing services in that year (i.e. the benchmark revenue requirement). The X factor is then determined as the value that results in the forecast present value of revenue from distribution charges over the Access Arrangement Period (given the first year prices) with the present cost (benchmark revenue requirement) of providing the services over that period.⁴⁵

As the Regulator (consistent with AlintaGas's proposal) has determined a real WACC, the most straight-forward approach for determining the opening year prices and X factor is to express all values in constant prices. The opening year prices would then be established by applying the requisite period of inflation to the "constant dollar" prices to re-express the prices as at the middle of the first year. Apart from simplifying computations, this approach reduces the relevance of the assumption that is made about inflation over the period.

AlintaGas, however, has provided all of its cost forecasts and undertaken all of its calculations in nominal (money of the day) terms, which also requires a nominal WACC to be employed. In order to assist the comparability with AlintaGas's proposal, and to avoid the need to attempt to convert AlintaGas's cost forecasts into constant prices), the Regulator has also expressed all values (and undertaken all calculations) in nominal terms. In addition, for the purpose of this calculation only, the Regulator has adopted AlintaGas's forecast of inflation over the Access Arrangement Period of 2.5 percent, and has used a nominal WACC that is consistent with inflation forecast. While this inflation assumption differs from that used by the Regulator to determine the real WACC (2.78 percent), the inflation assumption

⁴⁵ This methodology for determining the X factor (that is, as the factor that equates the present value and cost of providing distribution services) is the standard approach amongst Australian and UK regulators. Determining the first year prices so that revenue in the first year equates exactly to cost is just one of the possible levels for the first year prices, however.

that is used to calculate prices and the X does not have a significant effect on the resultant prices and X (given that revenue and costs are inflated by the same value).⁴⁶

The Regulator considers, however, that it is more appropriate to express forecasts of costs and revenue over a period in constant (real) prices. In addition, as noted above, where a real WACC is employed, the tariff calculations are considerably more straight-forward and transparent if all values are expressed in constant price terms (and the *real* WACC, rather than a nominal WACC, is used as the discount rate). This view is shared by the Office of the Regulator-General:

[W]here a real WACC is adopted, and all variables are expected to change with inflation (as is assumed implicitly by a CPI-X regime), then expressing all values in constant prices, and adjusting for differences in price levels at the end, reduces considerably the complexity of the modelling and the scope for error. In particular, the focus upon the nominal WACC, or other forms of return in nominal terms, is considered to be potentially misleading, given that ex post nominal will adjust according to outturn inflation to preserve real returns.⁴⁷

It is also understood that all of the UK regulators use a real WACC when determining price controls for the regulated utilities present all costs, and undertake all calculations in constant price terms.

Accordingly, the Regulator will consider requiring calculations of Reference Tariffs in future Access Arrangements, and the information provided in the Access Arrangement Information, to be presented in constant price terms rather than nominal dollar (money of the day) terms.

In regard to the CPI measure used to set the CPI-X constraint, the Regulator is of the view that inflation increases in AlintaGas's costs are more likely to bear a closer relationship to a national CPI measure than a State CPI measure due to the likelihood of substantial sourcing of inputs for the distribution business from outside of Western Australia. The Regulator will therefore maintain the requirement for amendment of the Access Arrangement to define the CPI as a national measure.

4.11.5 Required Amendments to the Access Arrangement

Amendment 39 [was Draft Decision Amendment 43]

Schedule 2 of the Access Arrangement should be amended to provide for variation of Reference Tariffs only in accordance with a CPI-X "price-cap" applying to individual tariff components.

⁴⁶ The inflation forecast that is used to establish the opening year costs and revenue (which should reflect inflation over the period from the middle of 1999 to the middle of 2000) is the only inflation forecast that could have a material effect on prices. The alternative choices for this forecast are the long term inflation forecast (2.8%), actual inflation over the year to March 2000 (2.8%), or the inflation over the year to September 1999 (1.7%). The latter measure is the most consistent with the *future* adjustments for inflation (as prices will be escalated annually according to the level of inflation over the previous year), and thus arguably would be least likely to result in a biased adjustment for 'first year' inflation. Given these choices, the Regulator does not consider that an assumption of 2.5% inflation is unreasonable.

