Economic Regulation Authority

Western Australia

Final Decision on the Proposed Revisions to the Access Arrangement for the Mid-West and South-West Gas Distribution Systems

Submitted by

AlintaGas Networks Pty Ltd

12 July 2005

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TABLES

DECISION

1. On 28 February 2005, the Authority issued a draft decision (**Draft Decision**) not to approve proposed revisions to the Access Arrangement for the Mid-West and South-West Gas Distribution Systems (**GDS**) submitted by AlintaGas Networks Ltd (**AGN**) on 31 March 2004 on the basis that they did not satisfy the principles in sections 3.1 to 3.20 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (**Code**). The Authority required amendments to the proposed revisions, as listed in the Draft Decision, in order to approve the revised Access Arrangement.

2. In the Draft Decision the Authority also decided, pursuant to section 2.30(a) of the Code, that it was not satisfied that the Access Arrangement Information submitted with the proposed revised Access Arrangement met the requirements of sections 2.6 and 2.7 of the Code and, therefore, required AGN to make changes to the Access Arrangement Information, as listed in the Draft Decision, before making a final decision to approve the proposed revised Access Arrangement.

3. On 21 March 2005, AGN submitted to the Authority, in response to the Draft Decision, amended revisions proposed to the Access Arrangement pursuant to section 2.37A of the Code and revised Access Arrangement Information, together with a written submission. Following consultation with the Authority, AGN submitted pursuant to section 2.37A further amended revisions to the proposed Access Arrangement, and further revised Access Arrangement Information, on 10 June 2005 and 27 May 2005 respectively. These documents were intended to substitute for the earlier documents which responded to the Draft Decision and represent AGN's final position in response to the Draft Decision.

4. Under section 2.38A of the Code the Authority may approve the further revised Access Arrangement submitted by AGN on 10 June 2005 only if the Authority is satisfied that the revised Access Arrangement:

   - incorporates or substantially incorporates the amendments specified by the Authority in its Draft Decision; or

   - otherwise addresses to the Authority's satisfaction the matters the Authority identified in its Draft Decision as being the reasons for requiring the amendments specified in the Draft Decision.

5. The Authority is not satisfied that the proposed revisions to the Access Arrangement submitted on 10 June 2005 meet the requirements of section 2.38A of the Code and has thus determined not to approve it. In accordance with the requirements of section 2.38(b)(ii) of the Code the Authority in this Final Decision states the amendments that need to be made to the revised Access Arrangement submitted on 10 June 2005 in order for the Authority to approve it.

6. The Authority is also not satisfied that the further revised Access Arrangement Information submitted on 27 May 2005 meets the requirements of section 2.6 and 2.7 of the Code for the reasons set out in this Final Decision. The Authority requires changes to the further revised Access Arrangement Information as listed after the reasons (in box format) prior to approving the Access Arrangement.

7. The Authority is also required by section 2.38(b)(ii) of the Code to state the date by which amended revisions to the Access Arrangement addressing this Final Decision must be submitted to the Authority. In accordance with section 2.38(b)(ii), AGN must submit a revised Access Arrangement addressing the matters in this Final Decision to the Authority by 4 pm on 27 July 2005.

8. In reaching its Final Decision, the Authority has considered the revised Access Arrangement under the principles set out in the Code. The Authority has considered and weighed the factors in section 2.24 of the Code as fundamental elements in making the overall decision whether to approve the proposed revisions to the Access Arrangement.

9. As part of this assessment, the Authority has considered the issues raised and views expressed in submissions made by interested parties on the proposed revisions to the Access Arrangement.

10. The required changes to the proposed revised Access Arrangement and Access Arrangement Information prior to final approval are listed sequentially in Appendix 1 to this document.

REASONS

Introduction

Access Arrangement Documents

11. AGN originally submitted its proposed revised Access Arrangement on 31 March 2004. Documentation submitted comprised:

- a proposed revised Access Arrangement; and
- Access Arrangement Information.

12. In response to the Draft Decision, AGN submitted to the Authority on 21 March 2005:

- an amended proposed revised Access Arrangement; and
- revised Access Arrangement Information.

13. Following further consultation with the Authority, AGN submitted to the Authority:

- on 10 June 2005, a further amended proposed revised Access Arrangement; and
- on 27 May 2005, further revised Access Arrangement Information.

14. These documents were intended to substitute for the earlier documents submitted in response to the Draft Decision and represent AGN's position as to the amendments required in response to the Draft Decision.

15. Copies of these documents are available from the Authority or may be downloaded from the Authority's web site (www.era.wa.gov.au).

Requirements of the Code

16. Section 2.24 of the Code provides that:

> 2.24 The Relevant Regulator may approve a proposed Access Arrangement only if it is satisfied the proposed Access Arrangement contains the elements and satisfies the principles set out in sections 3.1 to 3.20. The Relevant Regulator must 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. In assessing a proposed Access Arrangement, the Relevant Regulator must take the following into account:
>
> (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;
>
> (g) any other matters that the Relevant Regulator considers are relevant.

17. The elements of an Access Arrangement, referred to in section 2.24 of the Code comprise:

- Services to be Offered (Services Policy) (sections 3.1 and 3.2 of the Code);
- Reference Tariff and Reference Tariff Policy (sections 3.3 to 3.5 of the Code);
- Terms and Conditions (section 3.6 of the Code);
- Capacity Management Policy (sections 3.7 and 3.8 of the Code);
- Trading Policy (sections 3.9 to 3.11 of the Code);
- Queuing Policy (sections 3.12 to 3.15 of the Code);
- Extensions/Expansions Policy (section 3.16 of the Code); and
- Review and Expiry of the Access Arrangement (sections 3.17 to 3.20 of the Code).

18. By section 2.29 of the Code, an Access Arrangement as revised by proposed revisions may include any relevant matter but must include at least the elements described in sections 3.1 to 3.20.

19. In applying the Code to consideration of AGN's proposed revisions to the current Access Arrangement, the Authority has taken into account relevant judicial and other decisions such as those by review bodies relating to the Code.

20. The remainder of these reasons:

- examine each of the elements of the proposed revisions to the current Access Arrangement as originally submitted by AGN;
- set out the Authority's considerations in respect of each element in the Draft Decision and required amendments as set out in the Draft Decision;
- examine each proposal which AGN has submitted by way of amendment to either the proposed revised Access Arrangement or revised Access Arrangement Information in response to the Draft Decision; and
- set out the Authority's assessment (where applicable) of whether AGN has met the requirements of the Draft Decision and, if not, the further amendments which are required in order for the Authority to approve the proposed revised Access Arrangement.

Services Policy

Code requirements

21. Section 3.1 of the Code requires that an Access Arrangement include a policy on the Service or Services to be offered, known as a Services Policy.

22. Section 3.2 of the Code requires that the Services Policy comply with the following principles:

> 3.2 (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 which 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.

23. The Services Policy for an Access Arrangement includes descriptions of a set of Services that the Service Provider will make available. The Service Provider is not obliged to provide a Service unless it is one of the Services specified in the Access Arrangement (or an element of such a Service).

24. A Reference Service is a Service that is specified in an Access Arrangement and for which a Reference Tariff is specified in that Access Arrangement under section 3.3 of the Code:

> 3.3 An Access Arrangement must 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.

25. Only those Services likely to be sought by a significant part of the market and for which the Authority considers there should be a price need to have a Reference Tariff specified.

26. For other Services included in the Services Policy and therefore offered to Prospective Users by the Service Provider, section 6 of the Code provides a process of arbitration for determining the price and other terms and conditions in the event that contractual negotiations prove to be unsuccessful.

27. In assessing the compliance of the proposed Services Policy with the Code, the Authority is required to consider the Services that a significant part of the market is likely to seek. One or more such Services must be included in the Access Arrangement and must be described. If the Authority forms the opinion that other Services should also be included then they must also be included and described in the Services Policy. Such description must be sufficient to enable a User or Prospective User to know and understand what Services are on offer and to request to acquire any one or more of such Services from AGN.

28. If the Authority concludes that a Service is likely to be sought by a significant part of the market, and therefore must be described in the Services Policy, the further question will arise whether a Reference Tariff is required for the Service. The Code, in section 3.3(b), provides that a Reference Tariff must be included for Services for which the Authority considers a Reference Tariff should be included. Consideration is given below to whether a Reference Tariff is required in respect of each such Service.

Proposed revised Access Arrangement

29. The Services Policy under the proposed revisions to the Access Arrangement as originally submitted on 31 March 2004 described both Reference Services and Services for which no Reference Tariff is proposed (or Non-Reference Services).

30. In relation to Reference Services, the Services Policy contained five such Services being Reference Services A1, A2, B1, B2 & B3. These Reference Services are for the haulage of gas through the GDS under Haulage Contracts with Users.

31. A description of each proposed Reference Service was set out in clauses 12 to 16 respectively of Part A – "Principal Arrangements" - of the proposed revised Access Arrangement. The Reference Tariff for each was set out in Part B – "Reference Tariffs and Reference Tariff Policy".

32. In relation to Non-Reference Services, the Services Policy included a description of an Interconnection Service and made provision for other Non-Reference Services, but did not provide a more specific description of these other Non-Reference Services.

33. No Reference Tariff was specified for the Interconnection Service. Rather, AGN proposed that the Interconnection Service and other Non-Reference Services would be offered on terms to be agreed or as determined in accordance with section 6 of the Code[1]. Section 6 of the Code provided a mechanism whereby disputes between Prospective Users and Service Providers about the terms and conditions of access could be arbitrated.

34. The Services Policy was provided in clauses 12 to 30 of Part A – "Principal Arrangements" - of the proposed revised Access Arrangement as originally submitted by AGN.

35. The proposed revised Access Arrangement as originally submitted differed in a number of respects from the current Access Arrangement, either by amendment, inclusion or deletion.

36. The proposed Services Policy was set out in clauses under the following subject headings:

- Reference Services (clauses 12 to 16);
- Re-allocation of Reference Services (clauses 17 to 20);
- Interconnection Service (clauses 21 to 23);
- Services other than Reference Services (clauses 24 and 25);
- Elements of a Service (clause 26);
- Obtaining access to Services (clause 27);
- Parties required to enter a Service Agreement (clause 28);
- Pre-conditions to the provision of Services (clause 29);
- Obligation to accept and deliver Gas (clause 30).

37. The Authority's deliberations and views on various clauses of the proposed Services Policy as originally submitted and as proposed by AGN to be amended in response to the Draft Decision are presented below.

Reference Services

Draft Decision

[1] Proposed revised Access Arrangement, Part A, clause 24.

38. The proposed descriptions of the Reference Services for the haulage of gas through the AGN GDS in the Services Policy as originally submitted by AGN were contained in clauses 12 to 16 of Part A of the proposed revised Access Arrangement.

39. In its Draft Decision, the Authority noted that the proposed descriptions of Reference Services A1, B2 & B3 in the Services Policy, with minor amendments, corresponded to the descriptions of the Haulage Services described as Reference Service A, B2 & B3 of the Services Policy in the current Access Arrangement.

40. Further, the Authority noted that the remaining two proposed Reference Services – A2 & B1 – for gas haulage were new. However, they were created by subdividing Reference Service B1 under the current Access Arrangement into two. In this sense, the five proposed Reference Services provided, in effect, the same market coverage for gas haulage as the previously approved four Reference Services.

41. The subdivision of existing Reference Service B1 into two new Reference Services as explained by AGN in the originally submitted Access Arrangement Information was intended to address AGN's responsibilities under the Retail Market Scheme (**RMS**) which came into effect from 31 May 2004 as a consequence of Full Retail Contestability (**FRC**) for gas in Western Australia.

42. It is a requirement of the RMS that Users with Delivery Points taking more than 10 TJ of gas per Year have Telemetry installed at the Delivery Point, whereas those taking less than that amount are not so required. The currently approved Reference Service B1 caters for Users taking less than 35 TJ of gas at a Delivery Point in any year of a Haulage Contract, without distinction between those Users taking more or less than 10 TJ of gas per Year. Therefore, the proposed revised Access Arrangement as originally submitted by AGN subdivided the currently approved Reference Service B1 into two, with the proposed new B1 Reference Service catering for Users taking less than 10 TJ of gas per year (without Telemetry installed) and the proposed new Reference Service A2 catering for Users taking more than that amount (with Telemetry installed). Both Reference Services B1 and A2 would only be available to Users taking less than a Contracted Peak Rate of 10 GJ of gas per hour at a Delivery Point.

43. In its Draft Decision, the Authority considered these proposed revised Service descriptions in the context of the requirement in section 3.2(a)(i) of the Code that the Services Policy includes a description of one or more Services that are likely to be sought by a significant part of the market.

44. In its Draft Decision, the Authority noted that no submissions had been received suggesting, nor had the Authority any other reason to believe, that the Reference Services for gas haulage under the existing or proposed Access Arrangements did not provide a suitable description of one or more Services that are likely to be sought by a significant part of the market in which Haulage Services are supplied.

45. The Authority was, therefore, satisfied in its Draft Decision that the proposed Services Policy for Reference Services for gas haulage, as set out in clauses 12 to 16 of part A as originally submitted provided a description of Reference Services that satisfied the requirements of section 3.2(a)(i) of the Code.

Final Decision

46. The Authority has not received any submissions in relation to this aspect of its Draft Decision nor has AGN proposed any amendment to the Service descriptions of Reference Services as originally submitted to the Authority. The Authority's final decision, therefore, is to confirm the Draft Decision on this point.

Overrun Service

Draft Decision

47. In the proposed revised Access Arrangement as originally submitted, AGN proposed in respect of Reference Services A1 and A2 an Overrun Service for the haulage of gas in excess of the Contracted Peak Rate. This Overrun Service was described in Schedule 1 of Part C, clause 7, and Schedule 2 of Part C, clause 10 respectively.

48. In its Draft Decision, the Authority considered that the Overrun Service is likely to be sought by a significant part of the market because the Overrun Service is applicable to all Users of Reference Services in respect of any "occasion" on which the User overruns their Contracted Peak Capacity. Therefore, the Authority's Draft Decision was that under section 3.2(a) of the Code a description of the Overrun Service had to be included in the Access Arrangement. The Authority further concluded that such a description was provided in the abovementioned clauses of Part C of the proposed revised Access Arrangement as originally submitted.

Final Decision

49. In the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 AGN has deleted the proposed Overrun Service for Reference Service A2. AGN therefore only seeks inclusion of an Overrun Service in respect of Reference Service A1. The description of the Overrun Service in relation to Reference Service A1, which is contained in Schedule 1 of Part C, clause 7 of the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005, is unaltered from that which the Authority indicated in the Draft Decision would be approved. The Authority's final decision, therefore, is to confirm its Draft Decision that the proposed revised Access Arrangement contains an appropriate Service description of the Overrun Service for the purposes of section 3.2(a) of the Code.

Ancillary Services

Draft Decision (Amendment 1)

50. Under the current Access Arrangement, the Services Policy in Chapter 2 includes in Division 4 – Listed Ancillary Services – a description of four such services: Disconnection Service (clause 12); Reconnection Service (clause 13); Additional Meter Reading Service (clause 14) and Additional Meter Testing Service (clause 15). AGN's proposed revisions to the Access Arrangement delete the description of the four Ancillary Services from the Services Policy.

51. It is noted that the definition of Services in section 10.8 of the Code specifically includes services ancillary to haulage and interconnection services.

52. In the originally submitted Access Arrangement Information, AGN indicated that it proposed to continue to offer and provide the current range of Services ancillary to the Reference Services for gas haulage as described in the current Access Arrangement. However, AGN indicated that it intended to do so under the ambit of the RMS. For this reason, AGN submitted that it is no longer necessary for such Services to be described in the Access Arrangement.

53. In the Draft Decision, the Authority did not agree with AGN's reasoning for excluding Ancillary Services from the proposed revisions. The fact that such Services may be subject to the RMS did not, in the Authority's view, remove the Authority's duty under section 3.2 of the Code to determine whether such Ancillary Services must be included in the Services Policy. That is, if the Services ancillary to the Reference Services are likely to be sought by a significant part of the market, then regardless of whether or not provision is made under the Retail Market Scheme for such Services, the Authority is obliged not to approve an Access Arrangement which does not describe such Services in its Services Policy.

54. Given the ubiquitous nature of the Ancillary Services described in the current Access Arrangement, and the essential functions that are being performed for Users to facilitate the effective utilisation of Reference Services, the Authority, in its Draft Decision, concluded that the Ancillary Services are likely to be sought by a significant part of the market. No submissions to the contrary were put to the Authority, nor did the Authority have before it any other evidence suggesting to the contrary.

55. The Authority's conclusion in the Draft Decision was that, subject to any further evidence submitted by AGN or market participants, the proposed revised Access Arrangement would not be approved unless descriptions were included of the Services ancillary to the Reference Services that are likely to be sought by a significant part of the market.

56. The Authority noted in the Draft Decision that such descriptions may differ from the descriptions in the current Access Arrangement to reflect any changes in the market, including the introduction of the RMS.

57. The amendment required by the Authority (Amendment 1) in its Draft Decision was as follows:

> The Services Policy should be amended to include descriptions of the Services ancillary to the Reference Services which are likely to be sought by a significant part of the market.

Final Decision

58. Subsequent to the Draft Decision, in consultation with the Authority, AGN has provided further information regarding the nature of and demand for Services provided by AGN to Users ancillary to the provision of Haulage Services.

59. Following such consultation, AGN has accepted the requirement to amend the proposed revised Access Arrangement to meet the requirements of Amendment 1 of the Draft Decision.

60. In clause 17 of Part A of the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 in response to the Draft Decision AGN has included Service descriptions of the following Ancillary Services:

    (a) Apply Meter Lock Service;

    (b) Remove Meter Lock Service;

    (c) Deregistration Service;

    (d) Disconnection Service;

    (e) Reconnection Service.

61. The information provided to the Authority indicated that these Services were integral to effective credit management by Users provided with Reference Services under the Access Arrangement.

62. The Authority is satisfied that the abovementioned clause describes satisfactorily the Ancillary Services which are likely to be sought by a significant part of the market as required by the Code. The Authority is therefore satisfied that the amendments proposed by AGN meet the requirements of Amendment 1 of the Draft Decision.

63. The Authority notes that there were two Ancillary Services that the information provided by AGN indicated for which there would be an insignificant likely demand. These Services were the Additional Meter Testing Service and the Additional Meter Reading Service. The Authority therefore does not require these Services to be described in the revised Access Arrangement.

64. For completeness, the Authority was provided with information in relation to three other services incidental to the provision of Reference Services. The first was an abolishment service incidental to the demolition of a building previously served by AGN's GDS. The information provided to the Authority was that this was a service not provided to the User, but rather to the building company engaged by the property owner. The other two services were "tagging" and "special meter read" services, which a User could access without requiring AGN to perform the service. The Authority is satisfied that these services are not Services provided to Users and therefore do not attract the provisions of the Code requiring their description in the Access Arrangement.

Services other than Reference Services

Draft Decision (Amendment 3)

65. Clause 24 of the proposed revised Access Arrangement as originally submitted by AGN relating to the Services Policy provided that:

> Subject to Part A, clause 25[2], AGN will make Services other than Reference Services available to Users or Prospective Users as agreed or as determined in accordance with section 6 of the Code.

66. Clause 24 of Part A thus provided two situations in which AGN would make available Services other than Reference Services. First, where the parties agreed that AGN would provide the Service. Second, where the Arbitrator determined that AGN would provide the Service in accordance with section 6 of the Code.

67. In its Draft Decision, the Authority noted that in neither situation was AGN required upon request to provide the Service to a User. Rather, the User would only have a right to acquire the Service if, in the first case, AGN agreed, or in the second, the Arbitrator so determined. The Authority noted further in its Draft Decision that the Arbitrator has no power to determine the Services that a Service Provider must provide to Users. The Arbitrator's jurisdiction is confined to Services that are required to be provided by the terms of the Access Arrangement. Therefore, the effect of clause 24 if approved would be that there is no obligation on AGN to provide Services other than Reference Services to Users.

68. In its Draft Decision, the Authority therefore did not consider that clause 24 of Part A as originally proposed met the requirements of the Code in relation to a Services Policy. The Authority noted that the requirement in the Code for a Services Policy is intended to provide Users or Prospective Users with a description of Services that the Service Provider will make available upon request. The right to acquire the Services described in the Services Policy could not in the Authority's opinion be qualified in the way it was in clause 24 of Part A of the proposed revised Access Arrangement as originally submitted by AGN.

69. The Authority's Draft Decision therefore was that clause 24 of Part A should be deleted before the proposed revised Access Arrangement will be approved, and proposed an Amendment (Amendment 3) accordingly. For the same reasons, the Authority's Draft Decision was that clause 25 of Part A, to which clause 24 is subject, and which further qualified the right to acquire Services other than Reference Services described in the Services Policy, should also be deleted.

Final Decision

70. In paragraph 30 of its submission dated 21 March 2005, AGN accepted the requirement to amend in response to Amendment 3 of the Draft Decision, and has deleted clause 24 of Part A from the proposed revised Access Arrangement submitted on 10 June 2005. The Authority is, therefore, satisfied that AGN has met the requirements of Amendment 3 of the Draft Decision in relation to clause 24 of Part A.

71. Amendment 3 of the Draft Decision also required AGN to delete clause 25 of Part A as originally submitted by AGN. Clause 25 of Part A concerned a proposed requirement that a User hold firm upstream capacity in order to acquire Services. The

[2] The provisions of clause 25 of Part A to which clause 24 was subject set out restrictions upon the availability of such other Services in circumstances where a User or a Prospective User would be unable to meet the requirements of proposed clause 29(2)(b)(iv) of Part A relating to a requirement for a User to have sufficient firm capacity on an Interconnecting Pipeline in order to qualify for a Reference Service.

amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 in response to the Draft Decision has deleted this clause, and therefore meets the requirements of Amendment 3.

72. The Authority notes that the substantive matter previously dealt with by clause 25 of Part A, relating to the requirement for firm upstream capacity or alternative arrangements in order for a User to obtain supply of Non-Reference Services, has been dealt with in AGN's response to Amendments 65 to 68, which also concerned the firm upstream capacity requirement.

Interconnection Service

Draft Decision (Amendment 4)

73. Clause 21(1) of Part A of the proposed revised Access Arrangement as originally proposed described an Interconnection Service which AGN proposed to offer in the following terms:

> An Interconnection Service is a Service provided to a User who is a Pipeline Operator in respect of the interconnection between a Sub-network and a Pipeline which is, or is to become, an Interconnected Pipeline supplying gas to the Sub-network.

74. The principles with which a valid Services Policy must comply include, in section 3.2(a)(i), that 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 one or more Services that are likely to be sought by a significant part of the market.

75. The Interconnection Services referred to in the definition of Service in the Code referred to a right to interconnect with a Covered Pipeline. This includes both upstream interconnection, for the purpose of delivering gas into the GDS, and downstream interconnection, for the purpose of receiving gas from the GDS for distribution to end-use customers.

76. However, the description of the Interconnection Service in the proposed revised Access Arrangement as originally submitted referred only to interconnection for the purpose of supplying gas to the GDS, that is, upstream interconnection.

77. In its Draft Decision, the Authority noted that in relation to upstream interconnection, there are only two pipelines that currently interconnect with the GDS, namely the Dampier to Bunbury Pipeline (**DBP**) and the Parmelia Pipeline. Further, that there was evidence before the Authority that there will be on-going demand during the second Access Arrangement Period for both the continuance of existing points of interconnection and the establishment of further points of interconnection between the GDS and these pipelines.

78. In its Draft Decision, the Authority therefore was of the view that the right to interconnect with an upstream pipeline is a Service which is likely to be sought by a significant part of the market. Therefore, the Authority in its Draft Decision considered AGN's proposed approach of including a description of an upstream

Interconnection Service in the proposed revised Access Arrangement was appropriate under the Code.

79. In relation to downstream interconnection, in the Draft Decision the Authority noted that there were no submissions or other evidence before the Authority of any current or likely demand during the second Access Arrangement Period for such a Service. The Authority, therefore, in its Draft Decision did not see a requirement for AGN to describe a downstream interconnection service in its proposed Services Policy, and therefore agreed with AGN's proposed approach of not extending the description of the Interconnection Service to downstream interconnection.

80. One difficulty noted by the Authority in its Draft Decision with the description of the Interconnection Service proposed by AGN related to the definition of the term "User" in Schedule 2 – "Definitions and Interpretation" - of Part A of the proposed revised Access Arrangement as originally submitted. The definition was:

> **User** means a contestable customer (as defined in subsection 91(1) of the Act) who has a current Service Agreement or an entitlement to a Service as a result of an arbitration.

81. The definition of contestable customer referred to in section 91(1) of the *GPAA* refers exclusively to certain persons who are to take delivery of gas for consumption.

82. In its Draft Decision, the Authority noted that the term "User" as defined in the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that term in the Code and with the definition of the term "Prospective User" in both the proposed revised Access Arrangement as originally submitted and the Code.

83. The effect of the way in which the term "User" was defined in the proposed revised Access Arrangement, as originally submitted, would have been to limit the Interconnection Service to contestable customers that are consumers of gas. Persons who are not contestable customers and who only sought to deliver gas into the GDS, including for the purpose of trading and delivering gas to customers, would be excluded by the definition as originally submitted.

84. Therefore, the Authority concluded in the Draft Decision that for the proposed revised Access Arrangement and the Services Policy to be consistent with the Code there was a need for the term "User" to be defined as it is in the Code, and required an amendment (Amendment 4) whereby the definition of "User" would be the same as that in section 10.8 of the Code as follows:

> **'User'** means a person who has a current contract for a Service or an entitlement to a Service as a result of an arbitration.

Final Decision

85. In paragraph 32 of its submission dated 21 March 2005 in response to the Draft Decision, AGN noted that it had amended the proposed revised Access Arrangement to amend the definition of "User" as suggested by the Authority. The proposed revisions to the Access Arrangements submitted on 10 June 2005 included an appropriately amended definition in the Glossary in Schedule 2 of Part A.

86. The Authority notes the comment at paragraph 33 of AGN's submission dated 21 March 2005 in response to the Draft Decision that:

> However, AGN does not accept that it is necessary for the terminology used in the AA to be identical to the terminology used in the Code in order for the AA to be compliant with the Code.

87. The Authority makes the following comments on AGN's submission. Nowhere in the Draft Decision did the Authority state that it was its view that the terminology used in the revised Access Arrangement must be identical to the terminology in the Code in order for the Access Arrangement to comply. Therefore, AGN's comment rejected a proposition that the Authority did not advance in the Draft Decision.

88. The reason why, in the Draft Decision, the Authority required amendments to definitions in the proposed revised Access Arrangement as originally submitted which did not accord with the Code definitions is not because it is a Code requirement, but rather because as a general principle in the absence of any justification, it is desirable for there to be consistency between different definitions of a term used in both the Code and an Access Arrangement. Such amendments were required in the Draft Decision in relation to the definitions of User (Amendment 4) and Code, Confidential Information, Cost of Service, Delivery Point, Developable Capacity, Gas, New Facilities Investment and Prospective User (Amendments 73 to 81). The Authority's Draft Decision to require amendments to each of these definitions was based upon there being an inconsistency between the definitions as originally submitted and the Code, and no explanation having been advanced by AGN when submitting the proposed revised Access Arrangement justifying the inconsistency.

89. In certain of the instances referred to in the preceding paragraph (e.g. the definition of User) AGN has since accepted the requirement in the Draft Decision to amend to provide consistency between definitions in the Code and the revised Access Arrangement. However, in other instances AGN has responded by putting forward in its submission provided on 21 March 2005 a reason why the Code definition is unsatisfactory, and why, therefore, the alternative definition as originally submitted is to be preferred. In such cases, consistent with the above general approach, where the Authority has been satisfied that the justification advanced by AGN in response to the Draft Decision for maintaining the definition as originally advanced is sound, and there are no other undesirable consequences of having different definitions in the Code and the revised Access Arrangement, the Authority has accepted the definition.

90. The Authority's final decision in relation to each of these other definitions is set out below at paragraphs 865 to 919.

Requirement for a Reference Tariff

Reference Services

Draft Decision

91. Under section 3.3 of the Code an Access Arrangement must include a Reference Tariff for at least one Service that is likely to be sought by a significant part of the

market and for each such Service for which the Authority considers that a Reference Tariff should be included.

92. In its Draft Decision, the Authority noted that no submissions had been received suggesting that the Reference Services proposed by AGN should not be Reference Services. Therefore, for the purposes of section 3.3 of the Code, the Authority in its Draft Decision considered that Reference Tariffs should be included for Reference Services A1, A2, B1, B2 and B3 in the proposed revised Access Arrangement.

Final Decision

93. Since the Draft Decision, the Authority has not received any submissions on this point. The Authority therefore does not propose to vary its decision as expressed in the Draft Decision that Reference Tariffs should be included for Reference Services A1, A2, B1, B2 and B3 in the proposed revised Access Arrangement.

Ancillary Services

Draft Decision (Amendment 2)

94. In relation to Ancillary Services, that is Services ancillary to the provision of Services for the haulage of gas, the further question arises whether, under section 3.3(b) of the Code, the Authority considers Reference Tariffs ought to be included for such Services.

95. In the Draft Decision, the Authority noted the following:

(a) At the time the current Access Arrangement was approved the Relevant Regulator did not consider it appropriate that Ancillary Services be Reference Services for which a Reference Tariff was required.[3]

(b) Notwithstanding this, under the approved Access Arrangement the specified Ancillary Services (Disconnection Service; Reconnection Service; Additional Meter Reading Service and Additional Meter Testing Service) were to be made available to Users of Reference Services B2 and B3 under standard terms and conditions and at a set tariff. This reflected concern by the Relevant Regulator to protect small use gas customers. By contrast, Users of Reference Services A and B1 were left to negotiate with AGN regarding the terms and conditions and prices of Ancillary Services.

(c) The reasons of the Relevant Regulator for declining to require AGN to specify Reference Tariffs for Ancillary Services under the current Access Arrangement were set out at page 35 of Part B – Supporting Information – of the Final Decision for the current Access Arrangement. Those reasons included:

- the relatively simple and discrete nature of the Services;

[3] Independent Gas Pipelines Access Regulator Western Australia, 30 June 2000, *Final Decision: Access Arrangement Mid-West and South-West Gas Distribution Systems*, Part B, p 35.

- the history of provision of such Ancillary Services without specific terms and conditions;

- the availability of resort to arbitration by a User under section 6 of the Code should the services not be provided at a reasonable quality and price;

- the short period, 21 months, following the introduction of Full Retail Contestability before the Regulator would have to consider amendments to the Access Arrangement, at which time the question could be revisited in light of the provisions introduced under Full Retail Contestability (**FRC**) to guard against anti-competitive pricing of Ancillary Services.

(d) Since that approval, in late 2002, the Essential Services Commission (Victoria) (**ESC**) approved revised Access Arrangements for each of the three major gas distribution systems in Victoria, subject to, among other things, the inclusion of Reference Tariffs for Services ancillary to Reference Services. The Independent Pricing and Regulatory Tribunal (**IPART)**, in its December 2004 draft decision on revisions to the Access Arrangement for AGL Gas Networks, proposed to approve an arrangement whereby Ancillary Services would effectively form part of the terms and conditions on which AGL Gas Networks will supply its Reference Services under the Access Arrangement.[4]

96. In May of 2004, FRC was introduced into the Western Australian gas market. In its originally submitted Access Arrangement Information, AGN relied upon the regulation of Ancillary Services under the RMS as justifying the conclusion that there was no need for such Services to be Reference Services with their own Reference Tariffs. On this basis, no such tariffs were included by AGN in the proposed revised Access Arrangement as originally submitted.

97. In its Draft Decision, the Authority noted that while the Retail Market Rules (**RMRs**) introduced as part of the RMS contain various provisions in relation to the Ancillary Services in relation to the arrangements for transfer of customers to facilitate FRC, the RMRs do not set tariffs for such Services. Therefore, under AGN's proposal, the charges for Ancillary Services would be unregulated.

98. In the circumstances, the Authority concluded in its Draft Decision that Reference Tariffs and terms and conditions should be specified for the services in question, being Services offered by AGN ancillary to Reference Services offered under the Access Arrangement. The Authority required an amendment (Amendment 2) accordingly, as follows:

> The proposed revised Access Arrangement should be amended to include Reference Tariffs and terms and conditions for Ancillary Services described in the Services Policy.

Final Decision

[4] IPART, *Draft Decision, Revised Access Arrangement for AGL Gas Network*, December 2004, p 134, 143.

99. Subsequent to the Draft Decision, in consultation with the Authority, AGN has provided further information regarding its costs and pricing of the Services to be included in the Services Policy as Ancillary Services, namely:

(a) Apply Meter Lock Service;

(b) Remove Meter Lock Service;

(c) Deregistration Service;

(d) Disconnection Service;

(e) Reconnection Service.

100. AGN indicated to the Authority that the costs involved in providing these Services during the second Access Arrangement Period were not included in the Total Revenue sought to be recovered through Reference Tariffs. On this basis, AGN indicated to the Authority that it did not regard it as appropriate for tariffs for the Ancillary Services to be incorporated in the Reference Tariffs to be determined under the Final Decision.

101. AGN indicated in consultation with the Authority that it was, however, willing to meet the requirement to amend under Amendment 2 of the Draft Decision by including terms and conditions in relation to Reference Services. These terms and conditions would provide for specified charges in relation to the provision of the Ancillary Services to be collected by AGN from Users, to be escalated in accordance with an appropriate index during the second Access Arrangement Period. This proposed approach reflected the approach taken by IPART in its December 2004 draft decision on revisions to the Access Arrangement for AGL Gas Networks, which IPART confirmed in its final decision delivered on 29 April 2005[5]. It also reflects the approach in the AGN GDS Access Arrangement which applied during the first Access Arrangement Period.

102. The Authority considers that the approach suggested by AGN both meets the requirements of the Draft Decision and of the Code. The further issue is whether the Authority is satisfied that the proposed terms and conditions as to the charges for Ancillary Services are reasonable for the purpose of section 3.6 of the Code.

103. As to the charges proposed by AGN, in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005, AGN sets out in clause 1 of Schedule 5 of Part C proposed charges for Ancillary Services as follows (inclusive of GST):

(a) Apply Meter Lock Service: $16.50;

(b) Remove Meter Lock Service: $16.50;

(c) Deregistration Service: $183.70;

[5] IPART, *FinalDecision, Revised Access Arrangement for AGL Gas Network*, 29 April 2005, para 13.4.8, Amendment 39

(d) Disconnection Service: $183.70;

(e) Reconnection Service: $183.70.

104. Clause 2 of Schedule 5 of Part C provides a formula for escalation of these charges by applying the Western Australian Labour Price Index for the Energy Industry. Each of the Schedules setting out the Terms and Conditions for Reference Services contain a clause specifying that these charges will apply to the relevant Reference Service.

105. The Authority is satisfied that the abovementioned provisions are reasonable for the purpose of section 3.6 of the Code. The Authority is therefore satisfied that the amendments proposed by AGN meet the requirements of Amendment 2 of the Draft Decision.

Interconnection Service

Draft Decision (Amendment 5)

106. The current Access Arrangement does not include a Reference Tariff for the Interconnection Service. Further, in the proposed revised Access Arrangement as originally submitted, AGN did not seek to include a Reference Tariff for the Interconnection Service.

107. At the time of the approval of the current Access Arrangement, all of the gas carried through the AGN GDS was delivered from the DBP. At the time, there were preliminary proposals for interconnection of the Parmelia Pipeline as an alternative transmission source. However, the vast majority of the gas delivered to the GDS would continue to be delivered from the DBP.

108. The Authority noted in the Draft Decision that the owners of the Parmelia Pipeline, after having successfully trialled limited interconnection with the GDS during the first Access Arrangement Period, are now seeking to make additional interconnections, as well as to increase volumes of gas delivered through existing points of interconnection. Further, that there have been negotiations between the owners of the Parmelia Pipeline and AGN in relation to the terms upon which the volumes of gas delivered into the GDS from the Parmelia Pipeline would be increased, including through the establishment of further points of interconnection with the GDS, and such negotiations have been unsuccessful.

109. An issue addressed in the Draft Decision arose from the fact that the gas delivered from the two sources differs in heating value. As a result, the injection of gas from the Parmelia Pipeline at commercial volumes will cause AGN to incur both capital expenditure and Non Capital Costs in managing such differences in heating value within the distribution system. Therefore, when the owners of the Parmelia Pipeline seek a new interconnection at a particular point on the GDS, the location chosen may not suit AGN, including because the heating value management and other consequential costs incurred by AGN will be greater than otherwise might be the case if a different location was to be chosen. Equally, AGN's preferred location of any new point of interconnection may not suit the owners of the Parmelia Pipeline, because the capital expenditure and Non Capital Costs to the Parmelia Pipeline

associated with making and maintaining the interconnection (by running a lateral and connecting with the GDS) may be greater than might otherwise be the case.

110. The issue raised by these matters is whether it would be appropriate for the Authority to determine that the Interconnection Service be a Reference Service to enable these consequential costs to be recovered through Reference Tariffs for the Interconnection Service.

111. AGN in its Access Arrangement Information as originally submitted commented in relation to such costs (see section 3.6). In particular, AGN advanced the following forecasts:

- capital expenditure (New Facilities Investment) is likely to be in the range $0.1 million to $1.0 million, for equipment to take gas samples from the AGN GDS at predetermined intervals and frequencies; and

- Non Capital Costs in the range of $0.1 million to $1.0 million per annum, to model the network flows under a range of operating conditions, analyse the gas samples supporting the modelling results and report compliance to the Office of Energy.

112. The Authority in its Draft Decision noted that because at the time AGN originally submitted its proposed revised Access Arrangement negotiations had not been finalised as to price or terms and conditions of new or expanded interconnections, whether these costs will materialise, and if they do whether the forecasts will be accurate, was at the time of the Draft Decision speculative.

113. AGN advanced the following arguments against the costs of the Interconnection Service being recovered through the general Reference Tariffs for the GDS or by a specific Reference Tariff being established for the Interconnection Service in its Access Arrangement Information as originally submitted[6]:

> The implementation of heating value management plans would result in a benefit to those Users and Related Shippers associated with the interconnecting Pipeline at Sub-networks where the interconnection occurs. As the benefits are not available to all Users and all Sub-networks, it is not equitable for the costs to be allocated across the whole AGN GDS. Therefore, these costs could not be recovered via the Reference Tariffs.
>
> The introduction of the Retail Market Scheme means that the relationship between Users and Pipelines is now much more dynamic. Whereas during the First Access Arrangement Period AGN would have been able to predict with some stability which Users were injecting Gas from the interconnecting Pipeline and which were not, under the Retail Market Scheme Users' allocation instructions can be changed regularly and at short notice, and in addition Users can acquire swing services from either Pipeline on a day-by-day basis. Thus, it is not practical or efficient for AGN to seek to recover these costs from only those Users who inject Gas out of the relevant Pipeline.
>
> A person named in a User's allocation instruction for the sub-network under the Retail Market Rules is termed a "Related Shipper". AGN cannot seek to recover interconnection costs from the Related Shipper, as AGN does not have a direct contractual relationship with the Related Shipper. However, the Pipeline Operator seeking the Interconnection Service does have a direct contractual

[6] AAI, p 25.

> relationship with the Related Shippers transporting Gas for a User on that Pipeline and could recover costs from these parties in an efficient manner.

114. AGN said the following at the conclusion of section 3.6 of the Access Arrangement Information:

> AGN's preferred mechanism is to seek recovery of the costs it incurs in relation to, or associated with, the Interconnection Service, directly from the Pipeline Operator seeking the Interconnection Service. Given that AGN has a direct contractual relationship with this party, AGN believes that this would be the most efficient recovery mechanism. Similarly, the Pipeline Operator could seek recovery of its costs from the Related Shippers transporting Gas for a User on that Pipeline as part of its contract with the Related Shipper.

115. Prior to making its Draft Decision the Authority received submissions from a number of interested parties contesting AGN's proposed approach to the setting of prices for Interconnection Services, and for recovering the consequential costs of heating value management from expanded interconnection activity during the second Access Arrangement Period.

116. In two submissions, the Office of Energy commented that the Authority ought to require amendments to the proposed revised Access Arrangement to specify the allocation of costs for heating value management. The Office of Energy suggested that costs, which AGN may incur as a consequence of interconnection of a pipeline offering an alternative source of supply, should be treated as costs that could be recovered through Reference Tariffs for haulage services from Users of the GDS. Neither of these comments would necessitate that the Interconnection Service be a Reference Service, but rather the costs associated with interconnection be treated as part of AGN's overall cost base to be recovered from Users of the GDS.

117. The Authority also received two submissions, one from a group of potential new gas retailers (Western Power Corporation, Origin Energy, and AGL Gas Trading) and the other from CMS Gas Transmission of Australia (**CMS**), the then current owners of the Parmelia Pipeline (the Parmelia Pipeline has since been acquired by a listed pipelines business, the Australian Pipelines Trust). In contrast to the other submissions, these submissions contend that the Interconnection Service should be a Reference Service and the Access Arrangement should include a set of terms and conditions, including a tariff, for any new interconnections.

118. The submissions referred to in paragraph 117 contended that AGN's costs within the distribution system of implementing interconnection should not be recoverable by AGN from the owner of an interconnecting pipeline through the Reference Tariff for the Interconnection Service, but rather from Users of the GDS (not users of the Parmelia Pipeline) through the proposed Reference Tariff for Reference Services. Thus, it was submitted that such costs be treated as a cost to AGN of implementing FRC, recoverable through the mechanisms in place for the recovery of such costs as part of the Reference Tariff for use of the GDS.

119. The submission from CMS as the then owner of the Parmelia Pipeline also reflected a concern regarding the failure of contractual negotiations to deliver agreed terms and conditions, including tariffs, for new interconnections.

120. In the Draft Decision, on the evidence before it, the Authority concluded that the issue which appeared to have prevented the parties from reaching agreement regarding the

terms and conditions, including price, of new interconnections, was the question of how to allocate AGN's capital expenditure and Non Capital Costs associated with interconnection. Such costs included costs associated with heating value management of gas of different quality delivered into the GDS from the two interconnected pipelines.

121. The Authority noted also in its Draft Decision that it had considered the range of views advanced on whether the Interconnection Service should be a Reference Service. The Authority regarded increased competition, diversity and security in the supply of gas through new interconnections as having system-wide benefits. In these circumstances, the Authority concluded in its Draft Decision that the costs to AGN of heating value management were therefore appropriately allocated across the whole of the GDS.

122. As stated in the Draft Decision, the Authority was not otherwise persuaded by the submissions referred to in paragraph 117 above that requiring the Interconnection Service to be a Reference Service is necessary to promote such interconnection. With a mechanism in place for the recovery of the costs to AGN of managing heating values through Reference Tariffs, there was in the Authority's view no basis for the issue of recovery of such costs to arise in negotiations for interconnection contracts.

123. In these circumstances, the Authority concluded in its Draft Decision that, on the evidence before it, and subject to any further comments by Users, Prospective Users, AGN or any other interested party, there was no need for a Reference Tariff for the Interconnection Service in the revised Access Arrangement.

124. In relation to the Authority's conclusion in the Draft Decision that if and when heating value management costs are incurred, they should be regarded as costs incurred in supplying Services for haulage of gas on the GDS, it was necessary in the Draft Decision for the Authority to consider the mechanism for recovery by AGN of such costs.

125. In the Draft Decision, the Authority noted that given the presently speculative nature of such increased interconnection activity, there would be great difficulty in producing a reliable estimate for the associated costs over the next Access Arrangement Period. Further, the Authority regarded the wide range in cost estimates provided by AGN for managing heating value on the GDS with a second interconnected Pipeline as being indicative of a high degree of uncertainty.

126. On this issue, the Authority noted that a Service Provider has a range of options under the Code which it may pursue to recover, through Reference Tariffs, New Facilities Investment and Non Capital Costs for heating value management, such as:

- including projected New Facilities Investment and Non Capital Costs in the forecasts of such costs in the revised Access Arrangement;
- using the Trigger Event Adjustment Approach, being an Approved Reference Tariff Variation Method under section 8.3(d) of the Code; and

- recovering by way of an application under section 8.21 of the Code which provides for prior approval by the Authority of New Facilities Investment together with a return on such investment during the second Access Arrangement Period.

127. The Authority considered in the Draft Decision that in order to provide certainty for the parties in relation to the allocation of costs incurred by AGN for heating value management arising from further interconnection activity, the proposed revisions to the Access Arrangement needed to be amended to make provision for the recovery of those costs through Reference Tariffs for gas haulage Services through one or other of the available methods.

128. Accordingly, the Authority required AGN to amend to the proposed revised Access Arrangement to include provisions by which Reference Tariffs may recover from all Users of the GDS the costs of heating value management during the second Access Arrangement Period. Amendment 5 of the Draft Decision addressed this issue and was as follows:

> The proposed revised Access Arrangement should be amended to include provisions, in accordance with the Code, by which Reference Tariffs may recover from all Users of the GDS the costs of heating value management during the second Access Arrangement Period.

Final Decision

129. In relation to the Authority's conclusion that the Interconnection Service not be a Reference Service, since the Draft Decision the Authority has not received any submissions from AGN or interested parties in relation to the Draft Decision that the Interconnection Service not be a Reference Service. The Authority therefore does not propose to vary its decision as expressed in the Draft Decision. Given the Authority's final decision that the Interconnection Service is not to be a Reference Service the Authority further concluded that the revised Access Arrangement only required a description of the Service in accordance with section 3.2(a) of the Code.

130. The description of the Service is contained in clause 24(2)(a) of Part A of the proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision. That description provides as follows:

> An Interconnection Service is a Service provided to a User who is a Pipeline Operator in respect of the interconnection between a Sub-network and a Pipeline at a Physical Gate Point which is, or is to become, an Interconnected Pipeline supplying Gas to the Sub-network at a Physical Gate Point at a Minimum Receipt Temperature of between 09 (sic) and 10^0C.

131. The Authority is satisfied that this is an appropriate description of the Interconnection Service so as to satisfy the requirements of the Code with respect to the Services Policy.

132. In relation to the further issue of the recovery of heating value management costs from all Users of the AGN GDS during the second Access Arrangement Period AGN has accepted the requirement to amend. AGN has chosen to meet the requirement by including in the revised Access Arrangement a Trigger Event Adjustment Mechanism in relation to heating value management costs.

133. AGN's proposal for a Trigger Event Adjustment Mechanism is contained in clauses 13 to 17 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005.

134. The relevant provisions of the Code, concerning Approved Variation Methods, are contained in sections 8.3 to 8.3H. Those sections provide as follows:

> 8.3 Subject to section 8.3A and to the Relevant Regulator being satisfied that it is consistent with the objectives contained in section 8.1, the manner in which a Reference Tariff may vary within an Access Arrangement Period through the implementation of a Reference Tariff Policy is within the discretion of the Service Provider. For example, the Reference Tariff Policy may specify that Reference Tariffs will vary within an Access Arrangement Period through the implementation of:
>
> (a) a Cost of Service Approach;
>
> (b) a Price Path Approach;
>
> (c) a Reference Tariff Control Formula Approach;
>
> (d) a Trigger Event Adjustment Approach; or
>
> (e) any variation or combination of the above.
>
> 8.3A A Reference Tariff may vary within an Access Arrangement Period only through implementation of the Approved Reference Tariff Variation Method as provided for in sections 8.3B to 8.3H.
>
> 8.3B (a) If a Specified Event occurs the Service Provider must, within the time provided for in the Reference Tariff Policy, provide a notice to the Relevant Regulator containing the information set out in section 8.3C.
>
> (b) If the Service Provider otherwise wishes to vary a Reference Tariff in accordance with the Approved Reference Tariff Variation Method, the Service Provider must provide a notice to the Relevant Regulator containing the information set out in section 8.3C.
>
> 8.3C The Service Provider's notice under section 8.3B must contain:
>
> (a) the Service Provider's proposed variations to the Reference Tariff and the proposed effective date for those variations; and
>
> (b) an explanation of how the variations proposed are consistent with the Approved Reference Tariff Variation Method contained in the Reference Tariff Policy.
>
> Notwithstanding any other section of the Code, the Relevant Regulator must make public, and must provide the Code Registrar with a copy of, any information provided under paragraphs (a) and (b) above.
>
> 8.3D Unless the Relevant Regulator has disallowed the variation under section 8.3E, the Reference Tariff will be varied automatically on and from the later of:
>
> (a) the date specified in a notice from the Service Provider given in accordance with section 8.3B;
>
> (b) (i) if the Reference Tariff Policy specifies a minimum notice period for the variation, the expiry of that period after the date of the notice from the Service Provider given in accordance with section 8.3B; or
>
> (ii) if the Reference Tariff Policy does not specify a minimum notice period for the variation, 35 days after the date of the notice from the Service Provider given in accordance with section 8.3B,

but if, before the end of the relevant period in paragraph (i) or (ii) above, the Relevant Regulator notifies the Service Provider that it requires additional information from the Service Provider, which the Relevant Regulator has reason to believe may assist the Relevant Regulator to determine whether the variations proposed are consistent with the Approved Reference Tariff Variation Method, the relevant period will be extended by the number of days commencing on the day on which the Relevant Regulator gave notice to the Service Provider and ending on the day on which the Relevant Regulator receives the additional information from the Service Provider.

8.3E The Relevant Regulator may, by notice to the Service Provider before the variation is due to come into effect under section 8.3D, disallow a variation of a Reference Tariff. The Relevant Regulator may disallow a variation only if the Relevant Regulator considers, on reasonable grounds, that the proposed variation is inconsistent with, or not permitted under, the Approved Reference Tariff Variation Method. If the Relevant Regulator disallows a variation because it considers that it is inconsistent with, or not permitted under, the Approved Reference Tariff Variation Method, the Relevant Regulator may specify a variation that is consistent with the Approved Reference Tariff Variation Method. Any such variation comes into effect on the date determined in accordance with section 8.3D.

8.3F The Relevant Regulator must publish its reasons for:

(a) allowing a variation of a Reference Tariff (including if the variation is allowed because of the effluxion of time under section 8.3D);

(b) disallowing a variation of a Reference Tariff; or

(c) specifying any variation specified by the Relevant Regulator under section 8.3E,

at the time of allowing, disallowing or specifying that variation.

8.3G If a Specified Event occurs and the Service Provider does not serve a notice on the Relevant Regulator as required by section 8.3B(a), then the Relevant Regulator may itself vary the Reference Tariff concerned but only in accordance with the Approved Reference Tariff Variation Method. Any such variation comes into effect on the date specified in, or determined in accordance with, the Access Arrangement. The Relevant Regulator must publish its reasons for any variation of the Reference Tariff made under this section 8.3G at the time of making that variation.

8.3H The Relevant Regulator may:

(a) on application by the Service Provider, grant extensions to any time period in sections 8.3B to 8.3G that applies to the Service Provider; and

(b) extend any time period in section 8.3G that applies to the Relevant Regulator.

135. Under clause 15(a) of AGN's proposal, the Specified Event which triggers a variation for the purposes of section 8.3B(a) of the Code is if "AGN incurs or is to incur HHV Costs". If this occurs, or AGN otherwise wishes to vary a Reference Tariff in accordance with the Trigger Event Adjustment Approach (see clause 15(b) of AGN's proposal), then AGN may, provide a notice to the Authority in accordance with section 8.3B of the Code, and the process set out in sections 8.3B to 8.3H of the Code applies.

136. The Authority notes the definition of HHV Costs in clause 14 of Part B of the proposed revised Access Arrangement. Under this definition, the HHV Costs which are to be recovered through varied Reference Tariffs are defined only to include the New Facilities Investment and Non Capital Costs "which do not exceed the amount that would be incurred by a prudent Service Provider acting efficiently, in accordance

with accepted good industry practice, and to achieve the lowest sustainable cost of delivering Services, taking into account the obligations imposed on AGN by all applicable laws" (see clause 14(c) of AGN's proposal). This test mirrors the tests in sections 8.16(a) and 8.37 of the Code for allowable New Facilities Investment and Non Capital Costs.

137. The effect of including this provision in the definition of HHV Costs is that the HHV Costs which may be approved and recovered through varied Reference Tariffs cannot exceed the amount which the Authority could accept as New Facilities Investment and Non Capital Costs when approving an Access Arrangement or revisions thereto. Further, this means that as part of the notice and disallowance procedure, it will be necessary for the Authority to consider and determine whether or not the costs submitted for approval exceed the costs otherwise allowable under sections 8.16(a) and 8.37 in respect of New Facilities Investment and Non Capital Costs. The Authority considers that this is an appropriate method for ensuring that variations to Reference Tariffs using a Trigger Event Adjustment Mechanism Approach are consistent with the Code principles governing the relevant categories of costs.

138. The Authority is otherwise satisfied that the Trigger Event Adjustment Mechanism Approach in clauses 13 to 17 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 is consistent with the Code and should be approved.

Non-Reference Services

Draft Decision (Amendments 6 & 7)

139. There were provisions in Part B of the proposed revised Access Arrangement as originally submitted by which AGN sought to place conditions on negotiations of tariffs for Non-Reference Services. These clauses were clauses 16, 17 and 18 of Part B of the proposed revised Access Arrangement as originally submitted.

140. First, clauses 16 and 17 of Part B of the proposed revised Access Arrangement as originally submitted provided as follows:

> 16 In setting and negotiating Tariffs for a Service which is not a Reference Service, regard must be had to the Tariff structure and Tariff levels contained in the Reference Tariff Policy.
>
> 17 Without limiting the generality of Part B, clause 16, the Tariff for a Service which is not a Reference Service should to the extent practicable and reasonable be comparable to the Tariff for the Reference Service (if any) which most nearly corresponds to the Service.

141. Similar provisions are contained in clauses 40(2) and (3) of the current Access Arrangement. These were approved by the Relevant Regulator. However, the current provisions by their terms are confined to haulage services not being Reference Services. Clauses 16 and 17 of the proposed revised Access Arrangement as originally submitted by AGN, by contrast, sought to extend the provisions to any Service as defined in the Code for which a Reference Tariff is not provided.

142. In its Draft Decision, the Authority noted that the Code does not require the Authority to approve a tariff for Services other than Reference Services. Disputes between Prospective Users and Service Providers in respect of the terms and conditions, including tariffs, for Services which are not Reference Services are subject to arbitration under section 6 of the Code. In such arbitrations the Arbitrator is bound

under section 6.18(a) of the Code not to make a decision which is inconsistent with the Access Arrangement.

143. The Authority noted further in its Draft Decision that if clauses 16 and 17 of Part B were to be approved, then the Arbitrator would be bound to make decisions consistent with them. This would be despite the Services in question not being Reference Services and the Authority not having given consideration to whether or not the provisions of clauses 16 and 17 regarding the tariffs for the relevant Services are reasonable.

144. The Authority therefore concluded in its Draft Decision that it would be inappropriate to approve clauses 16 and 17 of Part B of the proposed revised Access Arrangement as originally submitted. The reason for this conclusion was that such provisions would place conditions on the setting of tariffs for Services not being Reference Services, which would fetter the Arbitrator's power to determine such tariffs by arbitration under Section 6 of the Code. The Authority in the Draft Decision required those clauses to be deleted from the revised Access Arrangement prior to its approval (Amendment 6).

145. A related issue considered in the Draft Decision concerned clause 18 of Part B as originally submitted by AGN. This was a further provision relevant to the setting of tariffs for the Interconnection Service. The proposed clause (of which there is no equivalent in the current Access Arrangement) read as follows:

> In setting and negotiating Tariffs for an Interconnection Service the rate shall be set to recover the capital costs and Non-Capital Costs incurred by AGN of implementing interconnection and facilitating the Interconnection Service in its day-to-day operation, including the cost identified in Part A, clause 62(2).

146. The cost identified in Part A, clause 62(2) was the cost of implementing a heating value blending management plan. The full text of Part A, clause 62, of the proposed revised Access Arrangement, headed 'Cost recovery of interconnection costs', was as follows:

> (1) AGN may recover the reasonable capital and Non-Capital Costs it incurs as a result of a Pipeline being interconnected with the AGN GDS from the owner or operator of the Interconnected Pipeline.
>
> (2) Without limiting Part A, clause 62(1), if AGN is required or agrees to implement, or is required or agrees to assist in the implementation of, a heating value blending management plan under the Gas Standards Regulations in respect of an Interconnected Pipeline, the owner or Pipeline Operator of the Interconnected Pipeline will be required to reimburse AGN's reasonable capital costs and Non-Capital Costs associated with the measurement, recording, auditing, facilitation or otherwise related to the development, implementation and administration of the heating value blending management plan.
>
> (3) If the costs referred to in Part A, clause 62(2) cannot be recovered from the owner or Pipeline Operator of the Interconnected Pipeline, then AGN may suspend the provision of the Interconnection Service to the owner or Pipeline Operator of the Interconnected Pipeline.

147. The Authority noted in its Draft Decision that the effect of clause 18 of Part B read with clause 62 of Part A of the proposed revised Access Arrangement would be to require the capital expenditure and Non Capital Costs incurred by AGN in relation to any interconnection with the Parmelia Pipeline to be recovered from the operator of that pipeline. This outcome would be inconsistent with another aspect of the

Authority's Draft Decision, namely that any such costs are costs of AGN providing Reference Services that should be recovered from all Users of the GDS through the revenue allocation mechanisms under the Code. Further, the Authority noted that the proposal as originally submitted would involve placing a condition on the setting of a tariff for a Non-Reference Service which for the reasons explained above[7] the Authority considered inappropriate.

148. In the circumstances, the Authority in its Draft Decision also required clause 18 of Part B of Part A of the proposed revised Access Arrangement as originally submitted should to be deleted (also in Amendment 6). Further, and consistent with Amendment 6 of its Draft Decision, the Authority required a consequential amendment (Amendment 7) to delete clause 31(c) of Part A as originally submitted, which referred to the clauses which under Amendment 6 were to be deleted.

Final Decision

149. In paragraphs 39 of its submission dated 21 March 2005 in response to the Draft Decision, AGN noted that it had amended the proposed revised Access Arrangement to delete clauses 16, 17 and 18 of Part A as originally submitted. The proposed revisions to the Access Arrangements submitted on 10 June 2005 no longer include such provisions. Further, in paragraph 40 of its submission dated 21 March 2005 in response to the Draft Decision, AGN noted that it had amended the proposed revised Access Arrangement to delete clause 31(c) of Part A as originally submitted. The proposed revisions to the Access Arrangements submitted on 10 June 2005 no longer include such a provision.

150. On the above basis the Authority is satisfied, for the purposes of this Final Decision, that AGN has met the requirements of Amendments 6 and 7 of the Draft Decision.

Elements of a Service

Draft Decision (Amendment 8)

151. Sections 3(2)(b) & (c) of the Code provide:

> 3.2 The Services Policy must comply with the following principles:
>
> …
>
> (b) To the extent practicable and reasonable, a User or Prospective User must be able to obtain a service which includes only those elements that the User or Prospective User wishes to be included in a 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.

152. The current Access Arrangement includes, in clause 11 of Chapter 2 – Services Policy, provisions that purport to give effect to this requirement in terms that are similar, but not identical, to those in the Code.

[7] See paragraphs 142 to 144.

153. In the Draft Decision, the Authority noted that in the proposed revised Access Arrangement as originally submitted clause 26 of Part A provided as follows:

> (1) To the extent that it is practicable and reasonable for AGN, a Prospective User will be able to obtain a Service which consists only of elements of a Reference Service offered by AGN under the Services Policy.
>
> (2) If requested to do so by a Prospective User, AGN will, to the extent that it is practicable and reasonable to do so, provide a separate Tariff for an element of the Service requested under Part A, subclause 26(1).

154. In its Draft Decision, the Authority noted that the proposed clause 26 of Part A as originally submitted by AGN appeared inconsistent with the provisions of the Code, particularly in that the proposed clause appeared to be confined to apply to Reference Services and to exclude Users.

155. The Authority concluded in its Draft Decision that, as section 3.2 of the Code requires that a Services Policy must comply with the principles of that section, clause 26 of Part A as originally submitted should be amended to be consistent with sections 3.2(b) and (c) of the Code (Amendment 8).

Final Decision

156. The Authority received a submission on this matter from AGN (see paragraphs 41 to 43 of the submission dated 21 March 2005) but has not received any other submissions from interested parties.

157. In response to the requirement that the restriction of the right to take elements of Services be amended so that it is not confined to Reference Services, AGN has proposed deleting the word "Reference" previously appearing before the word "Service" in clause 26 of the proposed revised Access Arrangement submitted on 10 June 2005. The Authority is satisfied that this amendment meets this requirement of Amendment 8 of the Draft Decision.

158. In relation to the further requirement in Amendment 8 of the Draft Decision that the clause as originally submitted be amended so that it did not exclude Users (i.e. so that it was not apparently confined to Prospective Users), in its submission dated 21 March 2005 in response to the Draft Decision AGN noted that:

> The definition of "Prospective User" in Part A of the PRAA expressly includes Users, and accordingly, this aspect of paragraph 26 is of identical effect to the provisions of the Code.

159. The Authority accepts AGN's submission on this point. Therefore, the Authority's final decision is that clause 26 of the proposed revised Access Arrangement submitted by AGN on 10 June 2005 meets the requirements of the Draft Decision and is approved, without the need to extend the reference to a "Prospective User" to a "User".

Reference Tariffs and Reference Tariff Policy

Preliminary matters

Code requirements

160. Section 3.3 of the Code requires that an Access Arrangement must 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.

161. Section 3.4 of the Code specifies circumstances in which Reference Tariffs must comply with the Reference Tariff Principles in section 8 of the Code:

> Unless a Reference Tariff has been determined through a competitive tender process as outlined in sections 3.21 to 3.36, an Access Arrangement and any Reference Tariff included in an Access Arrangement must, in the Relevant Regulator's opinion, comply with the Reference Tariff Principles described in section 8.

162. Section 3.5 of the Code requires that, in addition to a Reference Tariff, an Access Arrangement must include a Reference Tariff Policy:

> An Access Arrangement must also include a policy describing the principles that are to be used to determine a Reference Tariff (a ***Reference Tariff Policy***). A Reference Tariff Policy must, in the Relevant Regulator's opinion, comply with the Reference Tariff Principles described in section 8.

163. Section 8.1 of the Code provides that a Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:

(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.

164. Section 8.1 of the Code also provides guidance as to the reconciliation of the objectives set out in this section:

> 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.

165. In respect of the reconciliation of the objectives of section 8.1 of the Code, "the factors in s 2.24(a) to (g) should guide the Regulator in determining, if necessary, the

manner in which the objectives in section 8.1(a) to (f) can best be reconciled or which of them should prevail".[8]

166. In addition, section 8.2 of the Code requires that the Authority be satisfied about a number of factors in determining whether to approve a Reference Tariff and Reference Tariff Policy:

(a) the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period (the Total Revenue) should be established consistently with the principles and according to one of the methodologies contained in this section 8;

(b) to the extent that the Covered Pipeline is used to provide a number of Services, that portion of Total Revenue that a Reference Tariff is designed to recover (which may be based on forecasts) is calculated consistently with the principles contained in this section 8;

(c) a Reference Tariff (which may be based upon forecasts) is designed so that the portion of Total Revenue to be recovered from a Reference Service (referred to in paragraph (b)) is recovered from the Users of that Reference Service consistently with the principles contained in section 8;

(d) Incentive Mechanisms are incorporated into the Reference Tariff Policy wherever the Relevant Regulator considers appropriate and such Incentive Mechanisms are consistent with the principles contained in this section 8; and

(e) any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis.

167. The application of the principles contained in section 8 of the Code (i.e. sections 8.1 to 8.49) to the Reference Tariffs and the Reference Tariff Policy proposed by AGN are discussed below under the relevant headings.

Section 38 of *Gas Pipelines Access (Western Australia) Act 1998*

168. The *Gas Pipelines Access (Western Australia) Act 1998* (***GPAA***), which implements the Code in Western Australia, differs from the legislation which was enacted in South Australia and adopted as the national model legislation. One difference is the supplementary provisions of section 38.

169. The text of the relevant provision is as follows:

> **38 Provision supplementary to the Code**
>
> (1) This section applies where —
>
> (a) the Authority 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.
>
> (2) Where this section applies the Authority is 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.

[8] *Re: Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, Declaratory Order 3.

(3) 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.

(4) In subsection (3) —

"small quantities" means a quantity for the time being prescribed by the Minister by order published in the *Gazette*, being in every case —

(a) less than 1 terajoule in any period of 12 consecutive months; and

(b) for transport to a single metered connection to the pipeline concerned.

(5) An order under subsection (4) may be amended by the Minister by further order published in the *Gazette*.

170. By section 38(1), the section applies in circumstances where the Authority is required to take the public interest into account when assessing an Access Arrangement.

171. Section 2.24(e) of the Code provides that in assessing an Access Arrangement (or proposed revisions) as to compliance with sections 3.1 to 3.20 of the Code, the Authority must take into account the public interest.

172. Therefore, when considering the proposed revised Access Arrangement, the Authority must 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.

173. The provisions of section 38 of the *GPAA* have been considered by the Authority in assessing the proposed revisions to the Access Arrangement.

Reference Tariff proposal

174. The Reference Tariff proposal in the revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005 is in structure largely the same as that originally submitted by AGN.

175. Clause 35 of Part A – "Reference Tariffs and Reference Tariff Policy" – of the proposed revisions submitted in response to the Draft Decision on 10 June 2005 summarises the provisions which deal with Reference Tariff issues:

> Reference Tariffs and the Reference Tariff Policy applicable to this Access Arrangement are set out in Part B as follows:
>
> (a) Part B, clauses 1-13 and Schedules 1-5 describe the Initial Reference Tariffs and the basis for adjustment;
>
> (b) Part B, clause 19 describes the approach to be used for setting Tariffs for Services other than Reference Services;
>
> (c) Part B also sets out AGN's Reference Tariff Policy describing the principles used to determine a Reference Tariff. The policy relates to:
>
> (i) the calculation of Total Revenue;
>
> (ii) New Facilities Investment;
>
> (iii) allocation of revenue between Services and between Users;
>
> (iv) the Form of Regulation;

(v) Incentive Mechanism.

(d) Part B, clause 40 describes a range of Fixed Principles that are to apply to the Access Arrangement.

Approach to determining Reference Tariffs

176. The Reference Tariffs as originally proposed by AGN were determined using a Price Path Approach in accordance with section 8.3(b) of the Code. This approach has also been adopted by AGN in its proposed revisions to the Access Arrangement submitted on 10 June 2005 in response to the Draft Decision. The adoption of this approach is, under the Code, at the discretion of the Service Provider.

177. In the Draft Decision, the Authority summarised the broad steps involved in determining Reference Tariffs where a Price Path Approach is used as follows:

- determination of the Capital Base at the commencement of the revised Access Arrangement Period, by adjusting the Initial Capital Base by reference to New Facilities Investment and Depreciation during the current Access Arrangement Period;
- estimation of a forecast Capital Base on an annual basis over the next Access Arrangement Period, based upon the Service Provider's forecast New Facilities Investment, Depreciation and, where appropriate, working capital;
- estimation of an appropriate Rate of Return on the forecast Capital Base as determined;
- estimation of Non Capital Costs for the next Access Arrangement Period;
- determination of Total Revenue to be recovered through Reference Tariffs, being the total of the return on the Capital Base (including, where appropriate, working capital), Depreciation of the Capital Base and forecast Non Capital Costs during the next Access Arrangement Period;
- assessment of the Service Provider's forecasts of quantities (volumes, daily demand and customer numbers) for the next Access Arrangement Period;
- allocation of Total Revenue across Services by reference to the quantity forecasts;
- determination of Reference Tariffs for the first year of the next Access Arrangement Period; and
- determination of an 'X' factor to provide a smoothed price path over the next Access Arrangement Period.

178. Under the Code provision is made for variation of Reference Tariffs from the predetermined price path established under a Price Path Approach. In the proposed revised Access Arrangement as originally submitted on 31 March 2004, AGN proposed the following adjustment mechanisms:

- the adjustment annually for variation in Regulatory Costs from those forecast;

- a Reference Tariff Control Formula Approach which would permit adjustment to individual tariff components by reference to the annual revenue obtained from a basket of tariffs;

- a Trigger Event Adjustment Approach in respect of Non Capital Costs and New Facilities Investment relating to Full Retail Contestability (**FRC**);

- an Incentive Mechanism; and

- Fixed Principles.

179. In response to the Draft Decision, AGN has modified its position in relation to adjustments to the revised Access Arrangement during the second Access Arrangement Period, by:

- removing the Trigger Event Adjustment Approach in respect of FRC Costs; and

- including a proposed Trigger Event Adjustment Approach in relation to the Non Capital Costs and New Facilities Investment relating to heating value management consequent on additional interconnection activity.

180. In order for the Authority to assess the proposed Reference Tariffs, there is a need for the Authority itself to model AGN's proposed Reference Tariffs. This modelling process is necessary to replicate and verify AGN's calculations for determining Reference Tariffs, as well as to enable the Authority to specify its own Reference Tariffs where the Authority's conclusion regarding a particular input or parameter value differs from AGN's. The Authority intends to publish its model for determining the Reference Tariffs as specified in this Final Decision at the same time as it publishes this Final Decision.

181. The modelling process is highly complex and involves a series of inter-related calculations based upon a large number of inputs and parameter values. In this context, the Authority notes section 2.6 of the Code, which requires the Authority to ensure that the Access Arrangement Information contains such information as in the Authority's opinion would enable Users and Prospective Users to understand the derivation of the elements of the proposed Aceess Arrangement. The Authority takes the view that in order for the section 2.6 requirement to be met there is a need for Users and Prospective Users to be provided in the Access Arrangement Information with the outputs from each of the steps in the modelling process which lead to the Reference Tariffs in the revised Access Arrangement. The specification of these outputs will also assist Users and Prospective Users in future reviews to understand the base from which revised Reference Tariffs are to be determined.

182. For these reasons, in this Final Decision, where the Authority's calculation in respect of any step in the process of determining Reference Tariffs differs from AGN's the Authority has required AGN to substitute the Authority's calculation. This ensures that Users and Prospective Users have a complete picture of the process of determining Reference Tariffs, even if the differences between the Authority's and AGN's calculations might of themselves be regarded as small or immaterial.

Information required under Code

183. Section 2.28 of the Code requires the Service Provider to submit proposed revisions to the Access Arrangement, together with the Access Arrangement Information as originally submitted.

184. Section 2.6 of the Code provides that, in the Authority's opinion, the Access Arrangement Information must contain such information as would enable Users and Prospective Users to understand the derivation of the elements in the proposed Access Arrangement and to form an opinion as to the compliance of the Access Arrangement with the provisions of the Code.

185. Section 2.7 of the Code states that the Access Arrangement Information may include any relevant information but must include at least the six categories of information described in Attachment A to the Code. These six categories of information relate to:

- access and pricing principles;
- capital costs;
- operations and maintenance;
- overheads and marketing costs;
- system capacity and volume assumptions; and
- key performance indicators.

186. Section 2.30 of the Code provides that if the Authority is not satisfied that the Access Arrangement Information meets the requirements of the Code, it may at any time before a decision is made to approve an Access Arrangement, require the Service Provider to make changes to the Access Arrangement Information in order to comply with sections 2.6 and 2.7.

General Principles for determining Reference Tariffs

Draft Decision

187. Clauses 19 & 20 – "General Principles" – of Part B of the proposed revised Access Arrangement as originally submitted on 31 March 2004 provided as follows:

> 19 The Reference Tariffs have been designed to:
>
> (a) achieve the objectives set out in section 8.1 of the Code; and
>
> (b) recover:
>
> (i) all of the Total Revenue that reflects costs incurred (including capital costs) directly attributable to the Reference Services; and
>
> (ii) a share of the Total Revenue that reflects costs incurred (including capital costs) that are attributable to providing the Reference Services.

> 20 The share referred to in Part B, subparagraph 19(b)(ii) has been determined using a method that meets the objectives in section 8.1 of the Code and is otherwise fair and reasonable.

188. In order to meet the Code requirements these general principles must conform to the Reference Tariff Principles in section 8 of the Code.

189. In its Draft Decision the Authority stated that it was satisfied that the general principles in clause 19 and 20 of the Reference Tariff Policy in the proposed revised Access Arrangement were consistent with the provisions of the Code, and therefore there was no need for amendment by AGN.

Final Decision

190. In the amended proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005, clauses 19 and 20 of Part B were retained as originally submitted.

191. No submissions having been received questioning this aspect of the Draft Decision, or the relevant clauses, the Authority is satisfied, for the purpose of this Final Decision, that the General Principles proposed by AGN are consistent with the provisions of the Code, and there is no need for amendment by AGN.

Method of calculation of Total Revenue

Draft Decision

192. The Code gives the Service Provider a choice of three methods – Cost of Service, Internal Rate of Return or Net Present Value – to calculate Total Revenue. The Service Provider's proposed Reference Tariffs must comply with Reference Tariff Principles applicable to the chosen method.

193. The relevant Code provisions are sections 8.4 and 8.5 of the Code:

> 8.4 The Total Revenue (a portion of which will be recovered from sales of Reference Services) should be calculated according to one of the following 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 or are otherwise used to provide Services (***Capital Base***);
>
> (b) depreciation of the Capital Base (***Depreciation***); and
>
> (c) the operating, maintenance and other non capital costs incurred in providing all Services (***Non Capital Costs***).
>
> **IRR**: The Total Revenue will provide a forecast Internal Rate of Return (IRR) for the Covered Pipeline that is consistent with the principles in sections 8.30 and 8.31. 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 this section 8.

> **NPV**: The Total Revenue will provide a forecast Net Present Value (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.
>
> 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 this section 8.
>
> The methodology used to calculate the Cost of Service, an IRR or NPV should be in accordance with generally accepted industry practice.
>
> However, the methodology used to calculate the Cost of Service, an IRR or NPV may also allow the Service Provider to retain some or all of the benefits arising from efficiency gains under an Incentive Mechanism. The amount of the benefit will be determined by the Relevant Regulator in the range of between 100 percent and 0 percent of the total efficiency gains achieved.
>
> 8.5 Other methodologies may be used provided the resulting Total Revenue can be expressed in terms of one of the methodologies described above.

194. Clause 21 of the proposed Reference Tariff Policy in Part B as originally submitted stated that the Total Revenue had been calculated using the Cost of Service method as described in section 8.4 of the Code.

195. In the Draft Decision the Authority noted that the method of calculating Total Revenue is at the discretion of the Service Provider, and the Authority's role is to assess compliance with the chosen method. The Authority concluded that clause 21 of the Reference Tariff Policy in Part B as originally submitted complied with the Code, including the provisions relating to Reference Tariff Principles.

Final Decision

196. The relevant clause is unchanged in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 in response to the Draft Decision. The Authority is therefore satisfied for the purpose of the Final Decision that the approach proposed by AGN is acceptable.

Adjustment for inflation

Draft Decision

197. Each of the values used in the determination of the Reference Tariffs needs to be adjusted appropriately for the effects of inflation.

198. Section 8.5A of the Code provides discretion for AGN to choose a basis for dealing with inflation. AGN chose in the proposed revised Access Arrangement as originally submitted, as provided for in section 8.5A(b) of the Code, to make the relevant calculations on a real basis. This required, under section 8.5A(b), that the Capital Base, Depreciation and all other costs and revenues be expressed in constant prices and for a real Rate of Return to apply.

199. Accordingly, each of the values used in the calculation of the Reference Tariffs had to be adjusted for inflation at a fixed date. In the proposed revisions to the Access

Arrangement as originally submitted, AGN chose to present its calculations in dollars as at 30 June 2003.

200. In its Draft Decision, the Authority noted that in order for Reference Tariffs to be calculated as at the intended Revisions Commencement Date (i.e. 1 January 2005) it is necessary for AGN's calculations to be adjusted accordingly. The Authority considered that it would be more convenient for Reference Tariffs to be calculated as at the Revisions Commencement Date and adjusted its calculations for the purpose of the Draft Decision accordingly.

201. The Authority also noted in its Draft Decision that expressing all values in dollars as at the Revisions Commencement Date is consistent with the approach adopted in respect of most other current Access Arrangements.

202. Therefore in the Draft Decision, where the Authority required AGN to amend its Access Arrangement Information, it included a requirement that AGN express values in the amended Access Arrangement Information in real terms as at the Revisions Commencement Date.

Final Decision

203. The Authority notes that in the revised Access Arrangement Information submitted by AGN in response to the Draft Decision on 27 May 2005 AGN has met the requirements of the Draft Decision in this respect by expressing all values (where appropriate) in real terms as at 31 December 2004, and this is reflected in the Reference Tariffs proposed in the revised Access Arrangement submitted on 10 June 2005.

Mid year or end year timing

Draft Decision

204. AGN's Reference Tariff calculations for the purpose of the revisions to the Access Arrangement as originally submitted on 31 March 2004 assumed that depreciation of New Facilities Investment for a given year was calculated on the basis of half of the New Facilities Investment occurring in the middle of the year and the remainder at the end of that year.

205. In its Draft Decision, the Authority noted that its calculations had assumed that all forecast New Facilities Investment occurs at the end of each relevant year. The effect of this assumption is to align the timing of forecast New Facilities Investment with that of all other costs and revenues, which are assumed to occur at the end of each relevant year.

Final Decision

206. The Authority understands that AGN's calculations for the purpose of the proposed revisions to the Access Arrangement submitted on 10 June 2005 in response to the Draft Decision has adopted the assumption referred to in paragraph 205 hereof. The Authority is therefore satisfied that the proposed revisions meet this aspect of the requirements of the Authority's Draft Decision.

Opening Capital Base

207. Under the Cost of Service method, it is necessary to determine an opening value for the Capital Base at the commencement date of the relevant Access Arrangement Period. Where a revised Access Arrangement is being considered, this is done by taking the Capital Base at the commencement date of the immediately preceding Access Arrangement Period, and adjusting it to take account of New Facilities Investment and Depreciation during the immediately preceding Access Arrangement Period.

208. The value of the Initial Capital Base of the GDS at the commencement of the first Access Arrangement Period as set out in the current Access Arrangement was $535.9 million at 31 December 1999 plus the value of User Specific Delivery Facilities, being $12.7 million at 31 December 1999[9].

209. In the proposed revisions to the Access Arrangement as originally submitted, AGN proposed in Part B, clause 22 of the proposed revised Access Arrangement that the value of the Capital Base as at the Revisions Commencement Date is $634.4 million expressed in dollars at 30 June 2003. In the Draft Decision, the Authority noted that expressed in dollars at 31 December 2004 the opening value of the Capital Base proposed by AGN is $657.89 million.

210. The Authority in its Draft Decision did not agree that the opening value of the Capital Base as determined by AGN complied with the Code. Rather, the Authority concluded in its Draft Decision that the opening value for the Capital Base at the commencement of the revised Access Arrangement should be $658.39 million.

211. In clause 23 of Part B of the proposed revisions submitted by AGN on 10 June 2005 in response to the Draft Decision, AGN has proposed an opening value for the Capital Base of $658.4 million (dollars at 31 December 2005). While complying with the Authority's Draft Decision, by reason of matters arising since the Draft Decision (as explained below) the Authority is not satisfied that AGN's response meets the requirements of this aspect of the Draft Decision. Rather, the opening value of the Capital Base should be amended to $658.6 million (dollars at 31 December 2004) in order for the Authority to approve the revised Access Arrangement.

Code provisions

212. Sections 8.8 and 8.9 of the Code set out principles for establishing the Capital Base as follows:

> 8.8 Principles for establishing the Capital Base for the Covered Pipeline when a Reference Tariff is first proposed for a Reference Service (i.e., for the first Access Arrangement Period) are set out in section 8.10 to 8.14.
>
> 8.9 Sections 8.15 to 8.29 then describe the principles to be applied in adjusting the value of the Capital Base over time as a result of the addition to capital assets that are used to provide Services and as a result of capital assets ceasing to be used for the delivery of Services. Consistently with those principles, the Capital Base at the commencement of each Access Arrangement Period after the first, for the Cost of Service methodology, is determined as:

[9] Current Access Arrangement, clause 28.

(a) the Capital Base at the start of the immediately preceding Access Arrangement Period; plus

(b) subject to sections 8.16(b) and sections 8.20 and 8.22, the New Facilities Investment or Recoverable Portion (whichever is relevant) in the immediately preceding Access Arrangement Period; less

(c) Depreciation for the immediately preceding Access Arrangement Period; less

(d) Redundant Capital identified prior to the commencement of that Access Arrangement Period,

and for the IRR or NPV methodology, is determined as

(e) subject to sections 8.16(b) and sections 8.20 to 8.22, the Residual Value assumed in the previous Access Arrangement, less

(f) Redundant Capital identified prior to the commencement of that Access Arrangement period

subject, irrespective of which methodology is applied, to such adjustment for inflation (if any) as is appropriate given the approach to inflation adopted pursuant to section 8.5A.

213. As the Capital Base under the proposed revised Access Arrangement is for revised (as opposed to first) Reference Tariffs, the principles in sections 8.10 to 8.14 have no application, and the principles in section 8.15 to 8.29 apply. These principles relate respectively to:

- New Facilities Investment (sections 8.15 to 8.19);
- Forecast Capital Expenditure (sections 8.20 to 8.22);
- Capital Contributions (sections 8.23 and 8.24);
- Surcharges (sections 8.25 to 8.26); and
- Capital Redundancy (sections 8.27 to 8.29).

Reference Tariff Policy

Draft Decision (Amendment 9)

214. Clause 22 of the Reference Tariff Policy in Part B of the proposed revised Access Arrangement as originally submitted on 31 March 2004 provided as follows:

> The Capital Base for the AGN GDS as at 1 January 2005 is $634.4 million (expressed in $m as at 30 June 2003).

215. Prior to making its Draft Decision, the Authority did not receive any submissions in relation to this matter, other than a general submission from the Office of Energy that the Authority should in its assessment assure compliance with section 8.16 of the Code in relation to the capital costs incurred by AGN during the first Access Arrangement Period, which are claimed to form part of the Capital Base.

216. In its Draft Decision, the Authority noted that clause 22 of the Reference Tariff Policy as originally submitted, did not, as is required for a Reference Tariff Policy under the Code, describe the principles by which the opening value of the Capital Base is determined. Rather it set out the result without specifying the principles by which the opening value was determined.

217. The Authority also noted in its Draft Decision that the Access Arrangement Information as originally submitted at sections 4.2.1 to 4.2.5 set out in some detail the manner in which AGN has calculated the opening value of the Capital Base for the second Access Arrangement Period, which AGN had used to calculate the Reference Tariffs. Further, in the current Access Arrangement the Reference Tariff Policy in relation to the Initial Capital Base included a brief outline of the principles used to determine the Initial Capital Base[10].

218. Accordingly, in its Draft Decision the Authority required clause 22 of the Reference Tariff Policy to be amended to set out the principles used to determine the opening value of the Capital Base, in order to comply with section 3.5 of the Code (Amendment 9).

Final Decision

219. AGN has accepted the requirement to amend the proposed revised Access Arrangement in the manner set out in Amendment 9 of the Draft Decision. Clause 23 of Part B of the proposed revisions to the Access Arrangement submitted on 10 June 2005 in response to the Draft Decision states as follows:

> The Capital Base has been determined in accordance with the process set out in s8.9 and with respect to section 8.9(c) of the Code, the values used for depreciation are the approved forecast depreciation values for that period.

220. The Authority is satisfied that the revisions meet the requirements of Amendment 9 of the Draft Decision and comply with the Code provisions regarding a valid Reference Tariff Policy.

User Specific Delivery Facilities

Draft Decision (Amendment 10)

221. The Reference Tariff Policy in the current Access Arrangement specifies that the value of User Specific Delivery Facilities was excluded from the value of the Initial Capital Base[11].

222. In the Draft Decision, the Authority noted that AGN's proposed revised Access Arrangement as originally submitted on 31 March 2004 did not indicate whether the value of User Specific Delivery Facilities had been included in the value of actual and forecast New Facilities Investment for the first and second Access Arrangement Periods respectively. Prior to the Draft Decision, the Authority sought clarification on this matter from AGN. Such clarification was not received prior to the Draft Decision.

223. In the Draft Decision, the Authority concluded that to avoid any doubt an amendment should be made to the Reference Tariff Policy in the revised Access Arrangement to clarify the approach which AGN has adopted, and required that AGN amend the proposed revised Access Arrangement to specify that the value of User Specific

[10] Current Access Arrangement, clause 28(2).

[11] Current Access Arrangement, clause 28(4).

Delivery Facilities had been included in the value of actual and forecast New Facilities Investment for the first and second Access Arrangement Periods respectively (Amendment 10).

Final Decision

224. Clause 22 of Part B of the proposed revisions submitted on 10 June 2005 confirms that the value of User Specific Delivery Facilities has been excluded from the value for the Capital Base at the commencement of the second Access Arrangement Period as required by Amendment 10 of the Draft Decision.

225. The audit of AGN's New Facilities Investment during the first Access Arrangement Period, referred to below at paragraph 243, also addressed whether or not the value of User Specific Delivery Facilities has been excluded from the Capital Base as at the commencement of the second Access Arrangement Period.

226. The Authority is, therefore, satisfied that AGN has met the requirements of Amendment 10 of the Draft Decision in the proposed revisions to the Access Arrangement submitted on 10 June 2005.

Initial asset values

Draft Decision (Amendment 11)

227. In the Draft Decision the Authority noted a difference between the asset values of the Initial Capital Base as set out in Table 4.1 of the Access Arrangement Information as originally submitted and the Authority's conversion of those values to dollars at 31 December 2004 (set out in Table 1 of the Draft Decision). The difference between the two sets of figures was explained by a difference in the index value used to adjust for inflation.

228. Consequently, the Authority required the Access Arrangement Information to be amended to show the values for the assets comprising the Initial Capital Base converted to dollars at 31 December 2004 using the appropriate index value to adjust for inflation (Amendment 11).

Final Decision

229. AGN has accepted the requirement to amend the Access Arrangement Information in accordance with Amendment 11 of the Draft Decision. Table 4.1 of the revised Access Arrangement Information sets out the relevant values consistently with those in Table 1 of the Draft Decision.

Asset lives

Draft Decision (Amendment 12)

230. In the Draft Decision the Authority noted that the remaining lives of assets (by class of asset) comprising the Initial Capital Base were calculated in Table 4.4 of the Access Arrangement Information as originally submitted on an average basis as at

30 June 2003. However, the Authority considered that Reference Tariffs should be calculated as at the Revisions Commencement Date (i.e. 1 January 2005).

231. Consequently, the Authority required Table 4.4 of the Access Arrangement Information to be amended to set out the remaining lives of assets comprising the Initial Capital Base calculated as at 31 December 2004 as set out in Table 2 of the Draft Decision (Amendment 12).

Final Decision

232. AGN accepted the requirement to amend the Access Arrangement Information in accordance with Amendment 12 of the Draft Decision. Table 4.6 of the revised Access Arrangement Information sets out the relevant values consistently with those in Table 2 of the Draft Decision.

Depreciation relevant to opening value of Capital Base

233. The provisions in the Code relevant to Depreciation are sections 10.8, 8.32, 8.33 and 8.35:

> 10.8 The following definitions apply unless the context otherwise requires:
>
> …
>
> 'Depreciation' means, in any year and on any asset or group of assets, the amount calculated according to the Depreciation Schedule for that year and for that asset or class of assets.
>
> 'Depreciation Schedule' has the meaning given in section 8.32.
>
> 8.32 The Depreciation Schedule is a 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***).
>
> 8.33 The Depreciation Schedule should 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 (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 Capital Base 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 Capital Base 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 section 8.27, 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 that asset or group of assets was first include in the Capital Base, subject to such adjustment (if any) as is appropriate given the approach to inflation adopted pursuant to section 8.5A).

8.35 In implementing the principles in section 8.33 or 8.34, regard must be had to the reasonable cash flow needs for Non Capital Costs, financing cost requirements and similar needs of the Service Provider.

234. There are two aspects of Depreciation relevant to the opening value of the Capital Base as at the commencement of the second Access Arrangement Period. First, Depreciation of the assets comprising the Initial Capital Base for the first Access Arrangement Period. This is discussed immediately below. Secondly, Depreciation of New Facilities Investment during the first Access Arrangement Period has been separately calculated. This is discussed under the heading "Depreciation of New Facilities Investment" below.

Depreciation of Initial Capital Base assets

Draft Decision (Amendment 13)

235. AGN did not include in the Access Arrangement Information as originally submitted the approved Depreciation of the assets comprising the Initial Capital Base. In the Draft Decision, to enable Users and Prospective Users to understand the derivation of the elements of the Reference Tariffs as required by sections 2.6 and 2.7 of the Code, the Authority required an amendment to the Access Arrangement Information to include these values expressed in dollars at 31 December 2004 (Amendment 13) as set out in Table 3 of the Draft Decision.

Final Decision

236. The revised Access Arrangement Information submitted in response to the Draft Decision on 27 May 2005 did not include the approved Depreciation of the assets comprising the Initial Capital Base as set out in Table 3 of the Draft Decision. The Authority, therefore, requires that the Access Arrangement Information be amended accordingly before final approval.

Final Decision Amendment 1

The Access Arrangement Information should be amended to include the approved Depreciation of the assets comprising the Initial Capital Base as set out in Table 3 of the Draft Decision.

New Facilities Investment for first Access Arrangement Period

Draft Decision (Amendment 14)

237. Section 8.16 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) Subject to sections 8.16(b) and sections 8.20 to 8.22, the Capital Base may be increased under section 8.15 by the amount of the actual New Facilities Investment in the immediately preceding Access Arrangement Period provided that:

(i) that amount 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 providing Services; and

(ii) one of the following conditions is satisfied:

(A) the Anticipated Incremental Revenue generated by the New Facility exceeds the New Facilities Investment; or

(B) 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

(C) the New Facility is necessary to maintain the safety, integrity or Contracted Capacity of Services.

(b) If pursuant to section 8.20 the Relevant Regulator agrees to Reference Tariffs being determined on the basis of forecast New Facilities Investment, the Capital Base may be increased by the amount of the New Facilities Investment forecast to occur within the new Access Arrangement Period determined in accordance with sections 8.20 and 8.21 and subject to adjustment in accordance with 8.22.

238. Section 8.17 of the Code sets out two factors that the Authority 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.

239. The New Facilities Investment originally claimed by AGN for the first Access Arrangement Period was set out in the Access Arrangement Information[12] in annual aggregate terms. In total this actual cost, over the five years of the current Access Arrangement, amounted to $130.6 million, expressed in dollars at 30 June 2003. By comparison, the amount approved by the Relevant Regulator was $103.9 million (dollars at 30 June 2003). The difference of $26.7 million represented additional New Facilities Investment by AGN above forecast.

240. Prior to the Draft Decision, in response to a request for information, AGN provided further details of actual New Facilities Investment during the first Access Arrangement Period. This information, converted by the Authority to dollars at 31 December 2004, was set out in Table 4 of the Draft Decision.

241. In the Draft Decision, the Authority noted that the actual New Facilities Investment presented in Table 4 added up to an amount of $135.47 million which differed from $130.6 million referred to in the Access Arrangement Information as originally submitted. This difference was for reasons including that the values in Table 4 had been converted to values at 31 December 2004. An amendment to Table 4.2 of the Access Arrangement Information to reflect the values in Table 4 of the Draft Decision, was required (Amendment 14).

242. The Authority also noted in its Draft Decision that it was not satisfied that AGN had substantiated "the amount of the actual New Facilities Investment in the immediately preceding Access Arrangement Period" as referred to in section 8.16(a) of the Code. Consequently, the Authority noted that it had requested AGN to make available

[12] AAI, Table 4.2, p 38.

further information to enable the Authority to substantiate that the New Facilities Investment claimed has actually been outlaid.

Final Decision

243. For the purpose of substantiating AGN's actual New Facilities Investment during the first Access Arrangement Period, the Authority engaged a consultant to conduct an audit of selected categories of New Facilities Investment. The selected categories of capital expenditure were medium pressure mains, meters and service pipes and FRC which represented approximately 80 percent of AGN's overall New Facilities Investment during the first Access Arrangement Period.

244. The revised Access Arrangement Information in response to Amendment 14 of the Draft Decision was submitted by AGN on 27 May 2005, before the audit findings were finalised. This included in Table 4.3 - Regulatory Actual Costs for 2000-2004.

245. The audit found certain discrepancies between AGN's accounting records and the information provided to the Authority prior to the Draft Decision as to the amounts expended in the three categories audited, and therefore there were inconsistencies with the information contained in Table 4.3 of the revised Access Arrangement Information submitted on 27 May 2005. The adjusted values for New Facilities Investment for the first Access Arrangement Period, taking account of the audit findings, are set out in the following Table 1:

Table 1: Actual New Facilities Investment during first Access Arrangement Period ($ millions; 31 December 2004)

Asset class	2000	2001	2002	2003	2004
High Pressure Mains	1.364	1.875	-	-	-
Medium Pressure Mains	5.623	3.906	4.463	7.017	9.120
Medium / Low Pressure Mains	2.157	1.276	0.085	-	0.035
Low Pressure Mains	-	-	-	-	-
Regulators	0.183	0.168	0.015	-	0.006
Secondary Gate Stations	0.024	0.013	-	-	-
Buildings	-	0.064	-	-	-
Meter and Services Pipes	13.612	10.787	19.281	18.241	16.290
Equipment & Vehicles	1.228	0.263	0.005	0.180	0.078
Information Technology	3.563	0.670	0.378	0.348	0.987
FRC	0.000	0.004	1.796	3.138	7.003
Land	0.268	0.199	-	-	-
Total	28.024	19.225	26.023	28.924	33.520

246. While there were certain discrepancies between the figures submitted by AGN and the audited figures as illustrated by a comparison between Table 4.3 of the revised Access Arrangement Information and Table 1 above, the Authority does not consider that in the exercise of its discretion it is warranted to audit the remaining categories of capital expenditure during the first Access Arrangement Period to verify the figures submitted by AGN. This is because such categories only represent approximately 20 percent of the capital expenditure and any discrepancy or discrepancies of the same order of magnitude as those discovered during the audit would be unlikely to be material to the determination of Reference Tariffs.

247. Therefore, an amendment as follows to the Access Arrangement Information to reflect the audit findings is required in order for the Authority to give final approval.

Final Decision Amendment 2

Table 4.3 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 1 of the Final Decision in relation to AGN's New Facilities Investment for the first Access Arrangement Period.

248. The Authority notes that in addition to satisfying itself in accordance with section 8.16(a) of the Code that the amount of New Facilities Investment claimed by AGN

was in fact outlaid the Authority must also be satisfied that the amount to be added to the Capital Base:

- 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 providing Services; and

- meets at least one of the three conditions set out in section 8.16(a)(ii)(A), (B) or (C).

249. In the Draft Decision, the Authority concluded that these requirements were satisfied. The audit findings, and the consequential required amendment to the Access Arrangement Information, do not call into question the Authority's Draft Decision that the requirements of section 8.16(a)(i) and (ii) of the Code.

Depreciation of New Facilities Investment for first Access Arrangement Period

Draft Decision (Amendment 15)

250. AGN's calculation of Depreciation of the New Facilities Investment for the first Access Arrangement Period was based on depreciation of the forecast New Facilities Depreciation as approved by the Relevant Regulator under the current Access Arrangement.

251. In the Draft Decision, the Authority noted that AGN's approach was similar to that adopted in 2002 by the ESC for its approval of revisions to Access Arrangements for the three major Victorian gas distribution systems[13]. The approach had also been used by the Independent Competition and Regulatory Commission (ACT) (**ICRC**) for its final decision in October 2004 on the proposed revised Access Arrangement for the ActewAGL system in the ACT[14].

252. Further, the Authority recognised in its Draft Decision that the approach adopted by AGN (i.e. to depreciate forecast as opposed to actual New Facilities Investment) would ensure that the total value of Depreciation at the end of the asset life-cycle will be equal to the total value of the actual New Facilities Investment undertaken.

253. In the Draft Decision, the Authority noted that AGN had not included in its Access Arrangement Information any information in relation to the values for depreciation of forecast New Facilities Investment during the first Access Arrangement Period. In the Draft Decision the Authority set out in Table 5 its calculation of the depreciation expressed in dollars at 31 December 2004.

254. Further, to enable Users and Prospective Users to understand the derivation of the elements of the Reference Tariffs as required by sections 2.6 and 2.7 of the Code, the Authority required AGN to amend the Access Arrangement Information to include

[13] ESC, October 2002, *Review of Gas Access Arrangements: Final Decision*.

[14] ICRC, October 2004, *Final Decision, Review of Access Arrangement for ActewAGL Natural Gas System in ACT, Queanbeyan and Yarrowlumla*.

the values for Depreciation for New Facilities Investment during the first Access Arrangement Period as set out in Table 5 of the Draft Decision (Amendment 15).

Final Decision

255. The revised Access Arrangement Information submitted in response to the Draft Decision on 27 May 2005 did not include the depreciation of forecast New Facilities Investment for the first Access Arrangement Period as set out in Table 5 of the Draft Decision. The Authority, therefore, requires that the Access Arrangement Information be amended accordingly before final approval.

Final Decision Amendment 3

The Access Arrangement Information submitted on 27 May 2005 should be amended to include the depreciation of forecast New Facilities Investment for the first Access Arrangement Period as set out in Table 5 of the Draft Decision.

Total depreciation for first Access Arrangement Period

Draft Decision (Amendment 16)

256. Total depreciation for the first Access Arrangement Period is simply the sum of Depreciation of assets comprising the Initial Capital Base and Depreciation of forecast New Facilities Investment.

257. As indicated above, in the Draft Decision the Authority required AGN to amend the Access Arrangement Information in respect of both classes of Depreciation. Therefore, it was necessary for the Authority to require AGN to amend the values in the Access Arrangement Information to accord with the Authority's calculation of total Depreciation. This calculation was set out in Table 6 of the Draft Decision. The relevant amendment (Amendment 16) required AGN to amend the Access Arrangement Information "to include the values for total Depreciation for the first Access Arrangement Period as set out in Table 6 of this Draft Decision".

Final Decision

258. The revised Access Arrangement Information submitted on 27 May 2005 in response to the Draft Decision presented, in Table 4.4, revised total Depreciation. The Authority is satisfied that the revised total Depreciation as presented meets the requirements of Amendment 16 of the Draft Decision, and requires no further amendment before final approval.

Redundant Capital

Draft Decision

259. Section 8.9 of the Code provides for the deduction from the value of the Capital Base at the commencement of an Access Arrangement Period of "Redundant Capital identified prior to the commencement of that Access Arrangement Period". Section 10.8 provides that Redundant Capital has the meaning given in section 8.27. Section

8.27 of the Code refers to Redundant Capital as "assets which cease to contribute in any way to the delivery of Services."

260. In the Access Arrangement Information as originally submitted, AGN stated as follows in relation to this issue [15]:

> AGN is not aware of any material assets that have become redundant during the course of the First Access Arrangement Period. The administrative cost associated with the stranding of customer-specific assets, which are generally just the Meter and Service Pipe is unlikely to be of significant value where the costs of removing these assets from the regulatory asset base outweigh the benefit to the community.

261. In the Draft Decision, the Authority considered AGN's comments in relation to Meters and Service Pipes (i.e. Standard Delivery Facilities). The Authority noted that their value at cost was included in the Capital Base. However, AGN had not provided any substantiation of the value of de-commissioned Meters and Service Pipes. Further, the Authority understood that under FRC, AGN is required to keep records which should enable identification of de-commissioned Meters and Service Pipes, so as to establish the written down value of the assets within this class.

262. In the circumstances, the Authority noted in the Draft Decision that it would ask AGN to make available further information to enable the Authority to substantiate that the costs of removing the decommissioned Meters and Service Pipes from the Capital Base outweigh the benefit to the community.

263. In relation to assets other than Meters and Service Pipes, the Authority accepted in its Draft Decision AGN's assessment that there had been no material redundancy within the GDS. The Authority noted that any redundancy of User Specific Delivery Facilities (i.e. excluding Standard Delivery Facilities such as Meters and Service Pipes) could not affect the value of the Capital Base because AGN had excluded the value of such facilities from the Capital Base.

Final Decision

264. In response to a request by the Authority as foreshadowed in the Draft Decision AGN provided the Authority with further information and submissions in relation to whether or not certain investments in Meters and Service Pipes should be regarded as redundant capital.

265. Two broad categories of investments in Meters and Service Pipes were addressed by AGN:

- Those assets to which gas may have ceased to flow, either at a User's election (usually for credit control purposes) or at an end user's election (where they decide not to use gas). These assets, referred to as "suspended gas flow assets", are not usually permanently removed or destroyed.

[15] AAI, p 40.

- Assets that, as a result of the demolition of existing properties, are "abolished". Usually this involves the permanent closure or removal of related pipeline assets (service lines).

266. In relation to suspended gas flow assets such assets may occur as a result of a number of actions, including meter locking, "soft" turn off of a meter, disconnection or an end user simply electing not to buy gas. In such a case, ordinarily, the delivery point will still be under contract to a User as a delivery point for the purposes of the Haulage Contract. The only exception to this is the case where suspended gas flow assets are deregistered assets under the Retail Market Rules, which are not material. Further, ancillary services such as meter locking and unlocking, which are within the definition of Services for the purpose of the Code, may still be provided in relation to suspended gas flow assets.

267. AGN's position in relation to suspended gas flow assets was that they do not fall within the definition in section 8.27 of the Code of Redundant Capital because they are not assets which have ceased to contribute "in any way to the delivery of Services." The Authority is satisfied that it is a reasonable construction of the Code that suspended gas flow assets continue to contribute indirectly to the delivery of Services, and therefore should not be treated as Redundant Capital. The Authority therefore accepts AGN's proposed approach of making no allowance for Redundant Capital in relation to suspended gas flow assets.

268. In relation to the second class of assets, that is assets that are "abolished" as a result of demolitions of existing properties, AGN submitted that the Authority ought not treat such assets as Redundant Capital. AGN noted that demolitions predominantly occur in cases where the relevant building is aged and therefore the Standard Delivery Facilities which are "abolished" generally have been part of the AGN GDS for a substantial period of time, and in some cases will have been fully depreciated in AGN's books of account. Further, to the extent that "abolished" assets had an existing written down value as at the date of commencement of the first Access Arrangement Period the assets were devalued by 66 percent in the Initial Capital Base. Finally, to the extent that any Meters and Service Pipes which were "abolished" during the first Access Arrangement Period had any residual value in AGN's books of account at the time of abolishment, it may reasonably be inferred that the value of any Redundant Capital would be immaterial, and the cost of determining the Redundant Capital represented by such assets would therefore not be cost justified. In the above respects, AGN has noted that total abolishments in each year are approximately 2,500 so the likelihood of any material redundancy within the AGN GDS on this basis is remote.

269. The Authority considers that Meters and Service Pipes "abolished" during the first Access Arrangement Period, strictly speaking, meet the description of Redundant Capital in the Code. That being said, the Authority is satisfied by AGN's submissions that the quantum of such Redundant Capital is likely to be immaterial, and it is not cost justified for the Authority to enquire further into the matter. In this respect, the Authority notes that at the end of 2004, AGN had in the order of $40 million in Initial Capital Base assets in the Meters and Service Pipe category, and approximately 500,000 connections giving an average written down value of approximately $80 per connection. On the basis of approximately 2,500 "abolishments" per year, the amount of capital thereby rendered redundant annually may be estimated at $200,000.

270. Further, there would seem to be some force in AGN's submission that "abolished" Meters and Service Pipes are predominantly substantially older than average, and therefore will have a substantially lower written down value than the $80 per connection average as at the end of 2004, such that it is safe to assume that the actual amount of Redundant Capital in any year from "abolishments" is likely to be substantially less than $200,000. AGN has provided information in support of this proposition in the form of details of all abolishments for 2004. On this basis, the Authority is satisfied that it is not appropriate to investigate further, nor to make an allowance for, Redundant Capital associated with abolishments during the first Access Arrangement Period, on materiality grounds.

Opening value of Capital Base

Draft Decision (Amendment 17)

271. In the Access Arrangement Information as originally submitted on 31 March 2004, AGN stated that the opening value of the Capital Base for the second Access Arrangement Period was determined in the following manner[16]:

> For each Year of the First Access Arrangement Period the Initial Capital Base has been adjusted to reflect:
>
> - actual new capital expenditure net of any contribution made by consumers (including a forecast for 2004) meeting the requirements of section 8.16 of the Code has been added to the Initial Capital Base;
> - the forecast regulatory Depreciation (Return of Capital) as detailed in the Regulator's final approval of the Access Arrangement, dated 13 July 2000, has been deducted from the Initial Capital Base;
> - disposals at the regulatory written down book value has been deducted from the Initial Capital Base value; and
> - changes in the Capital Base as a result of inflation, with adjustments made to bring all asset values to June 2003.

272. In the Draft Decision the Authority accepted AGN's approach as consistent with the Code requirements (in particular the process outlined in section 8.9 of the Code[17]). The only exception was with respect to the adjustment for inflation where the Authority adopted as its preferred approach the use of dollars at 31 December 2004 as the relevant date, rather than June 2003 as proposed by AGN.

273. As indicated above (see paragraph 259 and following), the Authority has accepted for the purposes of this Draft Decision that there is no capital to be treated as Redundant Capital. Nor has AGN advised of any disposals of assets. As a consequence no deductions have been made for Redundant Capital or the disposal of assets.

[16] AAI, p 36.

[17] See paragraph 212 above.

274. In Table 4.1 of the Access Arrangement Information as originally submitted on 31 March 2004, AGN presented the closing values for the Capital Base grouped by asset class for each year of the first Access Arrangement Period[18]. In the Draft Decision, the Authority re-calculated these values using as input values Depreciation and New Facilities Investment determined by the Authority for the Draft Decision. The re-calculated values were presented in Table 7 of the Draft Decision to provide a revised opening value of the Capital Base for the second Access Arrangement Period of $658.39 million expressed in dollars at 31 December 2004. Amendment 17 of the Draft Decision required AGN to amend the proposed revised Access Arrangement to accord with the value calculated by the Authority for the opening value of the Capital Base.

Final Decision

275. In clause 22 of Part B of the proposed revisions to the Access Arrangement submitted by AGN on 10 June 2005, in compliance with Amendment 17 of the Draft Decision, AGN has proposed an opening value for the Capital Base of $658.4 million (dollars at 31 December 2004).

276. However, as indicated in paragraphs 243 to 247 above, the audit findings in relation to the actual New Facilities Investment during the first Access Arrangement Period have necessitated amendments to inputs to the calculation of the opening value of the Capital Base, which are not yet reflected in AGN's proposed revised Access Arrangement documentation. The Authority's calculation of the opening values for each asset class comprising the Capital Base at the start of the second Access Arrangement Period, adjusted to take account of the audit findings, are set out in the following Table 2:

[18] AAI, Table 4.1, p 37.

Table 2: Values for assets in Capital Base for first Access Arrangement Period ($ millions; 31 December 2004)

Asset class	1999	2000	2001	2002	2003	2004
High Pressure Mains	175.956	175.616	175.754	173.989	172.198	170.386
Medium Pressure Mains	208.945	210.327	209.915	209.998	212.598	217.275
Medium / Low Pressure Mains	113.515	112.798	111.199	108.408	105.532	102.691
Low Pressure Mains	32.808	31.750	30.647	29.496	28.298	27.050
Regulators	11.470	11.232	10.973	10.552	10.109	9.669
Secondary Gate Stations	2.328	2.246	2.143	2.027	1.911	1.795
Buildings	2.054	1.962	1.930	1.833	1.732	1.628
Meter and Services Pipes	62.325	70.019	74.517	87.156	98.412	107.389
Equipment & Vehicles	17.783	15.260	11.213	6.676	2.064	- 2.890
Information Technology	-	3.563	4.234	4.611	4.960	5.946
FRC	-	0.000	0.005	1.801	4.938	11.942
Land	5.277	5.545	5.743	5.743	5.743	5.743
Total	632.461	640.319	638.273	642.290	648.495	658.625

277. Notwithstanding that AGN has met the requirements of Amendment 17 of the Draft Decision, it is now appropriate for the Access Arrangement documentation to be adjusted to reflect the findings of the audit in relation to the New Facilities Investment during the first Access Arrangement Period. Amendments are required to both the revised Access Arrangement and Access Arrangement Information prior to approval by the Authority.