⁴⁷ Office of the Regulator-General, 2001 *Electricity Distribution Price Review: Draft Decision*, May 2000, page 183.

Amendment 40 [was Draft Decision Amendment 44]

Clause 15 of schedule 2 of the Access Arrangement should be amended such that the “X” value in a CPI–X price cap mechanism is 2.55 percent.

Amendment 41 [was Draft Decision Amendment 45]

Clause 14 of schedule 2 of the Access Arrangement should be amended such that the Consumer Price Index (CPI) refers to the Eight Capital City, All-Groups CPI measure, as published by the Australian Bureau of Statistics, or, in the event that the Australian Bureau of Statistics does not publish such an indicator, a substitute index agreed to by the Regulator. For the purposes of setting tariffs for 2001, the CPI measure should be reduced by 2.75 percent to account for the impact of the goods and services tax.

Amendment 42

Schedule 3 of the Access Arrangement should be amended to remove provision for changes to Reference Tariffs to reflect the pass through of changes in costs arising from changes to taxation or regulation.

4.12 FIXED PRINCIPLES

4.12.1 Access Code Requirements

Section 8.47 of the Code states that a Reference Tariff Policy may provide that certain elements of the Reference Tariff Policy (Fixed Principles) are fixed for a specified period and not subject to change when a Service Provider submits reviews to an Access Arrangement without the agreement of the Service Provider. The period during which the Fixed Principle may not be changed is the Fixed Period.

Section 8.48 of the Code states that a Fixed Principle may include any Structural Element, but in assessing whether any Structural Element may be a Fixed Principle regard must be had to the interests of the Service Provider and the interests of Users and Prospective Users. A Market Variable Element can not be a Fixed Principle. The Fixed Period may be for all or part of the duration of an Access Arrangement, but in determining a Fixed Period regard must be had to the interests of the Service Provider and the interests of Users and Prospective Users.

4.12.2 Access Arrangement Proposal

In clause 38 of the Access Arrangement, AlintaGas propose that the following principles are Fixed Principles for a Fixed Period of 10 years:

- the structure of Reference Tariffs as specified in clauses 21, 22, 23 and 24 of the Access Arrangement;

- the method of calculation of the Total Revenue as described in clause 27 of the Access Arrangement;
- the method of forecasting new facilities investment under clause 29 of the Access Arrangement;
- the financing structure that has been assumed for the purposes of determining the rate of return in accordance with section 8.30 of the Code;
- the Depreciation Schedule, referred to in clause 31 of the Access Arrangement;
- the allocation of revenue between services as described in clause 33 of the Access Arrangement; and
- the form of regulation as described in clause 35 of the Access Arrangement.

4.12.3 Draft Decision

The Regulator considered that the Fixed Principles proposed by AlintaGas are generally consistent with the nature of Structural Elements allowed as Fixed Principles by section 8.48 of the Code. However, for two of the proposed fixed principles – the Depreciation Schedule and the allocation of revenue between services – it is not clear whether the proposed Fixed Principle comprises a principle or a methodology within the meaning indicated in the definition of a structural element in section 10.8 of the Code. The Regulator considered that this needs to be clarified.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 46

Clauses 38(1)(e) and 38(1)(f) of the Access Arrangement should be amended to indicate whether the Fixed Principles of the Depreciation Schedule and the allocation of revenue between services comprise principles or methodologies within the meaning indicated in the definition of a structural element in section 10.8 of the Code.