Final Decision Amendment 4

Clause 23 of Part B of the revised Access Arrangement submitted on 10 June 2005 should be amended to provide a value for the opening value of the Capital Base at the commencement of the second Access Arrangement Period of $658.6 million in accordance with Table 2 of the Final Decision.

Final Decision Amendment 5

Table 4.1 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 2 of the Final Decision in relation to the values of the Capital Base during the first Access Arrangement Period by asset class, including the values at the conclusion of the first Access Arrangement Period.

Forecast New Facilities Investment

Code provisions

278. The relevant provisions of the Code relating to forecast New Facilities Investment are contained sections 8.20 to 8.22 of the Code as follows.

> 8.20 Consistent with the methodologies described in section 8.4, Reference Tariffs may be determined on the basis of New Facilities Investment that is forecast to occur within the Access Arrangement period provided that the New Facilities Investment is reasonably expected to pass the requirements in section 8.16(a) when the New Facilities Investment is forecast to occur.
>
> 8.21 The Relevant Regulator may at any time at its discretion agree (with or without conditions or limitations) that actual New Facilities Investment by a Service Provider meets, or forecast New Facilities Investment proposed by a Service Provider will meet, the requirements of section 8.16(a), the effect of which is to bind the Relevant Regulator's decision when the Relevant Regulator considers revisions to an Access Arrangement submitted by the Service Provider. Before giving any agreement under this section 8.21, the Relevant Regulator must conduct public consultation in accordance with the requirements for a proposed revision to the Access Arrangement submitted under section 2.28. For the avoidance of doubt, if the Relevant Regulator does not agree under this section that the New Facilities Investment meets, or (in the case of forecast New Facilities Investment) will meet, the requirements of section 8.16(a), the Relevant Regulator may consider whether those requirements are met when it considers revisions to an Access Arrangement submitted by the Service Provider.
>
> 8.22 For the purposes of calculating the Capital Base at the commencement of the subsequent Access Arrangement Period, either the Reference Tariff Policy should describe or the Relevant Regulator shall determine when the Relevant Regulator considers revisions to an Access Arrangement submitted by a Service Provider, how the New Facilities Investment is to be determined for the purposes of section 8.9. This includes how the Capital Base at the commencement of the next Access Arrangement Period will be adjusted if the actual New Facilities Investment or Recoverable Portion (whichever is relevant) is different from the forecast New Facilities Investment (with this decision to be designed to best meet the objectives in section 8.1).

279. In addition, section 8.16 of the Code, discussed in paragraph 237 above, and section 8.2(e) of the Code, are relevant. Section 8.2(e) of the Code provides:

> The factors about which the Relevant Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff Policy are that:
>
> …
>
> (e) any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis.

Draft Decision (Amendments 18 and 19)

280. The Access Arrangement Information as originally submitted provided, in section 4.2.8[19], AGN's forecast capital expenditure for the second Access Arrangement

[19] AAI, pp 43-47.

Period. Table 4.6 and Table 4.7 provided such expenditure disaggregated by asset class and by type of investment.

281. The investment types presented in the Access Arrangement Information as originally submitted were defined by AGN as follows[20]:

- **User Initiated Capital**. This is primarily capital required to connect new end use consumers on behalf of Users.
- **Renewals (Asset Replacement)**. This involves the replacement of aged and obsolete assets, or replacement of assets where the present-value cost of maintaining existing assets exceeds the cost of replacement.
- **Demand Capital**. This is capital to expand network capacity to cater for the additional load on existing assets from new connections, and also any increase in peak consumption per Delivery Point of existing consumers.
- **Other Capital**. This category includes miscellaneous capital items such as information technology equipment (including any on-going FRC compliance), vehicles, office furniture etc.

282. For the purpose of the Draft Decision, the Authority considered it appropriate to undertake a more detailed analysis of forecast unit costs and new customer connections in relation to the most significant category, being User Initiated Capital, which represented approximately 70 percent of forecast New Facilities Investment. As total User Initiated Capital costs depend upon both unit costs and growth in customer connections, an analysis of both was undertaken.

283. The purpose of this analysis was to obtain a better understanding of forecast movements in costs over the second Access Arrangement Period. In particular, the Authority sought to determine whether any movements in costs could reasonably be factored into Reference Tariffs over the forecast period.

284. As a starting point, the Authority used forecast User Initiated Capital costs and new connections in the B2 & B3 customer categories in AGN's Asset Management Plan for the period 2005-2009 (**AMP**) to derive an indicative forecast of unit costs[21]. This analysis revealed that unit costs were forecast to remain reasonably constant in real dollar terms over the second Access Arrangement Period.

285. The Authority noted that the indicative forecast of unit costs had been based on the B2 & B3 customer categories as these categories predominate User Initiated Capital costs. This also recognised that User Specific Delivery Facilities were directly funded through User specific charges in Reference Tariffs A1, A2 and B1 and therefore the costs of such facilities were excluded by AGN from User Initiated Capital.

286. Further, on the basis of the information available to the Authority, there were indications that unit costs for capital works were likely to decline in real terms over

[20] AAI, p 44.

[21] Only B2 and B3 customer categories were used for this analysis as User Initiated Capital costs predominantly reflect investment in these categories. Categories A1, A2 and B1 involve significant amounts of User Specific expenditure not included under the User Initiated Capital category.

the forecast period. On this basis, the Authority considered that it would be reasonable to assume that unit costs in nominal terms would change at a rate of 1 percent below the rate of inflation for the purposes of determining Reference Tariffs. To the extent that actual changes in unit costs differed from this assumption, New Facilities Investment would be re-assessed at the end of the second Access Arrangement Period and the Capital Base would be adjusted for any differences at that time.

287. As indicated above, in its Draft Decision the Authority also analysed AGN's forecasts of new customer connections. In doing so, the Authority had regard to the information provided by AGN, and past growth patterns in respect of new customer connections.

288. In comparing the information available from different sources, the Authority noted in its Draft Decision that there were appreciable differences in anticipated growth rates. On the basis of the information made available, the Authority considered that growth in customer connections indicated in AGN's AMP would be a suitable basis for projecting User Initiated Capital costs.

289. Having concluded that it would be reasonable to assume unit costs in nominal terms would change at the rate of 1 percent below the rate of inflation and that the forecast in the growth of new customer connections should be based on AGN's AMP, the Authority prepared an estimate of New Facilities Investment in the User Initiated Capital category. This estimate differed from that presented by AGN in Table 4.7 of the Access Arrangement Information as originally submitted.

290. The Authority considered that its estimate of forecast User Initiated Capital was reasonable and required AGN to amend Table 4.7 of the Access Arrangement Information accordingly. The relevant amendment was as follows:

> **Amendment 18**
>
> Table 4.7 of the Access Arrangement Information should be amended to reflect the Authority's calculation of forecast User Initiated Capital as set out in Table 8 of this Draft Decision, and to adjust all other values to dollars at 31 December 2004.

291. Further, Table 4.6 of the Access Arrangement Information as originally submitted also presented AGN's forecast New Facilities Investment by asset class[22]. For the purposes of determining Reference Tariffs, the Authority concluded that there was a need for AGN's forecast of New Facilities Investment by asset class to be amended to reflect the Authority's required amendment to forecast User Initiated Capital. The relevant amendment was as follows:

> **Amendment 19**
>
> Table 4.6 of the Access Arrangement Information should be amended to reflect the Authority's calculation of forecast New Facilities Investment by asset class as set out in Table 10 of this Draft Decision

[22] AAI, Table 4.6, p 43.

Final Decision

292. In its submission in response to Amendments 18 and 19 of the Draft Decision dated 21 March 2005, AGN initially declined to accept the requirement to amend. In particular, AGN did not accept that the Code permits or requires forecast efficiencies not yet achieved to be used in determining future expenditure requirements (see paragraph 55 of the submission).

293. However, AGN's revised Access Arrangement Information submitted on 27 May 2005 included the following tabular information which responded to Amendments 18 and 19:

- Table 4.9 – Forecast Capital Expenditure for the second Access Arrangement Period: By Type of Investment - which includes re-forecast User Initiated Capital in response to Amendment 18 of the Draft Decision.

- Table 4.8 – Forecast Capital Expenditure for the second Access Arrangement Period – which set out re-forecast New Facilities Investment by asset class in response to Amendment 19.

294. The two elements of the Authority's Draft Decision in relation to User Initiated Capital which AGN submitted were reflected in Tables 4.8 and 4.9 were first, a re-forecast of B2 and B3 customer growth to reflect updated customer connection numbers and second, a re-forecast of unit costs for customer connections to reflect productivity improvements during the second Access Arrangement Period of 1 percent below the rate of inflation.

295. In relation to the B2 and B3 customer connection growth projections, AGN submitted as follows in relation to the determination of annual growth in customer connections for B2 and B3 customers (see paragraph 157 of the submission):

> there [sic] will always be a greater number of customers who require connections in a year than the annual difference between opening and closing connection point numbers for the year. The difference relates to the number of abolishments made. AGN forecasts that the annual rate of abolishments is approximately 2,500 per year. Therefore assuming that the number of connections made in any one year is 17,500, the total customer connection point growth is 15,000, which represents the difference between connections and abolishments.

296. The Authority notes this submission, and that the Authority's forecast customer growth for B2 and B3 customers for the purpose of the Draft Decision did not take account of abolishments.

297. The Authority has reviewed AGN's re-forecast customer growth for B2 and B3 customers. While AGN has not provided any substantiation of the source or basis for the re-forecast, the Authority is satisfied that the re-forecast should be accepted as the basis for final approval. In particular, the Authority notes that the re-forecast is substantially similar to the Authority's own forecast of growth in B2 and B3 customer connections for the purpose of the Draft Decision, such that a further request for substantiation is not warranted.

298. The Authority has also reviewed AGN's re-forecast unit costs and is satisfied that AGN has incorporated into its forecasts productivity improvements in unit costs of 1 percent below the rate of inflation in relation to User Initiated Capital.

Forecast Depreciation

Draft Decision (Amendment 20)

299. AGN did not include its calculation of Depreciation in its Access Arrangement Information as originally submitted. The Authority however had access to AGN's Reference Tariff model and Depreciation model.

300. First, in relation to Depreciation of the assets comprising the Capital Base at the commencement of the second Access Arrangement Period, the Authority noted in its Draft Decision certain inconsistencies in AGN's application of asset lives. The Authority, therefore, adjusted AGN's calculations to address the inconsistencies identified as set out in Table 11 of the Draft Decision.

301. Second, in relation to Depreciation of forecast New Facilities Investment, the Authority noted that by reason of the adoption of end of year timing and the adjustment to express values in real terms at 31 December 2004 there was a need to amend AGN's calculation of Depreciation for forecast New Facilities Investment. Table 12 of the Draft Decision set out AGN's Depreciation of forecast New Facilities Investment as adjusted by the Authority accordingly.

302. Total forecast Depreciation is the sum of forecast Depreciation of the assets comprising the opening Capital Base and forecast Depreciation of New Facilities Investment. AGN set out its proposed total forecast Depreciation for each year of the second Access Arrangement Period in Table 4.5 of the Access Arrangement Information as originally submitted.

303. In the Draft Decision, the Authority noted that it was necessary to adjust AGN's calculation to reflect the adjusted forecast Depreciation set out in Tables 11 and 12 of the Draft Decision. The Authority set out its calculation of total forecast Depreciation in Table 13 of the Draft Decision, and required AGN to amend Table 4.5 of the Access Arrangement Information to accord with the Authority's calculation of total forecast Depreciation (Amendment 20).

Final Decision

304. AGN's revised Access Arrangement Information submitted on 27 May 2005 included in Table 4.7 revised total Depreciation for the second Access Arrangement Period. The Authority is not satisfied that Table 4.7 meets the requirements of Amendment 20.

305. This is because as a consequence of the audit of AGN's actual New Facilities Investment for the first Access Arrangement Period, it will be necessary for some assets to be re-classified between the meters and services pipes and medium pressure system categories, which categories have different depreciation lives. There is also a small change in the total of actual New Facilities Investment during the first Access Arrangement Period.

306. The Authority's calculation of total Depreciation for the second Access Arrangement Period also is impacted by the changes identified through the audit, and the result of the recalculation is set out in the following Table 3:

Table 3: Total Depreciation in each year of second Access Arrangement Period ($ millions; 31 December 2004)

Asset class	2005	2006	2007	2008	2009
High Pressure Mains	1.705	1.710	1.717	1.724	1.730
Medium Pressure Mains	4.695	4.788	4.875	4.948	5.030
Medium / Low Pressure Mains	2.892	2.921	2.952	2.982	3.017
Low Pressure Mains	1.002	1.002	1.002	1.002	1.002
Regulators	0.443	0.445	0.446	0.448	0.450
Secondary Gate Stations	0.094	0.095	0.095	0.095	0.095
Buildings	0.091	0.091	0.091	0.092	0.092
Meters & Service Pipes	10.273	11.061	11.820	12.412	13.108
Equipment & Vehicles	-	0.000	-	-	-
IS (exc FRC)	1.189	1.849	2.419	2.898	3.589
FRC	2.388	2.388	2.388	2.388	2.388
Land	-	-	-	-	-
Total Asset Depreciation	24.772	26.349	27.806	28.989	30.502

307. In the circumstances, it will be necessary for AGN to amend Table 4.7 of the revised Access Arrangement Information submitted on 27 May 2005 to accord with the above Table 3. The following is the required amendment:

Final Decision Amendment 6

Table 4.7 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 3 of the Final Decision in relation to total Depreciation during the second Access Arrangement Period.

Capital Base for second Access Arrangement Period

Draft Decision (Amendment 21)

308. The Capital Base at the end of each year of the second Access Arrangement Period is calculated using the opening value of the Capital Base, forecast New Facilities Investment and total forecast Depreciation.

309. Table 4.3 of AGN's Access Arrangement Information as originally submitted provided values for the Capital Base for each year of the second Access Arrangement Period grouped by asset class but calculated on this basis disaggregated by asset class.

310. In view of the amendments required by the Authority in its Draft Decision to the opening value of the Capital Base, forecast New Facilities Investment and total

forecast Depreciation as originally submitted by AGN, the Authority noted the need for AGN's Table 4.3 to be amended.

311. The Authority's calculation of the Capital Base during the second Access Arrangement Period was set out in Table 15 of the Draft Decision, and the Authority required an amendment in its Draft Decision (Amendment 21) to Table 4.3 of the Access Arrangement Information as originally submitted to accord with results of the Authority's calculation set out in Table 15 of the Draft Decision (Amendment 21).

Final Decision

312. AGN's revised Access Arrangement Information submitted on 27 May 2005 included in Table 4.5 the value of the Capital Base at the end of each year of the second Access Arrangement Period.

313. By reason of remaining differences between AGN and the Authority with respect to inputs to the calculation of the Capital Base at the end of each year of the second Access Arrangement Period, the Authority's calculation of the value of the Capital Base differs from AGN's calculation as presented in Table 4.5 of the revised Access Arrangement Information.

314. The Authority's calculation is as follows:

Table 4: Capital Base at the end of each year of the second Access Arrangement Period by asset class
($ millions; 31 December 2004)

Asset class	2005	2006	2007	2008	2009
High Pressure Mains	169.338	168.457	167.570	166.590	168.178
Medium Pressure Mains	218.147	218.556	218.063	218.074	217.388
Medium / Low Pressure Mains	101.556	100.483	99.334	98.412	97.457
Low Pressure Mains	26.049	25.047	24.045	23.043	22.041
Regulators	9.301	8.931	8.554	8.191	7.826
Secondary Gate Stations	1.708	1.621	1.533	1.447	1.360
Buildings	1.550	1.472	1.393	1.316	1.238
Meters & Service Pipes	116.826	124.738	127.734	132.713	137.025
Equipment & Vehicles	- 2.534	- 2.185	- 1.858	- 1.454	- 1.051
IS (exc FRC)	8.053	9.057	9.032	9.591	8.228
FRC	9.553	7.165	4.777	2.388	-
Land	5.838	5.931	6.018	6.125	6.232
Total	665.385	669.272	666.193	666.435	665.924

315. In the circumstances, it will be necessary for AGN to amend Table 4.5 of the revised Access Arrangement Information submitted on 27 May 2005 to accord with the above Table 4. The following is the required amendment.

Final Decision Amendment 7

Table 4.5 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 4 of the Final Decision in relation to the value of the Capital Base during the second Access Arrangement Period.

Working capital

Draft Decision

316. In the Access Arrangement Information as originally submitted, AGN noted that an allowance for a return on the working capital employed in providing Reference Services had been included in the Total Revenue from which the Reference Tariffs have been determined. Table 4.14 of the Access Arrangement Information indicated that the annual cost of providing working capital was $1.0 million (dollars at 30 June 2003). AGN submitted that this was consistent with the approach adopted in the current Access Arrangement and the Code requirements to recover the efficient cost of providing Reference Services.[23]

317. In the Draft Decision the Authority noted that the Code does not explicitly address the recovery of a return on working capital through Reference Tariffs. However, the following provisions provide implicit support for the inclusion of a return on working capital in the Total Revenue:

(a) Section 8.2(a) provides the definition of Total Revenue as "the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period".

(b) Section 8.4 provides that Total Revenue should be calculated according to one of several methodologies that include Cost of Service.

(c) Section 8.4 specifies that under the Cost of Service methodology, Total Revenue is to be equal to the cost of providing all Services where that cost includes at section 8.4(a) "a return (***Rate of Return***) on the value of the capital assets that form the Covered Pipeline or are otherwise used to provide Services (***Capital Base***)".

(d) Section 8.4 provides that the methodology used to calculate the Cost of Service should be "in accordance with generally accepted industry practice".

318. On this basis, the Authority suggested in its Draft Decision that if a return on working capital was to be included in the calculation of Total Revenue for the determination of Reference Tariffs under a Cost of Service approach, the quantum of working capital may be calculated using a generally accepted industry practice (if such exists) and be added to the Capital Base. Handled in this manner, working capital would be a non-

[23] AAI, p 54.

depreciable component of the Capital Base, the return on which would be calculated at the weighted average cost of capital (**WACC**).

319. The Authority noted in the Draft Decision that decisions by the ACCC, ORG (Victoria) and most recently ICRC (ACT)[24] have declined to allow a return on working capital as a component of Total Revenue. On the other hand, IPART (NSW)[25] and previously the Relevant Regulator in WA have allowed a return on working capital.

320. Further, the Authority recognised that the billing cycle and cash management policies of a Service Provider will impact on the need for working capital. The Authority noted that:

- a Service Provider may require working capital to fund periodic shortfalls in in-coming revenue streams over out-going costs;
- working capital may also be required to fund working stock, i.e. line pack, parts and inventories etc.; and
- the cost to the Service Provider of funds employed as working capital is no different to the cost of funds it uses to invest in the capital assets that form a tangible part of the Covered Pipeline.

321. The Authority recognised that the need for working capital is not limited to circumstances involving the billing cycle, but may include the funding of working stock. For example, in the case of the Dampier to Bunbury Natural Gas Pipeline a specific allowance for working capital is provided for non-depreciable assets including for the value of line pack which in that case is quite substantial[26].

322. Prior to making its Draft Decision, the Authority commissioned the Allen Consulting Group (**ACG**) to report on the manner of dealing with working capital for the AGN GDS. ACG reported in June 2004 (**ACG Working Capital Report**) concluding that:

- given the precedent provided by the ACCC and the ESC (and now more recently the ICRC), the Authority would have some justification in completely disallowing an allowance for working capital; or
- the Authority might accept an allowance for costs of working capital on only the operating and maintenance component utilising AGN's cash cycle assumptions.

323. The ACG Working Capital Report was published at the time of release of the Draft Decision.

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[24] ACCC, September 2002, *EAPL's application to the NCC for partial revocation of coverage of the Moomba to Sydney Pipeline System,* p 10; ORG, September 2001, *2003 Review of Gas Access Arrangements – Position Paper,* p 47; ICRC, October 2004, *Final Decision, Review of Access Arrangement for ActewAGL Natural Gas System in ACT, Queanbeyan and Yarrowlumla*, p 74.

[25] IPART, *Draft Decision, Revised Access Arrangement for AGL Gas Network*, December 2004, pp 96-97.

[26] Independent Gas Pipelines Access Regulator Western Australia, 30 December 2003, *Access Arrangement Information for the Dampier to Bunbury Natural Gas Pipeline*, p 12.

324. Based upon the above, the Authority in the Draft Decision accepted, in principle, that an allowance for working capital should be included in the Capital Base upon which a return may be earned through the Reference Tariffs, but working capital would not be subject to depreciation.

325. The allowance in respect of working capital proposed by AGN in its Reference Tariff model was based upon an estimate of its payment and receipt cycles. This was described in the Access Arrangement Information as follows[27]:

> The two significant components of the working capital formula are based on 30 days applied to total revenue applicable to providing the Reference Services and 20 days applied to the payment of both capital and operating costs incurred to provide the Reference Services.

326. However, as the Authority noted in the Draft Decision, the Reference Tariff model provided by AGN as additional information assumed 35 days for receipt of revenue and 20 days for payment of capital and operating costs in respect of Reference Services.

327. The Authority also noted AGN's proposal to amend the terms and conditions for the provision of Reference Services in its proposed revised Access Arrangement, by reducing the period for payment of invoices from 15 business days to 10 business days. As indicated elsewhere in the Draft Decision the Authority proposed to approve the reduced period for payment of invoices. In these circumstances, the Authority considered that, for the purposes of determining working capital, the assumed period for receivables would be more appropriately set at 20 days, which would also be consistent with AGN's assumed period for the payment of creditors.

328. The effect of the Authority's approach in the Draft Decision was to reduce the return on working capital to approximately $400,000 p.a. (expressed in dollars of 31 December 2004). This compared to approximately $1.0 million p.a. (dollars of 30 June 2003) proposed by AGN as set out in its proposed Access Arrangement Information as originally submitted in March 2004.

Final Decision

329. AGN did not make any submission in response to the Draft Decision concerning working capital. However, in the revised Access Arrangement Information submitted on 27 May 2005, AGN maintained the position it had taken in the Access Arrangement Information as originally submitted without accepting or otherwise addressing the different position taken by the Authority in the Draft Decision.

330. The explanation of AGN's approach to this issue is set out at section 4.2.11 of the revised Access Arrangement Information submitted on 27 May 2005. Further, the return on working capital calculated by adopting that approach is set out in Table 4.16 of the revised Access Arrangement Information as a component of AGN's Total Revenue for the second Access Arrangement Period. The amounts set out in Table 4.16, and the calculations in respect of working capital in AGN's relevant models, are unchanged.

[27] AAI, p 54.

331. With respect to the amount claimed as part of the Total Revenue, the Authority, below, has required AGN to amend Table 4.16 including the return on working capital to give effect to the Authority's approach as set out in this Final Decision. However, there remains a need for section 4.2.11 of the Access Arrangement Information, which outlines AGN's different approach to calculating the return on working capital, to be amended so that it accurately reflects the manner in which the Authority has determined working capital as set out above. The Authority, therefore, requires the following amendment.

Final Decision Amendment 8

Section 4.2.11 of the revised Access Arrangement Information submitted on 27 May 2005, concerning the return on working capital, should be amended to accord with the method adopted by the Authority in this Final Decision for determining the return on working capital.

Rate of Return

Draft Decision (Amendments 22 & 23)

332. Under the Cost of Service method, the Total Revenue recoverable through Reference Tariffs includes an allowance for a return on the Capital Base. This allowance recovers the opportunity cost of capital invested, including by owners. In determining a Reference Tariff the Rate of Return used to calculate the return on the Capital Base should be commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service.

333. Sections 8.30 and 8.31 of the Code state the principles for establishing the Rate of Return used in determining a Reference Tariff:

> 8.30 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).
>
> 8.31 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 Relevant Regulator is satisfied that to do so would be consistent with the objectives contained in section 8.1.

334. In the proposed revised Access Arrangement, AGN determined a real pre-tax Rate of Return using the 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 GDS. As with the current Access Arrangement, the relevant WACC was estimated using the Capital Asset Pricing Model (**CAPM**).

335. The CAPM is used to estimate the required nominal post-tax return to the equity share of an asset, with the most common formulation of the CAPM for this purpose being:

$$R_e = R_f + \beta_e (R_m - R_f)$$

where R_f is the risk free rate, $(R_m - R_f)$ is the expected risk premium above the risk free rate for a well-diversified portfolio of equities (R_m), β_e is the measure of the particular equity's relative risk, or its equity beta, and R_e is the required rate of return on that equity.

336. The outcome of this model is an estimate of the required nominal post-tax return to equity. The return required by the other source of financing – debt – can be observed directly from the market for debt finance. The average of these sources of financing (weighted by the respective shares of debt and equity in the financing of the asset) provides an estimate of the WACC for the asset. That is:

$$WACC = R_e \frac{E}{V} + R_d \frac{D}{V}$$

where $\frac{E}{V}$ and $\frac{D}{V}$ are equity and debt as shares of total assets (V), and R_d is the cost of debt.

337. There are a number of different versions of the post-tax WACC that are derived by transferring one or more of the particular costs or benefits from the cash flows to inclusion in the WACC formula. One popular form is the "Officer" nominal post-tax WACC, which AGN has adopted in accordance with the KPMG Report. The Officer form takes account of corporate income tax and the value of franking credits, and has the following formula:

$$WACC = R_e \cdot \frac{E}{V} \cdot \frac{1 - t_c}{(1 - t_c(1 - \gamma))} + R_d \cdot \frac{D}{V} \cdot (1 - t_c)$$

where t_c is the corporate tax rate and γ is the value of franking credits created (as a proportion of their face value).

338. The Rate of Return originally proposed by AGN for the proposed revised Access Arrangement is a real pre-tax WACC of 8.5 percent p.a. calculated using the CAPM as described above. This compared with the Rate of Return of 7.5 percent p.a. approved for the current Access Arrangement.

339. AGN based its proposed Rate of Return upon advice provided by KPMG as a consultant to AGN as to relevant parameters and inputs. The advice was contained in a report by KPMG entitled "The Weighted Average Cost of Capital for Gas Distribution", dated March 2004 (**KPMG Report**), which was Schedule 1 to the Access Arrangement Information as originally submitted.

340. To assist the Authority in considering AGN's proposed Rate of Return, and the KPMG Report, and in the absence of any other public submissions on the Rate of Return, the Authority commissioned the Allen Consulting Group (**ACG**) prior to the Draft Decision to advise on the estimation of WACC. ACG's advice was set out in a report to the Authority entitled "Allen Consulting Group Analysis of Alinta Network's Weighted Average Cost of Capital for Gas Distribution in the second

Access Arrangement Period", dated 28 May 2004 (**ACG Rate of Return Report**). The ACG Rate of Return Report was published at the time of release of the Draft Decision.

341. Based upon this material and other relevant information, the Authority was not satisfied in its Draft Decision that the proposed revised Access Arrangement in its treatment of Rate of Return was consistent with the provisions of sections 8.30 and 8.31 of the Code. This was because the Authority considered that certain of the values used by AGN to determine the Rate of Return were not consistent with the Authority's views regarding the bounds of the range of values that would reflect a return commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Services.

342. A comparison of the values used by AGN to determine the Rate of Return with those that the Authority considered in its Draft Decision to be commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Services, was set out in the Draft Decision[28]. The following Table 5 reproduces the relevant values.

Table 5: Input Parameters for the Calculation of Rate of Return for Draft Decision

Parameter	Column 1 AGN (at 31 March 2004)	Column 2 Authority (at 31 January 2005)
Risk free rate (nominal)*	5.9 percent	5.34 percent
Risk free rate (real) *	3.6 percent	2.72 percent
Market risk premium	7.0 percent	6.00 percent
Equity beta	1.0	1.00
Cost of debt margin*	1.4 > 1.8 percent	1.125 percent
Corporate tax rate	30 percent	30 percent
Franking credit value	0.3->0.5	0.50
Debt to total assets ratio	60 percent	60 percent
Expected inflation (implied)*	2.2 percent	2.55 percent

343. In its Draft Decision the Authority noted that the values marked * in Table 5 of the Draft Decision would be updated to reflect market conditions at the time of the Final Decision.

344. Adopting the input parameters set out in Table 5 above, the Authority calculated the WACC for the purpose of determining the return on capital for the Draft Decision. The WACC values calculated by the Authority for the purpose of the Draft Decision are reproduced in Table 6 below[29].

[28] See Table 19 of Draft Decision, p 78.

[29] See Table 20 of Draft Decision, p 78.

Table 6: WACC and Return on Equity for Draft Decision (as at 31 January 2005)

WACC and Return on Equity	Nominal	Real
Post-Tax (Officer)	6.45 percent	3.80 percent
Pre-tax (forward transformation of Officer WACC)	9.22 percent	6.50 percent
After-Tax Return on Equity	11.34 percent	8.57 percent

345. On the above basis the Authority concluded in the Draft Decision that a real pre-tax WACC of 6.50 percent would be commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Services. The Authority required the following amendments accordingly:

> **Amendment 22**
>
> The pre-tax weighted average cost of capital referred to at page 49 of the submitted Access Arrangement Information should be amended from 8.5 percent to 6.50 percent.
>
> **Amendment 23**
>
> The submitted Access Arrangement Information should be amended to include the values as set out in Column 2 of Table 19 in this Draft Decision as the values for determining the Rate of Return for the revised Access Arrangement.

Final Decision

346. AGN has not accepted the requirement to amend the Access Arrangement Information to meet Amendments 22 and 23 of the Draft Decision in relation to the Rate of Return. In response to the Draft Decision, AGN has made further submissions in relation to a number of aspects of the Rate of Return.

347. For the purposes of this Final Decision, in light of AGN's further submissions, the Authority has considered further the parameters of the CAPM and ranges of values that may reasonably be applied to these parameters. Appendix 3 to this Final Decision sets out in detail the various elements and parameters of the CAPM model, the position taken by AGN and the views of the Authority on each.

348. For the purpose of this Final Decision the Authority has given consideration to the analysis in Appendix 3 of this Final Decision to the determination of an appropriate Rate of Return.

349. In this context it is necessary to address certain aspects of AGN's submission in response to the Draft Decision dated 21 March 2005. In paragraphs 59 to 65 of that submission under the heading "*The Propose Respond Model in Gas*", AGN outlined an argument that the Authority's approach to the assessment of the WACC in the Draft Decision was inconsistent with sections 8.30 and 8.31 of the Code, and in particular, the approach to the application of those sections as outlined by the Australian Competition Tribunal in *Application by GasNet Australia (Operations) Pty Ltd*[30] *(Re GasNet).*

[30] [2003] A CompT6.

350. The thrust of AGN's submission is that Australian Competition Tribunal in *Re GasNet* decided that it is not part of the Regulator's task to make findings as to a particular Rate of Return. AGN outlined its submission as to the correct approach as follows (see paragraph 65 of the submission):

> The more important issue, however, is that the ERA's task is to assess whether the rate of return proposed by AGN falls within the range of rates commensurate with the prevailing market conditions and the relevant risk. In relation to those CAPM parameters that are directly observable in the market place (eg the risk free rate), AGN accepts that the ERA should generally require AGN to update the AGN submission for the latest available information, provided that information is consistent with a reasonable estimate of the forward looking costs that the service provider will incur. However, in relation to those CAPM parameters which are not directly observable, the ERA's approach should be to test whether AGN's proposal falls within a reasonable range. In contrast, AGN submits that the ERA has in fact gone further than this and, contrary to the finding of the Tribunal referred to above, has tried to determine specific inputs and a specific rate of return.

351. The Authority notes that it is AGN's position as outlined in the submission above that the CAPM parameters where the Relevant Regulator must consider a range of values are those not directly observable from the market, which presumably is a reference to the market risk premium, equity beta, cost of debt margin and franking credit value. In relation to two of these parameters – the market risk premium and the cost of debt margin – and contrary to AGN's submission, the Draft Decision was explicit that the point value referred to in the Draft Decision and used to determine the Rate of Return represented the upper bound of a range of reasonable values, rather than a single point value to the exclusion of others within a reasonable range.

352. That being said, in view of AGN's submission that the Authority is obliged to accept a Rate of Return proposed by AGN if the proposed value is within a possible range for the Rate of Return, the Authority has considered this matter for the purpose of the Final Decision.

353. In *Re GasNet*, the Tribunal found that in respect of a case where the Australian Competition and Consumer Commission had refused to approve a proposed Access Arrangement because of the approach that had been adopted by the Service Provider in relation to the Rate of Return that:[31]

> … there is no single correct figure involved in determining the values of the parameters to be applied in developing an applicable Reference Tariff. The application of the Reference Tariff Principles involves issues of judgement and degree. Different minds, acting reasonably, can be expected to make different choices within a range of possible choices which nonetheless remain consistent with the Reference Tariff Principles. Where the Reference Tariff Principles produce tension, the Relevant Regulator has an overriding discretion to resolve the tensions in a way which bests reflects the statutory objectives of the Law. However, where there are no conflicts or tensions in the application of the Reference Tariff Principles, and where the [Access Arrangement] … proposed by the Service Provider falls within the range of choice reasonably open and consistent with the Reference Tariff Principles, it is beyond the power of the Relevant Regulator not to approve the proposed [Access Arrangement] … simply because it prefers a different [Access Arrangement] … which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law.

[31] *Re: GasNet*, paragraph 29.

354. The Authority accepts that its task is to consider whether the Rate of Return used for the derivation of Reference Tariffs in the revised Access Arrangement falls within the range of rates commensurate with the prevailing market conditions and the relevant risk. This Rate of Return will comply with the Code if the value used is within the range of values that different minds acting reasonably might attribute to the Rate of Return, applying the methodology of the CAPM that was chosen by AGN.

355. In undertaking this task for the purpose of the Final Decision, the Authority has given consideration to the range of values within which the Rate of Return might be supported by reasonable minds as being commensurate with prevailing conditions in capital markets. For the purpose of this Final Decision the Authority has considered whether the value proposed by AGN for the Rate of Return for the proposed revised Access Arrangement as submitted on 10 June 2005 falls within that range.

356. Consistent with the general approach taken by AGN in its proposed revised Access Arrangement, the Authority has applied the CAPM to estimate the cost of capital for the AGN GDS. In doing so, the Authority has considered the parameters of the CAPM and ranges of values that may reasonably be applied to these parameters. As indicated above, this analysis has been set out in Appendix 3 to this Final Decision.

357. Based upon that analysis, the ranges that the Authority considers may reasonably be applied to parameters of the CAPM in estimating the Rate of Return for the AGN GDS for the purpose of this Final Decision are as follows.

Table 7: Reasonable CAPM parameter values for estimation of the rate of return for the AGN GDS

Parameter	Value
Risk free rate (nominal, percent)	5.15
Risk free rate (real, percent)	2.58
Expected inflation (percent)	2.51
Market risk premium (percent)	5.0 – 6.0
Equity beta	0.80 – 1.00
Cost of debt margin (percent)	1.310 – 1.455
Corporate tax rate (percent)	30
Franking credit value (γ)	0.3 – 0.6
Debt to total assets ratio (percent)	60
Equity to total assets ratio (percent)	40

358. The ranges in the estimated costs of equity derived from the limits in ranges in the values of the CAPM parameters are as follows.

Table 8: Estimated costs of equity derived from ranges in CAPM parameter values

Cost of Equity (percent)	Nominal	Real
Post-Tax	9.15 – 11.15	6.48 – 8..43
Pre-tax	10.40 – 14.11	7.70 – 11.32

359. The ranges in estimated WACC values corresponding to the ranges in the values of the CAPM parameters and ranges in the estimated cost of debt are as follows.

Table 9: Estimated WACC values derived from ranges in CAPM parameter values

Estimated WACC (percent)	Nominal	Real
Post-Tax (Officer)	5.62 – 6.73	3.04 – 4.12
Pre-tax (forward transformation of Officer WACC)	8.04 – 9.61	5.39 – 6.93

360. Having identified the upper and lower extremes of the range of values for the Rate of Return, it is appropriate to note the position taken by AGN in relation to the Rate of Return (or range of values for the Rate of Return) which the Authority ought specify in its Final Decision. This position is set out at paragraphs 135 to 139 of AGN's submission in response to the Draft Decision as follows:

> 135 In light of this discussion AGN considers that a range of WACC variables can be constructed to show upper and lower ranges that are within the ranges commensurate with the prevailing conditions of the market and the risks of the service.
>
> 136 A lower range can be provided by the ERA Draft Decision. AGN considers that an upper range could be constructed by the variables outlined above including revised figures for the MRP, the Cost of Debt, the Risk Free Rate and the Gamma. This is shown in the table below and represents a Real Pre Tax WACC of 8.17 percent.
>
> 137 AGN would suggest that an appropriate WACC would be the 75th percentile of the upper and lower bounds / a Real Pre Tax WACC of 7.75 percent:
>
> | | |
> |---|---|
> | Nominal Risk Free Rate | 5.7 percent |
> | Real Risk Free Rate | 3.3 percent |
> | Market Risk Premium | 7.0 percent |
> | Cost of Debt Margin | 1.36 percent |
> | Gamma | 35 percent |
>
> 138 The 75th percentile is chosen to be consistent with the Productivity Commission's concerns that regulatory pricing decisions should err on the side of the utility to encourage investment.
>
> 139 In a recent report the Commission stated:
>
> > *the Commission considers it appropriate to give particular weight to ensuring that investment in essential facilities is not jeopardised. While it is unarguable that access can promote investment in markets using the services of essential facilities, such investment is contingent on preserving incentives to build or expand those facilities in the first place.*

361. The Authority does not accept AGN's proposed approach as outlined in the above extract.

362. The Authority notes that applying the extremes of the Authority's ranges in CAPM parameter values and estimates of the cost of debt give rise to wide ranges in estimates of the WACC.

363. The Authority considers that the range of values that different minds acting reasonably could attribute to the cost of equity and WACC is narrower than the ranges that the extremes of ranges in CAPM parameters would suggest. An approach by a Service Provider to determination of the Rate of Return that adopted the highest value within the reasonable range for each of the relevant CAPM parameters would not, in the Authority's view, result in a value for the Rate of Return that different minds, acting reasonably, would attribute to the Rate of Return. Also, such an approach would be inconsistent with the nature of regulatory oversight because the incentive throughout the process of consideration of a Rate of Return would be for the Service Provider to contend for those values for each of the underlying parameters that would produce the highest rate of return. The process would be reduced to a consideration of what would be the highest possible Rate of Return rather than determining a best estimate of the Rate of Return on a reasonable basis.

364. Similarly it would not be reasonable for the Authority to make a determination based on, or implying, a Rate of Return at the lower extreme of the range.

365. Even allowing for the uncertainties associated with forming a judgement as to the range of values that different minds acting reasonably might attribute to the Rate of Return, the value proposed by AGN for the determination of the Reference Tariff set out in its proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision (7.75 percent real pre-tax) lies outside of the range of values that may be derived by the application of the extremes of values for each of the parameters (5.39 percent to 6.93 percent). Therefore, even without considering the precise limits for values that different minds, acting reasonably, would attribute to the Rate of Return, it is evident that a value close to or outside the limits of the range implied by these parameter values would result in a value of Total Revenue (and hence a Reference Tariff) that would not comply with the Code. Accordingly, the Authority is of the view that the Rate of Return proposed by AGN does not meet the requirements of the Code.

366. The Authority has given consideration to defining a reasonable range of estimates of the Rate of Return that would comply with the Code, which would be narrower than the range that may be derived by the application of the extremes of values for each of the parameters of the CAPM. However, while the Authority recognises that no reasonable person would adopt the extremes of this range, the Authority is of the view that there is no apparent rigorous statistical or other methodology for determining precisely at which point values close to the extreme values of the range do not reflect a reasonable view of the current market for funds.

367. As a result, the Authority is left determining subjective limits marked out by the standard of reasonableness and the extent to which different minds might reach different results. It is possible that there may be factors that indicate that the results might be skewed towards one end of the range or the other. However, the Authority has been unable to identify any such factors in this case.

368. Taking account of these matters, and noting that the Code requires the uncertainties associated with determining the Rate of Return to be bought into account in determining the Total Revenue, the Authority is of the view that the range of values that would comply with the Code should not include the values that lie within the lower 10 percent or upper 10 percent of the range that may be derived by the application of the extremes of values for each of the parameters of the CAPM. The range of values that the Authority considers would comply with the Code is therefore 5.55 percent to 6.78 percent, real pre-tax.

369. The Authority's consideration of the appropriate Rate of Return within this range to be used to determine Reference Tariffs, and the amendments necessary to meet the requirements of Amendments 22 and 23 of the Draft Decision, are set out below in the context of the Authority's final decision regarding Total Revenue.

Return on Capital

Draft Decision (Amendment 24)

370. In the proposed revised Access Arrangement as originally submitted AGN proposed that the return on the Capital Base to be allowed would be the product of the real pre-tax Rate of Return and the average of the opening and closing values of the assets comprising the GDS for each year[32]. The proposed return on the Capital Base for each year of the second Access Arrangement Period was set out in Table 4.8 of the originally submitted Access Arrangement Information accordingly.

371. The averaging approach in the proposed revised Access Arrangement as originally submitted by AGN to determine the return is the same as the approach approved by the Relevant Regulator for the first Access Arrangement Period[33].

372. In the Draft Decision, the Authority noted that in view of the Authority's decision not to accept mid-year timing for Depreciation[34] it would be appropriate to depart from the averaging of opening and closing values. Rather, the Rate of Return should be applied to the opening value of the assets comprising the Capital Base for each year of the second Access Arrangement Period.

373. In Table 21 of the Draft Decision the Authority set out its calculation of the return on the Capital Base (excluding working capital) for each year of the second Access Arrangement Period. The values set out in Table 21 differed from those set out in Table 4.8 of the Access Arrangement Information as originally submitted. A significant contributing factor was the difference between the Rate of Return proposed by AGN as compared with that used in the Draft Decision. Further, a large part of the difference between the Authority's and AGN's Rate of Return resulted from reductions in risk free rates within financial markets since the date of the

[32] AAI, p 47.

[33] *AlintaGas's Access Arrangement Information for the South-West and Mid-West Gas Distribution Systems* , 13 July 2000, para 3.4.

[34] See above, paragraph 205.

original submission by AGN of the proposed revised Access Arrangement[35]. An amendment to the Access Arrangement Information as originally submitted was required as follows:

> **Amendment 24**
>
> Table 4.8 of the Access Arrangement Information should be amended to reflect the Authority's calculation of the return on the Capital Base for each year of the second Access Arrangement Period as set out in Table 21 of this Draft Decision.

Final Decision

374. AGN did not accept the requirement to amend in accordance with Amendment 24 of the Draft Decision in view of its non-acceptance of the Authority's required amendments with respect to the Rate of Return to apply for the second Access Arrangement Period. Table 4.10 of the revised Access Arrangement Information submitted on 27 May 2005 sets out AGN's proposed return on the Capital Base for the second Access Arrangement Period.

375. Having regard to the Authority's final decision that a Rate of Return different to that proposed by AGN is appropriate and the amendments necessary to meet the requirements of Amendment 24 of the Draft Decision, the Authority's consideration of the appropriate return on the Capital Base is set out below in the context of the Authority's final decision regarding Total Revenue.

Non Capital Costs

376. Sections 8.36 and 8.37 of the Code provide for the recovery of Non Capital Costs through the Reference Tariff as follows:

> 8.36 Non Capital Costs are the operating, maintenance and other costs incurred in the delivery of the Reference Service. Non Capital Costs may include, but are not limited to, costs incurred for generic market development activities aimed at increasing long-term demand for the delivery of the Reference Service.
>
> 8.37 A Reference Tariff may provide for the recovery of 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.

377. In addition, section 8.2(e) of the Code provides:

> The factors about which the Relevant Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff Policy are that:
>
> …
>
> (e) any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis.

[35] To illustrate the impact of the fall in interest rates on the rate of return and total revenue, the Authority estimated that using the interest rates at the time AGN originally submitted the proposed revisions, the Authority's rate of return would rise to 7.43 percent which would correspond to additional revenue to AGN amounting to $26.1 million in present value terms using a 6.5 percent discount rate.

378. Clause 27 of Part B of the Reference Tariff Policy in the proposed revised Access Arrangement as originally submitted provided as follows:

> (1) The Reference Tariffs provide for the recovery of all forecast Non-Capital Costs to the extent permitted under section 8.37 of the Code.
>
> (2) Without limiting Part B, subclause 27(1) the [Full Retail Contestability] Costs that are incurred, or expected to be incurred, in the delivery of the Reference Services, are included in the Non-Capital Costs.

379. In the Access Arrangement Information as originally submitted, AGN presented a comparison of Non Capital Costs approved for the first Access Arrangement Period with those actually incurred.[36]

380. Based upon this data, AGN submitted that it has spent substantially more on operating and maintaining the GDS than was projected for the first Access Arrangement Period[37]. The reasons given for this by AGN were as follows:

> Significant restructuring costs were incurred in addition to [regulatory forecasts]. These restructuring costs have enabled AGN to achieve the level of efficiencies made. Without them, AGN's Non-Capital Costs would likely have remained close to the actual 2000-2001 levels.
>
> The outcome of this restructuring has seen an underlying cost improvement of $5.7m from 2000 to 2004 (2004 forecast included $0.65m for FRC). This compares favourably with the regulatory benchmark improvement of $2.8m. This improvement in AGN's efficient cost base will be passed onto consumers in the Second Access Arrangement Period[38].

381. Based upon these comments, AGN submitted that it would be appropriate for the Authority to infer that its actual operating expenditure is efficient for the purpose of satisfying the requirements of section 8.37 of the Code, because under these regulatory arrangements, distributors have a commercial incentive to minimise expenditure levels. It was also submitted that it is important for AGN to demonstrate to all stakeholders that its actual expenditure is efficient[39]. AGN added that it has not received, nor will it receive, any compensation for overspending against its benchmarks in the first Access Arrangement Period[40].

382. In the Draft Decision, the Authority recognised that Service Providers face substantial incentives to be efficient. However, the Authority did not accept that it would be appropriate, having regard to its responsibilities under the Code, to infer, simply from the existence of such incentives, that AGN's current operating and maintenance costs are efficient.

383. In the Access Arrangement Information as originally submitted, forecast Non Capital Costs for each year of the second Access Arrangement Period were grouped into six categories:

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[36] AAI, Table 4.10, p 55.

[37] AAI, p 54.

[38] AAI, p 55.

[39] AAI, p 55.

[40] AAI, p 55.

- network costs;
- unaccounted for gas (**UAFG**);
- corporate costs;
- marketing costs;
- information technology (**IT**) costs; and
- Full Retail Contestability (**FRC**) costs[41].

AGN provided forecast Non Capital Costs in each of these categories.

384. In the Draft Decision the Authority considered whether AGN had satisfied the requirements of section 8.37 of the Code in relation to its forecast Non Capital Costs by reference to these six categories. The following discussion sets out the Authority's Draft Decision, AGN's response to the Draft Decision, the Authority's Final Decision in relation to each category of forecast Non Capital Costs and the amendments required to give effect to the Final Decision.

Network costs

Draft Decision

385. In its Access Arrangement Information as originally submitted, AGN proposed two changes in the scope of its network operations. The impact of these scope changes would be to increase network Non Capital Costs by $1.4 million. The first of these scope changes was the introduction by AGN of a Guaranteed Service Level (**GSL**) scheme[42] at a forecast cost of $0.1 million p.a. The second was a proposed new regulatory requirement for land clearing permits at a forecast cost of $1.3 million p.a.

386. AGN's estimated cost of land clearing permits of $1.3 million p.a. was based upon an understanding that each permit would cost $50, and that a total of 26,000 permits p.a. would be required.[43]

387. With the new regulatory arrangements having now been put in place, the Authority was advised prior to the Draft Decision by the Department of Environment[44] that infrastructure service providers such as electricity and gas utilities would be able to obtain an activity permit that covers the large bulk of routine clearance activities. While some individual clearance works such as for installation of gas mains through reserves or parklands would require individual permits, these were expected to be few in absolute terms. No precise estimate of the final number and type of permits was available at the time of the Draft Decision, but indications were that total permit costs for AGN would be unlikely to exceed $0.01 million.

[41] AAI, Table 4.11, p 56.

[42] The details of the proposed GSL scheme were set out at pp 33-33 of the AAI.

[43] AAI, p 57.

[44] Incorrectly referred to as the Environmental Protection Authority in the Draft Decision, para 378.

388. Accordingly, the Authority considered in its Draft Decision that the allowance made by AGN in respect of the change in scope relating to regulatory arrangements involving land clearing permits should be reduced to reflect the arrangements actually adopted.

389. In relation to the cost of the proposed GSL scheme, given the modest cost of this scope change, and the potential for it to enhance service levels for Users and consumers of gas, the Authority accepted the change in scope.

390. In relation to forecast Network Costs for the second Access Arrangement Period, AGN had forecast that:

- apart from the scope change for GSL and regulatory permits, and an increase in FRC costs, there would be no change in network costs for 2005 as compared with actual costs in 2004 (in real terms);
- for years two and three of the second Access Arrangement Period (2006 and 2007), there would be a total fall in network costs of $1.7 million (in real terms); and
- Non Capital Costs, including network costs, would remain constant in real terms for the final two years (2008 and 2009) of the second Access Arrangement Period.

391. AGN submitted in its Access Arrangement Information as originally submitted that two independent benchmarking studies "demonstrate that the company's proposed operating cost benchmarks for the second Access Arrangement Period meet the requirements of section 8.37 of the Code."[45]

392. However, as the benchmarking studies provided by AGN did not address the forecasts of Non Capital Costs, including network costs, the Authority was unable to accept for the purpose of the Draft Decision that these studies would provide a sufficient basis for the Authority to accept that these costs comply with the Code.

393. In order to gain a better appreciation of AGN's forecast Non Capital Costs, including network costs, the Authority therefore had regard to additional evidence as follows:

- confidential data on current unit costs for AGN's operations, maintenance and capital works activities;

[45] AAI, p 55. The results of the benchmarking studies were set out in section 4.3.11 at pp 60-61 of the AAI. Details of the studies, which were provided on a confidential basis, were:

(a) A report by PA Consulting entitled "Review of Operating and Maintenance Costs" and dated 18 March 2004 (**PA Consulting Report**). The PA Consulting Report compared AGN unit cost estimates for 2004 for some of the major categories of Non Capital Costs with unit cost information publicly available for mid-2003 for four of the gas distributors in the eastern states of Australia.

(b) A report by GTL International is entitled "Study of Alinta Gas Benchmark Data" and dated 25 March 2004 (**GTL Report**). The GTL Report compared AGN unit cost estimates for 2004 for a number of field operations that are involved in the operations and maintenance function and/or in the capital works area, against data available for some gas distributors in the UK.

- existing accounting audits of AGN's historic capital and Non Capital Costs;
- advice and assistance from the Director of Energy Safety (as provided for under section 37(4) of the *GPAA*);
- audited financial information available to the Authority as the licensor of AGN as a gas distributor; and
- information on AGN's existing contracts for the supply of operating and maintenance services.

394. On the basis of the information available, and as submitted by AGN, the Authority recognised that the overall decline in Non Capital Costs, including network costs, over the first Access Arrangement Period reflected, at least in part, the achievement of operational efficiencies.

395. The Authority also noted in its Draft Decision that in the recent draft decision by IPART on the revisions to the Access Arrangement for the AGL gas distribution system, IPART referred to a report by the Energy Consulting Group (**ECG**), commissioned by IPART to investigate trends in productivity gains in the gas industry[46]. In relation to ECG's report, IPART had noted as follows:

> It concluded that these gains had slowed dramatically, and that the 3 per cent per annum efficiency saving implied in [IPART's] final decision on the current access arrangement could not be sustained. It also considered AGLGN's forecast increase in customer numbers and the productivity gains that might be expected from proposed capital expenditure on renewing mains, increasing residential meter replacement and upgrading IT systems. Based on its findings, ECG reported that AGLGN's proposed real efficiency saving of 1.5 per cent per annum after allowing for growth was reasonable.

396. The Authority also noted in its Draft Decision that the ESC in its final decision at the end of 2002 for the three major Victorian gas distribution systems concluded that a general productivity factor of 1 percent would be reasonable for all Non Capital Costs over the final three years (2004-2007) of Access Arrangements in Victoria.

397. The Authority noted further that AGN forecast significant productivity improvements in network costs in the early years of the second Access Arrangement Period (2006-2007). However, on average, productivity improvement over the full five years of the Access Arrangement Period, was much reduced. That is, the average efficiency gains for network costs were 1.4 percent p.a. It was also noted that no efficiency gains had been provided for in the final two years of the second Access Arrangement Period (2008-2009).

398. Having regard to all of the information available, the Authority considered that AGN's forecasts of network costs complied with section 8.37 of the Code, except in relation to those for the final two years of the second Access Arrangement Period. In respect of these final two years the Authority considered that provision for efficiency gains in network costs of 1 percent p.a. (in real terms) for each of these two years would be consistent with the provisions of section 8.37.

[46] IPART, December 2004, *Draft Decision, Revised Access Arrangement for AGL Gas Networks*, p 91.

Final Decision

399. In response to the Draft Decision, AGN accepted the Authority's conclusion that the proposed scope change in network costs in respect of land clearing permits was not warranted. The Authority is satisfied that AGN has amended its forecasts of network costs accordingly.

400. However, in relation to the Authority's Draft Decision requiring that AGN's forecast network costs to provide for efficiency gains in network costs of 1 percent p.a. (in real terms) for each of the final two years of the second Access Arrangement Period, it appears to the Authority that the revised Access Arrangement Information does not incorporate this adjustment, such that there is a need for consequential amendment to the relevant forecasts in the Access Arrangement Information (see below).

401. The Authority also notes that the revised Access Arrangement Information submitted by AGN on 27 May 2005 incorporates forecast network costs associated with heating value management. As appears from this Final Decision in relation to the Interconnection Service, it is now AGN's proposal (and the Authority has accepted) that any heating value management costs (including Non Capital Costs) will be recovered through the Trigger Event Adjustment Mechanism referred to above. As a consequence there is also a need for AGN to amend its revised Access Arrangement Information to remove heating value management costs from its forecast network costs (see below).

Unaccounted for gas

Draft Decision

402. Unaccounted for gas (**UAFG**) is the difference between recorded gas inflows at receipt points into the GDS and reported outflows at delivery points from the GDS. It includes the effects of metering inaccuracies, metering errors, operational losses from leakage, third party damage, blow-down and purge during maintenance and commissioning, line pack changes, and theft.

403. For the current Access Arrangement, the Relevant Regulator approved a decline in UAFG as a proportion of total gas delivered from the GDS from 2.7 percent to 2.5 percent over the first Access Arrangement Period[47]. However, for the purpose of the proposed revised Access Arrangement as originally submitted, AGN projected the proportion of UAFG for 2005 to be 2.7 percent and 2.8 percent for each of the remaining years of the second Access Arrangement Period (2006-2009)[48].

404. In its Draft Decision, in considering a best estimate of UAFG arrived at on a reasonable basis as provided for in section 8.2(e) of the Code the Authority had regard to the following information:

[47] Independent Gas Pipelines Access Regulator Western Australia, 30 June 2000, *Final decision for the South-West and Mid-West Gas Distribution Systems*, pp 98-99.

[48] AAI, p 58.

- Table 5.1 of the NIEIR Report (March 2004) provided by AGN to the Authority in confidence presents actual and predicted figures for total gas inflow and the total distribution losses (i.e. UAFG) for the years 1997 to 2012.

- AGN's gas licence data (Gas Distribution Licence 2, GDL2) for the 2001 to 2004 financial years.

405. On the basis of the information available, the Authority considered in its Draft Decision that 2.5 percent of gas received would be a best estimate of annual UAFG arrived at on a reasonable basis.

406. In translating the annual proportion of UAFG into a monetary value, the Authority also had regard to the PA Consulting Report provided by AGN.

407. On the basis of the information referred to in paragraphs 405 and 406, the Authority estimated that the annual cost of replacing UAFG would be reduced by approximately $0.3 million per annum (dollars at 31 December 2004) from that forecast in AGN's Access Arrangement Information as originally submitted.

Final Decision

408. AGN has not accepted the Authority's Draft Decision that 2.5 percent of gas received would represent a best estimate of UAFG. Rather, in the revised Access Arrangement Information submitted on 27 May 2005, AGN has continued to use the percentages for UAFG which were used to forecast UAFG cost in the original Access Arrangement documentation (see Table 4.15 on page 60).

409. Further, the Authority notes that the revised Access Arrangement documentation submitted by AGN following the Draft Decision is internally inconsistent in that total volumes are forecast to increase, whereas the cost of UAFG is forecast to remain constant based upon a constant percentage of volume.

410. In the circumstances, the Authority is not satisfied that AGN's re-forecast represents a best estimate and proposes to maintain the position expressed in the Draft Decision in relation to UAFG expenditure forecasts, and base forecast UAFG costs on 2.5 percent of gas received over the second Access Arrangement Period.

411. In determining forecast UAFG costs, the Authority has had regard to further information as to AGN's actual UAFG expenditure for 2004 revealed as part of an audit of all operating expenditure for the year 2004, actual percentage of UAFG for 2004, actual volume delivered in 2004 and the total forecast volume as determined by the Authority. The Authority's re-forecast of Non Capital Costs, including UAFG costs, below has been calculated accordingly. The cost of UAFG over the five year period determined by the Authority is higher than AGN's proposed forecast cost.

Regulatory Costs

Draft Decision

412. Under AGN's proposed revisions as originally submitted, the Authority was required to give consideration to AGN's Regulatory Costs as part of its consideration of a

Reference Tariff Control Formula Approach under section 8.3(c), whereby Reference Tariffs are to be adjusted for variations in Regulatory Costs during the second Access Arrangement Period. This matter was considered by the Authority as described below[49].

413. During the assessment process prior to the Draft Decision, the Authority sought clarification from AGN about forecast Regulatory Costs and was informed that regulatory costs of approximately $0.7m per annum had been included in forecast Non-Capital Costs in the corporate costs category.

414. The Authority considered that forecast Regulatory Costs should be disaggregated from other categories of Non Capital Costs, so that the costs involved would be clearly identified for the purpose of any tariff adjustment mechanism so that the effect of any variation may be readily understood by interested parties.

415. Therefore, an amendment to the Access Arrangement Information was required so that Regulatory Costs would be presented separately from other corporate costs. This requirement was addressed in Amendment 25 of the Draft Decision by requiring the relevant Table 4.11 of the Access Arrangement Information as originally submitted to include Regulatory Costs as a separate line item.

Final Decision

416. In relation to the Authority's requirement that Regulatory Costs be presented separately from other corporate costs, it appears the revised Access Arrangement Information submitted on 27 May 2005 does not reflect this. There is, therefore, a need for consequential adjustment to the relevant forecasts in the Access Arrangement Information (see below).

Corporate and IT Costs

Draft Decision

417. In its Draft Decision, the Authority noted that AGN's forecast Non Capital Costs included forecasts for Corporate and IT Costs.

418. The Authority considered the forecasts presented by AGN having regard to the relevant Code criteria. The Authority noted that the forecasts for Corporate Costs had increased substantially from the forecasts approved for the first Access Arrangement Period. The Authority had no reason to believe that the forecasts presented for these categories of Non Capital Costs did not comply with the relevant provisions of the Code. Therefore, the Authority proposed to accept the forecasts for the purpose of the Draft Decision. However, the Authority required further substantiation of the forecasts from AGN prior to making the Final Decision.

[49] See paragraphs 572 to 582 below.

Final Decision

419. Subsequent to the Draft Decision, in accordance with the Authority's request, AGN supplied a substantial report explaining its allocation of corporate and other shared costs, including IT costs. AGN also supplied detailed financial reports as to the costs which were subject to allocation. The information contained in the reports, as well as access to AGNs' financial records systems, were also provided by AGN to auditors appointed by the Authority to assist in substantiating AGN's corporate and IT cost forecasts.

420. Having regard to reports provided by auditors, the Authority is satisfied that AGN has substantiated its corporate and IT costs forecasts. However, the forecasts included in the revised Access Arrangement Information for corporate costs continue to include regulatory costs which, as indicated above, are to be disaggregated for the purpose of the Access Arrangement Information.

Marketing Costs

Draft Decision

421. In response to an information request by the Authority prior to the Draft Decision, AGN provided brief substantiation of its forecast of Non-Capital Costs for marketing. In this respect, AGN submitted that it should be allowed to continue to spend at historical levels on marketing activities that included advertising and sponsorship to promote the efficient use of gas, the promotion of gas appliances, and advice to industry concerning benefits of gas usage and gas appliances.

422. Section 8.36 of the Code expressly provides that Non Capital Costs may include, but are not limited to, costs incurred for generic marketing activities aimed at increasing long-term demand for the delivery of the Reference Service.

423. The Authority concluded for the purpose of the Draft Decision that AGN's forecast of Non Capital Costs for marketing, which are consistent with similar amounts committed in previous periods, represented a best estimate of anticipated marketing costs during the second Access Arrangement Period on a reasonable basis.

Final Decision

424. As indicated above, the Authority engaged auditors to review amongst other things AGN's operating expenditure for 2004. In that context, the auditors reviewed AGN's 2004 marketing costs, which had provided the basis for AGN's forecast marketing expenditure of $1.3 million p.a. (approximately) for the second Access Arrangement Period.

425. This review revealed that total actual marketing costs for 2004 were overstated by approximately $300,000.

426. By reason of this discrepancy there is a need for AGN's forecast expenditure in the marketing category to be adjusted accordingly.

FRC Costs

Draft Decision

427. AGN forecast FRC Non Capital Costs at a constant $1.3 million p.a. throughout the second Access Arrangement period in its Access Arrangement Information as originally submitted. Actual FRC Non Capital Costs incurred during 2004 have been reported by AGN at $0.6 million[50]. The increased forecast reflected the introduction of FRC on 31 May 2004 and an expectation by AGN of significantly increased operational costs attributable to compliance with FRC.

428. The Non Capital Costs comprising the forecast FRC costs, included costs associated with participation as the operator of the GDS in the Retail Market Scheme and interaction with REMCo as required under that scheme and by the Retail Market Rules.

429. The Authority noted in the Draft Decision that at this early stage of FRC implementation, there would be limited actual evidence on which to forecast FRC costs for the second Access Arrangement Period.

430. The Authority also noted that AGN had proposed a Trigger Event Adjustment Approach for the recovery of FRC costs that exceeded the costs already factored into Reference Tariffs during the second Access Arrangement Period.

431. In view of the uncertainty relating to the amount of FRC costs, and recognising that such costs are beyond AGN's direct control, the Authority considered in its Draft Decision that there may be justification for providing a Reference Tariff Variation Method which would enable account to be taken of variance in actual FRC Non Capital Costs from forecast. This matter was considered by the Authority separately in the context of a proposal by AGN for the inclusion of such a mechanism in the revised Access Arrangement.

Final Decision

432. Following the Draft Decision AGN's actual FRC Non Capital Costs for 2004 were reviewed by auditors as part of an audit of all operating expenditure to confirm it as an appropriate basis for AGN's Non Capital Cost forecasts.

433. This aspect of the audit confirmed AGN's FRC Non Capital Costs as reported for 2004 were accurate and therefore provided an appropriate basis for AGN's forecast costs in this category.

Required amendments

Draft Decision (Amendment 25)

434. Having regard to the Authority's conclusions regarding the various categories of forecast Non Capital Costs the Authority included in the Draft Decision a Table 23 which set out the Authority's calculation of forecast Non Capital Costs adjusting

[50] AAI, Table 4.12, p 57.

AGN's forecasts to take account of the Authority's conclusions. Given the Authority's departure from the approach taken by AGN in certain respects, there were differences between the values in Table 23 of the Draft Decision and Table 4.11 of the Access Arrangement Information as originally submitted which set out AGN's forecast Non Capital Costs by category of expenditure. The Authority therefore required AGN to amend Table 4.11 of the Access Arrangement Information to accord with the forecast Non Capital Costs shown in Table 23 of the Draft Decision (Amendment 25).

Final Decision

435. AGN's revised forecast Non Capital Cost by expenditure category in response to Amendment 25 of the Draft Decision is set out in Table 4.13 of the revised Access Arrangement Information submitted on 27 May 2005.

436. For reasons explained above in relation to individual categories of Non Capital Costs there is a need for Table 4.13 of the revised Access Arrangement Information to be amended to take account of the following adjustments:

- the provision of a productivity improvement of 1 percent per annum in relation to network costs for the final two years of the second Access Arrangement Period;
- the removal of forecast heating value management costs from the network costs category;
- the adjustment of UAFG expenditure forecasts to reflect the Authority's Final Decision above;
- the disaggregation of regulatory costs from the corporate costs category; and
- the reduction of marketing costs to more accurately reflect the audited actual costs for 2004.

437. The Authority has re-forecast AGN's revised Non Capital Costs to take account of the above. The re-forecast is set out in the following Table 10:

Table 10: Forecast Non Capital Costs for second Access Arrangement Period ($ millions; 31 December 2004)

	2005	2006	2007	2008	2009
Network	22.525	21.699	20.820	20.307	20.086
Corporate	5.030	5.030	5.030	5.030	5.030
IT	6.542	6.542	6.542	6.542	6.542
UAFG	2.928	3.042	3.145	3.136	3.175
Marketing	1.030	1.030	1.030	1.030	1.030
FRC	1.339	1.339	1.339	1.339	1.339

Regulatory Cost	0.739	0.741	0.744	0.748	0.748
Total	40.132	39.422	38.650	38.131	37.950

438. There is a need for the revised Access Arrangement Information as submitted on 27 May 2005 to be amended to accord with the forecast Non Capital Cost set out in Table 10 of this Final Decision. There is also a need for Table 4.15 of the Access Arrangement Information as submitted on 27 May 2005 to be amended to reflect the Authority's final decision regarding the forecast percentage of UAFG during the second Access Arrangement period. The Authority, therefore, requires the following amendment prior to final approval:

Final Decision Amendment 9

Table 4.13 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 should be amended to accord with the values for forecast Non Capital Costs for the second Access Arrangement Period set out in Table 10 of this Final Decision.

Final Decision Amendment 10

Table 4.15 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 should be amended to provide for forecast UAFG of 2.5 percent of gas received over the second Access Arrangement Period.

Calculation of Total Revenue

Draft Decision (Amendment 26)

439. The provisions of section 8.4 of the Code relevant to the calculation of Total Revenue are as follows:

> 8.4 The Total Revenue (a portion of which will be recovered from sales of Reference Services) should be calculated according to one of the following 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 or are otherwise used to provide Services (***Capital Base***);
>
> (b) depreciation of the Capital Base (***Depreciation***); and
>
> (c) the operating, maintenance and other non capital costs incurred in providing all Services (***Non Capital Costs***).
>
> **IRR**: The Total Revenue will provide a forecast Internal Rate of Return (IRR) for the Covered Pipeline that is consistent with the principles in sections 8.30 and 8.31. 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 this section 8.
>
> **NPV**: The Total Revenue will provide a forecast Net Present Value (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.
>
> 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 this section 8.
>
> The methodology used to calculate the Cost of Service, an IRR or NPV should be in accordance with generally accepted industry practice.
>
> However, the methodology used to calculate the Cost of Service, an IRR or NPV may also allow the Service Provider to retain some or all of the benefits arising from efficiency gains under an Incentive Mechanism. The amount of the benefit will be determined by the Relevant Regulator in the range of between 100 percent and 0 percent of the total efficiency gains achieved.

440. Section 8.6 of the Code as set out below is also relevant to the determination of Total Revenue.

> 8.6 In view of the manner in which the Rate of Return, Capital Base, Depreciation Schedule and Non Capital Costs may be determined (in each case involving various discretions), it is possible that a range of values may be attributed to the Total Revenue described in section 8.4. In order to determine an appropriate value within this range the Relevant Regulator may have regard to any financial and operational performance indicators it considers relevant in order to determine the level of costs within the range of feasible outcomes under section 8.4 that is most consistent with the objectives contained in section 8.1.

441. If the Authority has considered financial and operational performance indicators for the purposes of section 8.6 of the Code, section 8.7 requires the Authority to identify the indicators and provide an explanation of how they have been taken into account.

442. In the Draft Decision, in exercising the discretions conferred on the Authority with respect to Rate of Return, Capital Base, Depreciation Schedule and Non Capital Costs, the Authority in each case determined a value. In the case of the Rate of Return, the Authority determined a single value having regard to the range of values that may be attributed to the parameters used in determining an appropriate Rate of Return. As to other values brought to account in determining Total Revenue, there was not a substantial variation between the Authority's assessment and the values proposed by AGN. In those circumstances there was no range of values that the Authority carried forward into the determination of the Total Revenue and therefore no need to determine an appropriate value within the range of values for total revenue.

443. The components of Total Revenue are Non Capital Costs, a return on the Capital Base, Depreciation of the Capital Base and a return on working capital. In the Draft Decision, in each case, the Authority determined values that differed from those submitted by AGN for the reasons explained in the Draft Decision (and as referred to above in this Final Decision).

444. The Authority's revised values for each of the inputs to the calculation of Total Revenue were set out in tabular form in Table 24 of the Draft Decision. Table 24 set out, for each of 2005-2009, the Total Revenue as determined by the Authority disaggregated into Non Capital Costs, Depreciation, Return on Capital Base and Return on Working Capital.

445. In the Draft Decision, the Authority noted that the present value of the Total Revenue determined by the Authority for the second Access Arrangement Period as set out in Table 24 was $454.78 million (dollars at 31 December 2004). This figure was derived using a discount rate of 6.50 percent, which was the WACC determined by the Authority in the Draft Decision. This compared with a present value of the Total Revenue proposed by AGN of $520.01 million (dollars at 31 December 2004) calculated using the same discount rate.

446. AGN's Access Arrangement Information as submitted prior to the Draft Decision included Total Revenue which differs from that which the Authority had determined as outlined above. The Authority therefore required the following amendment to the Access Arrangement Information as originally submitted:

> **Amendment 26**
>
> Table 4.14 of the Access Arrangement Information should be amended to accord with the Authority's determination of Total Revenue for each year of the second Access Arrangement Period, as set out in Table 24 of this Draft Decision.

Final Decision

447. AGN has not accepted the requirement to amend in accordance with Amendment 26 of the Draft Decision. The principal difference between the position of the Authority and that of AGN relevant to the Total Revenue is the Rate of Return.

448. With respect to the Rate of Return AGN has not accepted the Authority's requirement to amend in accordance with Amendment 22 of the Draft Decision, which specified a pre-tax real WACC of 6.50 percent as the appropriate Rate of Return. Rather, as discussed above, AGN has proposed a range of appropriate values of between 6.50 and 8.17 percent, and has proposed that the Authority use a Rate of Return of 7.75 percent being the 75th percentile of that range. On the other hand, the Authority has indicated above that it regards the appropriate range of WACC values as between 5.55 and 6.78 percent, real pre-tax. Therefore, AGN has proposed a Rate of Return, and consequently proposes a return on the Capital Base and Total Revenue, higher than the range of values which the Authority has determined is consistent with sections 8.30 and 8.31 of the Code.

449. Section 8.6 of the Code contemplates that it is possible that uncertainties in each of the cost components of Total Revenue, including the Rate of Return, may cause a range of values to be attributed to Total Revenue in which event the Authority is required to determine the value of Total Revenue within this range that is most consistent with the objectives contained in section 8.1.

450. The Authority accepts that, in this instance, consideration of a range in values of Total Revenue is necessitated by uncertainty in the value of the Rate of Return and the

specification by the Authority for the purposes of the Final Decision of a range of values for the Rate of Return.

451. Section 8.1 provides that a Reference Tariff and Reference Tariff Policy (and hence the Total Revenue from which the Reference Tariff is derived) should be designed with a view to achieving the following objectives:

(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.

452. To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Authority may determine the manner in which they can best be reconciled or which of them should prevail, by reference to the factors set out in section 2.24 of the Code. The Authority sets out its consideration of each of the section 8.1 objectives as follows.

(a) The objective of 8.1(a) is to give the Service Provider the "opportunity" to earn a "stream of revenue" that recovers the efficient costs over the expected life of the assets used. Accordingly, a value higher in the range of Total Revenue would provide greater assurance that this objective would be met.

(b) In the Epic Decision, the Supreme Court held that section 8.1(b) refers to a "workably competitive market", being a market in which past investments and risks taken may provide some justification for prices above the efficient level. However, there is no evidence before the Authority that such circumstances exist in this case so this factor would point to a lower value in the range of Total Revenue, reflecting the efficient cost of Service provision.

(c) With respect to section 8.1(c), there is no evidence to suggest that any values within the range of values of Total Revenue under consideration by the Authority would not enable the safe and reliable operation of the distribution system.

(d) Section 8.1(d) has two limbs: firstly an objective of not distorting investment decisions in pipeline transportation systems, and secondly in not distorting investment decisions in upstream and downstream industries:

(i) The Authority is of the view that the objective of first limb of section 8.1(d) would tend to be satisfied by higher values in the range of possible values for Total Revenue, consistent with a conservatively high estimate of the Rate of Return and seeking to ensure that the Service Provider obtains a sufficient return to motivate investment.

(ii) The second limb of section 8.1(d) is concerned with not distorting investment decisions in upstream and downstream industries. To the extent that a higher value of Total Revenue risks resulting in a price for pipeline Services that is in excess of efficient costs, this objective would point to lower values within the range of possible values for Total Revenue.

(e) Section 8.1(e) is concerned with the interests of Users and Prospective Users and would tend to point to a lower value in the range, although this is tempered by a consideration of the longer term interests of Users and Prospective Users that require a level of Total Revenue consistent with motivating investment by the Service Provider in ongoing investment in the pipeline and which may point to higher values within the range, consistent with the objective of the first limb of section 8.1(d) as set out above.

(f) Section 8.1(f) is concerned with provision of incentives to a Service Provider to reduce costs and develop the market for pipeline Services. Such incentives arise from the structure of the Reference Tariff and Incentive Mechanisms in the Reference Tariff Policy, and do not point to any particular value of Total Revenue.

453. Given that the objectives in section 8.1 conflict in their application to the determination of the Total Revenue, the Authority must determine the manner in which they can best be reconciled, or which of them should prevail, by reference to the factors in section 2.24(a) to (g). The Authority's consideration of these factors is as follows:

(a) Section 2.24(a) is concerned with the Service Provider's legitimate business interests and investment in the pipeline and, in accordance with the objectives of sections 8.1(a) and (d) (first limb), would point to higher values in the range of Total Revenue.

(b) Section 2.24(b) relates to firm and binding contractual obligations of the Service Provider. No issue is raised as to the firm and binding contractual obligations of AGN in this case, so section 2.24(b) does not assist in the reconciliation of the section 8.1 objectives.

(c) Section 2.24(c) relates to requirements for the safe and reliable operation of the pipeline. For the reasons referred to above in relation to section 8.1(c), section 2.24(c) does not assist in determining an appropriate value for Total Revenue in this case.

(d) Section 2.24(d) directs attention to the "economically efficient" operation of a pipeline. This factor is consistent with the objectives of sections 8.1(b), (d) (second limb) and (e) and a lower value of Total Revenue.

(e) Section 2.24(e) relates to the public interest, including the public interest in having competition in markets. For the AGN GDS, there is some public interest in further investment in additional interconnections between with the GDS and the Parmelia Pipeline to stimulate upstream competition, and enhanced entry into retail markets by Users to stimulate downstream

competition. To this extent, section 2.24(e) is therefore generally consistent with the objective of section 8.1(d) (first limb) and a lower value of Total Revenue. While there is a public interest in keeping retail charges for gas for small use customers affordable, there is also a public interest in there being a sustainable margin available to gas retailers so as to enhance competition in gas supply for those same small use customers. To this extent, section 2.24(e) is therefore generally consistent with a lower value of Total Revenue.

(f) Section 2.24(f) is concerned with the interests of Users and Prospective Users and would point to a lower value in the range consistent with the objectives of sections 8.1(b), (d) (second limb) and (e), but tempered by the longer term interests of Users and Prospective Users in ensuring ongoing investment in the pipeline and a higher value of Total Revenue consistent with the objective of the first limb of section 8.1(d).

(g) Section 2.24(g) provides for the Authority to take into account other matters that it considers relevant. The Authority has not identified any other matters it considered relevant.

454. After considering the matters in section 2.24 there remains an unresolved tension between the outcomes that would be indicated for Total Revenue by each of the objectives in section 8.1. Accordingly, it is necessary for the Authority to resolve this tension and determine an appropriate value for Total Revenue.

455. The Authority is of the view that the interests of Users and Prospective Users under sections 8.1(b), (d) (second limb), (e) and 2.24(f) and the public interest under sections 8.1(b), (d) (second limb) and (e) in ensuring efficient prices for pipeline Services is of particular importance in determining a value for Total Revenue. The Authority is also of the view that weight should also be given to ensuring that incentives are maintained for further investment in the pipeline, consistent with objectives of section 8.1(d) (first limb).

456. Having taken into account these considerations, the Authority is satisfied that a value of Total Revenue that is based on a Rate of Return of 6.60 percent – which is in the upper range but not the upper limit of the range of values of the Rate of Return that would comply with the Code – will best achieve the objectives of sections 8.1.

457. The Authority has not considered financial and operational performance indicators for the purposes of determining a value of Total Revenue under section 8.6 of the Code. A determination of Total Revenue and Reference Tariffs under the Code is predicated on the use of benchmarks of costs and financial structure for the particular pipeline rather than, necessarily, the particular costs and financial structure of the Service Provider's business. In this way, problems of the financial decisions of the regulated entity being distorted by application of the regulatory regime are largely avoided.

458. However, the use of these benchmark assumptions means that any consideration of financial performance indicators calculated on the basis of the same assumptions would be tautological: such an analysis would simply show that the benchmark cost assumptions made on the basis of deemed adequacy for the financial sustainability of the business are indeed adequate. Conversely, a consideration of financial indicators for the actual business of the Service Provider would potentially create the incentive

problems that the use of benchmark assumptions seeks to avoid. As such, the Authority considers that it is only in special circumstances of the Service Provider that financial indicators should be bought to account in a determination of Total Revenue. In the case of the GDS, AGN has not made any submission that such indicators should be taken into account by the Authority, and the Authority does not have any information before it that would provide reason to take into account the particular financial circumstances of AGN in making a determination on the value of Total Revenue.

459. It remains for the Authority to determine the Total Revenue for an Access Arrangement Period of 1 January 2005 to 31 December 2009 on the basis of the various parameter values as determined in this Final Decision.

460. The Total Revenue may be determined using a cost of service calculation. This involves first calculating the return on the Capital Base using the appropriate Rate of Return of 6.60 percent and applying it to the Capital Base determined as appropriate by the Authority in this Final Decision. On this basis the return on the Capital Base for the second Access Arrangement Period is as set out in the following Table 11.

Table 11: Return on Capital Base
($ millions; 31 December 2004)

	1/1/2005	1/1/2006	1/1/2007	1/1/2008	1/1/2009
Opening value of Capital Base	658.625	665.385	669.272	666.193	666.435
Return on Capital Base	43.469	43.915	44.172	43.969	43.985

461. Having determined the return on the Capital Base as set out in Table 11 above it is possible to determine the Total Revenue, being the sum of the approved forecast Non-Capital Costs and Depreciation, together with a return on each of the Capital Base and working capital. The Total Revenue determined on this basis by the Authority for the second Access Arrangement Period is set out in the following Table 12:

Table 12: Total Revenue
($ millions; 31 December 2004)

	2005	2006	2007	2008	2009
Non Capital Costs	40.132	39.422	38.650	38.131	37.950
Depreciation	43.469	43.915	44.172	43.969	43.985
Return on Capital Base	24.772	26.349	27.806	28.989	30.502
Return on working capital	0.418	0.422	0.423	0.425	0.431
Total Revenue	108.791	110.109	111.050	111.513	112.867

462. The Total Revenue that should be applied in the determination of the Reference Tariff for the period 1 January 2005 to 31 December 2009 is the revenue set out in Table 12 expressed in dollar values at 31 December 2004. The present value of the Total Revenue for the second Access Arrangement Period, as shown in Table 12, is $459.0 million in dollar values at 31 December 2004.

463. The Authority's determinations of the Rate of Return, return on the Capital Base and Total Revenue differ from those presented by AGN in its revised Access Arrangement Information submitted on 27 May 2005. It is therefore necessary for the following amendments to be made with respect to the Rate of Return, return on Capital Base and Total Revenue prior to approval.

Final Decision Amendment 11

The pre-tax real weighted average cost of capital referred to at page 50 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended from 7.75 percent to 6.60 percent.

Final Decision Amendment 12

Table 4.9 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to include the values as set out in Table 7 in this Final Decision as the values for determining the Rate of Return for the revised Access Arrangement.

Final Decision Amendment 13

Table 4.10 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with the values for the return on the Capital Base for the second Access Arrangement Period set out in Table 11 of this Final Decision.

Final Decision Amendment 14

Table 4.16 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with the values for Total Revenue set out in Table **12** of this Final Decision.

Determination of Reference Tariffs

464. In the Draft Decision, the Authority noted that AGN had determined the proposed Reference Tariffs as originally submitted in the following manner:

- Total Revenue was allocated to Reference Services and Users, using the same allocations as under the current Access Arrangement;
- an adjustment to the allocations was made to take account of prudent discounts under section 8.43 of the Code;
- the Reference Tariffs for the first year of the second Access Arrangement Period, i.e. 2005, were set by rolling forward the Reference Tariffs which applied in the fifth year of the first Access Arrangement Period, i.e. 2004[51];

[51] AAI, p 62.

- the Reference Tariffs required to meet the revenue requirement for years two to five of the second Access Arrangement Period, i.e. 2006-2009 was determined using AGN's demand forecasts;

- a smooth path for recovery of Total Revenue was determined by adjusting the Reference Tariffs annually after the first year by the formula CPI x (1-X)[52] where X is a smoothing factor;

- provision was made for annual variation to the price path under a tariff basket form of price control and/or a Regulatory Cost adjustment, and variation in accordance with a Trigger Event Adjustment Approach for FRC costs.

465. AGN has proposed a broadly similar approach for determining Reference Tariffs for final approval. The Authority notes that it does not intend to approve the Reference Tariffs submitted by AGN in response to the Draft Decision principally because they are based upon AGN's calculation of Total Revenue, which differs substantially from the Authority's calculation for reasons outlined above.

466. Having said that, it remains necessary for the Authority also to consider its final decision in relation to each aspect of AGN's proposed approach to determining Reference Tariffs for the purpose of determining Reference Tariffs that could be given final approval by the Authority in a conforming response to the Final Decision. Therefore, for the purpose of the Final Decision, the Authority sets out below a discussion of each aspect of the process for determining Reference Tariffs as outlined above, the Authority's Draft Decision in relation to that aspect, and the matters relevant to the Final Decision including further submissions and information received from AGN in response to the Draft Decision.

Revenue allocation

Draft Decision

467. Principles for the allocation of revenues are provided in sections 8.38 to 8.43 of the Code.

468. Section 8.38 of the Code requires that Reference Tariffs should be designed to recover only 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 set out in section 8.1 of the Code and is otherwise fair and reasonable.

469. Section 8.39 of the Code provides for the Authority to require a different methodology to be used for cost allocation than may have been proposed by a Service Provider in an Access Arrangement pursuant to section 8.38 of the Code. However, if

[52] 'X' is a smoothing (not productivity) factor which provides for a smoothed path for recovery of forecast revenue from Reference Services equal to Total Revenue in net present value terms for the relevant period.

such a requirement is proposed, the Authority must provide a detailed explanation of the methodology that it requires to be used.

470. Section 8.40 of the Code addresses the allocation of revenue between Reference Services and Rebatable Services. Under section 10.8 of the Code, a Rebatable Service is 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.

471. Under section 8.40 of the Code, 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 the following objectives set out in section 8.40 of the Code:

(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.

472. Section 8.41 provides a Service Provider with discretion to adopt alternative approaches to revenue allocation, subject to any approach adopted having substantially the same effect as the approach outlined in sections 8.38 and 8.40 of the Code.

473. Section 8.42 relates to the allocation of revenue between Users. This section provides that, subject to provisions for prudent discounts in section 8.43 of the Code, the Reference Tariff should 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.

474. For the purpose of the Reference Tariffs as originally submitted for approval, AGN proposed that the revenue allocations used to determine the Reference Tariffs under the current Access Arrangement would also be used to determine the Reference Tariffs for the second Access Arrangement Period. The only exceptions to this were the following (which are discussed separately below):

- approval of certain User discounts as Prudent Discounts under section 8.43 of the Code; and
- annual variation, at AGN's discretion, to the structure of Reference Tariffs under a proposed tariff basket form of price control.

475. Clause 28 of Part B of AGN's Reference Tariff Policy as originally submitted provided as follows:

> The portion of the Total Revenue that each Reference Service has been designed to recover includes, to the maximum extent commercially and technically reasonable:
>
> (a) all of the Total Revenue that reflects costs incurred (including capital costs) that are directly attributable to each Reference Service
>
> (b) a share of the Total Revenue that reflects costs incurred (including capital costs) that are attributable to providing each Reference Service jointly with other Services, with this share being determined using a methodology that meets the objectives in section 8.1 of the Code and is otherwise fair and reasonable; and
>
> (c) a share of the Total Revenue that reflects costs incurred but not recovered from those Users of Reference Services who pay at a prudent discount to the Reference Tariff.

476. Clause 28 of Part B was identical to the current Reference Tariff Policy, with the exception of clause 28(c) which has been added to reflect AGN's proposal for prudent discounts to be discussed below.

477. Clause 31 of Part B of the proposed revised Access Arrangement as originally submitted was also a new provision in the Reference Tariff Policy relating to prudent discounts. This provision stated that "[s]ome Users of Reference Services pay a discount to the Reference Tariff. AGN has structured Tariffs in accordance with section 8.43 of the Code which permits recovery of the revenue foregone in a fair and reasonable manner."

478. AGN proposed the following method of allocating Total Revenue as set out at paragraph 5.1 of the Access Arrangement Information as originally submitted:

> The Reference Tariffs applying in 2005 (the first Year of the Second Access Arrangement Period) have been determined based on detailed cost of supply modelling described in the 2000 Access Arrangement Information. The only significant amendment was required to comply with the introduction of FRC and the subsequent introduction of Reference Tariff A2 (and a consequential amendment to Reference Tariff B1).

479. In considering AGN's revenue allocations to Reference Services for the purpose of the Draft Decision, the Authority had regard to the Relevant Regulator's assessment of the current Access Arrangement that approved the current revenue allocations[53]. In summary, the Relevant Regulator concluded that the allocations complied with the Code for the following reasons:

- capital costs (return on capital and depreciation) and other common costs (marketing costs, corporate costs and the return on working capital) were fully distributed between Users in a manner consistent with the equity and efficiency objectives of the Code; and
- the bulk of costs allocated to each Reference Service comprised capital costs so that the revenue recovered from each Reference Service would in all probability cover the avoidable cost of providing the Service, regardless of the method of allocating operating and maintenance costs.

[53] Independent Gas Pipelines Access Regulator Western Australia, 30 June 2000, *Draft decision on the AlintaGas South-West and Mid-West Gas Distribution Systems Access Arrangement*, Part A, pp 22-24; Part B, pp 157-162.

480. The Authority noted, however, that the Relevant Regulator considered operating and maintenance costs to have been allocated in a manner that may have been inconsistent with the efficiency objective of the Code, but that this was likely to have been compensated for in the overall allocation process.

481. In the Access Arrangement Information as originally submitted, AGN contended that:

> Since the initial Reference Tariffs were set, the price control formula in the First Access Arrangement Period has restricted the Tariff Component relativities from being altered. No new Tariffs or Tariff Components were introduced over that period, and the nature of AGN's distribution business, and the basis of allocating its underlying costs have not changed materially since 2000, with the exception of FRC and growth in new residential connections. To the extent that these result in an increase to the cost base, these have been appropriately allocated to the Reference Services. The costs and revenue relativities remain consistent with those determined by the cost of supply model applied in 2000.

482. In its Draft Decision, the Authority accepted AGN's submission that changes in circumstances relating to FRC and growth in new residential connections had not changed in a material way the relativities between costs and revenue of providing Reference Services.

483. In view of the above, the Authority accepted that the revenue allocations between Reference Services under the current Access Arrangement continued to provide an appropriate basis for allocating revenue for the revised Access Arrangement.

Final Decision

484. There has been no alteration by AGN of its position in relation to this matter in response to this aspect of the Draft Decision, nor have any submissions been received by the Authority in relation to the issue. There is therefore no need for any variation to this aspect of the Draft Decision in this Final Decision.

Prudent discounts

Draft Decision (Amendment 27)

485. 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).

486. The effect of section 8.43(b) is to require that a discount may only be provided to a User as a prudent discount if the incremental revenue from that User exceeds the

incremental cost of providing a Service to that User, and the incremental revenue consequently makes some contribution to the joint costs of providing Services provided using the Covered Pipeline. The proportion of Total Revenue that comprises such a discount may be recovered from other Users of the Reference Service or some other Service or Services in a manner that the Authority is satisfied is fair and reasonable.

487. Under section 8.43(c) & (d) of the Code, the Authority may only permit recovery of prudent discounts from other Users not receiving the prudent discounts, or from Reference Services or Services generally, in a manner that the Authority is satisfied is fair and reasonable.

488. Under the current Access Arrangement, AGN did not seek approval of any prudent discounts under section 8.43 of the Code. However, under the proposed revised Access Arrangement as originally submitted, AGN sought approval of certain prudent discounts.

489. In section 5.4 of the Access Arrangement Information as originally submitted[54], AGN described the discounts as follows:

> Consistent with the Code, a discount to the relevant Reference Tariff is offered where:
>
> - there has been (or will be) a reasonable expectation that:
>
> - the User can obtain haulage Services from a bypass pipeline at a Tariff lower than the relevant Reference Tariff; or
>
> - without the discount, the consumer supplied by the User would cease to use Gas delivered from the AGN GDS; and
>
> - continued delivery of Gas from the AGN GDS to the consumer, with the User paying a discounted Reference Tariff, would result in Reference Tariffs which were lower than they would have been if the User were to have obtained haulage Service from a bypass pipeline, or if the consumer supplied by the User had ceased to use Gas delivered from the AGN GDS.

490. During the assessment process prior to the Draft Decision, at the Authority's request, AGN provided additional confidential information in relation to AGN's process for approving discounts, and the details of individual discounts which have been offered by AGN.

491. In the Access Arrangement Information as originally submitted, AGN submitted the following further reasons why the Authority should accept the discounts as prudent discounts:

> While the Access Arrangement for the First Access Arrangement Period has no stated provision for prudent discounts and thus no mechanism to recover the foregone revenue from discounting, AGN implemented a discount regime during the period based on a rigorous assessment of applications received to ensure that both criteria under the Code are met. As AGN has under recovered from those Users receiving discounts, there has been an extremely powerful incentive to restrict discounts only to those Users who would otherwise not use the

[54] AAI, p 65.

> system at all. For the Second Access Arrangement Period it is anticipated that those Users who received discounts in the First Access Arrangement Period, and continue to be in the same situation in the Second Access Arrangement Period, will continue to receive prudent discounts.

492. The Authority was satisfied for the purpose of the Draft Decision, that the principles used by AGN to determine the prudent discounts, and the individual discounts which have been offered by AGN during the first Access Arrangement Period demonstrate that the discounts have been offered in accordance with the provisions in section 8.43(a) of the Code. The Authority also noted AGN's submission that AGN had an incentive during the first Access Arrangement Period to offer only prudent discounts, because there was no mechanism to recover the discounted revenue from other Users under the current Access Arrangement. In the circumstances, the Authority's draft decision was that it was satisfied that discounts had been offered in accordance with section 8.43(a) of the Code.

493. The Authority was also satisfied that if Users who have been given discounts had ceased to obtain Reference Services from AGN altogether, Reference Tariffs would have been higher than if Reference Tariffs were to have been increased to recover the discounts from other Users. The Authority, therefore, was satisfied that the discounts offered by AGN complied with section 8.43(b) of the Code.

494. The Authority noted, however, that under section 2.6 of the Code the Access Arrangement Information "must contain such information as in the opinion of the Relevant Regulator would enable Users and Prospective Users to understand the derivation of the elements in the proposed Access Arrangement and to form an opinion as to the compliance of the Access Arrangement with the provisions of the Code". The Authority, therefore, considered for the purpose of its Draft Decision that there was a need for the Access Arrangement Information to be amended to include information sufficient to provide an understanding of the derivation of Reference Tariffs in the proposed revised Access Arrangement taking account of prudent discounts.

495. Table 25 of the Draft Decision set out information provided by AGN to the Authority which the Authority considered should be included in the Access Arrangement Information as originally submitted as sufficient to satisfy the requirements of section 2.6 of the Code in respect of prudent discounts. The relevant information was, for each year from 2005 to 2009:

- Forecast volume delivered at prudent discount [GJ p.a.]; and
- Discounted notional tariff [$/GJ; 31 December 2004]

496. Amendment 27 of the Draft Decision therefore provided as follows:

> The submitted Access Arrangement Information should be amended to include the information set out in Table 25 of this Draft Decision in relation to prudent discounts.

Final Decision

497. AGN has accepted the requirement to amend in accordance with Amendment 27 of the Draft Decision. The required information is contained in the revised Access Arrangement Information submitted on 27 May 2005 as follows:

- forecast discounted volumes are set out in Table 6.4 on page 76; and
- the approximate average forecast price of those Users who receive a discount is set out in section 5.4 on page 68.

Initial Reference Tariffs

Draft Decision (Amendments 28 and 29)

498. In the Access Arrangement Information as originally submitted, AGN proposed that the Reference Tariffs for the first year of the second Access Arrangement Period (i.e. 2005) be the Reference Tariffs for the fifth year of the first Access Arrangement Period (i.e. 2004) "rolled forward" from that year.[55]

499. However, as at the date of the Authority's Draft Decision (28 February 2005) the intended Revisions Commencement Date under the current Access Arrangement (i.e. 1 January 2005) had already passed. Further, prior to 1 January 2005 AGN had sought an adjustment to the Reference Tariffs to apply from 1 January 2005. The relevant adjustment was by reference to the CPI-X percent formula approved by the Relevant Regulator for the first Access Arrangement Period with 'X' being 2.55 percent[56]. Prior to 1 January 2005, the Authority approved this adjustment.

500. In circumstances where adjusted Reference Tariffs from 1 January 2005 were in place, the Authority considered in its Draft Decision that it would be appropriate if such Reference Tariffs were to continue for the remainder of the first year of the second Access Arrangement Period (i.e. 2005).

501. The Reference Tariffs to apply for the first year of the second Access Arrangement Period (being the Reference Tariffs approved by the Authority to apply from 1 January 2005) were set out in Table 26 of the Draft Decision. The amounts in Table 26 were expressed to be exclusive of GST.

502. As the initial Reference Tariffs set out in Table 26 of the Draft Decision differed from those referred to in the Access Arrangement Information and the proposed revised Access Arrangement as originally submitted, the following amendments were required by the Authority in the Draft Decision.

[55] AAI, p 62.

[56] AGN, December 2004, *Access Arrangement for the Mid-West and South-West Gas Distribution System: Variation Report for Variation Year 2005,* published at the Authority web-site: www.era.wa.gov.au.

Amendment 28

The Reference Tariffs for Reference Services A1, A2, B1, B2 and B3 in Schedules 1, 2, 3, 4 and 5 of Part B of the proposed revised Access Arrangement respectively should be amended to accord with Table 26 of this Draft Decision for the Reference Tariffs to apply for the first year of the second Access Arrangement Period.

Amendment 29

The proposed 2005 Reference Tariffs set out in Tables 3.1 and 3.1A of the submitted Access Arrangement Information should be amended to accord with Table 26 of this Draft Decision.

Final Decision

503. In relation to the Amendment 28 of the Draft Decision, AGN submitted amended GST-inclusive Reference Tariffs for Reference Services A1, A2, B1, B2 and B3 in Schedules 1, 2, 3, 4 and 5 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005. The amended Reference Tariffs are identical to the currently approved Reference Tariffs for 2005, with the exceptions that:

- certain components of the proposed Reference Tariffs to be included in the revised Access Arrangement have been expressed in per day terms rather than per year terms as set out in the approved Reference Tariffs for 2005, and
- the proposed Reference Tariffs to be included in the revised Access Arrangement are expressed to four decimal places rather than to two decimal places as set out in the approved Reference Tariffs for 2005.

504. These differences are regarded by the Authority as material and, therefore, the Authority requires AGN to amend the proposed Reference Tariffs for 2005 to be included in the revised Access Arrangement in terms of the currently approved Reference Tariffs for 2005.

505. In relation to Amendment 29 of the Draft Decision, the 2005 Reference Tariffs set out in Tables 3.1 (per year basis) and 3.2 (per day basis) of the revised Access Arrangement Information submitted on 27 May 2005 do not accord with the approved Reference Tariffs for 2005 in a number of respects. Therefore, the Authority requires the proposed Reference Tariffs in the revised Access Arrangement Information to be amended to accord with the approved Reference Tariffs for 2005.

506. The Authority notes that the approved Reference Tariffs for 2005 are the GST-inclusive tariffs set out in the Variation Report for Variation Year 2005 submitted by AGN and published by the Authority on 9 December 2004. The Reference Tariffs in Table 26 of the Draft Decision were, however, expressed to be GST-exclusive. As the approved Reference Tariffs for 2005 are GST-inclusive the Authority proposes that the Reference Tariffs for 2005 in the revised Access Arrangement and the revised Access Arrangement Information to be expressed accordingly, notwithstanding Table 26 of the Draft Decision.

Final Decision Amendment 15

The Reference Tariffs for Reference Services A1, A2, B1, B2 and B3 in Schedules 1, 2, 3, 4 and 5 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended to accord with the approved Reference Tariffs for 2005 as set out in the Variation Report for Variation Year 2005 submitted by AGN and published by the Authority on 9 December 2004.

Final Decision Amendment 16

Tables 3.1 and 3.2 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 should be amended to accord with the approved Reference Tariffs for 2005 as set out in the Variation Report for Variation Year 2005 submitted by AGN and published by the Authority on 9 December 2004.

Annual volume forecasts

Draft Decision

507. Forecast annual demand for the relevant Access Arrangement Period is an input to the determination of Reference Tariffs. The forecast annual demand per customer for Reference Services, together with forecasts of customer connections, determines the overall units of Reference Services to be consumed during the relevant Access Arrangement Periods. Using this forecast of overall units for each Reference Service, the Reference Tariffs which will enable recovery of Total Revenue may be calculated.

508. In section 6.3 of the Access Arrangement Information as originally submitted, AGN stated as follows in relation to its volume forecasts:

> AGN engaged the National Institute of Economics and Industry Research (NIEIR) to assist in the preparation of volume forecasts. The model used by NIEIR was developed within a regional economic model of the Western Australian economy.
>
> Temperature is an important factor affecting consumption. Data collection from the Australian Bureau of Meteorology from various Perth based weather stations indicates a strong trend towards warming weather. This has been factored into the "Heating Degree Days" underpinning the volume forecasts.
>
> In addition, average consumption by Small Use Customers for residential purposes is expected to be negatively impacted by two key items.
>
> - the replacement of gas hot water systems by solar hot water systems supported by State and Federal rebate schemes; and
> - the extensive use of reverse cycle air conditioners replacing traditional gas heating loads.
>
> Early evidence suggests that these impacts will have the potential to reduce average usage, below that is included (sic) in Table 6.4 and 6.5 for Small Use Customers. This is further reason (sic) why the introduction of the Tariff basket is required to protect AGN's ongoing investment.

509. For the purpose of its Draft Decision, the Authority had regard to the NIEIR Report as referred to in section 6.3 of the Access Arrangement Information as originally

submitted, a copy of which was provided in confidence by AGN. In order to gain a better appreciation of AGN's volume forecasts, the Authority also had regard to audited financial information available to the Authority as the licensor of AGN as a gas distributor.

510. Based upon the above information, the Authority noted in its Draft Decision that throughput volume for large use customers (A1, B1 and B2) for the year to 30 June 2004 was well above AGN's volume forecasts for the year ended 31 December 2004. The Authority noted in the Draft Decision that in these circumstances it had requested AGN to make available further information to enable the Authority to understand what, if any, changes would be necessary to the forecast.

Final decision

511. In response to the Draft Decision, AGN provided, in the revised Access Arrangement Information, updated volume forecasts for all customer classes including the large use customers the subject of comment in the Draft Decision. AGN also provided actual volumes by customer class for the 2004 calendar year, as supporting information for the forecast volumes.

512. The Authority has assessed these forecasts and accepts the forecasts for A1, A2, B1 and B2.

513. This review, however, raised concerns in relation to volume forecasts for the B3 category, being primarily domestic end use customers representing the vast majority by number (over 500,000) of connections to the AGN GDS. The forecasts for this customer group considered by the Authority at the time of the Draft Decision, which were supported by a confidential report commissioned by AGN, were broadly consistent with historical licence data concerning consumption levels, and on that basis were accepted by the Authority. However, the revised forecasts for B3 customers submitted subsequent to the Draft Decision are inconsistent with the previous forecast, as well as inconsistent with historical licence data and actual data in relation to calendar year 2004 provided to the Authority by AGN.

514. The Authority notes that actual data relating to volume per B3 customer has been relatively stable over the period 2001-2004. In those circumstances, the Authority considers that the appropriate starting point for the relevant forecast is the most recent actual data for volume per B3 customer. The Authority therefore proposes to use as the starting point (i.e. the forecast average volume per B3 customer connected for calendar year 2005) the licence data with respect to the 2003-2004 year (adjusted to account for the inclusion of unused connections as discussed below in paragraphs 523 to 525). In relation to the projected volumes in future years (i.e. 2006-2009), the previously forecast trend as accepted by the Authority for the purposes of the Draft Decision and defining the average annual movement in volume per B3 customer connected remains an appropriate basis for the forecast, being consistent with all of the data available to the Authority at this time. In the circumstances, the Authority has adopted B3 customer volume forecasts reflecting the above for the purpose of determining Reference Tariffs for this Final Decision, and requires AGN to amend its revised Access Arrangement Information accordingly. Table 13 sets out the B3 customer volume forecasts adopted by the Authority.

Table 13: Forecast volumes for Reference Service B3

Year ending 31 December	2005 TJ	2006 TJ	2007 TJ	2008 TJ	2009 TJ
B3	10,147	10,493	10,752	10,947	11,165

515. The Authority requires the following amendment:

Final Decision Amendment 17

Table 6.4 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 – Forecast volumes by Service - should be amended by replacing the B3 customer volume forecasts with those in Table 13 of this Final Decision.

Customer connection forecasts

Draft Decision (Amendment 30)

516. A second aspect of determining forecast overall consumption during the relevant Access Arrangement Period is forecast numbers of customers connected.

517. In Table 6.4 of the Access Arrangement Information as originally submitted, AGN presented an estimate of the customer numbers connected to the network for each year of the second Access Arrangement Period for each Reference Service. These estimates were also based on forecasts in the NIEIR Report.

518. Based upon the information available to the Authority at the time it made the Draft Decision, the Authority noted that the forecast number of existing B2 and B3 customers connected at the commencement of the first year of the second Access Arrangement Period (i.e. 2005) were below the actual number of connections as at 30 June 2004.

519. In these circumstances, the Authority considered that there was a need for AGN's forecast of the number of B2 and B3 customers connected to the network as at 1 January 2005 to be adjusted. Therefore, for the purposes of determining Reference Tariffs in the Draft Decision, the Authority made its own estimate of the number of B2 and B3 customers connected to the network as at 1 January 2005, reflecting updated information available to the Authority.

520. The Authority noted in its Draft Decision that in order to enable a best estimate of customer numbers to be determined for the purpose of final approval, the Authority would, following the Draft Decision, request AGN to confirm the actual number of B2 and B3 customers connected to the network as at 1 January 2005.

521. In relation to likely growth in the number of customers connected to the network during the second Access Arrangement Period, the Authority had already noted in its Draft Decision, in relation to forecast New Facilities Investment, appreciable differences in anticipated growth rates in new connections for B2 and B3 customers from various sources of available information (see paragraph 287 above). Further, for the purpose of the Draft Decision in relation to forecast New Facilities Investment the

Authority had concluded that AGN's AMP for the period 2005-2009 would represent a suitable basis for estimating anticipated growth in new connections for B2 and B3 customers.

522. In the Draft Decision, in Table 27, the Authority set out projected numbers of B2 and B3 customers connected to the network at the end of each year of the second Access Arrangement Period taking account of the information referred to in the previous paragraph which the Authority regarded as representing a reasonable basis for forecasting such connections. The forecasts set out in Table 27 of the Draft Decision differed from those referred to in Table 6.5 of the Access Arrangement Information as originally submitted, and therefore the Authority required an amendment as follows:

> **Amendment 30**
>
> The forecast number of B2 and B3 customers connected, as set out in Table 6.5 of the submitted Access Arrangement Information, should be amended to accord with Table 27 of the Draft Decision.

Final decision

523. In its submission in response to the Draft Decision dated 21 March 2005, AGN submitted as follows in response to Amendment 30 of the Draft Decision:

> 156 AGN agrees with Amendment 30 and will amend the Access Arrangement Information to incorporate latest available customers as at January 2005. The ERA has highlighted differences between customer information provided in Table 6.5 of the AAI and the number of connections to be made as part of AGN's capital program.
>
> 157 there [sic] will always be a greater number of customers who require connections in a year than the annual difference between opening and closing connection point numbers for the year. The difference relates to the number of abolishments made. AGN forecasts that the annual rate of abolishments is approximately 2,500 per year. Therefore assuming that the number of connections made in any one year is 17,500, the total customer connection point growth is 15,000, which represents the difference between connections and abolishments.

524. In its revised Access Arrangement Information submitted in response to the Draft Decision on 27 May 2005, AGN included a revised version of Table 6.5 – Forecast Delivery Points 2005-2009. The Authority has reviewed this table and is satisfied that the customer connections for each Reference Service for 2005 reflect up to date values including connections that are unused at any particular time, and to that extent address the Authority's concerns in the Draft Decision.

525. Further, the Authority has indicated in its discussion of AGN's forecast New Facilities Investment that it accepts as reasonable AGN's revised forecasts of annual customer growth for the second Access Arrangement Period (see paragraphs 297 and 298 above). While AGN has not provided any substantiation of the source or basis for the re-forecast, the Authority is satisfied that the forecast annual customer connections set out in Table 6.5 of the revised Access Arrangement Information are reasonably consistent with annual customer growth as accepted by the Authority for the purpose of the Draft Decision, such that a further request for substantiation is not warranted for the purpose of the Final Decision which is to accept that the re-forecast by AGN of B2 and of B3 customer connections complies with Code requirements.

Price path for Reference Tariffs

Draft Decision (Amendment 31)

526. In section 5.2 of the Access Arrangement Information as originally submitted, AGN described the method proposed for determining Reference Tariffs after the initial year of the second Access Arrangement Period as follows.