In regard to the proposed Fixed Period of 10 years, the Regulator acknowledged that it may be desirable for certain underlying parameters of the Reference Tariffs to be exempt from variation by regulatory decisions over an extended period as this may reduce financing costs and so reduce long-term charges to customers. However, the Regulator considered that there are risks to locking in aspects of the regulatory regime where there is currently little regulatory experience and both the gas industry and market are subject to substantial change within the foreseeable future. In particular, the effects of the current regulatory regime on competition in gas markets are uncertain. In view of these uncertainties, a Fixed Period in excess of the Access Arrangement Period was considered to be potentially contrary to the interests of Users and Prospective Users.

The required amendment to the Access Arrangement was as follows.

Draft Decision Amendment 47

Clause 38(2) of the Access Arrangement should be amended to provide for a Fixed Period of no greater than five years starting on the Commencement Date.

4.12.4 Responses to Submissions on the Draft Decision***“Depreciation Schedule” and “Allocation of Revenue Between Services” as Fixed Principles***

Draft Decision Amendment 46. Clauses 38(1)(e) and 38(1)(f) of the Access Arrangement should be amended to indicate whether the Fixed Principles of the Depreciation Schedule and the allocation of revenue between services comprise principles or methodologies within the meaning indicated in the definition of a structural element in section 10.8 of the Code.

- AlintaGas

AlintaGas objected to Amendment 46 for the following reasons.

- (a) There is uncertainty about what the Regulator requires in the amendment and, to the extent that the Regulator requires statements of clarification to be included in the Access Arrangement, such a requirement is unsatisfactory for legal and policy reasons.
- (b) The Regulator has not complied with the requirement under section 7.7 to provide reasons to support the Regulator’s decision.
- (c) The Depreciation Schedule and “allocation of revenue between services” are both principles within the meaning of “structural element” in section 10.8.

Details of AlintaGas’s reasoning behind these arguments are presented in Attachment O of AlintaGas’s submission to the Regulator on the Draft Decision.

The Regulator recognises that a Depreciation Schedule and the allocation of revenue both fall within the definition of a structural element given in section 10.8 of the Code and therefore may comprise fixed principles. The reason for Draft Decision Amendment 46 was the removal of ambiguity in the meaning assigned to, or implied for, the Depreciation Schedule and revenue allocation in the Access Arrangement and associated documents.

For example, the Depreciation Schedule is defined in section 31 of the Access Arrangement as the basis upon which assets that form the AlintaGas network have been depreciated for the purposes of determining the Reference Tariffs. The implication of this definition is that the Depreciation Schedule comprises a methodology or a set of assumptions for determining the value of depreciation costs. However, in Table 3.5 of the Access Arrangement Information, the values of depreciation costs are presented as the depreciation schedule.

Similarly, the allocation of revenue between services is presented as a methodology in section 33 of the Access Arrangement, but cost allocation is presented as a set of values in Figures 2.1 and 2.2 of the Access Arrangement Information.

The Regulator notes that AlintaGas has indicated in section 4.3 of Attachment N of the submission on the Draft Decision that both “Depreciation Schedule” and “allocation of revenue between services” refer to methodologies. The definition and use of the relevant terms should be amended in the Access Arrangement and Access Arrangement Information such that it is clear that both terms refer to methodologies and not to the values derived by application of the methodologies. The Regulator therefore maintains the requirement of

Draft Decision Amendment 36 for the Access Arrangement to be amended to clearly indicate that the “Depreciation Schedule” and “allocation of revenue between services” clearly refer to methodologies. The Regulator also notes that removal of ambiguity on this issue may require amendments to the Access Arrangement documents beyond section 38 of the Access Arrangement.

Duration of Fixed Period

Draft Decision Amendment 47. Clause 38(2) of the Access Arrangement should be amended to provide for a Fixed Period of no greater than five years starting on the Commencement Date.

- AlintaGas

AlintaGas objects to Amendment 47 and submits that the Regulator should not require such an amendment in the Final Decision for the following reasons.

(a) The Regulator did not have regard to AlintaGas’s interests as required by section 8.48. If the Regulator did have regard to the interests of AlintaGas, the Regulator did not record them in the reasons for decision and the Regulator has accordingly failed to comply with the Regulator’s obligation to give reasons under section 7.7.