> In this Access Arrangement Revision, AGN has proposed a tariff basket form of price control as an appropriate and efficient form of price control, consistent with the requirements of the Code. Under a tariff basket, the limit on allowed increases is expressed in terms of a ratio of "notional revenues", taking into account all of the components of a Service Provider's Tariffs:
>
> - the first "notional revenue" is the revenue implied by the quantities of each Tariff Component sold in the previous Year and the Service Provider's current Tariffs. This becomes the denominator in the price control formula; and
>
> - the second notional revenue is the revenue that would result if the same Quantity was sold at the Service Provider's proposed (new) prices. This becomes the numerator in the price control formula.
>
> This cap is (CPI) x (1-X) x (1+R)
>
> Where:
>
> CPI is as defined in Schedule 2 of Part A of the Access Arrangement
>
> X is the X factor
>
> R is the regulatory cost recovery factor as outlined in clause 8 of Part B of the Access Arrangement.

527. Under this approach X is a constant which provides a smoothed path for variation in Reference Tariffs beyond the first year of the scond Access Arrangement Period whereby the present value of forecast revenue for Reference Tariffs over the second Access Arrangement Period will equal the present value of Total Revenue.

528. The X factor as calculated by AGN in the proposed revised Access Arrangement as originally submitted was -0.0218, and was referred to in the Reference Tariff adjustment formula, $CPI_t \times (1-X_t) \times (1+R_t)$, in clause 8(2) of Part B. The Authority notes that in its Draft Decision the Authority required amendments to formulae relevant to Reference Tariff adjustment and which contain the X factor, which are discussed below at paragraphs 558 and 559.

529. In the Draft Decision, the Authority noted that as Total Revenue and initial Reference Tariffs as determined by the Authority in the Draft Decision differed from those proposed by AGN, there was a need for the X factor to be re-calculated. The X factor as calculated by the Authority using the values determined by the Authority for the Draft Decision was 0.0396. The Authority noted in its Draft Decision that the difference between the X factor as determined by AGN and the Authority respectively was primarily explained by the Total Revenue as determined by the Authority being substantially less than that proposed by AGN.

530. In the circumstances, the following amendment to the proposed revised Access Arrangement was required in the Draft Decision:

Amendment 31

The X factor referred to in clause 8(2) of Part B of the proposed revised Access Arrangement should be amended from -0.0218 to 0.0396.

Final decision

531. AGN did not accept the requirement to amend in accordance with Amendment 31 of the Draft Decision.

532. One issue raised by AGN with the Authority following the Draft Decision related to the most appropriate method for adjusting the initial Reference Tariffs for inflation. AGN requested an adjustment to the Authority's approach (on this issue alone) that if accepted by the Authority would have resulted in the X factor for the Draft Decision (or tariff path for the years 2006-2009) changing from a real decrease of 3.97 percent (as required under Amendment 31 of the Draft Decision) to a real decrease of approximately 2.5 percent (as referred to at paragraph 158 of AGN's submission in response to the Draft Decision dated 21 March 2005). For the purpose of assessing AGN's request, the Authority successfully replicated AGN's calculation of the X factor on the adjusted basis.

533. Having considered AGN's request the Authority accepts that the adjusted method for adjusting intial Reference Tariffs for inflation is an appropriate method and should be adopted for the purpose of this Final Decision.

534. In AGN's proposed revised Access Arrangement dated 10 June 2005 submitted in response to the Draft Decision, AGN's calculation of X, taking into account amendments to the proposed revised Access Arrangement as originally submitted, was negative 2.65 percent. This X factor was presented in clause 8 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005. By contrast, the Authority's calculation of X, taking into account the Authority's various determinations for the purpose of this Final Decision, is 2.82 percent. The following amendment is therefore required:

Final Decision Amendment 18

The X factor referred to in clause 8(2) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended from -0.0265 to 0.0282.

Tariff basket form of price control

535. AGN has proposed a tariff basket price cap approach for the variation of Reference Tariffs during the second Access Arrangement Period[57]. Under this approach AGN would have the discretion to vary the structure of Reference Tariffs and tariff components annually during the second Access Arrangement Period within the overall CPI x (1-X) constraint on tariff adjustment.

[57] Proposed revised Access Arrangement as originally submitted by AGN, 31 March 2004, Part B, clause 4.

536. The proposed tariff basket approach would replace the simple price cap approach under the current Access Arrangement, which precluded increases in individual Reference Tariff Components during the first Access Arrangement Period.

537. The details of AGN's tariff basket proposal were set out in paragraphs 3 to 11 of Part B of the proposed revised Access Arrangement as originally submitted to the Authority.

538. AGN's tariff basket proposal represents an application of the Reference Tariff Control Formula Approach for varying Reference Tariffs provided for in section 8.3(c) of the Code. The manner of variation under this method is by notice to the Authority in accordance with section 8.3B of the Code. Under the proposed amendments in clause 11 of Part B, the required notice is in the form of an annual Tariff Variation Report to be given to the Authority for approval under the Code. The annual Tariff Variation Report is proposed to be submitted 30 days prior to the start of the Variation Year, being the calendar year in respect of which the Varied Reference Tariff is being calculated.

Adoption of tariff basket

Draft Decision

539. The first issue considered by the Authority was whether or not to adopt the proposed tariff basket form of price control.

540. AGN's arguments in support of the adoption of the tariff basket approach were summarised in section 5.2 of the Access Arrangement Information as originally submitted as follows:

> AGN has adopted a tariff basket price-cap approach to Reference Tariff variation on the grounds of economic efficiency and compliance with the Code.
>
> Section 8 of the Code sets out the principles to be followed in Tariff variation and section 8.3 provides that as long as a variation policy is consistent with the objectives contained in section 8.1, then this falls within "the discretion of the Service Provider". AGN believes a tariff basket approach is consistent with section 8.1 and notes that such an approach has been both advocated by regulators and applied in other jurisdictions.
>
> There are also strong efficiency arguments for a tariff basket approach which are directly applicable to the section 8.1 criteria:
>
> - **Risk.** AGN faces significant risk in forecasting volumes, with issues such as weather and competition from other energy sources meaning that outcomes may vary considerably from those forecast. Given that revenues are a function of volume and Tariffs, this creates a commercial risk. The tariff basket approach allows this risk to be managed in the most efficient way, by allowing revenues to shift between Reference Services, subject to an overall cap to ensure that AGN is not earning more than its allowable revenue as a result.
>
> - **Variations in Costs.** The cost of providing Reference Services may also vary within an access period. The tariff basket approach allows for Tariff variation to meet these cost changes so that the cost of providing Services continues to track the revenues from those Services. A scenario where costs and revenues diverge is a recipe for inefficiency and runs counter to the principles in section 8.1.

- **Efficient Behaviour by Service Provider.** A tariff basket approach promotes efficient behaviour by AGN in that it does not encourage restrictions or increases to output when it is not efficient to do so.

- **Reduced Cost of Tariff Variation.** It has been suggested that an alternative to a tariff basket approach is that a Service Provider can trigger a revision at any time and that therefore Tariff variation can be dealt with in this way should they be necessary. However, this ignores the very significant costs involved in a reset – costs which ultimately are borne by Users. AGN believes that the tariff basket approach provides a much more cost-effective approach to Tariff variation.

541. In the Draft Decision, the Authority noted that the forms of price control adopted by regulators for gas and electricity distribution businesses throughout Australia include the tariff basket approach.

542. Further, that the tariff basket form of price control has a number of incentive properties that constitute advantages over other approaches, such as simple price caps and the "average yield" form of price control which is another form of rebalancing. In this respect the Authority referred to the discussion of the tariff basket approach by the Office of the Regulator General, Victoria, in its *Consultation Paper No. 5, Tariff Basket Form of Price Control: Detailed Proposal*, December 1999.

543. As well as its incentive properties, the Authority noted that the tariff basket form of price control is also regarded as having additional advantages over other forms of price control, including the following:

- Minimisation of complexity – absence of forecasts and correction factors

  The constraint on tariff changes under the tariff basket may be based on information which is known at the time the tariff basket formula is applied, i.e. tariffs proposed for the coming year, current tariffs and the quantities sold in the year previous to the coming year. There is no need to use forecast quantities, and to apply a correction factor to account for the difference between the forecast and realised quantities (as is necessary under the revenue yield form of price control). The absence of forecasts minimises the complexity of the formula and the workload associated with verifying compliance. It also limits the scope and the incentive for strategic behaviour on the part of the Service Provider, in terms of the under and over-statement of forecasts in order to increase total allowed revenue. Because the weights in the tariff basket approach are determined by realised sales in a past year, there is no uncertainty for the industry or the regulatory agency as to whether or not a proposed set of prices satisfy the constraint[58].

  There is a concomitant low administrative burden on the Relevant Regulator, limited to verifying known information and to auditing the application of the tariff basket form of control.

[58] Bradley, I. and Price, C., 1988, "The economic regulation of private industries by price constraints", *Journal of Industrial Economics,* 37(1): 99-106.

- Ease of introducing new tariffs and new tariff components.

  New tariffs and tariff components may be readily introduced into the tariff basket control mechanism by making estimates of quantities that would have been sold under the new tariff or tariff components in the base year (for which quantities sold comprise the weights in the tariff basket control formula) if the tariff had been offered to customers.

544. On the other hand, the Authority has also noted a number of potential concerns arising from the adoption of the tariff basket approach.

- Restructuring or rebalancing tariffs in a manner that does not reflect costs and without regulatory review.

  To date, no regulator under the Code has made a rigorous assessment of the efficiency of a Reference Tariff by a Service Provider. Regulators have tended simply to satisfy themselves that Reference Tariffs are in excess of the avoidable costs of Service provision and less than stand alone costs. The reasons for this level of assessment by regulators have no doubt included that a determination of efficient price structures requires knowledge of demand elasticities and cost functions – information that is generally not available. Concern that a Service Provider may restructure or rebalance tariffs without regulatory scrutiny as to whether objectives of cost-reflectivity and efficiency are met should therefore be considered in the context that it is very unlikely that a regulator would or could exercise such scrutiny.

  It is for reason of the limited ability of regulators to assess the efficiency of regulated tariffs that attention has been given to forms of price control such as the tariff basket. The regulatory objective is to provide a means for the Service Provider to itself find and establish an efficient tariff structure.

- Restructuring or rebalancing tariffs for the purposes of "ratcheting" revenue above the level of regulated revenue.

  There may be a concern that under the tariff basket form of price control, AGN may rebalance tariffs in such a way as to favour an increase in the tariff (or tariff component) for the Service (or component of a Service) for which demand in the forthcoming period is forecast to increase over demand in the base period (i.e. the period for which actual quantities sold are used as the weights in the calculation of weighted average tariffs). The concern applies generally to the potential incentive of the Service Provider to rebalance the tariff so as to increase the tariff or tariff component for which a significant increase in demand is expected.

  However, the Service Provider also faces an incentive to raise prices of those service outputs with inelastic demand and to lower prices for those Services with more elastic demands. This incentive may or may not coincide with that to increase prices for the Service with the greatest forecast increase in demand. Further, for the Service Provider to increase prices for the Service with the greatest forecast increase in demand, the Service Provider will also need to bear in mind the consequences of the corresponding reduction in the price of another Service. The Service Provider may additionally be exposed to profit risk if any

price reduction for another Service results in the price of that Service falling below marginal cost.

- Restructuring or rebalancing tariffs in a manner that is contrary to the enhancement of competition in the supply of gas to small use customers.

  In the determination of Reference Tariffs, the Authority has a specific obligation under section 38(2) of the *GPAA* 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. The lessening of the estimated retail margins in supply of gas to small business and residential customers (comprising the margins between AGN's associate, AlintaGas Sales, current retail prices of gas and all other costs of gas supply including gas distribution under Reference Services B2 and B3) may be contrary to the extension of effective competition in the supply of gas to these consumers. If AGN was to increase Reference Tariffs B2 and B3 substantially then it could, potentially, reduce retail margins available to gas retailers and make entry of gas retailers uneconomic in this section of the market.

  Considerations relating to engaging in predatory conduct are very complex. Such considerations include whether or not it would be profitable for AGN to increase Reference Tariffs B2 and B3 at the expense of reductions in other Reference Tariffs, which would depend upon the nature of demand in the different sectors of the market and any potential benefits from engaging in predatory conduct.

- Price uncertainty for Users of the distribution systems and for end-users of gas.

  A potential concern with the tariff basket approach may be that the ability of AGN to restructure and rebalance tariffs will create pricing uncertainty for Users and for end-users of gas. This uncertainty may increase transaction costs in contracts for gas supplies and increase commercial risks for gas retailers, possibly resulting in a reduction in growth of gas markets and gas consumption.

  Empirical studies of the outcomes of the tariff basket and other forms of price control that allow tariff rebalancing indicates that regulated businesses do not tend to engage in substantial variation of tariffs from year to year. A survey of firms subject to tariff basket price caps in the USA and United Kingdom has found that despite the short term profit incentives for regulated business to do so, price rebalancing has occurred only to a limited extent. This has been attributed to the influences of other elements of regulatory regimes and more complex government agendas, including distributional concerns over equity in pricing.[59]

545. On balance, the Authority was satisfied that the adoption of the tariff basket form of price control as proposed by AGN is consistent with the efficiency objectives in section 8.1 of the Code.

[59] Giulietti, M. and Waddams Price, C., 2004, *Incentive regulation and efficient pricing*, unpublished paper, Aston Business School and University of East Anglia.

Final Decision

546. The Authority has not received any submissions calling into question the Draft Decision in relation to the proposed adoption of the tariff basket form of price control. Further, in the proposed revised Access Arrangement submitted in response to the Draft Decision, AGN has maintained its proposal to introduce the tariff basket form of price control. There is therefore no reason for the Authority to vary its Draft Decision on this aspect.

Rebalancing cap

Draft Decision (Amendment 32)

547. In the Draft Decision, the Authority noted that the Code requires that the portion of AGN's Total Revenue that a Reference Tariff is designed to recover should include a share of costs attributable to providing the Reference Services jointly with other Services in accordance with a methodology that meets the objectives in section 8.1 and is "otherwise fair and reasonable".[60] Further, the Authority was mindful of the statutory requirements under section 38(2) of the *GPAA*.

548. The Authority noted, therefore, that where the form of price control would permit unconstrained rebalancing of Reference Tariffs or adding or removing Tariff Components during the life of an Access Arrangement the Relevant Regulator must ensure that any consequential tariff increases reflect an allocation of costs which is both "fair and reasonable" and that rebalanced charges are consistent with the extension of effective competition in the supply of natural gas to residential and small business consumers.

549. Having regard to these considerations, the Authority considered it appropriate that the tariff basket provisions be amended to include a constraint which would limit the extent to which any particular Tariff Component may be varied in a single year.

550. Such a measure would aim at ensuring that rebalanced tariffs reflect an allocation of costs which is fair and reasonable and consistent with the extension of effective competition in the supply of natural gas to residential and small business consumers, while at the same time providing an opportunity for AGN to introduce more efficient Reference Tariff structures.

551. The Authority considered that an appropriate constraint would be to limit the amount by which any particular Tariff Component may increase in any one year to 2 percent above the price path for any Tariff Component established by the Reference Tariff adjustment formula. This cap reflected the Authority's analysis of a constraint which would be consistent with the maintenance of a retail margin sufficient to create an environment consistent with the extension of effective competition in the supply of natural gas to residential and small business customers.

[60] Sections 8.38 and 8.42 of the Code. While these provisions refer to the share of AGN's Reference Tariff revenue between Users (that is retailers or very large customers), whether that share would be considered 'fair and reasonable' will depend at least in part upon the implications for the ultimate end-users.

552. As AGN did not propose any constraint on rebalancing, the proposed revised Access Arrangement as originally submitted did not include any formula for determining the Varied Tariff Components within the constraint which the Authority considered to be necessary.

553. In these circumstances, the Authority indicated in its Draft Decision a suggested formula which AGN might consider adopting for determining the Varied Tariff Components within the proposed rebalancing constraint.

554. The Authority required an amendment (Amendment 32) accordingly:

> **Amendment 32**
>
> Clause 8 of Part B of the proposed revised Access Arrangement should be amended to include a constraint which would limit the amount by which any particular Tariff Component may increase in any one year to 2 percent above the price path for any Tariff Component established by the Reference Tariff adjustment formula.

Final Decision

555. In its submission dated 21 March 2005 in response to the Draft Decision AGN stated that it did not agree with Amendment 32. AGN stated that "[a]dopting Amendment 32 would severely limit the benefits of the tariff basket mechanism". AGN nevertheless indicated that it would welcome the opportunity to discuss this issue with the Authority.

556. The proposed revised Access Arrangement submitted on 10 June 2005 by AGN includes formulae amended from those which had been included in the proposed revised Access Arrangement as originally submitted. The Authority notes, however, that these proposed formulae, while substantially acceptable, are deficient in two respects:

- the formula in clause 7 of Part B of the proposed revised Access Arrangement, with respect to Tariff Component variations, omits the X factor;
- the Tariff Component variation formula in clause 7 of Part B, and the Price Basket formula in clause 8(1) of Part B, define the CPI in a manner which will lead the formulae not to achieve their intended purposes.

557. The Authority has considered amendments to the two formulae in Part B which would address these two deficiencies and thus meet the requirements of Amendment 32 of the Draft Decision.

558. In relation to the Tariff Component variation formula in clause 7 of Part B the Authority requires AGN to amend as follows:

Final Decision Amendment 19

Clause 7 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended to read as follows:

"A Tariff Component variation under Part B, clause 4 must be in accordance with the following

$$P_t \le P_{t-1} * \frac{SepCPI_{t-1}}{SepCPI_{t-2}} * (1 - X) * (1 + R_t) * (1 + Y)$$

where:

$\boldsymbol{P_t}$ is the value of the Reference Tariff Component for year *t:*

$\boldsymbol{X}$ is positive 0.0282;

$\boldsymbol{Y}$ is positive 0.02;

$\boldsymbol{R_t}$ is the regulatory costs factor for calendar Year *t* and is calculated in accordance with Part B, clause 9;

$\boldsymbol{SepCPI_{t-1}}$ is the September quarter Consumer Price Index for Year *t-1*;

$\boldsymbol{t}$ is calendar year for the Reference Tariff Components that are being calculated (i.e. the following year)."

559. In relation to the Price Basket formula in clause 8(1) the Authority requires AGN to amend as follows:

Final Decision Amendment 20

Clause 8(1) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended to read as follows:

"AGN must ensure that the ratio B_t, being the ratio calculated in accordance with Part B, Clause 8(2), for all Reference Tariff Components does not exceed:

$$\frac{SepCPI_{t-1}}{SepCPI_{t-2}}(1 - X)(1 + R_t)$$

where:

$\boldsymbol{X}$ is positive 0.0282;

$\boldsymbol{R_t}$ is the regulatory costs factor for calendar Year *t* and is calculated in accordance with Part B, clause 9;

$\boldsymbol{SepCPI_{t-1}}$ is the September quarter Consumer Price Index for Year *t-1.*"

Adding or removing tariff components

Draft Decision (Amendment 33)

560. Clause 5(b) of Part B of the proposed revised Access Arrangement as originally submitted provided that AGN may "in its discretion…vary the structure of a Tariff by adding or removing one or more Tariff Components (for example without limitation by adding or removing volume bands, or introducing or removing peak and off-peak bands)".

561. In its Draft Decision, the Authority considered that such discretion has the potential to result in an allocation of costs which may not be "fair and reasonable", or tariffs which may be inconsistent with the extension of effective competition in the supply of natural gas to residential and small business consumers.

562. The Authority, therefore, proposed not to approve clause 5(b) of Part B as originally submitted, and required the following amendment:

> **Amendment 33**
>
> Clause 5(b) of Part B of the proposed revised Access Arrangement, providing AGN with a discretion to add or remove one or more Tariff Components, should be deleted.

Final Decision

563. AGN accepted the requirement to amend in accordance with Amendment 33 of the Draft Decision. AGN deleted clause 5(b) of Part B and thus met the requirements of Amendment 33 of the Draft Decision.

Forecasts of tariff components

Draft Decision (Amendment 34)

564. In the Draft Decision, the Authority noted that retailers or prospective retailers in the residential and small business markets, in order to plan effectively to compete in these markets, will require information in relation to any likely material variation in Reference Tariffs under the tariff basket form of price control.

565. The Authority, therefore, considered that the requirements of section 38(2) of the *GPAA* supported a requirement that AGN provide in advance information about likely material variations in the structure of Reference Tariffs under the tariff basket approach.

566. To address this issue the Authority required the proposed revised Access Arrangement to be amended to require AGN to submit, at the time it submits its annual Variation Report under clause 11 of Part B of the proposed revised Access Arrangement, a forecast of Tariff Components of Reference Tariffs for 3 years or to the end of the second Access Arrangement Period whichever is the sooner.

567. An amendment (Amendment 34) was required as follows:

Amendment 34

Clause 11 of Part B of the proposed revised Access Arrangement should be amended to include a requirement that, at the time it submits the annual Variation Report, AGN also submits a forecast of Tariff Components of Reference Tariffs for 3 years or to the end of the second Access Arrangement Period whichever is the sooner.

Final Decision

568. In its submission dated 21 March 2005 in response to the Draft Decision AGN did not accept the requirement to amend in accordance with Amendment 34 of the Draft Decision.

569. In subsequent consultation with the Authority, AGN submitted that the combined effect of the rebalancing constraint pursuant to Amendment 32 of the Draft Decision, and the removal of AGN's ability to add or remove Tariff Components pursuant to Amendment 33 of the Draft Decision, meant that AGN will be severely constrained with respect to the pace of, and the market will have a great deal of certainty about the extent of any possible, tariff restructuring.

570. In these circumstances AGN submitted that the proposed requirement under Amendment 34 would be of limited utility and would impose an unnecessary additional burden on AGN.

571. The Authority accepts AGN's submission, and, therefore, does not propose to require AGN to amend its revised Access Arrangement to meet Amendment 34 of the Draft Decision prior to giving final approval.

Regulatory Cost pass through

Draft Decision (Amendment 35)

572. Section 8.3(c) of the Code provides a mechanism, the Reference Tariff Control Formula Approach, whereby an initial set of Reference Tariffs may vary over the Access Arrangement Period in accordance with a specified formula or process.

573. In the proposed revised Access Arrangement as originally submitted, AGN included forecast Regulatory Costs of $0.7 million p.a. in its forecast Non Capital Costs. In respect of such costs AGN proposed a pass through mechanism under which the Reference Tariff price path will be adjusted each year according to variances from forecast.

574. The Regulatory Costs that AGN proposed to be subject to the pass through mechanism were defined in Schedule 2 to Part A of the proposed revised Access Arrangement as originally submitted:

> **Regulatory Costs** means a cost connected or associated with:
>
> (a) the submission and approval of this Access Arrangement; and
>
> (b) AGN's compliance with the Act, the Code, its Distribution Licences, the Energy Coordination Act 1994, the Gas Standards Act 1972, the Energy Operators (Powers) Act 1979, Environmental Protection Act 1986 and all other applicable Laws.

575. Under the proposed revisions to the Access Arrangement as originally submitted, clause 11 of Part B provided that notice of any variation would have to be given in the form of an annual Tariff Variation Report to the Authority for approval, 30 days prior to the end of each calendar year within the second Access Arrangement Period.

576. It is noted that AGN's ability to control the level of Regulatory Costs is limited as they may be affected by regulatory events outside of AGN's direct control.

577. AGN proposed, in Part B clause 8, a Reference Tariff adjustment formula by which it was intended to adjust the Reference Tariff for Regulatory Cost variations by inclusion of a Regulatory Cost factor, R.

578. In the Draft Decision the Authority noted that when modelled by the Authority the formula for determining the R factor did not appear to achieve its intended purpose and may require reformulation. AGN was requested to provide additional clarification, however, the response then provided to this request did not resolve the Authority's concerns.

579. An alternative formulation of the R factor formula which the Authority suggested might address the Authority's concerns was set out in the Draft Decision.

580. In these circumstances, the Authority required an amendment (Amendment 35) under which AGN was required to amend the formula in clause 8 of Part B for determining the R factor so that the formula achieved its intended purpose.

Final Decision

581. AGN accepted the requirement in Amendment 35 to amend the R factor formula, and subsequent to the Draft Decision worked with the Authority to determine a formula which would achieve the intended purpose, namely the annual adjustment of Reference Tariffs to capture variances of Regulatory Costs from forecast.

582. The proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision includes, in clause 9 of Part B, a formula for determining the R factor. The Authority is satisfied that the formula is effective to achieve its intended purpose and therefore AGN had met the requirements of Amendment 35 of the Draft Decision.

Trigger Event Adjustment for FRC costs

Draft Decision (Amendment 36)

583. Section 8.3(d) of the Code provides a mechanism, the Trigger Event Adjustment Approach, whereby Reference Tariffs are varied in the manner specified in a Reference Tariff Policy upon occurrence of a Specified Event.

584. In the proposed revised Access Arrangement as originally submitted on 31 March 2004, AGN proposed in clause 66 of Part A, a Trigger Event Adjustment Approach that was designed to ensure that AGN could recover unforeseen FRC costs. In relation to the forecast amount of these costs, AGN included in its Access Arrangement Information as originally submitted for FRC costs ($1.3 million p.a.) in

its forecast Non Capital Costs. Capital expenditure associated with FRC was included in the Other Capital category of forecast New Facilities Investment.

585. In the proposed revisions to the Access Arrangement as originally submitted, AGN proposed that, subject to the Authority deeming that certain criteria were complied with, Reference Tariffs may be adjusted or a Charge imposed in the event of variations from forecast FRC Costs. These criteria were set out in Part B, clause 12(1) of the proposed revisions as originally submitted in relation to Non Capital Costs incurred by AGN associated with FRC, and in Part B, clause 12(2) in relation to New Facilities Investment associated with FRC.

586. Further, Part B, clause 14 of the originally submitted proposed revisions provided that any actual or forecast New Facilities Investment that the Authority deems to comply with the criteria of clause 12(2) would be considered to meet the requirements of section 8.16 and would be added to the Capital Base at the commencement of the next Access Arrangement Period.

587. In the Draft Decision, the Authority noted that AGN's ability to control the level of FRC Costs and FRC New Facilities Investment is limited as such costs may be affected by regulatory events outside of AGN's direct control. However, in considering AGN's proposed Trigger Event Adjustment Approach, the Authority noted the following concerns:

- The proposal only provided for a Reference Tariff variation to be triggered in circumstances where FRC Costs and/or FRC New Facilities Investment exceeded forecast. There was no provision for a Reference Tariff variation where such expenditure was less than forecast. The approach proposed by AGN was, therefore, asymmetrical and would be inconsistent with the objectives of sections 8.1(a), (b) and (e) of the Code.

- The proposal, in clause 14 of Part B, provided for the Authority to make a binding determination that actual or forecast FRC New Facilities Investment would be considered to meet the requirements of section 8.16 of the Code. However, under section 8.21 of the Code, the Authority only has power, during the life of an Access Arrangement, to make a binding determination in relation to this matter, after a public consultation process has been conducted in accordance with the Code. AGN's proposal therefore appeared to exceed the Authority's ability to make a binding determination, because it did not make provision for public consultation.

- The proposed Trigger Event Adjustment Approach gave no recognition to the Regulatory Costs recoverable from Users that may be incurred in triggering a review of Reference Tariffs under this adjustment approach. There was therefore justification for considering a cost threshold below which the Trigger Event Adjustment Approach could not be invoked. The inclusion of an appropriate threshold would be consistent with section 8.1(a), (b) and (e) of the Code.

588. Further, the Authority noted in its Draft Decision that under section 8.3 of the Code, other Reference Tariff Variation Methods are available, including a Reference Tariff Control Formula approach, which AGN otherwise had proposed be used to adjust for variations in Regulatory Costs from forecast. The Authority also noted that under

section 8.3 of the Code the manner in which a Reference Tariff may vary within an Access Arrangement Period is a matter for the Service Provider's discretion (subject to the Authority being satisfied that it is consistent with the objectives in section 8.1). An alternative approach, therefore, which the Authority suggested AGN may consider to address this issue would be to incorporate FRC cost variations by a similar mechanism to that proposed for addressing variations in Regulatory Costs.

589. In these circumstances, the Authority's draft decision was that in order for the Authority to be satisfied that AGN's proposed Reference Tariff Variation Method was consistent with sections 8.1 and 8.21 of the Code there was a need for clause 66 of Part A, and clauses 12 to 14 of Part B of the proposed revised Access Arrangement to be amended. The Authority therefore provided in Amendment 36 of the Draft Decision as follows:

> Clause 66 of Part A, and clauses 12 to 14 of Part B of the proposed revised Access Arrangement should be amended to provide for a Reference Tariff Variation Method under section 8.3 of the Code, in relation to FRC Costs and FRC New Facilities Investment, that is consistent with sections 8.1 and 8.21 of the Code.

Final Decision

590. In the proposed revisions to the Access Arrangement submitted by AGN on 10 June 2005 AGN determined not to meet the specific requirements of the Draft Decision in relation to this matter, but rather deleted the provisions originally submitted altogether. As a result AGN proposes that the situation under the current Access Arrangement continue, namely that there is to be no mechanism by which the FRC Costs recoverable through Reference Tariffs may vary during the life of the second Access Arrangement Period. The Authority is satisfied that this proposed approach complies with the Code and that there is no further requirement for amendment.

Use of Incentive Mechanisms

591. Sections 8.44 to 8.46 of the Code make provision for the Service Provider to establish an Incentive Mechanism within the Reference Tariff Policy as follows:

> 8.44 The Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism (an ***Incentive Mechanism***) that permits the Service Provider to retain all, or any share of, any returns to the Service Provider from the sale of the Reference Service:
>
> (a) during an Access Arrangement Period, that exceed the level of returns expected for that Access Arrangement Period, that exceed the level of returns expected for that Access Arrangement Period; or
>
> (b) during a period (commencing at the start of an Access Arrangement and including two or more Access Arrangement Periods) approved by the Relevant Regulator, that exceed the level of returns expected for that period,
>
> particularly where the Relevant Regulator is of the view that 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.

8.45 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.

8.46 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(a) 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).

592. The current Access Arrangement does not make any specific provision for the retention of cost-related efficiency gains beyond the end of the first Access Arrangement Period. AGN has proposed that the revised Access Arrangement should introduce a rolling carryover mechanism under which cost-related efficiency gains may be retained by AGN for 10 years.

593. AGN's proposal reflects the amendments to section 8.44(b) of the Code which took effect in November 2001, and which expressly provided, for the first time, carry-forward of efficiency gains into future Access Arrangement Periods.

594. In the Draft Decision, the Authority acknowledged that an efficiency carryover mechanism as contemplated by the amendments to the Code is likely to have superior incentive properties to the approach under the current Access Arrangement. For this reason, the Authority was willing to accept, in its Draft Decision, the adoption of a carryover mechanism in the revised Access Arrangement.

595. AGN's proposal was set out in clauses 33 to 36 of Part B of the proposed revised Access Arrangement as originally submitted. The proposal was modelled closely upon the Incentive Mechanism approved by the ESC for the three major Victorian gas distributors in 2002, with the major exception that the carryover period approved by the ESC was 5 years, whereas under AGN's proposal efficiency gains would be carried over for 10 years.

Length of carryover period

Draft Decision (Amendment 37)

596. A key issue is the length of carryover of any efficiency gains into future regulatory periods. As indicated above AGN had proposed that efficiency gains be carried over for 10 years after they have been earned.

597. In the Draft Decision the Authority noted that on 17 May 2004 it had released a discussion paper, *Incentive Mechanisms for Code Regulated Pipeline Systems*, prepared by Farrant Consultancy Pty Ltd (**Farrant Discussion Paper**). The Farrant Discussion Paper provided support for the adoption of a 5 year rolling carryover mechanism confined to efficiencies achieved in relation to Non Capital Costs[61].

598. While the Authority did not receive any submissions in relation to AGN's carry over mechanism proposal, it did receive five submissions on the Farrant Discussion Paper. In particular, in respect of the length of the carryover period:

- AGN supported a 10 year carryover and that gains or losses would not be carried forward unless "adjustments are made to account for scope changes" and are related "principally to factors within the control of the company"; and

- Western Mining Corporation supported a 5 year carry-forward period for savings in only Non Capital Costs that are attributable to the actions of the Service Provider, but suggested that the Relevant Regulator should have flexibility to award carryover for 10 or more years for exemplary performance.

599. Further, in the Draft Decision the Authority noted the following regulatory outcomes in respect of the use of Incentive Mechanisms under the Code[62]:

- The ESC has approved a five year rolling efficiency carryover mechanism in its October 2002 final decision for the three major Victorian gas distribution systems for both capital and Non Capital Costs.

- AGL's Central West System in New South Wales and the Amadeus Basin to Darwin System both have 10 year Access Arrangement Periods with retention of benefits only to the end of the period.

[61] See Conclusion 6.18 of the Farrant Discussion Paper, p 45.

[62] Farrant Discussion Paper, p 40.

- Envestra's SA Distribution System has a 5 year Access Arrangement Period with retention of variances beyond the end of the first period but to cut off at the end of the second 5 year period.

600. The Authority recognised in the Draft Decision that the length of the period of carryover adopted will affect the proportion of the efficiency gains for AGN and Users respectively. In this respect AGN suggested in section 3.6 of the Access Arrangement Information as originally submitted that a 10 year carryover period will result in a 50:50 benefit sharing ratio between Users and AGN.

601. In relation to the benefit sharing issue, the Authority noted the comments of the ESC as follows[63]:

> [T]he Commission has previously noted that the trade-off inherent in designing the efficiency carryover mechanism is one between the size of the efficiency gain achieved, and the proportion (and timing) of that gain which is passed through to consumers. There is no pre-determined 'optimal' sharing of gains, and the design of the carryover mechanism must therefore be partly a matter of judgment. However, under reasonable assumptions, 50 per cent would be the *maximum* share consistent with providing optimal incentives, and there are reasonable grounds for thinking that the optimal sharing ratio would be less than this, not least the recognition of the allocative efficiency implications associated with the carryover mechanism.

602. In its Draft Decision, the Authority expressed the view that the Code provisions of section 8.44 to 8.46 are consistent with the approach outlined by the ESC referred to in paragraph 601 above. In particular, section 8.44 of the Code provides that the Authority may, where it considers "appropriate", approve an Incentive Mechanism that permits the Service Provider to retain "all, or any share of," any returns that exceed the level of returns expected.

603. Further, section 8.46 of the Code provides that an Incentive Mechanism should be designed with a view to achieving objectives as follows:

- providing the Service Provider with "an incentive" to engage in certain conduct consistent with the efficiency objectives of the Code: sections 8.46(a) to (d); and

- ensuring that Users and Prospective Users gain from increased efficiency: section 8.46(e).

604. The Authority concluded that the Code provisions, therefore, are not prescriptive as to the share of efficiency improvements which may be regarded as sufficient to provide a Service Provider with the appropriate incentives, nor as to what sharing as between the Service Provider and Users may be regarded as optimal.

605. In these circumstances, and in particular taking account of the regulatory outcomes as to efficiency sharing arrangements in other jurisdictions, the Authority considered that a 5 year carryover period would be appropriate. The Authority therefore required the proposed Incentive Mechanism to be amended as follows:

[63] Essential Services Commission, July 2002, *Review of Gas Access Arrangements: Draft Decision,* p. 118.

Amendment 37

Clauses 35 of Part B of the proposed revised Access Arrangement should be amended to provide for an Incentive Mechanism that provides for a rolling carry-over mechanism of no longer than five years.

Final Decision

606. In response to Amendment 37 AGN did not accept the requirement to amend.

607. In its submission dated 21 March 2005 in response to the Draft Decision, AGN made submissions at paragraphs 182 to 191 as to why it considered that the Authority ought re-consider its Draft Decision and award a 10 year carry-forward mechanism to AGN under the revised Access Arrangement.

608. The Authority has considered AGN's submissions carefully but does not consider that they provide a basis for the Authority to re-consider its Draft Decision in this respect.

609. Consistent with AGN's submissions, the proposed revised Access Arrangement submitted by AGN on 10 June 2005 in response to the Draft Decision, continues to provide, in clause 35(1)(b) of Part B, for a 10 year carry-forward. The Authority proposes to require AGN to amend this provision to provide for a 5 year carry-forward prior to final approval. The required amendment, therefore, is as follows:

Final Decision Amendment 21

Clause 35(1)(b) of Part B of the proposed revised Access Arrangement submitted by AGN on 10 June 2005 should be amended to provide for an Incentive Mechanism that provides for a rolling carryover mechanism of no longer than five years.

Treatment of negative carryovers

Draft Decision (Amendment 38)

610. Clause 34(1)(b) of Part B of the proposed revised Access Arrangement as originally submitted provided for a carryover under which AGN would retain "the reward" associated with efficiency gains during the second Access Arrangement Period.

611. In its Draft Decision, the Authority considered that it was unclear whether provision was being made for the carryover of any net efficiency losses which may have accrued at the end of the second Access Arrangement Period.

612. The Authority noted in this respect that AGN's proposal with respect to carryover at the end of the relevant Access Arrangement Period was worded consistently with the Access Arrangements approved in 2002 by the ESC for the three major gas distribution companies. In that review, while noting that negative carryover is permitted under the Code the ESC accepted the gas distributors' proposal that there not be an automatic carryover of net efficiency losses into the next period. Accordingly, the ESC approved the gas distributors' proposals on the condition that the ESC would retain discretion in determining the treatment of any accrued negative carryover amount at the end of future access arrangement periods.

613. The Authority regarded the ESC's approach as an appropriate means of addressing the possibility of an accrued net efficiency loss at the end of the second Access Arrangement Period. The Authority, in its Draft Decision, therefore required AGN to amend the proposed Incentive Mechanism to clarify how AGN proposes that net negative efficiency losses at the end of the second Access Arrangement Period are to be treated, including the exercise of any discretion by the Authority in this matter.

614. The required amendment (Amendment 38) was as follows:

> Clauses 33 to 36 of Part B of the proposed revised Access Arrangement should be amended to clarify how AGN proposes that net negative efficiency losses at the end of the second Access Arrangement Period are to be treated, including the exercise of any discretion by the Authority in this matter.

Final Decision

615. In response to Amendment 38 AGN did not accept the requirement to amend.

616. In its submission dated 21 March 2005 in response to the Draft Decision, AGN made submissions at paragraphs 192 to 195 as to why it considered that the Authority ought re-consider its Draft Decision.

617. In particular, AGN referred to the Victorian position referred to by the Authority in its Draft Decision. AGN noted in its submission that the final arrangements for the Victorian gas distributors did not appear to incorporate the express reservation of discretion in relation to net negative efficiency carryovers originally sought by the ESC. The Authority has considered the relevant decisions and has confirmed that AGN's submission is correct in this respect.

618. In the circumstances, AGN submitted as follows in relation to the ability of the Authority to exercise discretion at the next Access Arrangement review in relation to any net negative efficiency carryover amount (see paragraph 194 of the submission):

> Nothing in AGN's proposed revised Access Arrangement seeks to fetter the ERA's discretion regarding the treatment of negative carry-over amounts at subsequent access arrangement reviews. Given this consideration, and having regard to the similarity between the Incentive Mechanism provisions approved by the Victorian regulator and those proposed by AGN, it might reasonably be argued that there is no need to further clarify the Incentive Mechanism along the lines of Amendment 38.

619. The Authority is inclined to accept AGN's further submissions on this matter and, on the basis that the parties are proceeding on the assumption that the Authority will retain discretion to deal with negative efficiency carryover amounts at the next Access Arrangement review, the Authority does not propose to require AGN to meet the requirements of Amendment 38.

Capital expenditure

Draft Decision (Amendment 38)

620. A further issue relevant to the design of an "appropriate" Incentive Mechanism under the Code is which activities should be covered by the efficiency carryover mechanism. Particular issues arise with respect to capital expenditure.

621. The Authority notes that the Farrant Discussion Paper at section 6.1.3 explored issues in relation to allowing carry-forward of efficiency gains/losses for capital expenditure as well as for Non Capital Costs. The Farrant Discussion Paper stated at Conclusion 6.17 that:

> A price path Incentive Mechanism that provides in the calculation of Total Revenue for carry-forward of variances to return for the Service Provider arising from non capital expenditure is likely to be an enhancement beneficial to all stakeholders, compared to a simple price path Incentive Mechanism with no carry-forward. It is less clear that introducing a carry-forward arising from capital expenditure will ultimately be beneficial to all stakeholders.

622. In relation to the carry-forward of efficiency gains relating to capital costs in the Draft Decision the Authority noted that:

- There may not be suitable benchmarks to establish adjustments based upon changes in scope of capital works other than for consumer-driven core business activities such as connections at the small use customer end of the market (which activities are provided for by AGN under the User Initiated Capital category of New Facilities Investment). In relation to this matter, the ESC found that for the three major gas distribution systems the connection activity is customer-driven and an essentially continuous and routine activity for which the timing of expenditure should not become an issue and for which reasonably reliable cost benchmarks (on a unit connection basis) should be feasible[64].

- The application of an Incentive Mechanism is complicated by the process by which New Facilities Investment is carried forward to a new Access Arrangement Period through the Capital Base carry-forward process under the Code. The difficulties of this process are that it has the potential to create perverse incentives.

623. Consistent with the approach adopted by the ESC in Victoria the Authority's Draft Decision was to confine capital expenditure which is within the Incentive Mechanism to the User Initiated Capital category of New Facilities Investment. The Authority required the following amendment (Amendment 39) accordingly.

> Clauses 33 to 36 of Part B of the proposed revised Access Arrangement should be amended to confine the carry-over mechanism for New Facilities Investment to User Initiated Capital and amends the submitted Access Arrangement Information to include appropriate benchmark unit costs for this category.

Final Decision

624. In its submission in response to the Draft Decision, AGN submitted as follows in relation to Amendment 39:

> The ERA argues that the efficiency carry-over mechanism should be confined to capital expenditure where benchmarks can be established to capture changes in the scope of works. AGN recognises the ERA's concern that "efficiency" should not be mistaken for "scope changes". However, AGN does not accept that scope of works cannot be established or measured for matters other than User Initiated capital expenditure. For example, scope of works and benchmark costs could possibly be established for renewals expenditure. AGN

[64] Essential Services Commission, July 2002, *Review of Gas Access Arrangements: Final Decision.*

> would like to explore this possibility with the ERA, rather than accepting the proposed amendment at this stage, and may make further submissions on the subject.

625. In subsequent consultations between AGN and the Authority, AGN did not advance reasons why other categories of capital expenditure would be appropriate to be brought within the carryover mechanism as foreshadowed in the above submission.

626. In the circumstances, the Authority has no reason to depart from its Draft Decision on this point. The Authority notes that AGN's most recently submitted proposed revised Access Arrangement and Access Arrangement Information do not conform to Amendment 39 because they do not include benchmark unit costs for User Initated Capital[65].

627. In relation to benchmarks for unit costs in the User Initiated Capital category, the Authority is aware from consultations with AGN in relation to forecast New Facilities Investment following the Draft Decision that AGN has developed unit cost benchmarks which might readily be adapted for use in the context of the Incentive Mechanism. Those benchmarks have not, however, been included in the Access Arrangement Information so as to satisfy Amendment 39.

628. In the cirucmstances the Authority proposes to again require AGN to amend in similar terms to those set out in Amendment 39 to the Draft Decision.

Final Decision Amendment 22

Clauses 34 to 38 of Part B of the proposed revised Access Arrangement submitted by AGN on 10 June 2005 should be amended to confine the carryover mechanism for New Facilities Investment to User Initiated Capital and the revised Access Arrangement Information submitted on 27 May 2005 should be amended to include appropriate benchmark unit costs for this category.

FRC and Regulatory Costs

Draft Decision (Amendment 40)

629. The only activities which AGN has sought to exclude from the efficiency carryover mechanism are those related to FRC. Clause 13 of Part B of the proposed revised Access Arrangement as originally submitted provided:

> The impact of the FRC Costs and FRC New Facilities Investment under Part B, clause 12 shall not be taken into consideration when determining AGN's performance in relation to any efficiency or incentive mechanisms.

630. In the Draft Decision the Authority noted that as Regulatory Costs are proposed to be the subject of annual variation under section 8.3 of the Code there should not be any variations in costs to carry over.

[65] AGN has proposed excluding from the efficiency carry-over mechanism New Facilities Investment other than User Initiated Capital (see clause 38(b) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005).

631. In relation to Non Capital Costs, as AGN has a limited ability to control FRC and Regulatory Costs it is not clear that such costs are appropriately included as part of an Incentive Mechanism.

632. On balance, the Authority considered it appropriate in its Draft Decision to include in the efficiency carryover mechanism all Non Capital Costs, excluding FRC and Regulatory Costs. Amendment 40 was required accordingly, in the following terms:

> Clauses 33 to 36 of Part B of the proposed revised Access Arrangement should be amended to provide for an Incentive Mechanism that excludes from the carry-over mechanism those FRC and Regulatory Costs over which AGN has limited or no control.

Final Decision

633. In its submission in response to the Draft Decision dated 21 March 2005 AGN submitted that "[b]ecause the Draft Decision accepts AGN's proposed arrangements for the pass-through of Regulatory Costs (subject to the requirements of Amendment 35 being met) AGN has amended the PRAA in accordance with Amendment 40.

634. The relevant amended clause in the proposed revised Access Arrangement submitted on 10 June 2005 is clause 38 of Part B. On this basis, the Authority is satisfied that AGN has met the requirements of Amendment 40 of the Draft Decision.

Treatment of efficiency gains or losses in the last year of the second Access Arrangement Period

Draft Decision (Amendment 41)

635. Clauses 35(1) and (2) of Part B of the proposed revised Access Arrangement as originally submitted by AGN sought to address the practical problem of how to calculate the amounts (if any) to be carried forward into the third Access Arrangement Period during the last year of the second Access Arrangement Period, when the actual expenditure for the last year will not yet be known.

636. Clauses 35(1) and (2) of Part B as proposed by AGN were identical to the provisions approved by the ESC for the three major Victorian gas distributors which were intended to address this practical problem. The mechanism as approved by the ESC is intended to operate as follows:

> As information on the expenditure in the last year of the current regulatory period would not be available when new price controls are determined, the combination of the carryover and the new expenditure benchmarks would be designed to place the distributors in the same situation as if the [regulator] had information about those expenditures.[66]

637. The precise mechanism as originally proposed by AGN (and the mechanism approved by the ESC) provided for an assumption to be made that AGN makes no efficiency gain or loss relative to forecast in the final year of the second Access Arrangement Period, and that the relevant expenditure benchmark for any carryover mechanism that is to apply in the third Access Arrangement Period are to be adjusted to reflect the actual efficiency gain or loss in the final year of the second Access Arrangement

[66] ORG, September 2001, *2003 Review of Gas Access Arrangements: Position Paper*, p 73.

Period. Through this mechanism it is said in clause 34 of Part B of the proposed revised Access Arrangement as originally proposed that AGN would be provided with "precisely the same reward" as if the last year's expenditure was known.

638. The Authority considered the proposed adjustment mechanism for the purpose of the Draft Decision. The Authority noted in its Draft Decision that AGN had not provided in the proposed revised Access Arrangement or in the Access Arrangement Information as originally submitted any illustration of how the mechanism is intended to work, and therefore how the mechanism will operate in practice to ensure that AGN will be provided with "precisely the same reward" as if the last year's expenditure was known.

639. In particular, the Authority considered that it was unclear precisely how the adjustment to the expenditure benchmarks for the third Access Arrangement Period were to be made (e.g. whether the adjustment is intended to apply both to the forecasts for Non Capital Costs as well as for calculating the efficiency carryover; whether the adjustment is to apply for each year of the third Access Arrangement Period).

640. The Authority also noted that the adjustment mechanism for the last year of the Access Arrangement Period appears only to apply to gains and not to losses, unlike other years.

641. In the circumstances, the Authority was not satisfied that the proposed adjustment mechanism is appropriate for inclusion in an Incentive Mechanism under section 8.44 of the Code. The Authority therefore required amendments which would provide an appropriate mechanism, which should expressly apply to both efficiency gains or losses, for determining the efficiency carryover for the final year of the second Access Arrangement Period. Such amendments could include:

- to propose a mechanism which would enable the use of estimated efficiency gains or losses for the final year of the revised Access Arrangement, that may be updated prior to the Final Decision for the third Access Arrangement Period, so as to provide a best estimate; or

- to clarify how the proposed adjustment mechanism is intended to operate, including to illustrate how the mechanism will operate to ensure that AGN will be provided with "precisely the same reward" as if the last year's expenditure was known.

642. The required amendment (Amendment 41) was as follows:

> Clauses 33 to 36 of Part B of the proposed revised Access Arrangement should be amended to provide for an Incentive Mechanism that provides an appropriate mechanism, which should expressly apply to both efficiency gains or losses, for determining the efficiency carry-over for the final year of the second Access Arrangement Period.

Final Decision

643. In paragraph 198 of its submission in response to the Draft Decision dated 21 March 2005 AGN submitted that it "believes that the Incentive Mechanism proposed in the PRAA does operate in the manner described by the ERA. In relation to non-capital

expenditure, the effect of setting the next period's benchmark costs on the basis of the actual expenditure in year 4 is to provide a "bonus" or "penalty" in relation to any under- or over-spending in year 5."

644. Following the Draft Decision the Authority carried out further modelling to understand better how the proposed final year adjustment was intended to operate and whether the mechanism did, as stated in the proposed revised Access Arrangement, provide for "precisely the same reward" as if the final year expenditure was known in advance. In doing so, the Authority drew upon experience of the ESC, the Regulator responsible for the Victorian gas distributors, upon whose Access Arrangement this provision was based.

645. The Authority's further work indicated that while making the final year adjustment as understood by the Authority did not ensure that "precisely" the same reward would be achieved as if the final year expenditure was known the difference between the two was not material. Accordingly, the Authority is satisfied that it is unnecessary to require AGN to make amendments to meet the requirements of Amendment 41 of the Draft Decision.

Other charges for Reference Services

User Specific Delivery Facilities

646. User Specific Delivery Facilities are defined in Schedule 2 of Part A of the proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005 as follows:

> **User Specific Delivery Facilities** means:
>
> (a) a Meter which is not a Standard 6 m^3/hr Meter or a Standard 12 m^3/hr Meter;
>
> (b) Service Pipe from the main to the Delivery Point;
>
> (c) a User Specific Pressure Regulator;
>
> (d) any ancillary pipes and equipment; or
>
> (e) in the case of Reference Services A1 and A2, also includes Telemetry;
>
> being the facility or facilities which are the most appropriate for that User, as determined by AGN as a reasonable person.

647. Reference Tariffs A1 and A2 each include a User specific charge which "reflects the costs to AGN of providing the User Specific Delivery Facilities under the Haulage Contract."[67] The cost of providing User Specific Delivery Facilities is therefore to be recovered directly from the User, rather than being included in the Total Revenue to be recovered from Reference Tariffs for all Users. It is for this reason that AGN has

[67] For Reference Tariff A1, see Schedule 1 of Part B of the proposed revised Access Arrangement dated 10 June 2005, clause (3)(d), and for Reference Tariff A2, see Schedule 2 of Part B of the proposed revised Access Arrangement, clause (3)(c).

excluded the cost of User Specific Delivery Facilities from the value of the Capital Base as confirmed in clause 23 of Part A of the proposed revisions to the Access Arrangement submitted on 10 June 2005 in response to the Draft Decision.

648. The capital costs which AGN may recover from Users under the User specific charge in Reference Tariffs A1 and A2 are costs calculated "using the pre-Tax nominal weighted average cost of capital specified in the Access Arrangement Information as amended from time to time" (see clause (3)(d)(ii) of Schedule 1 and clause (3)(c)(ii) of Schedule 2 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005).

649. It is noted that the Authority has required in Final Decision Amendment 11 that the Access Arrangement Information submitted on 27 May 2005 be amended to accord with the Authority's Final Decision regarding the Rate of Return (i.e. to substitute a pre-tax real WACC of 6.60 percent for the 7.75 percent proposed by AGN in response to the Draft Decision). This WACC figure of 6.60 percent will, therefore, be incorporated by reference into the provisions of the revised Access Arrangement with respect to the User specific charge. Therefore there is no need for the Authority to require any amendment to the provisions regarding the calculation of the User specific charge.

Pro-rating of User Specific and Usage Charges

Draft Decision

650. For the purposes of the Draft Decision, WPC submitted that the proposed revised Access Arrangement as originally submitted at clause (4) of Schedule 1 to Part B did not make it clear what the financial impact is of pro-rating the User specific charge across a lesser period than one year.

651. However, as noted by the Authority in the Draft Decision, under the proposed revised Access Arrangement as originally submitted, clause (3)(d) set out the manner in which the User specific charge for User Specific Delivery Facilities was to be calculated, and provided for the charge to be an amount per day. The Authority concluded that the reference to determination on a per day basis resolved any uncertainty as to the manner in which the charge will be pro-rated and its financial impact, and determined not to require any further amendment to the proposed revised Access Arrangement.

Final Decision

652. The proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005 continues to provide for calculation on a per day basis at clause 3(d) of Schedule 1 of Part B. The Authority, therefore, does not propose to require any amendment in relation to this aspect of the revised Access Arrangement.

Pro-rating for Reference Tariffs A2 and B1

Draft Decision (Amendment 42)

653. For the purposes of the Draft Decision WPC also submitted that the Reference Tariffs for A2, B1 and B2 customers at Part B, Schedules 2, 3 and 4 of the proposed revised Access Arrangement as originally submitted by AGN were too vague "[p]articularly when attempting to understand what constitutes gas flow through a customer meter".

654. AGN's proposed Reference Tariffs A2 and B1 as originally submitted contained a provision under which a User must at the commencement of the Haulage Contract elect whether pro-rating is to be based on 5, 6 or 7 days of gas flow per week. The proposed Reference Tariffs then provided that "the Haulage Contract may specify the basis of the pro-rating and any necessary end-of-Year reconciliations." The proposed Reference Tariffs for B2 customers as originally submitted did not contain such a provision.

655. In its Draft Decision, the Authority noted that WPC's concern appeared to be that there would be potential for discrimination because the basis upon which any "end-of-Year reconciliation" under Reference Tariffs A2 and B1 is to occur would not be specified in the proposed revised Access Arrangement but rather would be a matter to be dealt with under the Haulage Contract.

656. The Authority concluded in its Draft Decision that as AGN was seeking to place conditions on Reference Tariffs A2 and B1 any such conditions would need to be specified in the revised Access Arrangement so that the Authority could consider whether or not such conditions are reasonable for the purposes of section 3.6 of the Code. Accordingly, the Authority required the following amendment to the proposed revised Access Arrangement (Amendment 42):

> Clause (5) of Schedule 1 and clause (5) of Schedule 2 of Part B of the proposed revised Access Arrangement should be amended to specify the basis of the pro-rating under Reference Tariffs A2 and B1, and the basis of any necessary end-of-year reconciliation.

657. The Authority notes that Amendment 42 of the Draft Decision contained a typographical error in that the references to Schedules "1" and "2" were intended to be references to Schedules "2" and "3" respectively.

Final Decision

658. In the proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005 AGN has accepted the requirement to amend in accordance with Amendment 42. Schedules 2 and 3 have been amended to add in each case clauses (6) to (8) in the following terms:

> (6) A pro-rating of the User specific charge under clause (4) of this Schedule … is to be done on the basis of a 365 day year.
>
> (7) A pro-rating of the usage charge under clause (4) of this Schedule … is to be done across the number of days elected by a User under clause (5) of this Schedule …, and if no election was made the usage charge is to be pro-rated based on 5 days of Gas flow per week.

(8) At the end of each Year of a Haulage Contract, if the total amount of usage charges paid by a User as a result of a pro-rating under clause (7) of this Schedule …:

(a) is less than the usage charge that would have been payable had the User been invoiced on an annual basis without pro-rating, then AGN may invoice the User for the balance on the next invoice; and

(b) is more than the usage charge that would have been payable had the User been invoiced on an annual basis without pro-rating, then AGN must allow User a credit on its next invoice for the balance.

659. The Authority is satisfied that the provisions proposed by AGN meet the requirements of Amendment 42 of the Draft Decision and are approved.

Release of information relating to pro-rating

Draft Decision

660. In its submission for the purpose of the Draft Decision, WPC also commented that if the proposed provisions requiring Users of Reference Services A2 and B1 to elect whether pro-rating is to be based upon 5, 6 or 7 days of gas flow per week are to remain, then AGN should provide historical information about a customer's days of operation to retailers at the outset of the Haulage Contract.

661. In the Draft Decision the Authority noted that the information held by AGN about its customer base has commercial value for its customers and, therefore, concluded that it would be unreasonable to expect this information to be shared by AGN with any other party.

662. The Authority also noted in the Draft Decision that it would nevertheless be reasonable to expect a gas retailer to secure information on future usage rates and continuity of demand from the particular gas consumer. In addition, the gas retailer could address any risk concerning the reliability of forecasts and consequently of the Usage charges to which the retailer might become exposed, in its commercial dealings with that consumer.

663. Finally in relation to this issue, the Authority noted in its Draft Decision that under FRC the matter of information release concerning consumer usage is now more relevant to information held by REMCo than to that held by AGN. There would therefore appear to be no specific barrier to the particular gas consumer asking REMCo to release historical usage pattern information in relation to itself to a retailer if the consumer saw a need for this in a commercial negotiation with a potential gas retailer. On this basis, no amendment was required in response to WPC's submission.

Final Decision

664. The Authority has not received any further submissions in response to this aspect of the Draft Decision and, therefore, for the purpose of this Final Decision concludes that there remains no need for any amendment to address WPC's comments.

Delivery Point costs

Draft Decision

665. For the purpose of the Draft Decision, WPC submitted that "it appears that when consumption reduces to the extent that another tariff may be more suitable, the high fixed costs relating to the original tariff remain." WPC submitted that "customers and retailers should not remain responsible for ongoing delivery point costs when a customer ceases to take, or reduces their gas consumption, by for example, the moving of premises, closure of the business or choosing another retailer." In view of these comments, WPC proposed that "[a]t the very least there should be an allowance for a range of circumstances, that should they occur, then customers and retailers are released from any obligation to pay any ongoing delivery point costs."

666. In the Draft Decision, the Authority noted that the fixed costs referred to by WPC are the User specific charges for the provision of User Specific Delivery Facilities under proposed Reference Tariffs A1, A2 and B1. Under the proposed revised Access Arrangement as originally submitted AGN's costs of providing User Specific Delivery Facilities were to be recovered through a monthly charge amortised over the lesser of the duration of the Haulage Contract and the economic life of the User Specific Delivery Facilities.

667. The Authority noted further that the effect of this proposed provision would be to expose the User to a commercial risk in the event that one of the circumstances referred to by WPC arises after a Haulage Contract has been entered into and User Specific Delivery Facilities have been installed. As this commercial risk can be managed by the User through contractual arrangements with the gas consumer the Authority was not convinced, for the purpose of the Draft Decision, that any particular amendment to the proposed revised Access Arrangement as originally submitted was required.

Final Decision

668. The Authority has not received any further submissions in response to this aspect of the Draft Decision and, therefore, for the purpose of this Final Decision concludes that there remains no need for any amendment to address WPC's comments.

Overrun Service and Overrun Charge

Draft Decision

669. AGN's proposed revised Access Arrangement as originally submitted included a description of a new Overrun Service and Overrun Charge to be made available to Users of Reference Services A1 and A2. This Service and associated charges were proposed to apply where a User's Instantaneous Flow Rate exceeds its Contracted Peak Rate for a Delivery Point.

670. Under the proposed arrangements in Schedule 1 of Part C applicable to Users of Reference Service A1, such Users would, for the first time, be charged for Overrun Services.

671. Prior to the Draft Decision, WPC submitted that the introduction of the Overrun Service and Overrun Charge would be inappropriate and any overruns "should be managed by the application of an appropriate curtailment policy".

672. In particular, WPC commented as follows:

> [W]hen customers exceed their Contracted Peak Rate they usually do so whilst remaining within the capacity of their current metering equipment, for which the customer pays the full value. The customer also pays a standing charge and a demand charge, which we understand covers the cost of Alinta's fixed assets. For these reasons we are of the opinion that the adoption of an Overrun Service and Charges appears equivalent to "double dipping". To avoid doubt, the concept of overrun requires further investigation to assess both appropriateness and financial implications.

673. In the Draft Decision, the Authority noted that in the case of Reference Tariff A1, which includes a demand charge, an Overrun Charge can provide an appropriate balance of commercial interests between a User and AGN in that a User who contracts for, and pays a demand charge at, a lower peak rate risks incurring overrun charges. While the excursion of a single end use customer may have no detrimental impact on the network as a whole, without an effective sanction there is the potential for inefficiency to develop in the system. A suitably structured Overrun Charge has the potential to encourage economically efficient capacity reservation.

674. In the Draft Decision, the Authority, therefore, indicated its approval of the introduction of an Overrun Service, subject to various amendments (Amendments 43 to 47) designed to address certain features of the Overrun Service the Authority regarded as unreasonable or otherwise non-compliant with the Code.

Final Decision

675. The proposed revised Access Arrangement submitted by AGN on 10 June 2005 makes provision for the introduction of an Overrun Service for Reference Service A1 customers (see Schedule 1 of Part C).

676. Since the Draft Decision, the Authority has not received any further submissions in relation to the introduction of an Overrun Service for Reference Tariff A1 Users.

677. Therefore, for the purpose of this Final Decision the Authority confirms its conclusion that it is reasonable for the Overrun Service to be introduced for Reference Service A1 Users.

Calculation of Overrun Charges

Draft Decision (Amendment 43)

678. In its proposed revised Access Arrangement as originally submitted, AGN proposed Overrun Charges calculated as follows:

$$OC = OSR \times Q_{Overrun}$$

where:

OC = the Overrun Charge payable by the User to AGN for the Delivery Point for the month;

OSR	= the "Overrun Service Rate" which is calculated by multiplying the average Reference Tariff applicable under the Haulage Contract for the month by 2; and
$Q_{Overrun}$	= the total for the month of each gigajoule or part of a gigajoule of Gas that was delivered to the User at the Delivery Point during a period of time in which the User's Instantaneous Flow Rate exceeded its Contracted Peak Rate.

679. In the Draft Decision, the Authority noted that the definition of the Overrun Charge as set out in paragraph 678 above was unclear as to the gigajoules of gas to which the Overrun Service Rate of twice the Reference Tariff was to apply.

680. The Authority therefore in its Draft Decision required AGN to amend the definition of the Overrun Charge applicable to clauses 7 to 9 of Schedule 1, and clauses 10 to 12 of Schedule 2, of Part C of the proposed revised Access Arrangement to clarify the gigajoules of gas to which the Overrun Service Rate of twice the Reference Tariff is to apply (Amendment 43).

Final Decision

681. AGN has accepted the requirement to amend. Clause 7 of Schedule 1 of Part C of the proposed revised Access Arrangement submitted on 10 June 2005, which applies to Reference Service A1, is now proposed to provide as follows (inserted words underlined):

$OC = OSR \times Q_{Overrun}$

where:

OC	= the Overrun Charge payable by the User to AGN for the Delivery Point for the month;
OSR	= the "Overrun Service Rate" which is calculated by multiplying the average Reference Tariff applicable under the Haulage Contract for the month by 2; and
$Q_{Overrun}$	= the total for the month of each gigajoule or part of a gigajoule of Gas <u>in excess of the User's Contracted Peak Rate</u> that was delivered to the User at the Delivery Point during a period of time in which the User's Instantaneous Flow Rate exceeded its Contracted Peak Rate.

682. The Authority is satisfied that the amendment meets the requirements of Amendment 43 of the Draft Decision. The Authority notes that the requirement under Amendment 43 to amend the definition applicable to Schedule 2 has become unnecessary by reason of the deletion of the relevant provisions by AGN in accordance with Amendment 44.

<u>Reference Tariff A2</u>

Draft Decision (Amendment 44)

683. In the Draft Decision, the Authority noted that while Reference Tariff A1 included a demand charge applicable to the Contracted Peak Rate, Reference Tariff A2 did not include such a charge. Therefore, the introduction of an Overrun Charge for Reference Tariff A2 if approved might provide Users with an incentive to over-estimate their Contracted Peak Rate. This raised a question for the Authority as to the appropriateness of this charge. On the other hand, the Authority noted that

notification of frequent overruns and a requirement to install a flow control device may nonetheless be appropriate in the case of Reference Tariff A2, regardless of whether a demand charge was in place.

684. Therefore, the Authority concluded that the introduction of an Overrun Service for Reference Service A2 customers would be unreasonable and required an amendment to the proposed revised Access Arrangement (Amendment 44) whereby the Overrun Charge in relation to Reference Service A2, in clauses 10 to 12 of Schedule 2, of Part C of the proposed revised Access Arrangement, would be deleted.

Final Decision

685. AGN has accepted the requirement of Amendment 44 to delete the Overrun Charge for Reference Tariff A2, and has therefore deleted clauses 10 to 12 of Schedule 2 of Part C to the proposed revised Access Arrangement submitted on 10 June 2005.

686. The Authority notes that in the proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision, AGN has proposed to amend clause 34 of Part C which deals with pricing if a Haulage Contract continues beyond the end of the second Access Arrangement Period. The effect of this amendment, if approved, would be to make the Overrun Service immediately applicable to any Haulage Contract, the term of which runs into the third Access Arrangement Period, in circumstances where a demand charge and an associated Overrun Service is introduced for the first time with respect to the relevant Reference Service to apply for the third Access Arrangement Period. The Authority is satisfied that this condition is reasonable, and therefore approves the amendment to 34 of Part C.

Notification of overruns

Draft Decision (Amendment 45)

687. In the proposed revised Access Arrangement as originally submitted, AGN proposed in Part C, that for Users of Reference Services A1 and A2, it may in the event of three or more "occasions" per 30 day period or of eight or more per year, notify the User of this fact.

688. In the Draft Decision, the Authority noted that under this proposal, if notification was given and an increase in Contracted Peak Rate would not breach the Queuing Policy, the User would have to elect either to increase its Contracted Peak Rate or have AGN install at the User's expense a flow control device, and if the User did not so elect within 10 Business Days, AGN could elect on the User's behalf. Further, if notification was given and an increase in Contracted Peak Rate would breach the Queuing Policy, AGN would have a discretion to install at the User's expense a flow control device.

689. One issue under AGN's original proposal which the Authority raised in its Draft Decision was whether the notification to be given by AGN to a User should be mandatory or discretionary. AGN had originally proposed that notification be discretionary. The Authority noted that under AGN's original proposal the ability of a User to increase its Contracted Peak Rate or have flow control installed would be contingent on AGN exercising its discretion to notify the User. Where overruns are

occurring, increasing a User's Contracted Peak Rate or having flow control installed may be more efficient regardless of whether AGN chooses to notify.

690. The Draft Decision noted that this aspect of AGN's original proposal raised the question whether a User who is incurring Overrun Charges should have the right to nominate an increase in its Contracted Peak Rate (subject to Queuing Policy) or have flow control installed. The Authority noted in the Draft Decision that this issue could be addressed by AGN's proposal being amended by either making notification mandatory in defined circumstances, or conferring a right upon a User who is incurring Overrun Charges to nominate an increased Contracted Peak Rate or having flow control installed.

691. The Authority therefore in its Draft Decision required AGN to amend the provisions regarding notification of overruns in clauses 7 to 9 of Schedule 1, and clauses 10 to 12 of Schedule 2, of Part C of the proposed revised Access Arrangement either to make notification mandatory in defined circumstances, or to confer a right upon a User who is incurring Overrun Charges to nominate an increased Contracted Peak Rate (subject to the Queuing Policy) or to have flow control installed (Amendment 45).

Final Decision

692. AGN has accepted the requirement to amend. Clause 9 of Schedule 1 of Part C of the proposed revised Access Arrangement submitted on 10 June 2005 makes notification mandatory. The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 45 of the Draft Decision.

693. The Authority notes that the requirement under Amendment 45 to amend the definition applicable to Schedule 2 has become unnecessary by reason of the deletion of the relevant provisions by AGN in accordance with Amendment 44.

Overrun "occasions"

Draft Decision (Amendment 46)

694. The Authority noted in the Draft Decision that a number of issues arose from the definition of the Overrun Charges proposed by AGN as originally submitted (as reproduced at paragraph 678 above) in relation to the meaning of the word "occasion" which triggers AGN's discretion to notify a User.

695. In the Draft Decision the Authority noted that the word "occasion" could, for example, mean each single instantaneous excursion, or a day in which one or more excursions occur. Further, the Authority noted that that there was a need for clarification in relation to the circumstances in which an excursion would count as being an "occasion" such as in the case of where an overrun is out of the control of the User, gas consumer or both. Finally, the Authority noted that it would also be appropriate for AGN to provide additional information to the Authority substantiating its choice of "three or more occasions during any 30 day period" and "8 or more occasions during a year" prior to notifying a User.

696. Therefore, in its Draft Decision the Authority required AGN to amend the provisions regarding notification of overruns in clauses 7 to 9 of Schedule 1, and clauses 10 to 12

of Schedule 2, of Part C of the proposed revised Access Arrangement to clarify the circumstances in which an excursion would count as being an "occasion" (Amendment 46).

Final Decision

697. AGN has accepted the requirement to amend in accordance with Amendment 46 of the Draft Decision. Clause 9 of Schedule 1 of Part C of the proposed revised Access Arrangement submitted on 10 June 2005 avoids the use of the undefined term "occasions" and substitutes the word "days" which appropriately clarifies the meaning as required by the Draft Decision. The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 46 of the Draft Decision.

698. The Authority notes that the requirement under Amendment 46 to amend the definition applicable to Schedule 2 has become unnecessary by reason of the deletion of the relevant provisions by AGN in accordance with Amendment 44.

Rebating of Overrun Charges

Draft Decision (Amendment 47)

699. In the Draft Decision the Authority noted that the application of Overrun Charges will generate revenue from Users of Reference Services. It was noted, however, that AGN had not provided any estimates of this revenue stream. Indeed, given the nature of the Overrun Service, it is likely that it would be difficult if not impossible to predict reasonably the revenue which AGN could expect to recover from this source.

700. Section 10.8 of the Code provides a definition of a Rebatable Service as follows:

> **'Rebatable Service'** is 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.

701. In view of the definition provided by section 10.8, and the "substantial uncertainty" regarding the receipt by AGN of revenue from sales of the Overrun Service, the Authority concluded in its Draft Decision that the Overrun Service should be provided as a Rebatable Service under the Code. On this basis, the revenue from Overrun Charges exceeding the reasonable cost of providing the Overrun Service would be rebatable in accordance with the provisions of section 8.40 of the Code.

702. In relation to the distribution of rebates, the Authority noted further in its Draft Decision that an important purpose of an Overrun Service would be to provide the system-wide benefit of encouraging economically efficient capacity reservation. Further, the costs involved in the provision of the Reference Services to which the Overrun Service applies are borne as part of Total Revenue by all Users of Reference Services. Given these considerations, the Authority considered that under any rebate mechanism it would be appropriate for the net revenue from Overrun Charges to be rebated across all Users of all Reference Services.

703. In relation to the Overrun Service and considering all of the matters before it, the Authority concluded in the Draft Decision that there was a need for AGN to amend its proposed revised Access Arrangement as follows:

> **Amendment 47**
>
> The proposed revised Access Arrangement should be amended to include a mechanism which complies with section 8.40 of the Code by which revenue from Overrun Charges exceeding the reasonable cost of providing the Overrun Service will be rebated across all Users of Reference Services.

Final Decision

704. In response to Amendment 47 AGN has accepted the requirement to amend to introduce a rebate scheme in relation to Overrun Charges collected from Users of Reference Service A1.

705. The rebate mechanism proposed by AGN is set out in clause 40 of Part B of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 as follows:

> (1) After the end of each calendar Year AGN must, within a reasonable period, calculate Overrun Rebates for Users for the Year by:
>
> (a) determining the total of all Overrun Charges received from all Users for the Year ("**Total Charges**");
>
> (b) deducting AGN's reasonable administration costs connected with administering the rebate scheme under this Part B clause 40 from the Total Charges; and
>
> (c) pro-rating the amount determined under Part B clause 40(1)(b) across each User by reference to the total volume of Gas delivered to that User by AGN in the Year to determine each User's "**Overrun Rebate**".
>
> (2) AGN must show the Overrun Rebate for a User as a credit on the first account issued to that User by AGN following its calculation of the Overrun Rebate for the Year and must provide to each User a summary of the elements referred to in Part B, clause 40(1) used in the calculation of its Overrun Rebate for the Year.

706. The Authority is satisfied that this proposal meets the requirements of the Code under section 41 for an appropriate mechanism for rebating charges for a Rebatable Services to Users, and meets the requirement to amend in Amendment 47 of the Draft Decision.

Fixed principles

707. Section 8.47 of the Code provides as follows:

> 8.47 The Reference Tariff Policy may provide that certain 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. A Fixed Principle is an element of the Reference Tariff Policy that can not be changed without the agreement of the Service Provider (***Fixed Principle***). The period during which the Fixed Principle may not be changed is the Fixed Period (***Fixed Period***).

708. Section 8.48 of the Code provides as follows:

> 8.48 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.

709. Section 10.8 of the Code provides the following relevant definitions:

> **'Market Variable Element'** means 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.
>
> **'Structural Element'** means 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, and includes the Depreciation Schedule, the financing structure that is assumed for the purposes of section 8.30, and that part of the Rate of Return (calculated pursuant to section 8.30) that exceeds the return that could be earned on an asset that does not bear any market risk.

710. The effect of these provisions is that under section 8.48 of the Code, the Authority has power to approve Fixed Principles which include Structural Elements, but a Market Variable Element may not be a Fixed Principle. In addition, section 8.48 of the Code requires that in assessing whether any Structural Element may be a Fixed Principle the Authority must have regard to the interests of the Service Provider and the interests of Users and Prospective Users.

711. Clause 37 of the Reference Tariff Policy in Part B of the proposed revised Access Arrangement as originally submitted by AGN on 31 March 2004 provided as follows:

> (1) In accordance with sections 8.47 and 8.48 of the Code, the following provisions are Fixed Principles:
>
> (a) the method of calculation of the Total Revenue as described in Part B, clause 21;
>
> (b) the method of forecasting New Facilities Investment under Part B, clause 23;
>
> (c) 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;
>
> (d) the Depreciation Schedule referred to in Part B, clause 26;
>
> (e) the inclusion of FRC costs in Non-capital costs as described in Part B, clause 27(2)(a);
>
> (f) the method of allocating revenue between Services as described in Part B, clause 28; and (sic)
>
> (g) the form of regulation as described in Part B, clause 32; and
>
> (h) the incentive mechanism described in Part B, clauses 33-36.
>
> (2) The Fixed Period is a period of 10 years commencing from the start of the Second Access Arrangement Period.

712. In the Draft Decision the Authority noted that AGN was proposing to vary some Fixed Principles that were part of the Reference Tariff Policy approved under the current Access Arrangement. The Fixed Period set for those Fixed Principles was a period of 10 years from the commencement date of the current Access Arrangement (i.e. 1 January 2000). This proposed revision is being assessed before the expiry of that Fixed Period.

713. The Authority's Draft Decision noted that it is, however, permissible under section 8.47 of the Code for AGN to propose as part of the proposed revised Access Arrangement a Reference Tariff Policy which varies or deletes one or more of the existing Fixed Principles that are still within their respective Fixed Period or which adds one or more principles as Fixed Principles.

714. The Authority's Final Decision in relation to each of the proposed Fixed Principles is set out below.

Method of forecasting New Facilities Investment

Draft Decision (Amendment 48)

715. In its Draft Decision, the Authority noted that the meaning of the Fixed Principle in clause 37(1)(b) of Part B as originally submitted (as reproduced above at paragraph 711) was unclear because it referred to a method of forecasting New Facilities Investment under Part B, clause 23 when that clause does not include a method of forecasting. The Authority, therefore, required clause 37(1)(b) of Part B to be amended to clarify the method of forecasting New Facilities Investment to which reference is being made.

Final Decision

716. AGN has accepted the requirement to amend. The relevant clause has been deleted from the proposed revised Access Arrangement submitted on 10 June 2005. The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 48 of the Draft Decision.

Financing structure for determining Rate of Return

Draft Decision (Amendment 49)

717. In its Draft Decision, the Authority noted that the meaning of the Fixed Principle in clause 37(1)(c) of Part B as originally submitted (as reproduced above at paragraph 711) was unclear because the financing structure assumed for the purposes of determining the Rate of Return referred to in clause 37(1)(c) of Part B was not specified. The Authority, therefore, required clause 37(1)(b) of Part B to be amended to specify the financing structure assumed for the purposes of determining the Rate of Return.

Final Decision

718. AGN has accepted the requirement to amend. The relevant clause has been amended to add the words "(being a 60/40 debt/equity ratio)" after the words "financing

structure" in clause 39(1)(b) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005. The Authority is satisfied that this amendment meets the requirements of Amendment 49 of the Draft Decision.

Depreciation method

Draft Decision (Amendment 50)

719. In its Draft Decision, the Authority noted that the meaning of the Fixed Principle in clause 37(1)(d) of Part B as originally submitted was unclear because it referred to a Depreciation Schedule under Part B, clause 26 when the content of that clause (as opposed to the heading) did not refer to a Depreciation Schedule, but rather to a method of depreciation. The Authority, therefore, required clause 37(1)(d) of Part B to be amended to clarify the Fixed Principle that was intended in relation to depreciation.

Final Decision

720. AGN has accepted the requirement to amend. Clause 39(1)(c) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision now refers to "the straight-line method of depreciation for each group of assets referred to in Part B, clause 27." The Authority is satisfied that this amendment meets the requirements of Amendment 50 of the Draft Decision.

FRC Costs

Draft Decision (Amendment 51)

721. In its Draft Decision, the Authority noted that there was a typographical error in the Fixed Principle in clause 37(1)(e) of Part B as originally submitted relating to FRC costs. Further, the intent of the proposed Fixed Principle in relation to FRC costs was unclear, for example was AGN's intent:

- To refer only to FRC Costs as defined, or was the intent to be wider than this.
- To recognise FRC Costs as a component of Non Capital Costs, or was the intent that the amount of FRC Costs will be accepted as Non Capital Costs for the third Access Arrangement Period.

722. The Authority, therefore, required clause 37(1)(e) of Part B of the proposed revised Access Arrangement to be amended to correct a typographical error by amending "Part B, clause 27(2)(a)" to read "Part B, clause 27(2)", and to clarify the Fixed Principle that is intended in relation to FRC costs.

Final Decision

723. AGN has accepted the requirement to amend. Clause 39(1)(d) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 now refers to "the inclusion of FRC Costs as a component of Non-Capital Costs for the duration of the Fixed Period as described in Part B, clause 28(2)". The Authority is satisfied that this amendment meets the requirements of Amendment 51 of the Draft Decision.

Tariff basket form of price control

Draft Decision (Amendment 52)

724. In clause 37(1)(g) of the proposed revised Access Arrangement as originally submitted AGN proposed that the tariff basket form of price control be a fixed principle for 10 years.

725. In its Draft Decision, the Authority noted that in its Draft Decision it had accepted, for the first time, the tariff basket form of price control to apply for the second Access Arrangement Period. Further, the Authority considered that until AGN and Users have some experience with this form of price control, the Authority did not regard it as being in their interests to make this form of price control a Fixed Principle beyond the second Access Arrangement Period, as had been proposed by AGN in clause 37(1)(g) of Part B.

726. Accordingly, the Authority's Draft Decision required AGN to delete clause 37(1)(g) of Part B of the proposed revised Access Arrangement as originally submitted (Amendment 52).

Final Decision

727. AGN has accepted the requirement to amend. The relevant clause has been deleted from the proposed revised Access Arrangement submitted on 10 June 2005. The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 52 of the Draft Decision.

Terms and Conditions

Requirements of the Code

728. Section 3.6 of the Code requires that:

> 3.6 An Access Arrangement must include the terms and conditions on which the Service Provider will supply each Reference Service. The terms and conditions included must, in the Relevant Regulator's opinion, be reasonable.

Access Arrangement proposal

729. To satisfy itself that the terms and conditions of proposed Reference Services are reasonable for the purposes of section 3.6 of the Code, the Authority has given consideration to:

- the effect of each of the relevant terms and conditions contained in the proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision;
- the submissions on the proposed terms and conditions; and
- the factors set out in section 2.24 of the Code so far as they are applicable.

Retail Market Rules

Draft Decision (Amendment 53)

730. The Retail Market Rules (**RMRs**) are a set of rules which have been agreed to by industry participants, as part of a Retail Market Scheme (**RMS**), to facilitate the fair and efficient introduction of Full Retail Contestability (**FRC**) for gas customers in Western Australia. As the RMRs and approved Access Arrangements both impact on the relations between Service Providers and Users they may overlap and, therefore, could be inconsistent.

731. In the Draft Decision the Authority noted that under the proposed revisions to the Access Arrangement as originally submitted, AGN included a number of terms and conditions which sought to cross-reference RMRs in the Access Arrangement, so as to make those RMRs terms and conditions of the Access Arrangement. In clause 3.9 of the Access Arrangement Information as originally submitted, AGN indicated that these proposed revisions were intended to avoid inconsistency between the Access Arrangement and the RMRs in areas of overlap.

732. The terms and conditions of Reference Services in the proposed revisions in Part C which seek to cross-reference RMRs in the Access Arrangement are as follows:

- Sub-clause 16(1) – Gas balancing
- Clause 26 – Meter Readings
- Clause 27 – Provision of data
- Sub-clause 32(1) – Disputed invoices
- Sub-clause 36(3) – Information exchange
- Clause 58 – Dispute not a default
- Clause 64 – Notices and addresses for notices

733. Under section 3.6 of the Code the Authority had to be satisfied that these terms or conditions of Reference Services under the proposed revisions to the Access Arrangement would be reasonable.

734. In its Draft Decision the Authority noted that the RMRs had been adopted by agreement by the industry, after lengthy consultation, to govern the introduction of FRC and have statutory recognition under the *Energy Co-ordination Act 1994*. Further, that the RMRs are enforceable as between participants, including between Service Providers and Users, in accordance with an agreed compliance regime under the RMRs.

735. The Authority indicated in its Draft Decision that one consequence of the RMRs being cross-referenced in an Access Arrangement would be to provide remedies for breach of the Haulage Contract in addition to those remedies which the industry has determined under the RMRs as being appropriate for the enforcement of the RMRs.

736. The Authority also expressed concern in its Draft Decision that it could be unreasonable for parties who have agreed to participate in and be bound by an industry process for determining a set of RMRs to find themselves subject to further regulation, through the Access Arrangement, of matters already dealt with reasonably under the RMRs.

737. A further matter of concern for the Authority in the Draft Decision arose from the RMRs being subject to an amendment process during the life of an Access Arrangement. The Authority was not satisfied that changes to cross-referenced RMRs during the life of the revised Access Arrangement could, in accordance with the provisions of the Code, automatically flow on to the Access Arrangement as envisaged by AGN. This is because, under section 2.49 of the Code, the only way to vary terms and conditions of Reference Services contained in an approved Access Arrangement is through the review process provided under section 2 of the Code. The Authority has no power to vary such terms and conditions in any other way.

738. Consequently, the Authority considered that whenever cross-referenced RMRs changed during the life of the revised Access Arrangement, the effect of section 2.49 of the Code would be to retain application of the RMR that applied as at the date the Access Arrangement came into effect. This would result in uncertainty, at least until the Access Arrangement is amended or revised to clarify that the amended RMR applies. The Authority considered that such uncertainty could result in an unreasonable outcome, contrary to section 3.6 of the Code.

739. In this regard, the Authority recognised that it would from 31 May 2005, take over from the relevant Minister formal responsibilities with respect to the approval of amendments to the RMRs[68]. In this role the Authority will have some capacity to monitor and enforce the reasonableness of RMRs affecting the Service Provider-User relationship. However, the Authority did not consider that this addressed its concerns about the reasonableness of terms and conditions cross-referenced to the RMRs, because the Authority will be fulfilling a different statutory function in relation to the RMRs, guided by different statutory objectives. For example, it may not be appropriate for the Authority to veto a proposed change to a cross-referenced RMR on the basis that the changed RMR may not be reasonable in the context of the Access Arrangement, having regard to the different statutory objectives under the Code and the *Energy Co-ordination Act 1994*.

740. For all of the above reasons, in its Draft Decision the Authority was not satisfied that it would be reasonable for an Access Arrangement to cross-reference RMRs so as to make the RMRs a term or condition of the Access Arrangement, where the RMRs are subject to separate amendment from time to time. The Authority, therefore, did not propose to approve the proposed revisions to the clauses of the Access Arrangement which cross-reference RMRs, unless the cross-references were removed.

741. The Authority noted in its Draft Decision that one way in which AGN could seek to address this issue may be to submit proposals for the revisions to the Access Arrangement to include the text as a term or condition of the Access Arrangement, rather than by cross-referencing to the RMRs. Under any such proposal the Authority

[68] See sections 17 to 19 of the *Energy Legislation Amendment Act 2003.*

would have to satisfy itself that the provision is reasonable. If, however, the Authority was to be satisfied that the provision would be reasonable, then the provision would operate regardless of changes in the RMRs. The operation of the Access Arrangement in this way is supported by Rule 403 of the RMRs which provides that in the event of inconsistency between the Access Arrangement and an RMR, the Access Arrangement takes precedence.

742. Finally, the Authority noted that the difficulties with respect to the inter-relationship between the RMRs and terms and conditions in the Access Arrangement appear to have arisen because the Code was written well before the advent of FRC and RMRs regulating the conduct of market participants in a contestable retail market. Further, other aspects of Access Arrangements, in particular Trading Policy, may be impacted by the advent of the RMS. To overcome the difficulties discussed in this Draft Decision, the Authority noted that Code amendments might be considered in order to better harmonise the RMS and the access regime.

743. The amendments required to the proposed revised Access Arrangement as originally submitted to give effect to the Authority's draft decision was Amendment 53:

> **Amendment 53**
>
> Clauses 16(1), 26, 27, 32(1), 36(3), 58 and 64 of Part C, of the proposed revisions should be amended to remove cross-referencing to the RMS or the RMRs.

Final Decision

744. In relation to the required amendments to clauses 16(1) (Gas balancing), 26 (Meter readings), 27 (Provision of data) and 32(1) (Disputed invoices), AGN accepted the requirement to amend in accordance with Amendment 53.

745. In relation to these clauses, in its amended proposed revised Access Arrangement submitted on 10 June 2005, AGN adopted the approach suggested by the Authority in its Draft Decision. That is, AGN amended the proposed clause so that it did not cross-reference, or incorporate by reference, a RMR or provision of the RMS as a term or condition. Rather, the amended clause incorporated the text of the previously cross-referenced RMR or provision of the RMS into the proposed revised Access Arrangement.

746. The effect of this approach will be that in the event that the relevant RMR or provision of the RMS is amended during the second Access Arrangement Period, any inconsistency between the revised Access Arrangement and the RMRs or RMS dealing with the same subject matter will be resolved, in accordance with Rule 403 of the RMRs, in favour of the Access Arrangement provisions (except where the amendment under the RMR imposes a higher standard than that under the revised Access Arrangement).

747. The Authority has considered the proposed clauses which have been amended in this way. The clause numbers of Part C in the amended proposed revised Access Arrangement submitted on 10 June 2005 are as follows:

- Clause 16(1) (Gas balancing);

- Clause 25 (Meter readings) (formerly clause 26);
- Clause 27 (Provision of data); and
- Clause 32(1) (Disputed invoices).

748. The Authority is satisfied that these clauses meet the requirements of Amendment 53 of the Draft Decision and otherwise are reasonable for the purposes of section 3.6 of the Code. In reaching this conclusion the Authority has had regard to the relevant provisions of the RMRs.

749. AGN adopted a different approach in relation to the other three clauses in Part C as originally submitted which the Authority required AGN to be amended under Amendment 53 of the Draft Decision. These clauses were:

- Clause 36(3) (Information Exchange);
- Clause 58 (Dispute not a Default); and
- Clause 64 (Notices).

750. In its submission in response to the Draft Decision dated 21 March 2005, AGN drew a distinction between a clause which seeks to incorporate a RMR as a term or condition of the Access Arrangement, and a term or condition of an Access Arrangement which refers to a RMR as an external standard. AGN's submission (paragraph 240) was as follows:

> A distinction must be drawn between the substantive terms and conditions of a contract and a reference in the terms and conditions to an external standard that determines the standard of performance of the terms and conditions of the contract. The ERA's task under section 3.6 of the Code is to determine whether the term of the Part C Haulage Contact, which in effect contains a mechanism by which the standard of performance of the obligation in the term is nominated, is reasonable. The RMR is a reasonable mechanism for determining the precise standard of performance of an obligation in a term of the Part C Haulage Contract.

751. Therefore, in AGN's submission, where the cross-referenced RMRs or provision in the RMS represents a standard of performance of an obligation, as opposed to the obligation itself, under an Access Arrangement then there is no difficulty in the Authority approving the provision (subject to the "reasonableness" test being satisfied). This is because any amendment or variation to the relevant RMR or the RMS during the life of the revised Access Arrangement will not amend or vary the underlying obligation in the Access Arrangement. On the other hand, by accepting the requirement to amend certain of the cross-references to the RMRs identified in Amendment 53 (i.e. clauses 16(1), 26, 27 and 32(1) as set out above), AGN recognised that if the reference to the RMR or provision of the RMS represented the incorporation by reference of the rights and obligations in the RMRs or RMS, then section 2.49 of the Code would create an obstacle to the Authority approving the provision.

752. The Authority accepts that AGN's submission as to the relevant distinction is valid. Indeed, there were a number of clauses in the proposed revised Access Arrangement as originally submitted by AGN that contained references to the RMRs or RMS which

operated as external standards or concepts relevant to terms or conditions, but that did not seek to incorporate such provisions as terms or conditions of the proposed Access Arrangement. In these instances, the Authority did not require any amendment to those clauses in its Draft Decision. The clauses in the proposed revised Access Arrangement as originally submitted falling into this category were clauses 8, 10(b) and 13(b) of Part A, and clauses 7(3) and 59 of Part C. Likewise, in making its Draft Decision, the Authority had no difficulty in approving definitions of terms in the Access Arrangement by reference to concepts and standards to be found in the RMS (eg. "Above 10 Tj Determination", "FRC Costs", "FRC New Facilities Investment", "Related Shipper").

753. Further, AGN referred the Authority to a number of features of the current Access Arrangement which involved references to "floating" external standards of performance analogous to the proposed references to standards and concepts created under the RMRs or RMS. These included:

(a) References to the Consumer Price Index;

(b) References to Prescribed Interest Rates;

(c) References to "Law" which may be amended from time to time, eg.:

- Codes of Practice and Australian Standards;
- Regulations, eg. the *Gas Standards (Gas Supply and System Safety) Regulations 2000*

(d) the Code itself.

754. The purpose of AGN's submission in relation to this distinction was to support a case for the Authority to reconsider its Draft Decision under Amendment 53 with respect to clauses 36(3), 58 and 64 of Part C as originally submitted. These clauses related to:

- Electronic information exchange, under detailed technical specifications developed for the purpose of the RMS (clause 36 referred);
- Procedures for resolution of disputes arising under the RMS (clause 58 referred);
- Detailed provisions regarding the giving of notices under the RMS (clause 64 referred).

755. AGN submitted that the references in each of these proposed clauses was intended to be a reference to either an RMR or a provision of the RMS represented as an external standard of performance of rights and obligations created under the proposed revised Access Arrangement itself. As such AGN submitted that the provisions did not run foul of section 2.49 of the Code with respect to their amendment during the life of the revised Access Arrangement and should be approved as reasonable.

756. In consultation with AGN, the Authority was provided with further information regarding the nature of the RMR or provision of the RMS to which clauses 36(3), 58

and 64(3) of the proposed revised Access Arrangement as originally submitted referred, to confirm that the relevant cross-reference would not involve bringing into the revised Access Arrangement RMRs or provisions of the RMS as terms and conditions. Further, AGN proposed to the Authority amendments to the wording of each of these clauses to make it clearer that the purpose of the reference to the RMRs or RMS was to provide an external standard of performance, rather than to incorporate them into the revised Access Arrangement as terms or conditions.

757. Having reviewed this matter, the Authority is satisfied that the clauses as amended, which were included in amended form in the amended proposed revised Access Arrangement submitted on 10 June 2005, do not cross-reference the RMRs or RMS so as to incorporate the relevant provisions into the revised Access Arrangement as terms or conditions. Further, the Authority is satisfied that the standards of performance set out in the amended clauses are reasonable, being the current standards provided for under the RMRs or RMS in relation to the relevant subject matters.

758. The approved provisions in the amended proposed revised Access Arrangement submitted on 10 June 2005 are as follows:

- Information exchange – Clause 36 of Part C;
- Dispute not a default – Clause 58 of Part C;
- Notices – Clause 63 of Part C (formerly clause 64).

Services other than Reference Services

Draft Decision (Amendment 54)

759. In its Draft Decision, the Authority noted that AGN had included in its proposed revised Access Arrangement as originally submitted terms and conditions of the provision of Services other than Reference Services. In this respect, in clause 34 of Part A the proposed Access Arrangement as originally submitted by AGN, it was provided that:

> The Terms and Conditions on which AGN will supply each Service other than a Reference Service are set out in Part C as a relevant matter in accordance with section 2.29 of the Code.

760. Section 2.29 of the Code, as referred to in the above clause, provides:

> The Access Arrangement as revised by the proposed revisions may include any relevant matter but must include at least the elements described in section 3.1 to 3.20.

761. These provisions of the proposed revisions to the Access Arrangement made it necessary for the Authority, for the purposes of the Draft Decision, to form a view regarding whether an approved Access Arrangement may include such terms and conditions.

762. In clause 34 of Part A of the proposed revised Access Arrangement as originally submitted, AGN's position was that terms and conditions of Non-Reference Services were included as terms of conditions as a "relevant matter" under section 2.29 of the Code.

763. In the Draft Decision, the Authority noted that section 3.6 of the Code only requires the Authority to form an opinion as to the reasonableness of terms and conditions upon which Reference Services are to be provided. Further, the Authority noted that the Code is not, however, explicit about whether an Access Arrangement may include terms and conditions upon which Non-Reference Services are to be provided. Unlike Reference Services, the Authority is given no express role in assessing the reasonableness of terms and conditions for Non-Reference Services[69].

764. In relation to whether terms and conditions of Non-Reference Services may be included in an Access Arrangement as "relevant matters" under section 2.29 of the Code the Authority considered that if this approach was to be accepted, terms and conditions would be included in an Access Arrangement that have not been subject to a reasonableness assessment by the Authority. The Authority did not consider that this outcome was intended under the Code.

765. In this regard, the Authority referred to section 6 of the Code and noted that it provides a mechanism for the arbitration of disputes between Prospective Users and Service Providers with respect to the terms and conditions of the provision of Services. This mechanism is put in place should contractual negotiations not result in an agreement.

766. The Authority noted also that in cases where terms and conditions are contained in an approved Access Arrangement, the Arbitrator is bound to apply those terms and conditions in determining the dispute by virtue of section 6.18 of the Code, which provides:

> Subject to sections 6.19 and 6.20 and to the Queuing Policy contained in the Access Arrangement, the Arbitrator must not make a decision that:
>
> (a) subject to paragraphs (b), (c) and (d), is inconsistent with the Access Arrangement;
>
> (b) would impede the existing right of the User to obtain Services;
>
> (c) 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;
>
> (d) is inconsistent with the applicable Queuing Policy; or
>
> (e) requires the Service Provider to provide, or the User or Prospective User to accept, a Reference Service at a Tariff other than the Reference Tariff.

767. In view of these matters, the Authority considered that if an approved Access Arrangement contains terms and conditions of Non-Reference Services, then the Arbitrator of a dispute in relation to such terms and conditions under section 6.18 would have no ability to determine the dispute on its merits. The Arbitrator would thus be bound to apply the terms and conditions for Non-Reference Services in the

[69] Indeed, the only basis for the Authority not to approve an Access Arrangement is because it does not contain one or other of the elements referred to in sections 3.1 to 3.20 of the Code. The Authority considers that it would not be open to it to decline to approve an Access Arrangement because, for example, it is of the opinion that any one or more of the proposed terms or conditions of a Non-Reference Service, is not reasonable.

Access Arrangement, even though there would not have been a review by the Authority of the reasonableness of those terms and conditions.

768. In such circumstances, the Authority concluded for the purpose of the Draft Decision that under the Code terms and conditions of Non-Reference Services are a matter for contractual negotiation subject to the arbitration procedure in Section 6 where agreement is not reached. This is consistent with such Services having been regarded by the Authority as Services for which a Reference Tariff is not required.

769. The Authority noted in the Draft Decision that this conclusion was reinforced by the wording of section 2.29 of the Code, which AGN was relying upon to justify the inclusion of terms and conditions for Non-Reference Services. In the Authority's view the phrase "relevant matter" in section 2.29 could not have been intended to cover terms and conditions for Non-Reference Services, which the Code does not require to be included in an Access Arrangement. Further, the Authority considered that it was difficult to see how terms and conditions for Non-Reference Services could be regarded as a "relevant matter" for the Authority when the Code confers no express role in assessing such terms and conditions, in contrast to the express role given under section 3.6 of the Code to assess the reasonableness of such terms and conditions of Reference Services.

770. For these reasons, the Authority concluded that terms and conditions of Services which are not Reference Services could not be included in an approved Access Arrangement as a relevant matter under section 2.29 of the Code. The Authority, therefore, required clause 34 of Part A – "Terms and conditions for Services other than Reference Services" – to be amended to remove provision for the inclusion of terms and conditions for Non-Reference Services in the revised Access Arrangement (Amendment 54).

Final Decision

771. The Authority has not received any submissions since the Draft Decision commenting on this conclusion. Further, AGN has accepted the requirement to amend under Amendment 54 by deleting clause 34 of Part A. The Authority is satisfied that this amendment meets the requirements of Amendment 54 of the Draft Decision.

Interconnection service

Draft Decision (Amendments 55 to 59)

772. Clause 21(2) of Part A of the proposed revised Access Arrangement as originally submitted by AGN states:

> The Interconnection Service provides a right to interconnect with the AGN GDS. Subject to Part A, clause 22, the terms and conditions and prices upon which an Interconnection Service will be made available are to be negotiated by AGN and the person to whom that Service is provided.

773. In its Draft Decision, the Authority concluded that the Interconnection Service was a Service which must be described in the Services Policy of the revised Access Arrangement. However, the Authority also concluded that the Interconnection Service was not a Service for which a Reference Tariff was required. In these

circumstances, the Authority considered in its Draft Decision that the terms and conditions of the Interconnection Service should be left to be determined between AGN and parties interconnecting with the GDS, subject to arbitration under section 6 of the Code in the event that agreement cannot be reached.

774. In this respect, the Authority noted in its Draft Decision that the approach AGN proposed in clause 21(2) of the proposed revised Access Arrangement as originally submitted (as set out in paragraph 772 above) was consistent with the Code, except to the extent that negotiations were expressed to be subject to clause 22 which itself was a term and condition of the Interconnection Service. Further, the Authority noted that proposed revised Access Arrangement also contained a number of other clauses (21(4), 22, 23 and 28(2) of Part A) which the Authority regarded as terms and conditions of the Interconnection Service. In the Authority's view, it was not appropriate for the Access Arrangement to specify such terms and conditions.

775. The Authority therefore required in the Draft Decision that clause 21(2) be amended so that negotiations for Interconnections Services would not be subject to clause 22 (Amendment 55). Further, that the other provisions of the proposed revised Access Arrangement as originally submitted which were terms and conditions of the Interconnection Service be deleted prior to approval of the proposed revised Access Arrangement, namely:

- Clause 21(4) of Part A setting out the list of matters with which it was expected that an Interconnection Contract will deal (Amendment 56).
- Clause 22 of Part A requiring that there be a term of each Interconnection Contract in relation to compliance with the Gas Quality Specifications (Amendment 57).
- Clause 23 of Part A setting out the requirements for an application for an Interconnection Contract (Amendment 58).
- Clauses 28(2) of Part A requiring that a Prospective User of an Interconnection Service who is a Pipeline Operator must enter into an Interconnection Contract with AGN (Amendment 59).

Final Decision

776. The Authority has not received any submissions since the Draft Decision commenting on these amendments. Further, AGN has accepted the requirement to amend under Amendments 55 to 59 by deleting the relevant clauses, which are not contained in the proposed revised Access Arrangement submitted in response to the Draft Decision by AGN on 10 June 2005. The Authority is therefore satisfied that the amendments made by AGN meets the requirements of Amendments 55 to 59 of the Draft Decision.

777. The Authority notes that in relation to Amendment 57, AGN chose to address the requirement to amend to confine the operation of clause 22 of Part A to Reference Services by deleting the clause. However, AGN made the following submission in response to Amendment 57 in its submission dated 21 March 2005 in response to the Draft Decision (references are to paragraph numbers in that submission):

284 AGN has deleted clause 22 of its PRAA.

285 However, as AGN has obligations under Law and under contracts with respect to the maintenance of certain gas quality specifications in relation to the GDS, AGN has inserted the following provision into the PRAA as a new clause 22 of Part A:

> *All Gas which enters the AGN GDS must comply with the Gas Quality Specifications.*

286 Inclusion of a clause dealing with gas quality as set out in paragraph 285 ("**Gas Quality Clause**") is consistent with the Code. Gas quality is a relevant matter for inclusion in the Access Arrangement as revised for the purposes of section 2.29 of the Code. Under the Code, the section 2.24 factors must be taken into account in assessing a proposed Access Arrangement.

287 The Gas Quality Clause will protect the interests of Users (s 2.24(f)) by ensuring that Users of the GDS received gas which meets the Gas Quality Specifications in accordance with section 2.24(f). Users have rights to receive gas which meets the Gas Quality Specifications under firm and binding contracts, in accordance with section 2.24(b). In addition, AGN as a reasonable and prudent pipeline operator must insist on operational and technical standards that ensure the safe and reliable operation of the GDS, in accordance with s 2.24(c)).

778. The proposed clause referred to in this submission has been included in the amended proposed revised Access Arrangement dated 26 May 2005, as clause 22 of Part A. The Authority is satisfied that this clause is reasonable for the purpose of section 3.6 of the Code and therefore proposes to approve it.

Obtaining access to Services

Draft Decision (Amendment 60)

779. Clause 27 of Part A of the proposed revised Access Arrangement as originally submitted set out terms and conditions in relation to the process by which Users could obtain access to Services, i.e. by application or by exercising an option. In the Draft Decision, the Authority noted that this clause in its terms extended to both Reference Services and Non-Reference Services. For the reasons summarised above in relation to Services other than Reference Services (see paragraphs 761 to 770), the Authority concluded that the clause should be confined in its operation to Reference Services. An amendment (Amendment 60) was required accordingly.

Final Decision

780. In its submission in response to the Draft Decision dated 21 March 2005 (paragraphs 296 and 297) AGN contended that clause 27 of Part A properly related to AGN's proposed Queuing Policy and was not intended to and did not operate as a term or condition of a Service Agreement. On this basis AGN proposed to revise the proposed Access Arrangement so that the matter previously governed by clause 27 of Part A was included in AGN's Queuing Policy. Clause 50 of Part A of the proposed revised Queuing Policy submitted by AGN on 10 June 2005 in response to the Draft Decision therefore incorporated the subject matter dealt with by clause 27 of Part A as originally submitted.

781. The Authority notes that under sections 3.12 to 3.15 of the Code an Access Arrangement must include a Queuing Policy for determining the priority that a Prospective User has against any other Prospective User to obtain access to Spare Capacity and Developable Capacity 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 by another Prospective User. Such a Queuing Policy must include appropriate provisions in relation to all Services which under the Services Policy the Service Provider must make available, whether or not such Services are Reference Services. These provisions, which govern the circumstances in which a Service Provider must make a Service or Services available to Users, may be distinguished from the terms and conditions on which Services are provided to a User once the User has established an entitlement to be provided with Services. In the latter case, the Authority has concluded that the Code does not permit the Access Arrangement to prescribe the terms and conditions of Non-Reference Services. However, if a matter is properly to be included in the Queuing Policy, then the Authority must ensure that the provisions extend to all Services, regardless of whether or not they are Reference Services.

782. In the present case, the Authority is satisfied that the matter previously dealt with by clause 27 of Part A, i.e. the manner by which a Prospective User may obtain access to a Service, is properly a matter to be dealt with by the Queuing Policy. Therefore, in view of AGN incorporating the provision into the Queuing Policy, the Authority is satisfied that the clause is no longer objectionable by reason of it extending to both Reference and Non-Reference Services. Further, the Authority is satisfied that the relevant clause, i.e. clause 50 in the proposed revised Access Arrangement submitted by AGN on 10 June 2005 in response to the Draft Decision, meets the criteria in section 3.13 of the Code being the requirements which must be met if a Queuing Policy is to comply with the Code. Therefore, the Authority proposes to approve the amended provisions as submitted by AGN as meeting the requirements of Amendment 60 of the Draft Decision.

Parties required to enter into a Service Agreement

Draft Decision (Amendment 61)

783. Clause 28 of Part A of the proposed revised Access Arrangement as originally submitted set out terms and conditions in relation to a requirement that Users enter into a Service Agreement (including a Haulage Contract) in order to obtain Services. In the Draft Decision, the Authority noted that this clause in its terms extended to both Reference Services and Non-Reference Services. For the reasons summarised above in relation to Services other than Reference Services (see paragraphs 761 to 770), the Authority concluded that the clause should be confined in its operation to Reference Services. An amendment (Amendment 61) was required accordingly.

Final Decision

784. In response to the Draft Decision, AGN has accepted the requirement under Amendment 61 by deleting clause 28(3) of Part A as originally submitted (rather than amending the clause as had been required). The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 61 of the Draft Decision.

Pre-conditions in relation to the provision of Services

Draft Decision (Amendment 62)

785. Clause 29 of Part A of the proposed revised Access Arrangement as originally submitted sets out certain terms and conditions in relation to pre-conditions to Users obtaining access to Services. In the Draft Decision, the Authority noted that this clause in its terms extended to both Reference Services and Non-Reference Services. For the reasons summarised above in relation to Services other than Reference Services (see paragraphs 761 to 770), the Authority concluded that the clause should be confined in its operation to Reference Services. An amendment (Amendment 62) was required accordingly.

Final Decision

786. The clause originally submitted by AGN - clause 29 of Part A - was regarded by the Authority as providing terms or conditions in relation to the provision of Services. The Authority's draft decision was that the clause should be amended to confine its operation to Reference Services, the Authority having no power to approve terms and conditions of Non-Reference Services (see paragraph 618 of the draft decision). Upon AGN making this amendment, the Authority's draft decision would be to approve clause 29, subject to a separate amendment (Amendment 65) to remove one of the preconditions - in clause 29(2)(b)(iv) - requiring a User to hold firm capacity upstream prior to entry into a Service Agreement.

787. In its submission in response to Amendment 62 of the draft decision (paragraphs 299-308) dated 21 March 2005 AGN indicated that parts of clause 29 of Part A were in fact relevant to the Queuing Policy. Accordingly, AGN stated that it has "amended its PRAA to move these parts into the Queuing Policy", which is relevant to all Services and not just Reference Services. It appears from the revised Access Arrangement submitted with AGN's submission on 21 March 2005 that the parts of section 29 moved to the Queuing Policy are those other than the parts relating to the firm capacity requirement, which remain (in amended form).

788. The Authority considers that under the provisions of the Code, if a matter is properly a matter relevant to the Queuing Policy it must relate to all Services, not only Reference Services. This is in contrast to terms and conditions of supply of a Service, in relation to which the Authority has concluded that only terms and conditions of Reference Services may be included in an Access Arrangement.