(b) The Regulator’s conclusion that a fixed period in excess of the access arrangement period is potentially contrary to the interests of users and Prospective Users is inconsistent with the very notion of fixed principles under sections 8.47 and 8.48. The effect of this conclusion is to incorrectly render sections 8.47 and 8.48 largely redundant.

(c) The effect and intent of sections 8.47 and 8.48 is that the fixed period should be a period that extends beyond a single access arrangement period. Consistent with, and to give effect to, sections 8.47 and 8.48, the Regulator should approve a fixed period that spans a number of access arrangement periods. As specified by AlintaGas in clause 38(2) of the Access Arrangement, the appropriate fixed period is 10 years.

(d) The Regulator’s decision to not allow the fixed period of 10 years proposed by AlintaGas will result in increased regulatory risk contrary to the legitimate business interests of AlintaGas.

(e) It is unreasonable for the Regulator to undermine the operation of sections 8.47 and 8.48 because of regulatory inexperience and market uncertainties. Those uncertainties were known at the time the Code was designed, and were implicitly accepted as risks.

(f) It is unreasonable for the Regulator to attach more weight to the potential adverse effect on consumers than the Regulator attaches to the definite adverse effect on AlintaGas’s legitimate business interests.

Details of AlintaGas’s reasoning behind these arguments are presented in Attachment P of AlintaGas’s submission to the Regulator on the Draft Decision.

AlintaGas emphasise that, by virtue of an implied definition of “the duration of an Access Arrangement”, the Code explicitly provides for Fixed Period of longer than an Access Arrangement Period. AlintaGas submit that section 1.20, 2.20 and 3.20 of the Code carry an implication that the duration of an access arrangement is the period between the time when the access arrangement becomes effective and the time it expires or terminates. An access arrangement period, however, is defined by section 10.8 of the Code to be the period from when an access arrangement or revisions to an access arrangement take effect until the next revisions commencement date. Accordingly, the duration of an access arrangement is not the same as the access arrangement period. Within the duration of an access arrangement, there will usually be a number of access arrangement periods. AlintaGas submitted that, by virtue of reference to a Fixed Period being for all or the duration of an Access Arrangement in section 8.48 of the Code, the intent of the Code is to provide for a Fixed Period of longer than an Access Arrangement Period. The proposal for a Fixed Period of 10 years is argued to therefore be consistent with the intent of the Code in respect of Fixed Principles.

The Regulator has further considered and sought legal advice on the intent of the Code in respect of the duration of the Fixed Period and has reached a view that the intention of

sections 8.47 and 8.48 of the Code is to give the Regulator a discretion to allow a Fixed Period to exceed a single Access Arrangement Period. However, in determining the Fixed Period, regard must be had to the interests of the Service Provider and the interests of Users and Prospective Users.

The Regulator has therefore examined each of the Fixed Principles proposed by AlintaGas and assessed whether AlintaGas's proposed Fixed Period of 10 years for each of these fixed principles is reasonable, having regard to the interests of AlintaGas and the interests of Users and Prospective Users.

The Fixed Principles proposed by AlintaGas are:

- the structure of Reference Tariffs as specified in clauses 21, 22, 23 and 24 of the Access Arrangement;
- the method of calculation of the Total Revenue as described in clause 27 of the Access Arrangement;
- the method of forecasting new facilities investment under clause 29 of the Access Arrangement;
- the financing structure that has been assumed for the purposes of determining the rate of return in accordance with section 8.30 of the Code;
- the Depreciation Schedule, referred to in clause 31 of the Access Arrangement;
- the allocation of revenue between services as described in clause 33 of the Access Arrangement; and
- the form of regulation as described in clause 35 of the Access Arrangement.