789. Therefore, if AGN's submission is accepted, and the relocated matters are properly the subject of the Queuing Policy, and meet the requirements for a valid Queuing Policy, then it would be appropriate for the Authority to accept the provisions as an alternative to AGN making the amendment to clause 29 as originally submitted, as required by Amendment 62 of the Draft Decision.

790. The re-located clause 29 of Part A is now contained in clauses 44 and 45 of the revised Access Arrangement of Part A provided on 10 June 2005. Having reviewed these clauses, the Authority is satisfied that they deal with matters which are appropriate for inclusion in the Queuing Policy, namely the conditions which a User of Reference and Non-Reference Services alike must comply with in order to be

entitled to enter a Service Agreement, and further the circumstances which will relieve AGN from being required to enter into a Service Agreement (e.g. insufficient spare capacity, any extension/expansion not accommodating the supply etc).

791. The further question arises in relation to the drafting of the re-located clause and its compliance with the requirements of a valid Queuing Policy. Those requirements are found in section 3.13 of the Code and are more specific than the generalised "reasonableness" test which the Authority must satisfy itself about with respect to terms and conditions under section 3.6. These requirements are to:

(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.

792. In re-locating clause 29 of Part A to the Queuing Policy AGN also made some minor drafting changes. These were merely to reference the provisions of the Code to which the pre-conditions relate. The Authority has considered these changes, and they do not affect the essential effect of the clause in its previous form, which the Authority regarded as reasonable. On the basis that the Authority (both under the current Access Arrangement and in the recent draft decision) regarded the clause as reasonable, the Authority has concluded that the re-drafted clauses meet the tests for a valid Queuing Policy under section 3.13 of the Code and should be approved for the purpose of this Final Decision.

Obligation to accept and deliver Gas

Draft Decision (Amendment 63)

793. Clause 30 of Part A of the proposed revised Access Arrangement as originally submitted sets out terms and conditions in relation to the obligation of AGN to accept and deliver gas. In the Draft Decision, the Authority noted that this clause in its terms extended to both Reference Services and Non-Reference Services. For the reasons summarised above in relation to Services other than Reference Services (see paragraphs 761 to 770), the Authority concluded that the clause should be confined in its operation to Reference Services. An amendment (Amendment 63) was required accordingly.

Final Decision

794. AGN has proposed certain amendments to clause 30 of Part A in response to the requirement to amend in accordance with Amendment 63 of the Draft Decision.

795. The clause as originally submitted by AGN was regarded by the Authority as providing a term or condition in relation to the provision of Services. The Authority's draft decision was that the clause should be amended to confine its operation to Reference Services, the Authority having no power to approve terms and conditions

of Non-Reference Services (see paragraph 618 of the Draft Decision). Otherwise the Authority was satisfied the clause was reasonable and proposed to approve it, subject to the required amendment.

796. In its submission in response to the Draft Decision (paragraphs 309-316) AGN has indicated that it has re-located the clause to Part C - Terms and Conditions - and has confined it to Reference Services as required. The relevant clauses of the revised Access Arrangement provided with AGN's submission are clause 5 of Part C - Obligation to accept and deliver Gas and clause 23 - Curtailment.

797. Clause 5 of Part C simply re-locates the provisions previously contained in clause 30(1) and (2) of Part A, subject to amendments confining the clause to Reference Services. The Authority has considered the clause and concluded that the relevant provisions have been appropriately amended to confine the provisions to Reference Services.

798. Clause 22 of Part C addresses the provisions previously contained in clause 30(3) of Part A. AGN has amended the previous version of clause 23 of Part C (which overlapped somewhat with clause 30 of Part A) so that clause 23 in its amended form covers the matters previously covered in clause 30 of Part A, but is confined to Reference Services. The Authority has reviewed the amended clause 23 of Part C. The Authority considers that it brings in appropriately the matters previously dealt with in clause 30 of Part A. The Authority is, therefore, satisfied that the relevant amendments meet the requirements of Amendment 63 of the Draft Decision.

Metering uncertainty

Draft Decision (Amendment 64)

799. Clause 28 of Part C of the proposed revised Access Arrangement sets out terms and conditions in relation to metering uncertainty. In the Draft Decision, the Authority noted that this clause in its terms extended to both Reference Services and Non-Reference Services. For the reasons summarised above in relation to Services other than Reference Services (see paragraphs 761 to 770), the Authority concluded that the clause should be confined in its operation to Reference Services. An amendment (Amendment 64) was required accordingly.

Final Decision

800. In response to the Draft Decision, AGN noted that clause 28 of Part C as originally submitted was intended to apply only to Reference Services and not to Non-Reference Services. AGN therefore accepted the requirement under Amendment 64 of the Draft Decision by confining the relevant clause to Reference Services accordingly. The amended clause is contained in clause 28 of the proposed revised Access Arrangement submitted on 10 June 2005 in response to the Authority's Draft Decision. The Authority is satisfied that this amendment meets the requirements of Amendment 64 of the Draft Decision.

Entitlement to sufficient firm capacity on Interconnected Pipelines

Current Access Arrangement

801. Clause 67 of the current Access Arrangement makes provision in relation the designated suppliers of gas for Users of AGN's GDS. A note to clause 67 explains the background to the designated supplier provisions:

> This clause reproduces regulation 56 of the *Gas Distribution Regulations 1996*. In order to integrate the operation of the *AlintaGas GDS* with the DBNGP (and any other *pipeline* used to deliver *gas* into the *AlintaGas GDS*), there must be a link between the *user* and the supplier who supplies *gas* to the *user*. This link is necessary, among other things, to ensure that the *user* has an appropriate right to receive *gas* for delivery into the *AlintaGas GDS*, to replace *gas* which it draws out at a *delivery point*, and also to deal with imbalance issues.

802. The *Gas Distribution Regulations 1996* were repealed on 18 July 2000, upon the current Access Arrangement taking effect.

803. Under the designated supplier provisions of the current Access Arrangement Users are required to give a notice to AGN specifying the designated supplier for each delivery point. A written notice must contain such information as AGN acting as a prudent gas distribution network operator may reasonably from time to time require. Such information includes information regarding the circumstances (if any) in which the designated supplier may refuse to supply gas to the User.

804. It is noted that the designated supplier provisions do not require that upstream capacity booked by Users with their designated suppliers be firm. Thus Users' commitments under Haulage Contracts can be met by firm, interruptible or spot capacity or a combination thereof.

805. An imbalance within the AGN GDS may occur where the amount of gas being drawn out of the GDS by the User is greater than that being injected into the GDS by the designated supplier. Where an imbalance is substantial there is a risk of system de-pressurisation. System de-pressurisation carries significant safety risks and costs of restoring supply.

806. Under the current Access Arrangements the risks associated with system de-pressurisation are managed through the designated supplier provisions in clause 67. AGN is supplied with full information in relation to the User's arrangements for supply of gas into the GDS, including the designated supplier for each delivery point. Further, AGN has the ability to curtail supply to any User in the event that the designated supplier has its supply from an interconnected pipeline curtailed or interrupted for any reason (see clause 67(3) of the current Access Arrangement.).

807. It is noted that the risk of de-pressurisation of the distribution system, which may be effectively managed through contractual arrangements including regulated contracts imposed by Access Arrangements are separate and distinct from risks to the security of gas supply into the AGN GDS. Issues regarding the security of gas supply are subject to oversight by the Office of Energy (and, in relation to emergency situations which may endanger public safety or otherwise put gas supply at risk, the Director of Energy Safety). These are not matters which the Authority is under a duty to regulate.

808. Since the current Access Arrangement was introduced the retail market for gas supply has been de-regulated. Under Full Retail Contestability (**FRC**), which was introduced on 31 May 2004, small use customers are fully contestable by Users of the AGN GDS. This means that the delivery points subject to the Access Arrangement will include the vast number of delivery points for small use customers which are now subject to FRC.

809. In this changed environment the industry has decided that it is no longer practical for a designated supplier to be nominated for each delivery point. Accordingly, under the Retail Market Rules (**RMRs)** which regulate the retail market following the introduction of FRC, there are no designated supplier provisions equivalent to clause 67 of the current Access Arrangement.

810. The issue which arises is what provisions will be appropriate under the revised Access Arrangement to address gas imbalance issues, and in particular mechanisms to manage the risks associated with system de-pressurisation.

Draft Decision (Amendments 65 to 68)

811. In both Parts A and C of the proposed revised Access Arrangement as originally submitted on 31 March 2004, there were inter-related provisions that, if approved, would have the effect of requiring a User or Prospective User to hold firm transportation capacity on an Interconnected Pipeline sufficient to meet the User's Contracted Peak Usage for each Delivery Point (**sufficient firm capacity**) as a condition of obtaining Services, including both Reference and Non-Reference Services, from AGN.

812. The relevant provisions submitted by AGN were as follows:

- Part A, clause 29(2)(b)(iv) – User holding sufficient firm capacity is a pre-condition for a User or a Prospective User to enter a Haulage Contract.
- Part A, clause 25 – a User or Prospective User who is refused a Reference Service under Part A, clause 29(2)(b)(iv) for not holding sufficient firm capacity may be offered a Non-Reference Service but only if that User or Prospective User has sufficient alternative arrangements to address the issues potentially arising from not being able to satisfy the sufficient firm capacity requirement.
- Part A, clause 60 - Each Haulage Contract contains a representation and warranty by the User that the User has sufficient firm capacity.
- Part A, clause 61 - AGN has discretion to make reasonable requests for information from a User for evidence of sufficient firm capacity.
- Part C, clause 22(1)(a)(vi) – User not holding sufficient firm capacity is a curtailment condition.

813. The proposed sufficient firm capacity provisions are new. As indicated above, under the current Access Arrangement Users could meet their commitments under Haulage Contracts through firm, interruptible or spot upstream capacity or a combination

thereof, subject to AGN's curtailment rights in the event of interruption to the supply of gas to the Designated Supplier.

814. In its Draft Decision the Authority noted that the proposed sufficient firm capacity provisions had the potential to hamper the development of competition. In particular the Authority noted that in meeting supply commitments to their customers, Users and Prospective Users of AGN's GDS should be free (as they presently are) to avail themselves of a combination of firm, interruptible and spot transmission pipeline capacities. A requirement that prior to entering a Haulage Contract or other Service Agreement, or at any time thereafter, a User or Prospective User must be able to demonstrate that it can satisfy their contractual commitments to AGN through firm gas transportation capacity could effectively prevent such a User or Prospective User from seeking to make full use of available upstream interruptible or spot transportation capacity.

815. Further, the Authority was concerned in its Draft Decision that the proposed revised Access Arrangement could adversely affect the development of competition by creating a barrier to entry for Prospective Users.

816. In a submission to the Authority dated 14 May 2004 prior to it making the Draft Decision, the Office of Energy questioned both the need for these provisions and their reasonableness in view of the potential for the requirement to operate as a barrier to entry affecting competition. A submission to the Authority dated 14 May 2004 from Western Power Corporation further expressed the view that this requirement for holding of sufficient firm capacity will reinforce a barrier to entry for retailers and hamper competition by acting as a limitation upon customers attempting to exercise their right to choose their gas retailer.

817. The Authority acknowledged in its Draft Decision that without the requirement for Users to hold sufficient firm capacity on an Interconnected Pipeline, AGN could face a commercial risk. That is, a User may acquire a right to firm capacity on the GDS via a Haulage Contract and then, without the added financial pressure of holding sufficient firm capacity upstream, may not avail itself of all or part of that Reference Service up to the potential of the Contracted Peak Rate. In such a case, AGN would be required to invest in assets sufficient to provide firm capacity on the GDS up to the contracted peak rate, but may be deprived of revenue sufficient to compensate AGN for investment in those assets at the regulatory rate of return.

818. To the extent that AGN could face such a risk, the Authority considered in its Draft Decision that this could be addressed adequately through the structure of the Reference Tariff, rather than, as was proposed by AGN, by imposing an obligation on Users and Prospective Users in advance to contract for sufficient firm capacity, which could affect the development of competition.

819. The Authority also noted in its Draft Decision that large volume Users supplying consumers under Reference Tariff A1 are already obliged to pay a substantial standing charge in addition to demand and usage charges. The standing and demand charges secure revenue streams irrespective of the utilisation made of the Contracted Peak Capacity at a Delivery Point. In the case of the demand charge this is because this charge is calculated for each day by multiplying the demand charge rate by the

User's Contracted Peak Rate. The remaining Reference Services have a Reference Tariff with a lower standing charge and no demand charge.

820. To the extent that AGN has legitimate concerns about under-utilisation by Users of Contracted Peak Capacity to AGN's detriment, the Authority noted that it would be open to AGN to consider seeking the Authority's approval to restructure its Reference Tariffs.

821. In its Draft Decision, the Authority was not satisfied that the proposed clauses requiring Users or Prospective Users to hold sufficient firm capacity on an Interconnected Pipeline are reasonable and required the following amendments to the proposed revised Access Arrangement:

> **Amendment 65**
>
> Part A, clause 29(2)(b)(iv) of the proposed revised Access Arrangement should be deleted.
>
> **Amendment 66**
>
> Part A, clause 60 of the proposed revised Access Arrangement should be deleted.
>
> **Amendment 67**
>
> Part A, clause 61 of the proposed revised Access Arrangement should be deleted.
>
> **Amendment 68**
>
> Part C, clause 22(1)(a)(vi) of the proposed revised Access Arrangement should be deleted.

Final Decision

822. In its submission dated 21 March 2005 responding to the Draft Decision, AGN did not accept the requirement to amend in response to Amendments 65 to 68.

823. In particular, AGN noted that the proposed sufficient firm capacity provisions were not intended as a means of maximising revenue. Rather, the provisions were intended to provide a means of managing the risks associated with system de-pressurisation in lieu of the designated supplier provisions operating under the current Access Arrangement. Further, that it appeared from the Draft Decision that the Authority had not appreciated this purpose.

824. In relation to the latter point, the Authority notes that in AGN's proposed revised Access Arrangement and Access Arrangement Information as originally submitted AGN did not indicate that the sufficient firm capacity requirement was intended to address the system de-pressurisation issue. Consequently, the Authority did not consider the proposal in that context.

825. In its 21 March 2005 submission AGN set out in detail its reasons as to why the Authority ought to accept the proposed provisions as originally submitted as a means of addressing the risk of sudden system depressurisation, in lieu of the designated supplier provisions. That submission addressed the following matters:

(a) The need to maintain system pressure in the GDS (paragraphs 323 to 325). This section of the submission outlined the reasons why maintenance of system pressure within the GDS is critical from a safety and efficiency point of view.

(b) The Firm Capacity Requirement is intended to protect system pressure (paragraphs 326 to 329). This section of the submission argued that the best approach to protecting against sudden system depressurisation is to minimise the likelihood of gate station curtailment at Receipt Points on the GDS, by requiring the User to have access to firm capacity rather than interruptible capacity.

(c) Responses to gate station curtailment (paragraphs 330 to 339). This section of the submission argued that the only two ways of maintaining system pressure in the event of a gate station curtailment are load curtailment and accessing Gas from the other interconnected pipeline, both of which are inefficient and costly.

(d) Available alternatives (paragraphs 340 to 348). This section of the submission examined indemnities by Users and other means of minimising the risk of sudden system depressurisation, which AGN argued were less effective than the Firm Capacity Requirement.

(e) Firm Capacity Requirement is reasonable – section 3.6 of the Code (paragraphs 349 to 367). This section of the submission examined reasons why AGN submitted that the Firm Capacity Requirement as originally proposed would be reasonable, in the context of the section 2.24 factors under the Code. The matters addressed in this section of the submission as to why AGN submitted that the Firm Capacity Requirement is reasonable were as follows:

(i) Cost–benefit analysis (paragraphs 350 to 352);

(ii) Legitimate Business Interests – section 2.24(a) (paragraphs 353 to 356)

(iii) Safe and reliable operation of the AGN GDS – section 2.24(c) (paragraphs 356 to 360);

(iv) Interests of Users – section 2.24(f) (paragraphs 361-362);

(v) Public interest – section 2.24(e) (paragraph 363);

(vi) Firm and binding contractual obligations of AGN and Users – section 2.24(b) (paragraphs 364 to 366);

(vii) Economically efficient operation of the AGN GDS – section 2.24(d) (paragraph 367).

826. It is not proposed to rehearse these arguments in this Final Decision. The arguments are fully set out in AGN's submission dated 21 March 2005, which the Authority has published for comment by interested parties.

827. For present purposes it suffices to say that the basis upon which AGN put its submission – that the proposed provisions were in response to a technical and safety issue in relation to sudden system depressurisation – was not apparent to the Authority at the time of the Draft Decision from the material originally submitted by

AGN. Further, the nature of the issue raised by AGN after the Draft Decision, being of a technical or safety nature, meant that it was appropriate for the Authority to seek advice in relation to this matter from the Director of Energy Safety (**DES**), pursuant to the Authority's power to make appropriate use of the expertise of DES under section 37(4) of the *Gas Pipelines Access (Western Australia) Act* 1998 as amended.

828. Having considered AGN's arguments and DES's advice, the Authority considers that there is a justification for AGN seeking to address the risk of sudden system depressurisation through a requirement for sufficient firm upstream capacity or other means. However, the Authority's further consideration of the issue has not removed its initial concern, as reflected in the Draft Decision, that if a requirement of sufficient firm pipeline capacity is the only or primary means of addressing this issue, there is a risk that the development of competition may be impeded in the ways outlined in the Draft Decision. Further, it appears that there may be a range of alternative means which may also satisfactorily address AGN's concerns with Users and Prospective Users, including that:

(a) an alternative supply source (e.g. using "swing service") is available to the User in sufficient quantity;

(b) the User is willing to provide indemnities for loss arising from system depressurisation;

(c) the User is willing to accept the installation of remotely operated flow controllers at critical Delivery Points.

829. The foregoing considerations have lead the Authority to the view that the most appropriate way forward is for AGN to be provided under the revised Access Arrangement with the ability to seek a firm capacity commitment from Users or Prospective Users, but that Users or Prospective Users not be obliged to meet such a commitment, but rather would have available to them a menu of other options for addressing the risk of sudden system depressurisation to the reasonable satisfaction of AGN as a prudent network operator.

830. On this basis, AGN has developed an amended framework for addressing this matter in the revised Access Arrangement to that framework originally submitted, without imposing an exclusive requirement for the User to hold sufficient firm upstream pipeline capacity which requirement the Authority might regard as unreasonable or otherwise contrary to the Code. This amended framework was submitted in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005. This amended framework involves the provision by Users or Prospective Users of a System Pressure Protection Plan to AGN as a precondition of taking Services from AGN, which Plan may address the potential risk of system depressurisation in any way which is satisfactory to AGN as a reasonable and prudent person. The framework is set out in the following clauses:

(a) Clauses 26 to 28 of Part A: Protection of system pressure – existing Service Agreements

(b) Clauses 29 to 32 of Part A: Protection of system pressure – new Service Agreements

(c) Clauses 63 and 64 of Part A: Maintaining and complying with approved System Pressure Protection Plan

(d) Clause 23(1)(vi) of Part C: Curtailment (for breach of warranty in clause 63(1) of Part A).

831. The Authority is satisfied that the framework set out in these clauses meets the requirements of Amendments 65 to 68 and otherwise is reasonable for the purpose of section 3.6, having regard to the section 2.24 factors, and is therefore approved.

Re-allocation of Reference Services

Draft Decision

832. Clauses 17 to 20 of Part A of the proposed revised Access Arrangement as originally submitted by AGN proposed conferring upon AGN a right to re-allocate a User's Reference Service from that currently being taken by that User (referred to as the Current Reference Service) to another Reference Service (referred to as the Replacement Reference Service).

833. Under AGN's proposal both the Current Reference Service and the Replacement Reference Service are to be one or other of the Reference Services in the proposed revised Access Arrangement, namely Reference Services A1, A2, B1, B2 & B3, which were described in clauses 12 to 16 of Part A.

834. Under the foregoing provisions only AGN would have the right to initiate a re-allocation of a Reference Service under a Haulage Contract. Further, AGN's right to re-allocate a Reference Service, while only available in cases where AGN acted as a reasonable and prudent person in assessing that the quantity of gas to be supplied would fall within the requirements other than for the Current Reference Service, would have effect regardless of whether the User agrees.

835. Prior to making its Draft Decision, the Authority received a submission from the Office of Energy which suggested that the Authority ought to consider whether it is appropriate for AGN to have an ability to give notice of a Replacement Reference Service that would take effect regardless of whether the User agrees to the terms of the notice. The Authority did not receive any other public submissions on this issue.

836. In view of the existence of dispute resolution, including binding arbitration, under clauses 55 to 59 of Part C of the proposed revised Access Arrangement, the Authority in its Draft Decision considered that the interests of Users are reasonably protected.

Final Decision

837. The Authority has not received any further submissions on this matter since the Draft Decision and, therefore, confirms its Draft Decision in this Final Decision. The relevant clauses have been re-numbered clauses 18 to 21 of Part A of the proposed revised Access Arrangement submitted by AGN on 10 June 2005.

Receipt Point to be subject of Interconnection Contract

Draft Decision (Amendments 69 and 70)

838. Under clause 21(3) of Part A of the proposed revised Access Arrangement as originally submitted it would be a requirement that every Receipt Point at which a Related Shipper will, from time to time, deliver gas into the GDS, will be the subject of an Interconnection Contract.

839. Further, clause 8 of Part C of the proposed revised Access Arrangement as originally submitted required that a Haulage Contract would specify the Interconnection Contract or Contracts applicable to the relevant Receipt Points, and would place conditions on the User's right to deliver gas into the GDS at a Receipt Point, namely that there is a current Interconnection Contract between AGN and the owner of the Interconnected Pipeline and no current breach thereof.

840. In the Draft Decision the Authority noted that the effect of these clauses would be to impose obligations first, on the owner of an Interconnected Pipeline to enter into an Interconnection Contract with AGN before contracting with a Related Shipper to deliver gas into the GDS and second, on a User to ensure that such an Interconnection Contract is in place, and not in breach, before arranging for gas to be transported through the GDS under a Haulage Contract. However, a User is not a party to the interconnection arrangement between the owner of the Interconnected Pipeline and AGN.

841. Prior to the Draft Decision, a submission was received from the owner of the DBP as an Interconnected Pipeline that, among other things, rejected as unnecessary and inappropriate any requirement under clause 21(3) of Part A for the DBP to be the subject of an Interconnection Contract before gas may be delivered to the GDS at the request of a Related Shipper.

842. In its Draft Decision, the Authority concluded that the Interconnection Service should not be a Reference Service. Therefore, the Authority's view was that an arrangement under which the GDS and a transmission pipeline would be interconnected should be a matter to be determined between AGN and the owner of the Interconnected Pipeline, subject to arbitration under section 6 of the Code. As the Interconnection Service would not be a Reference Service, it would be inappropriate for the Authority to approve clause 21(3) of Part A, which required that an Interconnection Contract be in place before gas is delivered into the GDS.

843. In relation to clause 8 of Part C, the Authority noted in its Draft Decision that this clause places obligations on Users of the GDS in relation to the arrangements between AGN and the owner of an Interconnected Pipeline. However, Users are not involved in these arrangements. The Authority, therefore, did not consider clause 8 of Part C to be reasonable, because it would require Users to meet obligations in relation to matters outside of their control.

844. Finally, the Authority noted that an equivalent provision to clause 8 is contained in the current Access Arrangement. The Authority recognised that its draft decision not to approve clause 8 of Part C involves a reconsideration of the decision taken previously. The Authority has received a submission questioning clause 21(3) of Part

A, which in turn has called into question clause 8 of Part C. Having reconsidered the issues in relation to this matter, the Authority required the following amendments.

> **Amendment 69**
>
> Clause 21(3) of Part A of the proposed revised Access Arrangement should be deleted.
>
> **Amendment 70**
>
> Clause 8 of Part C of the proposed revised Access Arrangement, concerning Interconnection Contracts, should be deleted.

Final Decision

845. In its submission in response to the Draft Decision dated 21 March 2005, AGN did not accept the requirement under Amendment 69 to delete clause 21(3). In that submission (see paragraphs 368 to 375) AGN explained its concern in seeking approval of these clauses as being to provide it with rights under the Access Arrangement to withdraw or curtail Services in the event that issues as between AGN and interconnecting pipeliners affected AGN's right or ability to provide Services to Users.

846. The Authority acknowledges AGN's submission that circumstances not relating to Users, but rather arising out of the management of interconnection arrangements may affect AGN's ability to provide Services to Users. However, the concern raised by the Authority's Draft Decision was that the provisions as originally submitted sought to regulate relations between AGN and its interconnecting pipeliners or to impose obligations upon Users in relation to matters outside the User's control.

847. In consultation with AGN, the Authority raised the possibility of AGN re-casting the proposed provisions such that the rights to be provided to AGN consequent upon issues arising with respect to their interconnection arrangements would be available to AGN independently of any breach by either interconnecting pipeliners or Users, but rather upon the occurrence of an objective event which would reasonably justify AGN as a prudent network operator, taking steps with respect to the provision of Services to its Users.

848. In the amended proposed revised Access Arrangement submitted on 10 June 2005, AGN proposed:

- In response to Amendment 69, substituting clause 24(3)(b) for the previous clause 21(3) of Part A. Clause 24(3)(b) would permit AGN acting as a reasonable and prudent person to refuse to supply Users upon the occurrence of an "Interconnection Event";
- In response to Amendment 70, amending clause 8 of Part C to require the Haulage Contract to specify the Interconnection Arrangements applicable to the Physical Gate Points associated with relevant Receipt Points, for the purpose of the right to refuse to supply upon the happening of an Interconnection Event.

849. While AGN has not met the requirements of Amendments 69 and 70 directly by deleting the relevant clauses as required by the Draft Decision, the Authority is satisfied that the proposed amendments described above meet the intent of the amendments required, and are approved for the purpose of this Final Decision.

Changes to terms and conditions through Replacement Schedules

Draft Decision (Amendment 71)

850. Clause 33(1) of Part A of the proposed revised Access Arrangement as originally submitted provided that AGN may from time to time, with the approval of the Authority, publish one or more Replacement Schedules. Under Schedule 2 to Part A, a Replacement Schedule was defined to be a schedule of terms and conditions for a Reference Service.

851. By clause 33(2) of Part A of the proposed revised Access Arrangement as originally submitted provided that such Replacement Schedules would operate to amend the Access Arrangement. The terms of clause 33(2) were as follows:

> (2) With effect on and from the later of:
>
> (a) the date on which the Regulator gives its approval to the Replacement Schedule; or
>
> (b) the date specified for this purpose in the Replacement Schedule,
>
> any such approved Replacement Schedule has effect, and is incorporated as a term of a Haulage Contract to which the replacement Schedule relates, in substitution for, as applicable, Part C, or Part C, Schedule 1, 2, 3 or 4 (or if applicable, a Replacement Schedule which had been substituted for Part C, or Part C, Schedule 1, 2, 3 or 4 by an earlier operation of this clause).

852. In its Draft Decision the Authority noted that Section 2.49 of the Code provides:

> An Access Arrangement that has become effective may be changed only pursuant to this section 2 or pursuant to the implementation of an Approved Reference Tariff Variation Method provided for in sections 8.3B to 8.3H

853. Further, the Authority noted that sections 8.3B to 8.3H of the Code provide for variations to an approved Access Arrangement without the need for the Authority to undertake the public consultation which applies under section 2 of the Code to all other variations. However, the Approved Reference Tariff Variation Methods provided for in sections 8.3B to 8.3H are confined to variations to an approved Reference Tariff, and do not extend to variations to approved non-tariff terms and conditions for the supply of Reference Services.

854. In these circumstances, the Authority concluded in the Draft Decision that any variation to the approved terms and conditions of Reference Services must be subject to the variation procedure prescribed by section 2 of the Code. In relation to review of an Access Arrangement, this procedure is set out in sections 2.28 to 2.48 of the Code.

855. Further, the Authority noted that, subject to section 2.33 of the Code, such procedure includes public consultation and the publication by the Authority of Draft and Final Decisions in relation to each variation. Section 2.33 of the Code provides an exception to the public consultation process in the following terms:

> The Relevant Regulator may dispense with the requirement to produce Access Arrangement Information in respect of proposed revisions and may approved or not approve the proposed revisions without consultation with, or receiving submissions from, persons other than the Service Provider if:
>
> (a) the revisions have been proposed by the Service Provider other than as required by the Access Arrangement; and
>
> (b) the Relevant Regulator considers that the revisions proposed are not material and will not result in changes to Reference Tariffs or to the Services that are Reference Services.

856. In its Draft Decision, the Authority indicated that it understood AGN to intend the proposed revisions relating to the amendment of the Access Arrangement by publication of Replacement Schedules to be consistent with the provisions of sections 2.28 to 2.48 of the Code (including the provisions of section 2.33 of the Code regarding situations in which public consultation will not be required).

857. The Authority was, however, not satisfied that Prospective Users who might propose to enter into a Haulage Contract with AGN would necessarily understand the intent of clause 33(1) of Part A. Namely, that the approval by the Authority referred to meant approval in accordance with the provisions of sections 2.28 to 2.48 of the Code. To remove any uncertainty, the Authority considered that, prior to approval, clause 33(1) should be amended to make clear that the approval referred to is approval by the Authority in accordance with the provisions of sections 2.28 to 2.48 of the Code. An amendment (Amendment 71) was required accordingly.

Final Decision

858. In response to the Draft Decision, AGN has accepted the requirement under Amendment 71 by deleting clause 33 of Part A as originally submitted (rather than amending the clause as had been required). The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 71 of the Draft Decision.

Definitions and Interpretation

Application of definitions in Haulage Contract

Draft Decision (Amendment 72)

859. Clause 1 of Part C as originally submitted by AGN in the proposed revised Access Arrangement submitted on 31 March 2004 provided that unless the contrary intention appears in the Haulage Contract, the Glossary in Part A of the Access Arrangement would apply to the interpretation of the Haulage Contract.

860. Under that proposal, the terms and conditions of the Access Arrangement were incorporated into the Haulage Contract by clause 2 of Part C of the proposed revised Access Arrangement. The Authority noted in the Draft Decision that it would be

conceivable that the Haulage Contract could be used to modify the meaning of a term defined in the Access Arrangement. Further, the Authority noted that by operation of proposed clause 1 of Part C, a term redefined in the Haulage Contract would govern the supply of Reference Services pursuant to the Haulage Contract.

861. The Authority, in its Draft Decision, expressed the view that as redefining a term through an amendment to the Haulage Contract would involve amending the Access Arrangement, such an amendment would need to be made in accordance with the procedure for amending an Access Arrangement under section 2 of the Code. Further, that clause 1 of Part C as originally submitted did not require the Code amendment process (in section 2 thereof) to be followed. Accordingly, the Authority's Draft Decision was not to approve clause 1 of Part C.

862. The Authority further indicated in the Draft Decision that its concerns relating to clause 1 of Part C could be addressed by removal of the words "[u]nless the contrary intention appears in the Haulage Contract". The Authority noted that such an amendment would ensure that any changes to the definitions applicable to a Haulage Contract must be subject to the amendment process under section 2 of the Code.

863. The Authority, therefore, required an amendment (Amendment 72) as follows:

> Clause 1 of Part C of the proposed revised Access Arrangement should be amended to ensure that any changes to the terms defined in the Access Arrangement and applicable in a Haulage Contract are subject to the procedure for amending an Access Arrangement in section 2 of the Code.

Final Decision

864. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in paragraph 863 above. That is, to remove the words "[u]nless the contrary intention appears in the Haulage Contract" in the relevant clause. Clause 1 of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and therefore the Authority is satisfied that AGN has met the requirements of Amendment 72.

Definition of "Code"

Draft Decision (Amendment 73)

865. In the Draft Decision, the Authority noted that the definition of "Code" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

866. Therefore, the Authority therefore required an amendment (Amendment 73) as follows.

> The definition of "**Code**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition of that term in the Code, that is the definition should refer to the Code as amended from time to time, and not to the Code in force as at the Revisions Submission Date.

Final Decision

867. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 73. The definition in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and therefore the Authority is satisfied that AGN has met the requirements of Amendment 73.

Definition of "Confidential Information"

Draft Decision (Amendment 74)

868. In the Draft Decision, the Authority noted that the definition of "Confidential Information" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

869. Therefore, the Authority therefore required an amendment (Amendment 74) as follows.

> The definition of "**Confidential Information**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 10.8 of the Code.

Final Decision

870. In its submission in response to Amendment 74 of the Draft Decision dated 21 May 2005 AGN did not accept the requirement to amend the definition of "Confidential Information". AGN included the same definition of that term in the amended proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005.

871. The issue arose because of differences between the definition of "Confidential Information" in section 10.8 of the Code and the definition proposed by AGN in the Glossary in Schedule 2 of Part A of the Access Arrangement. The AGN proposed definition was unchanged from that approved for the current Access Arrangement. That said, the Authority's draft decision was that, in the absence of any justification for the differences, it would be preferable for the definitions to accord, to avoid any unintended consequences (see paragraph 618).

872. AGN in its submission (see paragraphs 380-382) defended the differences between the Code and Access Arrangement definitions on the basis that "the definition of Confidential Information in the PRAA is for use in a Haulage Contracts (sic) and applies as between both parties to the contract. The Code definition of Confidential Information is for use in different contexts: access applications, ring fencing and regulatory submissions to the Regulator, the Minister and the National Competition Council. The Code definition is not appropriate for use in the context of the Haulage Contract."

873. The Authority has considered the definitions and the provisions of the Access Arrangement and the Code to which the definitions apply. AGN is correct that the

Code definition has very limited application. The only application of it appears to be the Ring Fencing arrangements in section 4 of the Code. Under clause 66(1)(d) of Part C of the proposed revised Access Arrangement submitted on 10 June 2005, the confidentiality regime is subject to section 4, such that even though there are different definitions, there is no scope for inconsistency. The only other reference in the Code to the term is in the heading of section 7 relating to information disclosed to the Authority, NCC or Minister. However, even though the term is used in the heading, that section concerns a much broader concept of confidential information, being information identified as such by the disclosing party.

874. On the foregoing basis, the Authority considers that there is no potential for the provisions of the Code and the Access Arrangement to conflict because of the different definitions of "Confidential Information" and therefore no reason for the Authority to disallow the use of a different definition in the Access Arrangement. Further, on the basis that the definition was accepted as reasonable by the regulator under the current arrangement, it is open for the Authority to conclude that the continued use of the definition, albeit a different definition from the Code definition, is reasonable.

875. The Authority's final decision, therefore, is that the definition of "Confidential Information" in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 is acceptable, notwithstanding differences between that definition and the Code definition of the same term.

Definition of "Cost of Service"

Draft Decision (Amendment 75)

876. In the Draft Decision, the Authority noted that the definition of "Cost of Service" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted referred to a section of the Code, i.e. section 8.3(d), which had been repealed, making the definition uncertain.

877. Therefore, the Authority therefore required an amendment (Amendment 75) as follows.

> The definition of "**Cost of Service**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement, which refers to a section of the Code which has been repealed, i.e. section 8.3(d), should be deleted, and replaced with an appropriate alternative definition.

Final Decision

878. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 75. The definition of "Cost of Service" in the Glossary in Schedule 2 of Part A submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 75.

Definition of "Delivery Point"

Draft Decision (Amendment 76)

879. In the Draft Decision, the Authority noted that the definition of "Delivery Point" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

880. Therefore, the Authority therefore required an amendment (Amendment 76) as follows.

> The definition of "**Delivery Point**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 10.8 of the Code.

Final Decision

881. In its submission in response to Amendment 76 of the Draft Decision dated 21 March 2005 AGN did not accept the requirement to amend the definition of "Delivery Point". Following consultation with the Authority, AGN withdrew part of its objection and submitted a revised definition of term in the amended proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005.

882. The definition finally submitted by AGN continues to differ from the Code definition in two respects:

- First, the Code definition refers to the point or points at which the "custody of Natural Gas is transferred", whereas the proposed definition for the Access Arrangement refers to a point specified in the Haulage Contract as the point at which the User takes delivery of gas. This difference reflects that under the Access Arrangement, the Haulage Contract specifies such points, which may differ from the point or points of transfer.

- Second, the proposed definition includes words which clarify what is meant by a point, by specifying that the word includes a flange or joint.

883. On the above basis, the Authority considers that there is no potential for the provisions of the Code and the Access Arrangement to conflict because of the different definitions of "Delivery Point" and therefore no reason for the Authority to disallow the use of a different definition in the Access Arrangement.

884. The Authority's final decision, therefore, is that the definition of "Delivery Point" in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 is acceptable, notwithstanding differences between that definition and the Code definition of the same term.

Definition of "Developable Capacity"

Draft Decision (Amendment 77)

885. In the Draft Decision, the Authority noted that the definition of "Developable Capacity" in the Glossary in Schedule 2 of Part A of the proposed revised Access

Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

886. Therefore, the Authority therefore required an amendment (Amendment 77) as follows.

> The definition of "**Developable Capacity**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 10.8 of the Code.

Final Decision

887. In its submission in response to Amendment 74 of the Draft Decision dated 21 March 2005 AGN did not accept the requirement to amend the definition of "Developable Capacity". AGN included the same definition of that term in the amended proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005

888. The basis for AGN's position was explained as follows (see paragraph 385 of the submission):

> The definition of Developable Capacity in the PRAA encompasses Extensions to the AGN GDS and therefore includes an extension of the geographic range of the AGN GDS. This means that the PRAA definition applies more widely than it is required to under the Code. AGN should not be required to amend its definition.

889. In view of AGN's clarification, the Authority is satisfied that there is no potential for the provisions of the Code and the Access Arrangement to conflict because of the different definitions of "Developable Capacity" and therefore no reason for the Authority to disallow the use of a different definition in the Access Arrangement.

890. The Authority's final decision, therefore, is that the definition of "Developable Capacity" in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 is acceptable, notwithstanding differences between that definition and the Code definition of the same term.

Definition of "Gas"

Draft Decision (Amendment 78)

891. In the Draft Decision, the Authority noted that the definition of "Gas" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in section 90(4) of the *GPAA*.

892. Therefore, the Authority therefore required an amendment (Amendment 78) as follows.

> The definition of "**Gas**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 90(4) of the *GPAA*.

Final Decision

893. In its submission in response to the Draft Decision dated 21 March 2005 AGN did not accept the obligation to amend as set out in Amendment 78.

894. The basis for AGN's objection to amending was that the Authority's amendment would require AGN to extend the definition of gas applying to the Access Arrangement from natural gas to include LPG. Even though this would be consistent with the extended definition of "gas" applying in Western Australia under the *GPAA*, AGN's contention was that this would be inappropriate as the AGN GDS only transports natural gas and does not carry LPG, nor is the AGN GDS able for technical reasons to accept LPG.

895. AGN also noted in its submission that the existing definition of "gas" in the current Access Arrangement did not include LPG, and AGN sought the continuation of this approach.

896. Following the receipt of this submission, in consultations between the Authority and AGN, an issue was identified in relation to an LPG network owned and operated by AGN at "the Vines" in outer metropolitan Perth (**Vines LPG network**). The Vines LPG network is not interconnected with the AGN GDS carrying natural gas, nor is the Vines LPG network included in the current Access Arrangement for the AGN GDS.

897. The issue arose whether the Vines LPG network in fact forms part of the Covered Pipeline for the purpose of the Code:

- If it does, then the Authority would need to consider whether or not it should require the revised Access Arrangement to extend to the Vines LPG network, such that there may be a need for the definition of gas to include LPG as required by Amendment 78 of the Draft Decision.

- If it does not, then there would be no need for the definition of gas for the purpose of the revised Access Arrangement to be amended to include LPG.

898. The Authority notes the following matters relevant to the issue of Code coverage:

(a) Section 8 of the *Gas Pipelines Access (Western Australia) Act 1998* extends the coverage of the *Gas Pipelines Access (Western Australia) Law* to pipelines for the reticulation of gas other than natural gas where that pipeline is a system for which a licence is in force under Part 2A of the *Energy Co-ordination Act 1994*.

(b) The terms of AGN's Gas Distribution Licence No. 2 (**GDL2**) under the *Energy Co-ordination Act 1994* includes the Vines LPG network along with network assets which carry natural gas.

(c) The *Gas Pipelines Access (Western Australia) Law* includes the Code, by reason of sections 8 and 9 of the *Gas Pipelines Access (Western Australia) Act 1998*, and the definitions in section 3 thereof.

899. On the face of it, these provisions would indicate that the Vines LPG network is intended to form part of the Covered Pipeline for the purposes of the Code.

900. However, it is noted that there are some other indications to the contrary in the Code itself. That is:

(a) The Code itself is entitled National Third Party Access Code for *Natural Gas* Pipeline Systems (emphasis added).

(b) There are various other references to Natural Gas in the Code which indicate an intention that the Code was intended only to apply to Natural Gas, eg:

- The Introduction to the Code, which refers to natural gas distribution systems.
- Sections 4.1A and 7.20 in relation to the disclosure of end-user information for the purpose of the ring-fencing and associate contract provisions.
- The definition of "Delivery Point" in section 10.8 which refers to the transfer of custody of natural gas.
- The definition of "End User" in section 10.8 which refers to a person who acquires or proposes to acquire natural gas.
- The definition of "End User Information" in section 10.8.
- The definition of "New Facility" in section 10.8.
- The definition of "Receipt Point" in section 10.8 which refers to the transfer of custody of natural gas.
- The definition of "Related Business" in section 10.8.
- The definition of "Service" in section 10.8.
- The preamble to Schedule A, which describes the covered distribution systems, including the AGN GDS in Western Australia, refers to "Western Australia – Natural Gas Distribution Systems".
- The description of the Alinta Gas Distribution System in Schedule A itself does not expressly refer to the Vines LPG network and appears to describe only natural gas distribution systems.

901. These references make it clear that, absent any other provision, the Code is not intended to extend to LPG distribution systems such as the Vines LPG network. However, the Code is subsidiary to the *Gas Pipelines Access (Western Australia) Act 1998* which contains an express provision, and therefore evinces a clear intention, to extend Code coverage to LPG systems where those systems are brought under the relevant distribution licence. In circumstances where the Vines LPG network has been brought under the relevant licence, the Authority takes the view that the Vines LPG network is intended to be covered by the Code, notwithstanding that this conclusion necessitates reading the references to natural gas in the Code as including LPG.

902. That said, the Authority considers that regardless of whether or not the Vines LPG network is subject to the Code, it is unnecessary for the definition of "gas" for the purpose of the revised Access Arrangement to be extended from natural gas to include LPG.

903. This is because the Authority is satisfied that even if the Vines LPG network is covered by the Code, in the exercise of the Authority's discretions under the Code it is unnecessary for the Authority to require AGN to submit an Access Arrangement for the Vines LPG network. The Authority's reasons are as follows:

(a) On the basis of the view that the Vines LPG network is covered by the Code, AGN had an obligation under section 2.2 of the Code to lodge an Access Arrangement for approval within 90 days of the pipeline becoming covered.

(b) Such an Access Arrangement was not lodged (the current Access Arrangement not having included the Vines LPG network).

(c) In those circumstances, the Authority's predecessor as the Relevant Regulator had discretion under section 2.23 of the Code to draft and approve its own Access Arrangement.

(d) The Relevant Regulator did not exercise such discretion in the absence of any issue having been raised in relation to access by a third party to the Vines LPG network.

(e) The available evidence weighs against the Authority exercising its discretion under section 2.23 to draft and approve its own Access Arrangement for the Vines LPG network, namely:

- The absence of any evidence of demand for access by a third party to the Vines LPG network, or of any real prospect of such a demand;

- The provision by AGN, on 23 May 2005, of a letter of undertaking for the purpose of clause 9 of GDL2 as to the terms on which it will enter into a contract with a User to provide access, which will involve the provision of terms and conditions similar to those to be offered under the revised Access Arrangement;

- Evidence provided by AGN to the Authority of its plans to convert the Vines LPG network to natural gas during the second Access Arrangement Period, possibly as early as next year (2006).

904. On the foregoing basis the Authority is satisfied that there is no need to require AGN to amend the definition of "gas" in the revised Access Arrangement to include LPG, assuming that the Vines LPG network is covered under the Code. Of course, if the Authority is wrong, and the Vines LPG network is not covered under the Code, the same conclusion follows.

905. In relation to the foreshadowed conversion of the Vines LPG network to natural gas, AGN has proposed that it then be covered by the revised Access Arrangement.

906. Suitable amendments to the relevant definitions have been proposed by AGN in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005, which the Authority is satisfied are reasonable and should be approved. The Authority is, therefore, satisfied that AGN has met the requirements of Amendment 78 of the Draft Decision.

Definition of "New Facilities Investment"

Draft Decision (Amendment 79)

907. In the Draft Decision, the Authority noted that the definition of "New Facilities Investment" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

908. Therefore, the Authority therefore required an amendment (Amendment 79) as follows.

> The definition of "**New Facilities Investment**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 10.8 of the Code.

Final Decision

909. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 79. The definition of "New Facilities Investment" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 79.

Definition of "Prospective User"

Draft Decision (Amendment 80)

910. In the Draft Decision, the Authority noted that the definition of "Prospective User" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

911. Therefore, the Authority therefore required an amendment (Amendment 80) as follows.

> The definition of "**Prospective User**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 10.8 of the Code.

Final Decision

912. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 80. The definition of "Prospective User" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement submitted by AGN in response

to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 80.

Definition of "Receipt Point"

Draft Decision (Amendment 81)

913. In the Draft Decision, the Authority noted that the definition of "Receipt Point" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement as originally submitted was inconsistent with the definition of that Term in the Code.

914. Therefore, the Authority therefore required an amendment (Amendment 81) as follows.

> The definition of "**Receipt Point**" in the Glossary in Schedule 2 of Part A of the proposed revised Access Arrangement should be amended to correspond with the definition in section 10.8 of the Code.

Final Decision

915. In its submission in response to Amendment 81 of the Draft Decision dated 21 March 2005 AGN did not accept the requirement to amend the definition of "Receipt Point". AGN included the same definition of that term in the amended proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005

916. The basis for AGN's position was explained as follows (see paragraph 398 of the submission):

> The definition is unchanged from the current Access Arrangement which was approved by the Regulator. The definition is an improvement from the Code's ambiguous definition and is tailored to AGN's requirements. The definition in the Code is used in a different context and is not appropriate to be adopted into the PRAA.

917. The Authority notes that the Code definition refers to the point at which custody of gas is transferred. AGN's proposed definition (which is the same as that applying under the current Access Arrangement) refers to points for each Sub-network as specified in a Schedule prepared by AGN. It is the Authority's understanding that the practice is that these points may or may not be the physical point at which custody of gas is transferred.

918. In view of AGN's clarification, the Authority is satisfied that there is no potential for the provisions of the Code and the Access Arrangement to conflict because of the different definitions of "Receipt Point" and therefore no reason for the Authority to disallow the use of a different definition in the Access Arrangement.

919. The Authority's final decision, therefore, is that the definition of "Receipt Point" in the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005 is acceptable, notwithstanding differences between that definition and the Code definition of the same term.

Identification of terms of Haulage Contract

Draft Decision (Amendments 82 & 83)

920. Clause 2 of Part C of the proposed revised Access Arrangement as originally submitted provided that:

> The terms of a Haulage Contract will be these general terms and conditions as amended or substituted from time to time by AGN and approved by the Regulator.

921. In the Draft Decision, the Authority indicated that it regarded certain of the provisions contained in Part A – "Principal Arrangements" – as originally submitted as also setting out terms and conditions upon which it was proposed by AGN Services including Reference Services would be supplied. Inconsistently with this, the reference in clause 2 of Part C to "these general terms and conditions" which were to be "the terms of a Haulage Contract" appeared to be a reference to the Part C terms and conditions only.

922. The Authority noted that in these circumstances clause 2 of Part C, if read on its own, could convey the misleading impression that the only terms and conditions in the Access Arrangement which were intended by AGN to be incorporated into the Haulage Contract would be those contained in Part C.

923. The Authority expressed the view in the Draft Decision that if clause 2 was left as it stood, it could cause confusion as to the intended status of terms and conditions contained in Part A of the proposed Access Arrangement, which it might be said were not intended to be incorporated into the Haulage Contract. Further, such confusion could be avoided readily by amending clause 2 of Part C to make it clear that terms and conditions contained in Part A of the Access Arrangement were also intended to be terms of the Haulage Contract.

924. On this basis, the Authority was of the opinion that clause 2 of Part C could operate unreasonably unless it was amended to provide that the terms and conditions of a Haulage Contract would be the terms and conditions in both Part A and Part C of the Access Arrangement.

925. Further, in its Draft Decision the Authority noted that the reference to approval of amended or substituted terms and conditions was not identified. The Authority assumed that the reference was to approval in accordance with the provisions of sections 2.28 to 2.48 of the Code. To remove any uncertainty, the Authority considered that clause 2 should be amended to make clear that the approval referred to is approval by the Authority in accordance with the provisions of sections 2.28 to 2.48 of the Code.

926. The Authority, therefore, required the following amendments (Amendments 82 & 83):

> **Amendment 82**
>
> Clause 2 of Part C of the proposed revised Access Arrangement should be amended to provide that the terms and conditions of a Haulage Contract are the terms and conditions in the Access Arrangement, including those in Part A plus the general terms and conditions in Part C.

Amendment 83

Clause 2 of Part C should be amended to provide that the Authority's approval of amendments to the terms of Haulage Contracts is approval of a revision to the Access Arrangement in accordance with the provisions of sections 2.28 to 2.48 of the Code.

Final Decision

927. AGN accepted the requirement to amend in accordance with Amendments 82 and 83 of the Draft Decision.

928. In its amended proposed revised Access Arrangement submitted on 10 June 2005 in response to the Draft Decision, AGN deleted the previously proposed clause 2 of Part C and substituted a new proposed clause 2 of Part C.

929. The proposed new clause 2 of Part C met the requirements of Amendment 83 by removing the reference to amended or substituted terms and conditions as approved by the Regulator.

930. In relation to Amendment 82, AGN responded to the requirement to amend by specifying that the terms and conditions of the Haulage Contract will be the terms and conditions in Part C and certain provisions of Part A of the amended proposed revised Access Arrangement.

931. The Authority is satisfied that this is an appropriate approach in response to the requirement in Amendment 82. Under the approach, however, adopted by AGN, it is necessary to consider the specific provisions of Part A which are referred to, in order to determine whether the provisions referred to are properly regarded as terms and conditions, and that there are no other terms and conditions included in Part A or indeed elsewhere in the proposed revised Access Arrangement to which reference ought to be made in clause 2 of Part C.

932. The provisions in Part A referred to in clause 2 of Part C as being terms and conditions as submitted on 10 June 2005 are as follows:

- Clauses 18 – 21 (Re-allocation of Reference Services);
- Clause 22 (Gas quality and temperature);
- Clauses 23 and 24 (General Operational Matters);
- Clause 24(3) (Interconnection Service);
- Clauses 26 – 28 (Protection of System Pressure – Existing Agreements);
- Clause 32 (System Pressure Change);
- Clause 62 (Receipt Points);
- Clause 63 (Maintaining and complying with approved System Pressure Protection Plan); and

- Clause 64 (Providing evidence).

933. The Authority has considered this matter and is satisfied that the clause 2 in its terms meets the requirement of Amendment 82 of the Draft Decision.

Additional terms contained in Haulage Contract

Draft Decision (Amendment 84)

934. Clause 3 of Part C of the proposed revised Access Arrangement as originally submitted provided that a Haulage Contract could specify other terms and conditions upon which AGN would make the Reference Service available to the User in addition to those set out in Part C.

935. Prior to the Draft Decision submissions were received by the Authority from two parties expressing concerns in relation to this matter.

936. In the Draft Decision, the Authority noted that the inclusion of such other terms and conditions in a Haulage Contract would occur without the Authority having had the opportunity to consider whether or not such terms or conditions are reasonable. Under section 3.6 of the Code the terms and conditions for Reference Services must be contained in an Access Arrangement and the Authority must, as the Relevant Regulator, be satisfied that they are reasonable. Therefore, in the Draft Decision the Authority was not satisfied that clause 3 of Part C as originally submitted was reasonable. The Authority accordingly required an amendment (Amendment 84) that the clause be deleted in order for the revised Access Arrangement to be approved.

Final Decision

937. In response to the Draft Decision, AGN has accepted the requirement under Amendment 84 by deleting clause 3 of Part C as originally submitted. The Authority is, therefore, satisfied that this amendment meets the requirements of Amendment 84 of the Draft Decision.

Security obligations and other relationship matters between AGN and User

Draft Decision (Amendment 85)

938. Under the current Access Arrangement, there is provision for the User to provide one form of security in an amount sufficient to protect AGN's legitimate business interests (see Schedule 7, clause 7(a) thereof).

939. Clause 4(1)(a) of Part C of the proposed revised Access Arrangement as originally submitted amended the provisions relating to this issue. The clause originally submitted by AGN specified that the form of security would be a bank guarantee for "at least an amount that is equal to AGN's reasonable estimate of all fees and charges that will be incurred by the User under the Haulage Contract in the 2 months following the date of estimation, and if necessary a greater amount if, in AGN's opinion, a greater amount is necessary to protect AGN's legitimate business interests."

940. In the Draft Decision the Authority noted that under the proposed clause 4(1)(a) of Part C the criterion for determining the amount of security would change from an objective one ("an amount sufficient to protect AGN's legitimate business interests") to one which would include a subjective element ("if, in AGN's opinion, a greater amount is necessary to protect AGN's legitimate business interests").

941. In the Draft Decision the Authority took the view that the proposed clause 4(1)(a) of Part C was not reasonable, to the extent that AGN would have discretion to determine an increase in the amount of the bank guarantee which, in AGN's opinion, would be necessary to protect its legitimate business interests. The Authority also took the view that any unreasonableness in this respect could be addressed by amending the clause to make any increase in the amount of the bank guarantee subject to an objective qualification (e.g. an amount reasonably necessary to protect AGN's legitimate business interests).