With the exception of the structure of Reference Tariffs as specified in clauses 21, 22, 23 and 24 of the Access Arrangement, these proposed Fixed Principles refer to general methodologies and assumptions for the determination of and allocation of costs,⁴⁸ and the determination of Reference Tariffs.⁴⁹ Subject to amendments being made to the Access Arrangement in accordance with this Final Decision, these methodologies are consistent with the requirements of the Code as it currently stands and with methodologies applied without contention in similar circumstances for regulatory purposes elsewhere in Australia. The Regulator is therefore of the view that the Fixed Principles of:

- the method of calculation of the Total Revenue as described in clause 27 of the Access Arrangement;

⁴⁸ Noting the requirement of the Regulator as per Amendment 43 that the Access Arrangement be revised to indicate that the Fixed Principles of the Depreciation Schedule and the allocation of revenue between services comprise methodologies within the meaning indicated in the definition of a structural element in section 10.8 of the Code.

⁴⁹ It is noted that the form of regulation proposed by AlintaGas in clause 35 of the Access Arrangement is the revenue yield approach and that the Regulator is requiring (Amendment 39 of this Final Decision) that the Access Arrangement be amended to replace this form of regulation with a price cap approach. If AlintaGas retain the Fixed Principle in respect of the form of regulation, it will relate to the price cap approach and not the revenue yield approach.

- the method of forecasting new facilities investment under clause 29 of the Access Arrangement;
- the financing structure that has been assumed for the purposes of determining the rate of return in accordance with section 8.30 of the Code;
- the Depreciation Schedule, referred to in clause 31 of the Access Arrangement;
- the allocation of revenue between services as described in clause 33 of the Access Arrangement; and
- the form of regulation,

are principles that may be appropriately set for a Fixed Period of 10 years, subject to amendments being made to the Access Arrangement in accordance with this Final Decision.

The Regulator is, however, concerned that the Fixed Principle of the structure of Reference Tariffs as specified in clauses 21, 22, 23 and 24 of the Access Arrangement would appear to include specific tariff structures, including gas quantity blocks as they relate to tariff structures. These tariff structures may potentially have a significant impact on the scope for competition in the retail market for gas, particularly where the retail price of gas is itself regulated. The Regulator is of the view that, considering the interests of AlintaGas, Users and Prospective Users, it is reasonable to approve tariff structures for the Access Arrangement Period, but that practical experience gained with the proposed tariff structures and impacts on competition in the retail gas market should be able to be taken into account in any review of the Access Arrangement.

The Regulator has therefore removed the requirement indicated in Draft Decision Amendment 47 that the Access Arrangement be amended to provide for a Fixed Period of no greater than five years starting on the Commencement Date, but will require amendment of the Access Arrangement to remove the fixed principle of the structure of Reference Tariffs.

4.12.5 Required Amendments to the Access Arrangement

Amendment 43 [was Draft Decision Amendment 46]

The Access Arrangement and Access Arrangement Information should be amended to indicate that the Fixed Principles of the “Depreciation Schedule” and “allocation of revenue between services” comprise only methodologies, and not values calculated using these methodologies.

Amendment 44

Clause 38(1) of the Access Arrangement should be amended to remove the Fixed Principle of the structure of Reference Tariffs.

5 OTHER ISSUES RAISED IN PUBLIC SUBMISSIONS

5.1 REGULATORY INTRUSION

- Western Power Submission No. 2

It has been stated several times that the Regulator favours light-handed regulation. Western Power's understanding of light-handed regulation is that it focuses on outcomes for customers rather than inputs to the network business, and uses audits from time to time to determine whether the network business behaviour is appropriate.

The approach in the draft proposal is tending towards a more heavy-handed approach with rigorous scrutiny of inputs prior to implementation. Western Power believes that light-handed regulation leads to the most efficient long-term outcomes for customers and reduces the regulatory burden for all.

The Regulator has considered these comments by Western Power but notes that the regulatory arrangement implemented by the Gas Pipelines Access Regulator is significantly guided by the Code. To the extent that the Regulator has discretion, light-handed approaches are preferred, but these must be considered along with the legitimate business interests of the Service Provider and the interests of Users and Prospective Users.

5.2 RING FENCING

- Office of Energy

The Draft Decision notes that once AlintaGas becomes subject to the ring fencing provisions of the Code, contractual arrangements between the distribution and trading businesses of AlintaGas for gas distribution in the AlintaGas network will comprise Associate Contracts within the meaning of part 7 of the Code. The Regulator's approval of an Associate Contract is required before such a contract comes into effect.

It is noted that it is possible for contractual arrangements between the distribution and trading businesses of AlintaGas to comprise Associate Contracts within the meaning of part 7 of the Code before AlintaGas becomes subject to the ring fencing provisions of the Code by virtue of the amendments to the *Gas Pipelines Access (WA) Act 1998* implemented through the *Gas Corporation (Business Disposal) Act 1999*. Therefore, a Regulatory approval of such arrangements may be required before that time.

As noted in the Draft Decision, AlintaGas will become subject to the ring fencing requirements of the Code on 1 July 2002 or on the date at which the Minister considers the disposal of AlintaGas (the Gas Corporation) to be substantially complete, whichever is earlier. Once AlintaGas becomes subject to the ring fencing provisions of the Code, contractual arrangements between the distribution and trading businesses of AlintaGas for gas distribution in the AlintaGas network will comprise Associate Contracts within the meaning of part 7 of the Code. While AlintaGas may implement ring fencing arrangements prior to the required date, there is no compulsion on AlintaGas to do so. Prior to ring fencing obligations coming into force, the Regulator has no influence over pricing arrangements between the AlintaGas distribution and trading businesses.

5.3 APPLICATIONS PROCEDURE FOR SERVICES

- CMS Gas Transmission of Australia Submission No. 2

CMS is disappointed that OffGAR has supported an Access Arrangement where the procedure for Prospective Users wishing to obtain access to a Reference Service has not been available for public scrutiny.

CMS questions why AlintaGas is not prepared to submit this procedure for review by the public. The means by which a Reference Service is obtained is fundamental to the terms and conditions of that service.

CMS contends that it is in the public interest for AlintaGas to make the Applications Procedure available for public comment before OffGAR passes its final decision on the Access Arrangement. The Chamber of Minerals and Energy and the Office of Energy have previously also asked for this procedure to be made available to public scrutiny.

Furthermore, the nature of the information required of a Prospective User that is to be provided to AlintaGas as a prerequisite for obtaining access to a Reference Service is of vital interest to all Potential Users of the AlintaGas Gas Distribution Systems at this stage of public consultation.

CMS Proposal: AlintaGas issues the AlintaGas Applications Procedure as soon as reasonably practical, so that it may be considered as part of the public consultation process prior to OffGAR passing its final decision on the Access Arrangement.

Under part 5 of the Code, a Service Provider is required to establish an Information Package containing general information on the terms and conditions of access and explaining how to make a specific access request. The required information includes a description of the Service Provider's procedures relating to specific access requests, including a detailed description of the information the Service Provider requires in order to consider an access request. The Regulator may require the Service Provider to amend or include additional information in the Information Package if the Regulator if the Regulator considers the amendment or additional information will assist the Prospective Users to decide whether or not to seek services from the Service Provider or to determine how to go about seeking services from the Service Provider.

The Regulator considers that it is sufficient for details of the procedure for obtaining a service to be provided in the Information Package, and that it is not necessary for such details to be provided in the Access Arrangement. Furthermore, the Regulator considers it reasonable for the Access Arrangement to be approved before the Information Package is produced.

In accordance with powers under section 2.1 of the Code, the Regulator may undertake public consultation in considering whether to require a Service Provider to make amendments to an Information Package or to require additional information to be included in an Information Package. In deciding whether or not to undertake public consultation, the Regulator would have a view to the envisaged level of public interest and the potential benefits of consultation.