942. The Authority, therefore, required an amendment (Amendment 85) as follows:

> Clause 4(1)(a) of Part C of the proposed revised Access Arrangement should be amended to make the exercise of the discretion by AGN to require further security subject to an objective qualification (e.g. to provide for such further amount as is reasonable to protect AGN's legitimate business interests).

Final Decision

943. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 85. Clause 3(1)(a) of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 85.

Unaccounted for Gas

Draft Decision (Amendment 86)

944. Clause 17 of Part C of the proposed revised Access Arrangement as originally submitted provided that AGN would replace gas which is lost while in its "control".

945. In the Draft Decision the Authority noted that the word "control" was not used elsewhere in the proposed revised Access Arrangement as originally submitted. In particular, clauses 11 and 12 of Part C, dealt with issues of delivery, title and possession of gas in the GDS, and made no mention of the term "control". The Authority was concerned that there may be scope for uncertainty as to exactly which circumstances give rise to AGN's obligation to replace unaccounted for gas.

946. The Authority in its Draft Decision, therefore, did not propose to approve clause 17 pending an amendment which clarified AGN's obligation. The Authority considered that a suitable amendment would be by adding the words "or possession", which is used in clauses 11 & 12 of Part C, after the word "control" in clause 17. An amendment (Amendment 86) was required as follows:

Clause 17 of Part C of the proposed revised Access Arrangement should be amended to clarify AGN's obligation to replace lost gas.

Final Decision

947. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 86. Clause 18 of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 86.

Curtailment for system reinforcement

Draft Decision

948. Clause 23 of Part C of the proposed revised Access Arrangement as originally submitted provided for curtailment of Services to the extent reasonably necessary to permit AGN to undertake any Extension or Expansion or maintenance at any time by arrangement with the User, or at least 30 days after giving the User written notice.

949. The current Access Arrangement contains an equivalent clause. However, AGN proposed a revision by which the period of notice to the User of any permitted curtailment is to be reduced from 90 to 30 days.

950. Prior to the Draft Decision, the Authority received a submission from CMS contending that the reduction from 90 to 30 days would be unreasonable and commercially unacceptable. CMS provided no substantiation of the basis for this submission.

951. AGN did not indicate in the originally submitted Access Arrangement Information the grounds for proposing to reduce the notice period, nor did it put forward any evidence that the present notice period is operating unreasonably.

952. In the Draft Decision, the Authority was of the opinion that, subject to any further submissions from AGN or interested parties, clause 23 of Part C as originally submitted would be reasonable to the extent that it proposes to reduce the notice period to the User of a curtailment for Extension or Expansion or maintenance from 90 to 30 days.

Final Decision

953. The Authority has not received any further submissions on this matter since the Draft Decision and, therefore, confirms its Draft Decision in this Final Decision.

Metering uncertainty

Draft Decision (Amendment 87)

954. Clause 28 of Part C as originally submitted by AGN provided that User Specific Delivery Facilities and Standard Delivery Facilities will be designed, adjusted, operated and maintained so as to achieve the best accuracy of measurement which is

technically feasible consistent with the standard of a prudent Service Provider acting efficiently, in accordance with good industry practice, and to achieve the lowest sustainable cost of delivering Services.

955. Prior to making its Draft Decision, the Authority sought advice in relation to this matter from the Director of Energy Safety (**DES**), pursuant to the Authority's power to make appropriate use of the expertise of DES under section 37(4) of the *Gas Pipelines Access (Western Australia) Act* 1998 as amended. DES advised that the accuracy of metering equipment is subject to provisions contained in the *Gas Standards (Gas Supply and System Safety) Regulations* 2000 and that AGN is required to ensure that as a minimum these requirements are complied with.

956. In the Draft Decision, the Authority noted that the *Gas Standards (Gas Supply and System Safety) Regulations* 2000 would take precedence over the Access Arrangement in circumstances where there was an inconsistency between the two instruments. However, clause 28 as presently drafted could create the misleading impression that the relevant standard is as expressed in clause 28, even if the application of that standard may fall short of the regulatory requirements. In view of DES's advice, the Authority was of the opinion that clause 28 of Part C is not reasonable.

957. Further, the Authority considered in its Draft Decision that this issue could be addressed by the clause noting, for the avoidance of doubt, the existence of the minimum standards under those regulations, which represent standards below which metering services supplied by AGN must not fall. The Authority therefore required that AGN appropriately amends clause 28 of Part C for the proposed clause to be approved. The required amendment (Amendment 87) was as follows:

> **Amendment 87**
>
> Clause 28 of Part C of the proposed revised Access Arrangement should be amended to note, for the avoidance of doubt, the existence of the minimum standards under the *Gas Standards (Gas Supply and System Safety) Regulations* 2000, which represent standards below which metering services supplied by AGN must not fall.

Final Decision

958. In its submission in response to Amendment 87 of the Draft Decision dated 21 March 2005 AGN did not accept the requirement to amend clause 28 to remove any doubt about the operation of the clause. AGN therefore included the same provision in its amended proposed revised Access Arrangement submitted in response to the Draft Decision on 10 June 2005

959. The basis for AGN's position was explained in paragraphs 406 to 411 of the submission. In essence, AGN's position was that the obligation under clause 28 of Part C to comply with good industry practice must involve AGN complying with applicable laws. Further, AGN did not agree that Users are unlikely to be aware of AGN's obligation to comply with regulatory metering standards, claiming that Users are well-informed and acquire gas transportation services at a commercial level. Further, even if a User was not aware of the standards it would not limit or lessen AGN's obligations under the regulations, because the monitoring mechanisms in place in the regulations are not dependent upon User notification.

960. AGN was also concerned that by highlighting AGN's obligations under one particular regulatory standard may imply that others are not applicable, or that the specific regulations mentioned in the Access Arrangement are somehow more important.

961. In view of AGN's clarification and further submission, the Authority is satisfied that the absence of any clarificatory words in the relevant clause is unlikely to cause the provision to operate unreasonably. The Authority's final decision, therefore, is that the provisions of clause 28 of Part C in relation to metering uncertainty as submitted by AGN in the amended proposed revised Access Arrangement on 10 June 2005 are acceptable, notwithstanding that they do not refer to the safety standards referred to in Amendment 87 of the Draft Decision.

Payment within 10 Business Days

Draft Decision

962. Under the proposed revisions contained in clause 31 of Part C as originally submitted, AGN sought to reduce its terms of payment from 15 Business Days (which applies under the current Access Arrangement) to 10 Business Days.

963. Prior to the Draft Decision, the Authority received a submission which raised concerns as to the reasonableness and commercial acceptability of this reduction.

964. In the Draft Decision the Authority was satisfied that the proposed terms of payment of 10 Business Days would be consistent with commercial practice. The Authority also considered that the proposed terms of payment would also be consistent with the Authority's amended Draft Decision on the Access Arrangement for Goldfields Gas Pipeline[70]. The Authority, therefore, considered that the proposed terms of payment of 10 Business Days were reasonable.

Final Decision

965. The Authority has not received any further submissions on this matter since the Draft Decision and, therefore, confirms its Draft Decision in this Final Decision.

Disputed invoices

Draft Decision (Amendment 88)

966. Clause 32(1) of Part C as originally submitted provided that the procedure for disputed invoices under the Retail Market Scheme (**RMS**) would apply to the Haulage Contract. Clause 32(2) provided for AGN to charge interest upon payments withheld by the User under a disputed invoice where the dispute is subsequently resolved in favour of AGN.

[70] Economic Regulation Authority, 29 July 2004, *Amended Draft Decision on the Proposed Access Arrangement for the Goldfields Gas Pipeline*, p 117 (NB: Clause 13.4 of the proposed General Terms and Conditions dated 15 December 1999 provided for payment within 14 days of receipt of an invoice.)

967. The equivalent clause in the current Access Arrangement – clause 17 of Schedule 7 - provides in clauses 17(2) & (3) for the payment of interest by the User and AGN respectively in respect of amounts withheld under the dispute procedure but later found to have been payable. In the Draft Decision the Authority noted that the proposed revisions contained in clause 32 involved retaining the provision for the payment of interest by the User – in clause 32(2) – but removing the previous provision for payment of interest by AGN – clause 17(3). The Authority received a submission prior to the Draft Decision that this would be unreasonable.

968. In the Draft Decision, the Authority concluded that there was no reason why the obligation to pay interest should not be reciprocal as it is under the current Access Arrangement. The Authority therefore required the proposed revised Access Arrangement to be amended to reflect the provisions of the current Access Arrangement. Amendment 88 of the Draft Decision provided:

> Clause 32(2) of Part C should be amended to reflect the wording of the equivalent clause in the current Access Arrangement, which provides an obligation applicable to both parties for the payment of interest upon amounts reimbursable following dispute resolution in relation to invoices.

Final decision

969. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 88. Clause 32(3) of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 re-inserts the obligation under the current Access Arrangement on AGN to pay interest to the User, and the Authority is satisfied that AGN has met the requirements of Amendment 88.

Correction of payment errors

Draft Decision (Amendment 89)

970. Clause 33 of Part C of the proposed revised Access Arrangement as originally submitted provided a procedure for payments between the parties to correct overpayments.

971. Prior to the Draft Decision, the Authority received a submission from one party in relation to an alteration to the current provision which deals with the payment of interest upon amounts not paid after notice being given by the payee.

972. The submitting party noted that by clause 33(2) of Part C as submitted for approval, AGN proposed removing the word "party" from the clause and replacing it with the word "User" resulting in the provision being one-sided. That is, the clause would impose an interest obligation on the User for late re-payment of detected overpayments, but would not subject AGN to the reciprocal obligation.

973. In the Draft Decision the Authority noted that AGN did not put forward in its Access Arrangement Information as originally submitted any explanation for this proposed revision which would appear to have the potential to disadvantage Users unreasonably.

974. The Authority in the Draft Decision considered that proposed clause 33(2) of Part C was unreasonable to the extent that it purported to impose an interest obligation on the User for late re-payment of detected overpayments, but would not subject AGN to a reciprocal obligation. Further, the Authority considered that any such unreasonableness could be addressed by amending the clause to reflect the wording of the equivalent provision in the current Access Arrangement – clause 18, Schedule 7 thereof – which makes the obligation applicable to both parties. The Authority required the following amendment (Amendment 89):

> Clause 33(2) of Part C of the proposed revised Access Arrangement should be amended to reflect the wording of the equivalent clause in the current Access Arrangement, which provides an obligation applicable to both parties for the payment of interest upon subsequently detected over-payments.

Final decision

975. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 89. Clause 33(1) of Part C of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 89.

Guaranteed Service Level Payments

Draft Decision (Amendment 90)

976. A Guaranteed Service Level (**GSL**) scheme proposed by AGN for small use customers was described in section 3.10 of the originally submitted Access Arrangement Information.

977. GSL schemes are intended to provide incentives to Service Providers to ensure that the level of service delivered to individual end use consumers is not materially less than the high level of service reliably delivered by the network as a whole. Where the Service Provider fails to deliver prescribed services within predetermined service levels, payments are made by the Service Provider to consumers.

978. Terms and conditions relating to the payments to be made by AGN under its proposed GSL scheme were set out in clause 35 of Part C of the proposed revised Access Arrangement as originally proposed. The proposed amounts to be paid under the GSL scheme were, however, set out in section 3.10 of the Access Arrangement Information as originally submitted.

979. There are no equivalent provisions in the current Access Arrangement or current Access Arrangement Information.

980. Prior to making its Draft Decision, the Authority received a submission in relation to proposed clause 35(2) of Part C. This proposed clause provides that:

If:

(a) the User receives notification of a matter and the User delays in passing on that notification to AGN; and

(b) as a result of that delay, AGN is required to make a payment to a Small Use Customer as a result of failing to satisfy a GSL, then the User must either:

(i) reimburse AGN for the payment made to the Small Use Customer; or

(ii) if requested by AGN, on its behalf, pay the required payment to the Small User Customer or credit that amount to the Small User Customer's next bill, and AGN is not required to reimburse or credit the User for that amount.

981. The submitting party raised a concern that there was no objective measure in the provision and that the clause must provide for a delay by the User of 2 days to be reasonable.

982. In the Draft Decision the Authority considered that clause 35(2) of Part C would not be reasonable to the extent that it purported to impose an obligation upon the User to reimburse AGN for GSL payments caused by any delay, no matter how minor, in the User giving AGN notice from a Small Use Customer.

983. Further, the Authority was of the view that any such unreasonableness could be addressed by AGN amending the proposed clause to provide a short period (e.g. no more than 2 days) within which the User could pass on the notice to AGN without being required to reimburse any GSL payment by AGN.

984. Accordingly, the Authority in its Draft Decision required clause 35(2) of Part C to be amended to provide a reasonable period within which a User may pass on a GSL notice from a Small Use Customer without the User being required to reimburse any GSL payment by AGN.

985. The Authority also noted in its Draft Decision that proposed clause 35(2)(a) of Part C referred to delay by a User in passing on notification of a "matter" without providing any indication of the types of matters to which the clause applied. The Authority noted that it had not, however, received any submissions expressing concerns in relation to this aspect of the proposed clause. In the circumstances, the Authority did not require any amendment in relation to this aspect at the time of making its Draft Decision.

986. The amendment required in relation to the GSL scheme (Amendment 90) was as follows:

Amendment 90

Clause 35(2) of Part C of the proposed revised Access Arrangement should be amended to provide a reasonable period within which a User may pass on a GSL notice from a Small Use Customer without being required to reimburse any GSL payment by AGN.

Final decision

987. In its submission dated 21 March 2005 in response to the Draft Decision, AGN accepted the requirement to amend in response to Amendment 90, and proposed that

the previous clause be amended so that the User will be liable to reimburse any GSL payment by AGN when the User has "unreasonably" delayed passing on a GSL notification to AGN (see paragraph 414). In the Authority's view, this amendment addresses adequately the intent of the required amendment, and creates an objective standard which could be arbitrated if necessary, and is therefore accepted by the Authority. The amended proposed revised Access Arrangement submitted on 10 June 2005 contained the amended clause at clause 35 of Part C.

988. In addition to making the required amendment, in its proposed revised Access Arrangement, AGN has proposed further amendments to the clause as originally submitted to the Authority. In such a case, the Authority must be satisfied that the proposed additional provisions are reasonable for the purposes of section 3.6 of the Code. These additional amendments were discussed at paragraph 415 of AGN's submission. There AGN said that it has further amended clause 35 of Part C to ensure that AGN is not required to make GSL payments when, due to the actions of a third party, the GSL is unable to be met. However, AGN has inserted a discretion enabling GSL payments to be made to Small Use Customers in such circumstances where it is the User's conduct that has led to the failure to meet the GSL.

989. The Authority considers that the additional provision should be regarded as reasonable in circumstances where AGN has no obligation in the first place to provide a GSL scheme. That being the case the Authority considers that the circumstances in which AGN will subject itself to an obligation to make payments should be a matter left to AGN. The distinction between these additional provisions and the provision in relation to which an amendment was required in the draft decision is that in the latter case the provision in question purported to pass on a GSL liability to the User, such that the Authority would need to be satisfied that exposing the User to the liability would only occur where reasonable, whereas in the former the provisions merely go to whether AGN will bear a GSL liability in the first place.

990. The Authority's final decision therefore is to accept as reasonable, and as meeting the requirements of Amendment 90, the GSL provisions in clause 35 of Part C the amended proposed revised Access Arrangement submitted by AGN on 10 June 2005.

Saving of AGN's other remedies

Draft Decision (Amendment 91)

991. Clause 44 of Part C as originally submitted contained provisions regarding the saving of the parties' remedies in addition to specific remedies conferred under the Access Arrangement. In the Draft Decision, the Authority noted that the title to this clause was inconsistent with its content which included saving of the User's rights and remedies as well as AGN's. The Authority took the view in the Draft Decision that the title of the clause should be amended before approval to conform with its content, so as to avoid uncertainty, by referring to the saving of the parties', not only AGN's, other remedies. Amendment 91 of the Draft Decision required an amendment accordingly.

Final decision

992. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 91. Clause 44 of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 91.

Novation of contracts do not trigger default provisions

993. Clause 46 of Part C of the proposed revised Access Arrangement as originally submitted set out terms upon which the Haulage Contract may be novated at the User's request. Novation refers to the substitution of a third party as the User under the Haulage Contract. The Authority noted in the Draft Decision that this would be a new provision for which there is no equivalent in the current Access Arrangement.

Withholding of consent to novation

Draft Decision (Amendment 92)

994. Prior to the Draft Decision, the Authority received a submission contending that this clause was unreasonable. The proposed clause 46(1) provided that a Haulage Contract may be novated with AGN's prior written consent, which consent may be withheld if there is an increase in commercial or technical risk to AGN. The submitting party argued that the words "such consent should not be unreasonably withheld" be included, in order to make the provision acceptable to all parties.

995. In the Draft Decision the Authority noted that commercial contracts commonly provide for consents of this kind to be subject to a requirement that the consent is not to be unreasonably withheld. Further, that it is conceivable that a novation may increase AGN's commercial or technical risk, in which case it may be reasonable for AGN to withhold consent. The Authority therefore required an amendment to ensure that AGN only exercises its discretion to refuse consent when it is reasonable to do so. Amendment 92 provided that:

> Clause 46(1) of Part C of the proposed revised Access Arrangement should be amended to add a requirement that AGN's discretion to withhold consent shall only be exercised in circumstances where it is reasonable to do so.

Final Decision

996. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 92. Clause 46(1) of Part C of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 92.

Costs of AGN considering consent to novation

Draft Decision

997. A second aspect of the submission received prior to the Draft Decision related to proposed clause 46(3) as originally submitted. This clause provided that "AGN may charge a reasonable fee, in its absolute discretion, to cover AGN's costs associated with assessing whether to grant its consent under Part C, subclause 46(1)." The submitting party contended that clause 46(3) be deleted as it is an unreasonable provision. The submitting party contended that AGN should pay its own costs as part of its own due diligence.

998. In the Draft Decision the Authority noted the following arguments detracting from the force of this submission. First, while there was a reference to AGN having an absolute discretion, this referred to a discretion whether or not to charge the fee, not to the setting of the amount. In fact, the fee had to be a "reasonable fee". Second, in relation to who should bear the costs of the necessary enquiries, AGN's costs would be occasioned by the User's request to novate. Thus the Authority did not regard it as unreasonable for AGN to pass on its reasonable costs to the User, just as it is common, and not regarded as unreasonable, for a lessor to be entitled to claim the costs of enquiring as to the suitability of an assignee of a lease.

999. In the circumstances, the Authority considered the provision for AGN to pass on its reasonable costs in relation to a User's request to novate to be reasonable.

Final Decision

1000. The Authority has not received any further submissions on this matter since the Draft Decision and, therefore, confirms its Draft Decision in this Final Decision.

Indemnity to AGN for liability for indirect damage

Draft Decision

1001. Clause 50 of Part C of the proposed revised Access Arrangement as originally submitted provides that neither party to the Haulage Contract would be liable to each other for any Indirect Damage. Indirect Damage was defined in Schedule 2 to Part A to include consequential loss or damage including without limitation loss of use, production, revenue, income, profits, business or savings, or business interruption, whether or not the consequential loss or damage was foreseeable.

1002. Clause 51 of Part C was a new provision for which there is no equivalent in the current Access Arrangement. Clause 51 would extend the operation of clause 50 by providing that where AGN is not liable to the User for Indirect Damage by reason of clause 50 of Part C, then if a person (defined as a downstream person) claims against AGN for Indirect Damage either directly or through the User then the User must indemnify AGN for any liability of AGN to the downstream person.

1003. Prior to the Draft Decision the Authority did not receive any submissions from Users or Prospective Users who may be affected by these new provisions. In the

circumstances, in the Draft Decision the Authority did not propose any amendment to these clauses.

Final Decision

1004. No further submissions having been received since the Draft Decision, the Authority confirms its Draft Decision to approve these clauses in this Final Decision.

Making good damage caused in the course of installing delivery facilities

Draft Decision

1005. Clause 62 of Part C of the proposed revised Access Arrangement as originally submitted was in identical form to the equivalent clause contained in the current Access Arrangement – clause 47, Schedule 7 thereof. Proposed clause 62(1) provided that AGN would not be liable to pay compensation for, or make good any, damage done to the land or premises of the User or the User's gas customer by AGN in the course of installing User Specific Delivery Facilities or Standard Delivery Facilities, except as otherwise provided for in clauses 62(2) to (6).

1006. Clause 62(2) provided further that if in the course of installing User Specific Delivery Facilities or Standard Delivery Facilities, AGN opens or breaks up any sealed or paved surface, or damages or disturbs any lawn, landscaping or other improvement, then AGN would if necessary fill in any ground to "restore it to approximately" its previous level.

1007. One submission received by the Authority prior to the Draft Decision raised concerns in relation to the words "restore it to approximately" in clause 62(2). However, the Authority noted in its Draft Decision that it is unlikely that AGN could ever restore ground opened up to exactly the same state as it was when AGN commenced the installation work.

1008. The submission received by the Authority also raised a concern in relation to AGN's liability where repair or reinstatement works would be required, as opposed to liability with respect to installation works which are dealt with by clause 62. The Authority noted, however, in its Draft Decision that liability in respect of matters other than installing User Specific Delivery Facilities or Standard Delivery Facilities, would be subject to the general liability regime under the Access Arrangement (clauses 48 to 54 of Part C). In the circumstances, the Authority was satisfied, in its Draft Decision, that proposed clause 62 of Part C was reasonable.

Final Decision

1009. No further submissions having been received since the Draft Decision, the Authority confirms its Draft Decision to approve these clauses in this Final Decision.

Capacity Management Policy

Draft Decision

1010. Sections 3.7 and 3.8 of the Code require that an Access Arrangement include a Capacity Management Policy as follows:

> 3.7 An Access Arrangement must include a statement (a ***Capacity Management Policy***) that the Covered Pipeline is either:
>
> (a) a Contract Carriage Pipeline; or
>
> (b) a Market Carriage Pipeline.
>
> 3.8 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.

1011. Contract Carriage is 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 the Contract;
- Users are normally required to enter into a Contract that specifies a quantity of Service;
- charges for use of a Service are normally based, at least in part, upon the quantity of Service specified in a Contract; and
- a User normally has the ability to trade its right to obtain a Service to another User.

1012. Market Carriage is 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;
- Users are not normally required to enter into a Contract that specifies a quantity of Service;
- charges for use of Services are normally based on actual usage of Services; and
- a User does not normally have the ability to trade its right to obtain a Service to another User.

1013. Clause 36 of Part A of the proposed revised Access Arrangement as originally submitted provided that AGN will manage the GDS as a Contract Carriage Pipeline.

1014. In the Draft Decision the Authority noted that the Code requires no more than a statement in the Access Arrangement that the GDS be a Contract Carriage Pipeline or, subject to Ministerial approval for any proposal for the pipeline to be a Market

Carriage Pipeline. As the proposed revised Access Arrangement stated that the GDS is to be managed as a Contract Carriage Pipeline, the Authority concluded, in its Draft Decision, that the requirements of the Code are met.

Final Decision

1015. No further submissions or proposed amendments having been received since the Draft Decision, the Authority confirms its Draft Decision to approve the Capacity Management Policy in this Final Decision.

Trading Policy

Draft Decision

1016. Section 3.9 of the Code requires that an Access Arrangement for a Covered Pipeline that is described 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**).

1017. Section 3.10 of the Code requires that the Trading Policy must comply with the following principles.

> 3.10 (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.

1018. Section 3.11 of the Code states that examples of things that would be reasonable for the purposes of sections 3.10(b) and (c) are:

3.11 (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.

1019. The Trading Policy proposed by AGN in the proposed revised Access Arrangement as originally submitted was set out at clauses 37 to 43 of Part A of the proposed revised Access Arrangement under the following headings:

- Transfers or assignments of Capacity (clause 37 of Part A);
- Bare transfers (clause 38 of Part A);
- Other transfers (clause 39 of Part A);
- Transferor remains liable to AGN (clause 40 of Part A);
- Change of Receipt Point or Delivery Point (clause 41 of Part A);
- Examples (clause 42 of Part A);
- Costs (clause 43 of Part A).

1020. With the exception of clause 43 of Part A, which was a proposed new clause dealing with the recovery by AGN of its reasonable costs of enquiries relevant to the granting of consent to a transfer other than a bare transfer, the Trading Policy proposed by AGN, as originally submitted, was identical to the Trading Policy under the current Access Arrangement.

1021. In the Draft Decision the Authority noted that the issue for determination with respect to the proposed Trading Policy is whether it complies with the principles set out in section 3.10 of the Code. In this respect, the Authority noted further that it had not received any submissions nor did it otherwise have any reason to believe that the proposed Trading Policy did not comply with the relevant principles. Subject to any comments or submissions from Users to the contrary, the Authority in its Draft Decision did not propose to require any amendment to the Trading Policy.

Final Decision

1022. No further submissions or proposed amendments having been received since the Draft Decision, the Authority confirms its Draft Decision to approve the Trading Policy in this Final Decision.

Queuing Policy

Draft Decision

1023. 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. Section 3.12 also makes provision for a Prospective User to seek dispute resolution under section 6 of the Code where relevant.

1024. 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.

1025. Section 3.14 of the Code provides for the Authority to require the Queuing Policy to deal with any other matter the Authority thinks fit, taking into account the matters listed in section 2.24 of the Code.

1026. In the proposed revised Access Arrangement as originally submitted, AGN provided a Queuing Policy at clauses 44 to 52 of Part A of the proposed revised Access Arrangement that was substantially unchanged from the Queuing Policy in the current Access Arrangement. The only exception was the inclusion of an additional provision at clause 51(2)(c) of Part A.

1027. Under the current equivalent of proposed clause 51(1) of Part A[71], the parties may not extend the duration of a Service Agreement or increase a User's Contracted Peak Rate other than in accordance with the Applications Procedure under the Access Arrangement. The proposed new clause 51(2)(c) of Part A provided, in effect, that the requirement in clause 51(1) of Part A does not prevent AGN or a User from exercising any rights under the proposed new Overrun Service under Schedules 1 and 2 of Part C (discussed in paragraphs 669 to 703 above) or the proposed new Replacement Reference Service under clauses 17 to 20 of Part A (discussed in paragraphs 832 to 836 above).

1028. Prior to making its Draft Decision, the Authority had not received any submissions raising concerns about the proposed Queuing Policy, nor was there otherwise any evidence before the Authority that the Queuing Policy in the current Access Arrangement has not operated in a way consistent with the Code requirements.

1029. In the circumstances, the Authority was satisfied in its Draft Decision that the proposed Queuing Policy complies with the relevant Code requirements.

Final Decision

1030. The Queuing Policy submitted by AGN in its amended proposed revised Access Arrangement on 10 June 2005, was unchanged from that originally submitted, with the exception of certain amendments addressing amendments required by the Authority in its Draft Decision with respect to the terms and conditions of Reference Services (Amendments 60 and 62). As explained above in this Final Decision, AGN's response to those amendments has been to re-locate certain provisions to the

[71] Current Access Arrangement, clause 55 of Chapter 6.

Queuing Policy and the Authority in this Final Decision has accepted such amendments as appropriate.

1031. In the circumstances, the Queuing Policy, amended as proposed by AGN in the revised Access Arrangement submitted on 10 June 2005, is accepted by the Authority, the Authority not having received any other submissions since the Draft Decision on the original proposal.

Extensions/Expansions Policy

1032. Section 3.16 of the Code requires that an Access Arrangement include a policy (an **Extensions/Expansions Policy**) which states:

(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) specify 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 provide:

(i) 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.

1033. Section 3.16 further provides that the Authority may not require the Extensions/Expansions Policy to state that the Service Provider will fund New Facilities, unless the Service Provider agrees.

1034. An Extensions/Expansions Policy was provided by AGN in clauses 53 to 58 of Part A of the proposed revised Access Arrangement as originally submitted. Except for clause 56(2) and clause 58, the proposed provisions were substantially the same as in the current Access Arrangement.

Excluded extensions

Draft Decision (Amendment 93)

1035. Clause 56(1) of Part A of the proposed revised Access Arrangement as originally submitted provided in relation to excluded extensions as follows:

> AGN may, in its discretion and with the Regulator's consent, declare that an Extension or Expansion which would otherwise become part of the AGN GDS under Part A, clause 54 is to be an Excluded Extension.

1036. This procedure for exclusion of an Extension or Expansion would have the effect, as set out in clause 56(4), that the Extension or Expansion would not be treated as part of the AGN GDS for any purpose under the Code.

1037. This proposed exclusion procedure was as contemplated by the example given in section 3.16(a) of the Code, namely:

> (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)

1038. Under the current Access Arrangement (clauses 60(2) and 60(3) of Chapter 7) AGN may, prior to AGN installing Extension or Expansion facilities, request the Authority's consent to the proposed Extension or Expansion being excluded from the Covered Pipeline.

1039. However, in its proposed revisions as originally submitted (clause 56(2) of Part A), AGN proposed that the consent to be given by the Authority to the exclusion of a proposed Extension/Expansion from the Covered Pipeline would be binding upon the Authority as follows:

> Before undertaking an Extension or Expansion, AGN may make a written request to the Regulator seeking the Regulator's prior consent under Part A, clause 56(1), which consent binds the Regulator in respect of the Extension or Expansion specified in the request.

1040. In its Draft Decision, the Authority noted that there was not discussion in the Access Arrangement Information as originally submitted explaining AGN's reasons for proposing the revised clause 56(2) as originally submitted.

1041. Under section 1.40 of the Code, any Extension or Expansion of the Capacity of a Covered Pipeline becomes part of the Covered Pipeline if the Extensions/Expansions Policy under the approved Access Arrangement so provides. Clause 54 of Part A of the proposed revised Access Arrangement as originally submitted would provide, in effect, that any Extension or Expansion which was part of, or (for the purposes of gas flow) directly connected with, an existing Sub-network would become part of the Covered Pipeline, subject to the exclusion procedure in clause 56.

1042. In the Draft Decision the Authority noted that a difficulty with AGN's proposed revision to the exclusions procedure was that prevented coverage of an excluded Extension or Expansion, including through the exercise of the NCC's discretion under section 1.2 of the Code to recommend to the Relevant Minister that an excluded Extension or Expansion be covered by the Code.

1043. Further, the Authority noted that under sections 1.22 and 1.23 of the Code, a Service Provider may request an opinion from the NCC as to whether a proposed Pipeline would meet the criteria for coverage, and the NCC may provide an opinion in response. However, the Authority noted that such an opinion is expressed in the Code not to bind the NCC in relation to any subsequent application for coverage of the Pipeline.

1044. The Authority, therefore, was not satisfied that the revisions originally proposed by AGN were appropriate under the Code. The Authority, therefore, did not intend to

approve the proposed revision to the Extensions/Expansions Policy and proposed an amendment (Amendment 93) as follows:

> Clause 56(2) of Part A of the proposed revised Access Arrangement should be amended to remove the words "which consent binds the Regulator in respect of the Extension or Expansion specified in the request".

Final Decision

1045. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 93. Clause 59 of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 93.

New connections

Draft Decision (Amendment 94)

1046. The proposed revisions as originally submitted included, in clause 58 of Part A, a provision regarding new connections:

> New Connections (sic) Where the provision of a Service requires AGN to install Delivery Facilities:
>
> (a) the Haulage Contract (or another contract) must deal to AGN's reasonable satisfaction with the construction and installation of the Delivery Facilities, including:
>
> (i) matters relating to site access, health and safety, standards of work and scheduling of work; and
>
> (ii) the User's obligations as to the payment for the installation of the Delivery Facilities;
>
> (b) subject to Part A, subclause 57(3), AGN may seek a Capital Contribution from the User in respect of the Delivery Facilities;
>
> (c) for the avoidance of doubt and without limiting Part A, subclause 58(b), AGN may decline to install Delivery Facilities where it is not obliged by a Distribution Licence to install them.

1047. Proposed clause 57(3) as referred to in clause 58(b) provided that

> Where AGN is obliged under a Distribution Licence to connect a premises (sic) to the AGN GDS ("Obligation to Connect") AGN will not impose Surcharges or seek Capital Contributions in respect of Standard Delivery Facilities used to provide either Reference Service B2 or Reference Service B3 to the extent that it is required by the Distribution Licence to bear costs under the Obligation to Connect.

1048. The Authority noted that to the extent that proposed clause 58 of Part A extended to Non-Reference Services, it contains terms and conditions for the provision of such Services. The Authority's Draft Decision was that it would not be appropriate to include terms and conditions of Non-Reference Services in an Access Arrangement.

The Authority required clause 58 of Part A to be amended accordingly. Amendment 93 of the Draft Decision provided as follows:

> Clause 58 of Part A of the proposed revised Access Arrangement should be amended to confine its operation to new connections for the provision of Reference Services under a Haulage Contract.

Final Decision

1049. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 94. Clause 61 of Part A of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 94.

Discretion to install Delivery Facilities

Draft Decision

1050. In the Draft Decision the Authority noted that the effect of clause 58 of Part A, if approved, would be that for any New Connections within the GDS, AGN would retain discretion to determine whether it would or would not install Delivery Facilities, except where required by the terms of its Distribution Licence.

1051. Further, the Authority also noted that the discretion to be conferred upon AGN to decline to install Delivery Facilities is to apply, even in circumstances where:

- the Facilities may be required to provide the Reference Service;
- the Haulage Contract in respect of such Reference Services must deal to AGN's reasonable satisfaction with respect to the construction and installation of Delivery Facilities as to matters such as site access, health and safety, standards of work, scheduling of work and payment, in accordance with clause 58(a);
- AGN may seek a Capital Contribution from the User in respect of the Delivery Facilities, in accordance with clause 58(b).

1052. In such circumstances, the Authority in its Draft Decision had difficulty understanding why AGN required the discretion to decline to install Delivery Facilities, as was proposed by clause 58(c) of the revised Access Arrangement as originally submitted. However, the Authority had not received any submissions on this matter and in the Draft Decision indicated its intention, subject to any submissions, to approve the clause as originally proposed.

Final Decision

1053. No further submissions or proposed amendments having been received since the Draft Decision, the Authority confirms its Draft Decision to approve this aspect of the Extensions/Expansions Policy in this Final Decision.

Review and Expiry of Access Arrangement

1054. Sections 3.17 to 3.20 of the Code provide as follows:

3.17 An Access Arrangement must 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 Submissions Date and Revisions Commencement Date, the Relevant Regulator must have regard to the objectives in section 8.1, and may in making its decision on an Access Arrangement (or revisions to an Access Arrangement), if it considers it necessary having had regard to the objectives in section 8.1:

(i) require an earlier or later Revisions Submission Date and Revisions Commencement Date than proposed by the Service Provider in its proposed Access Arrangement;

(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.

3.18 An Access Arrangement Period accepted by the Relevant Regulator may 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.

3.19 Nothing in section 3.18 shall be taken to imply that the Relevant Regulator may not approve an Access Arrangement Period longer than 5 years if the Relevant Regulator considers this appropriate, having regard to the objectives of section 8.1.

3.20 An Access Arrangement submitted under section 2.3 may include a date at which time the Access Arrangement will expire. If an Access Arrangement submitted under section 2.3 expires, the Covered Pipeline the subject of the Access Arrangement ceases to be Covered on the expiry date. The Service Provider must notify the Code Registrar if a Pipeline ceases to be Covered under this section and the Code Registrar must update the Public Register accordingly.

Revisions Submission Date

Draft Decision (Amendment 95)

1055. Under Part A, clause 63 of the proposed revised Access Arrangement as originally submitted, AGN has proposed a Revisions Submissions Date of 30 June 2009, and in clause 64, an intended Revisions Commencement Date of 1 January 2010.

1056. Under section 3.17(i) of the Code the Authority may, having regard to the objectives of section 8.1 of the Code, require an earlier or later Revisions Submissions Date and Revisions Commencement Date than proposed by AGN.

1057. In its Draft Decision, the Authority indicated that it was satisfied that the intended Revisions Commencement Date proposed by AGN of 1 January 2010 would be appropriate. However, the Authority considered that the proposed Revisions Submission Date of 30 June 2009, which would only provide 6 months before the intended Revisions Commencement Date for all stakeholders to make submissions, and for the Authority to consider the proposed revisions, would not allow an adequate period, having regard to the objectives in section 8.1 of the Code. The Authority considered that an appropriate period for submissions and assessment would be not less than 9 months, and required an appropriate amendment (Amendment 95) to the proposed revised Access Arrangement which provided as follows:

> Clause 63 of Part A of the proposed revised Access Arrangement should be amended to provide a Revisions Submissions Date of not later than 31 March 2009.

Final Decision

1058. In response to the Draft Decision, AGN accepted the requirement to amend and indicated it would adopt the approach suggested by the Authority as set out in Amendment 95. Clause 65 of Part A of the proposed revised Access Arrangement submitted by AGN in response to the Draft Decision on 10 June 2005 has been amended accordingly, and the Authority is satisfied that AGN has met the requirements of Amendment 95.

Forecast total costs

Draft Decision (Amendment 96)

1059. Schedule 1 of Part A of the proposed revised Access Arrangement as originally submitted included two specific major events, in relation to higher-than-forecast gas flows, and regulatory and tax changes, which it was proposed by AGN would trigger an obligation on AGN to submit revisions prior to the Revisions Submission Date.

1060. In relation to the trigger event for regulatory and tax changes the Authority noted in its Draft Decision that AGN had specified in Schedule 1, clause 2(1)(b) values for the forecast total costs for providing Reference Services. Further, there was a need for these values to be amended to accord with the amended values to be included in Table 4.14 of the Access Arrangement Information as originally submitted as required by Amendment 26 in this Draft Decision.

1061. In its Draft Decision the Authority did not also consider it necessary, having regard to the objectives in section 8.1 of the Code, to require under 3.17(b)(ii) of the Code that any additional specific major events be defined that trigger an obligation on AGN to submit revisions prior to the Revisions Submission Date.

1062. The required amendment (Amendment 96) was as follows:

> The values in Schedule 1, clause 2(1)(b) of Part B (sic) of the proposed revised Access Arrangement for the forecast total costs for providing Reference Services should be amended to accord with the amended values to be included in Table 4.14 of the submitted Access Arrangement Information as required by Amendment 26 in this Draft Decision.

Final Decision

1063. AGN has amended the relevant clause in the proposed revised Access Arrangement submitted on 10 June 2005, although the amended values do not accord with the values for Total Revenue determined by the Authority for the purpose of this Final Decision as set out in Table 12 of this Final Decision. The following amendment, therefore, is required before final approval.

Final Decision Amendment 23

The values in Schedule 1, clause 2(1)(b) of Part A of the proposed revised Access Arrangement submitted on 10 June 2005 for the forecast total costs for providing Reference Services should be amended to accord with the values for Total Revenue set out in Table 12 of this Final Decision.

Other matters

1064. In the Draft Decision the Authority noted that on the basis of the Authority's Draft Decision to accept an intended Revisions Commencement Date of 1 January 2010, the duration of the proposed second Access Arrangement Period is not intended to exceed 5 years. Accordingly, the provisions of sections 3.18 and 3.19 of the Code did not arise for consideration by the Authority.

1065. Further, with respect to section 3.20 of the Code, the Authority noted that AGN did not propose an expiry date for the revised Access Arrangement, and therefore there was no need for the Authority to consider the issue of expiry under that section.

Typographical Corrections

1066. The Authority notes that there are certain typographical errors in the proposed revised Access Arrangement submitted on 10 June 2005 which should be corrected before final approval, as set out in the following amendment:

Final Decision Amendment 24

The following typographical errors in the proposed revised Access Arrangement submitted on 10 June 2005 should be corrected prior to final approval:

(a) The term "90 to 10^0C" in clause 24(2) of Part A should be amended to read "0^0 to 10^0C";

(b) Clauses 24(2) and (3) of Part A should be re-numbered 25(1) and 25(2) and the subsequent clauses of Part A should be re-numbered accordingly;

(c) The opening words of clause 5 of Part B "AGN will vary Tariff Components annually in accordance with Part B, clauses 3-12 (the price path)" should be re-numbered Part B, clause 4.

APPENDIX 1 - REQUIRED AMENDMENTS

Final Decision Amendment 1

The Access Arrangement Information should be amended to include the approved Depreciation of the assets comprising the Initial Capital Base as set out in Table 3 of the Draft Decision.

Final Decision Amendment 2

Table 4.3 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 1 of the Final Decision in relation to AGN's New Facilities Investment for the first Access Arrangement Period.

Final Decision Amendment 3

The Access Arrangement Information submitted on 27 May 2005 should be amended to include the depreciation of forecast New Facilities Investment for the first Access Arrangement Period as set out in Table 5 of the Draft Decision.

Final Decision Amendment 4

Clause 23 of Part B of the revised Access Arrangement submitted on 10 June 2005 should be amended to provide a value for the opening value of the Capital Base at the commencement of the second Access Arrangement Period of $658.6 million in accordance with Table 2 of the Final Decision.

Final Decision Amendment 5

Table 4.1 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 2 of the Final Decision in relation to the values of the Capital Base during the first Access Arrangement Period by asset class, including the values at the conclusion of the first Access Arrangement Period.

Final Decision Amendment 6

Table 4.7 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 3 of the Final Decision in relation to total Depreciation during the second Access Arrangement Period.

Final Decision Amendment 7

Table 4.5 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with Table 4 of the Final Decision in relation to the value of the Capital Base during the second Access Arrangement Period.

Final Decision Amendment 8

Section 4.2.11 of the revised Access Arrangement Information submitted on 27 May 2005, concerning the return on working capital, should be amended to accord with the method adopted by the Authority in this Final Decision for determining the return on working capital.

Final Decision Amendment 9

Table 4.13 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 should be amended to accord with the values for forecast Non Capital Costs for the second Access Arrangement Period set out in Table 10 of this Final Decision.

Final Decision Amendment 10

Table 4.15 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 should be amended to provide for forecast UAFG of 2.5 percent of gas received over the second Access Arrangement Period.

Final Decision Amendment 11

The pre-tax real weighted average cost of capital referred to at page 50 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended from 7.75 percent to 6.60 percent.

Final Decision Amendment 12

Table 4.9 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to include the values as set out in Table 7 in this Final Decision as the values for determining the Rate of Return for the revised Access Arrangement.

Final Decision Amendment 13

Table 4.10 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with the values for the return on the Capital Base for the second Access Arrangement Period set out in Table 11 of this Final Decision.

Final Decision Amendment 14

Table 4.16 of the revised Access Arrangement Information submitted on 27 May 2005 should be amended to accord with the values for Total Revenue set out in Table 12 of this Final Decision.

Final Decision Amendment 15

The Reference Tariffs for Reference Services A1, A2, B1, B2 and B3 in Schedules 1, 2, 3, 4 and 5 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended to accord with the approved Reference Tariffs for 2005 as set out in the Variation Report for Variation Year 2005 submitted by AGN and published by the Authority on 9 December 2004.

Final Decision Amendment 16

Tables 3.1 and 3.2 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 should be amended to accord with the approved Reference Tariffs for 2005 as set out in the Variation Report for Variation Year 2005 submitted by AGN and published by the Authority on 9 December 2004.

Final Decision Amendment 17

Table 6.4 of the revised Access Arrangement Information submitted by AGN on 27 May 2005 – Forecast volumes by Service - should be amended by replacing the B3 customer volume forecasts with those in Table 13 of this Final Decision.

Final Decision Amendment 18

The X factor referred to in clause 8(2) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended from -0.0265 to 0.0282.

Final Decision Amendment 19

Clause 7 of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended to read as follows:

> "A Tariff Component variation under Part B, clause 4 must be in accordance with the following
>
> $$P_t \leq P_{t-1} * \frac{SepCPI_{t-1}}{SepCPI_{t-2}} * (1 - X) * (1 + R_t) * (1 + Y)$$
>
> where:
>
> P_t is the value of the Reference Tariff Component for year *t:*
>
> X is positive 0.0282;
>
> Y is positive 0.02;
>
> R_t is the regulatory costs factor for calendar Year *t* and is calculated in accordance with Part B, clause 9;
>
> $SepCPI_{t-1}$ is the September quarter Consumer Price Index for Year *t-1*;
>
> t is calendar year for the Reference Tariff Components that are being calculated (i.e. the following year)."

Final Decision Amendment 20

Clause 8(1) of Part B of the proposed revised Access Arrangement submitted on 10 June 2005 should be amended to read as follows:

> "AGN must ensure that the ratio B_t, being the ratio calculated in accordance with Part B, Clause 8(2), for all Reference Tariff Components does not exceed:
>
> $$\frac{SepCPI_{t-1}}{SepCPI_{t-2}}(1-X)(1+R_t)$$
>
> where:
>
> ***X*** is positive 0.0282;
>
> $\boldsymbol{R_t}$ is the regulatory costs factor for calendar Year *t* and is calculated in accordance with Part B, clause 9;
>
> $\boldsymbol{SepCPI_{t-1}}$ is the September quarter Consumer Price Index for Year *t-1.*"

Final Decision Amendment 21

Clause 35(1)(b) of Part B of the proposed revised Access Arrangement submitted by AGN on 10 June 2005 should be amended to provide for an Incentive Mechanism that provides for a rolling carryover mechanism of no longer than five years.

Final Decision Amendment 22

Clauses 34 to 38 of Part B of the proposed revised Access Arrangement submitted by AGN on 10 June 2005 should be amended to confine the carryover mechanism for New Facilities Investment to User Initiated Capital and the revised Access Arrangement Information submitted on 27 May 2005 should be amended to include appropriate benchmark unit costs for this category.

Final Decision Amendment 23

The values in Schedule 1, clause 2(1)(b) of Part A of the proposed revised Access Arrangement submitted on 10 June 2005 for the forecast total costs for providing Reference Services should be amended to accord with the values for Total Revenue set out in Table 12 of this Final Decision.

Final Decision Amendment 24

The following typographical errors in the proposed revised Access Arrangement submitted on 10 June 2005 should be corrected prior to final approval:

(a) The term "90 to 10^0C" in clause 24(2) of Part A should be amended to read "0^0 to 10^0C";

(b) Clauses 24(2) and (3) of Part A should be re-numbered 25(1) and 25(2) and the subsequent clauses of Part A should be re-numbered accordingly;

(c) The opening words of clause 5 of Part B "AGN will vary Tariff Components annually in accordance with Part B, clauses 3-12 (the price path)" should be re-numbered Part B, clause 4.

APPENDIX 2 - INTERPRETATION

Definitions

The definitions in the *Gas Pipelines Access (Western Australia) Act 1998* (**GPAA**), including Schedule 1 and Schedule 2 (the *National National Third Party Access Code for Natural Gas Pipeline Systems*) (**Code**) thereto, apply to the terms used in this Final Decision. In addition, the definitions in the table below apply. Further, where a term has been defined in the proposed revised Access Arrangement, that definition applies in this Final Decision.

Term	Definition
Authority	The Economic Regulation Authority of Western Australia established pursuant to the *Economic Regulation Authority Act 2003*.
Capital expenditure	Expenditure on a Covered Pipeline and associated regulated assets that may be incorporated into the Capital Base of that pipeline.
Current Access Arrangement	*AlintaGas's Access Arrangement for the Mid-West and South-West Gas Distribution Systems*, submitted on 13 July 2000, as approved by the Independent Gas Pipelines Access Regulator in Western Australia with effect from 18 July 2000.
Draft Decision	*Draft Decision on the Proposed Revisions to AlintaGas's Access Arrangement for the Mid-West and South-West Gas Distribution Systems,* Economic Regulation Authority, 28 February 2005.
Excursion	A single instance of a User exceeding its Contracted Peak Rate at a Delivery Point.
First Access Arrangement Period	The period commencing 1 January 2000 and ending on 31 December 2004.
Full Retail Contestability	Contestability in all retail markets for gas within Western Australia, effected by the commencement on 31 May 2004 of the Retail Market Scheme, including the Retail Market Rules.
Minister	The Western Australian Minister for Energy.
Non-Reference Service	A Service other than a Reference Service.
Proposed revised Access Arrangement	The proposed revisions to the current Access Arrangement Information submitted by AGN on 31 March 2004 in the form of a proposed revised Access Arrangement.
Retail Market Rules	Rules, established by the Retail Energy Market Company Limited (ACN 103 318 556), that govern the operation of the gas retail markets of South Australia and Western Australia, as amended from time to time.
Retail Market Scheme	The retail market scheme, including the Retail Market Rules, approved under section 11ZOJ of the *Energy Coordination Act 1994 (WA)* for the purposes of AGN's GDS as amended from time to time.
Second Access Arrangement Period	The period commencing 1 January 2005 and ending on 31 December 2009.
Submitted Access Arrangement Information	The Access Arrangement Information submitted by AGN on 31 March 2004 with respect to the proposed revisions to the Access Arrangement for the GDS.

Term	Definition
Telemetry	The communication equipment used for transmission of data collected from a meter to AGN's central data management system and typically encompasses modems, telecom landline (which may be dedicated or part of the PSTN network) or radio transceivers (which may be in the form of a dedicated radio network, GSM, GPRS or satellite telephony).
Unaccounted for gas	The difference between recorded gas inflows at Receipt Points into the GDS and reported outflows at Delivery Points from the GDS.

Inconsistency of definitions

In the event of any inconsistency, the hierarchy of definitions shall be first, the *GPAA* (including Code) definitions, second, the definitions in the table above and third, the definitions in the proposed revised Access Arrangement.

Abbreviations

The following abbreviations are used in this Final Decision.

Abbreviation	For
AA	Current Access Arrangement
AAI	Access Arrangement Information as originally submitted by AGN on 31 March 2004.
ACCC	Australian Competition and Consumer Commission
ACT	Australian Competition Tribunal
AGN	AlintaGas Networks Pty Ltd
Bp	Basis points – 100 bp equals 1percentage point
CAPM	Capital Asset Pricing Model
CMS	CMS Gas Transmission of Australia
CPI	Consumer Price Index
DBP	Dampier to Bunbury Pipeline
DES	Director of Energy Safety
ESCOSA	Essential Services Commission of South Australia
ESC	Essential Services Commission (Victoria)
FRC	Full Retail Contestability
GDS	Mid-West and South-West Gas Distribution Systems
GJ	Gigajoules (10^9 joules)
GPAA	*Gas Pipelines Access (Western Australia) Act 1998*
GSL	Guaranteed Service Level
ICRC	Independent Competition and Regulatory Commission (ACT)
IPART	Independent Pricing And Regulatory Tribunal (New South Wales)
Kpa	Kilopascals
Mpa	Megapascal
N/A	Not applicable

Abbreviation	For
NPV	Net Present Value
OOE	Office of Energy (Western Australia)
OES	Office of Energy Safety (Western Australia)
ORG	Office of the Regulator General (Victoria)
PC	Productivity Commission (Commonwealth)
PJ	Petajoules (10^{15} joules)
QCA	Queensland Competition Authority
RMR	Retail Market Rules
RMS	Retail Market Scheme
TJ	Terajoules (10^{12} joules)
UAFG	Unaccounted for gas
WA	Western Australia
WACC	Weighted Average Cost of Capital
WPC	Western Power Corporation

APPENDIX 3 - CAPM PARAMETERS AND COST OF CAPITAL

1. For the purposes of this Final Decision, the Authority has considered the parameters of the CAPM and ranges of values that may reasonably be applied to these parameters, in the context of the AGN GDS. This Appendix 3 sets out in detail the various elements and parameters of the CAPM model, the position taken on each by AGN and the views of the Authority on each for the purpose of this Final Decision.

Risk Free Rate and Inflation Rate

Draft Decision

2. In its proposed revisions to the Access Arrangement as originally submitted, AGN proposed using the yield to maturity on Commonwealth Government 10 Year Treasury Bonds averaged over the 20 trading days to 9 December 2003, as a measure of the nominal risk free rate. By this method it estimated the nominal risk free rate at 5.9 percent per annum.

3. AGN also proposed using the estimated yield to maturity on Commonwealth Government Indexed Linked Bonds for an equivalent 10 year term and averaged over the same 20 trading days, to estimate a real risk free rate of 3.6 percent per annum. It has then estimated the rate of inflation at 2.2 percent per annum using the Fisher equation.

4. However, as noted by the Authority in its Draft Decision, the data that were adopted for the WACC calculation in the Access Arrangement Information as originally submitted by AGN, which were current at 9 December 2003, were in need of updating. For example, in the 20 trading days to 31 January 2005, the average yield to maturity on Commonwealth Government 10 Year Treasury Bonds indicated a nominal risk free rate of 5.34 percent per annum, and the average yield to maturity on Commonwealth Government Indexed Linked Bonds for an equivalent 10 year term indicates a real risk free rate of 2.72 percent. This implied an inflation rate of 2.55 percent per annum.

5. In its Draft Decision, the Authority adopted the updated values referred to in the previous paragraph for the purpose of determining the Rate of Return to be used to determine Reference Tariffs. It noted however that the relevant values would need to be updated at the time of the Final Decision, so as to be commensurate with prevailing market conditions at that time.

Final Decision

6. Regulatory decisions under the Code in Western Australia and elsewhere in Australia have typically estimated the nominal risk free rate by calculating the average yield to maturity on 10 year Commonwealth Government Treasury Bonds over 20 consecutive trading days. Similarly, the real risk free rate has been estimated by calculating the average yield to maturity on 10 year Commonwealth Government Indexed Treasury

Bonds over the same 20 consecutive trading days. A forecast of inflation over the period typically has been calculated from the two rates, using the Fisher equation.[72]

7. This approach to the estimation of risk free rates and the inflation rate was not considered by the Authority to be contentious and was applied by the Authority for the purposes of the Draft Decision. While there has been an appeal by a Service Provider against a regulatory decision made under the Code by the ACCC and in relation to the determination of risk free rates and the inflation rate, this appeal related to whether observations of yields on 10 year or 5 year bonds should be used for the determination rather than the general methodology.[73]

8. That said, in response to the Draft Decision, AGN has made submissions questioning the approach adopted in the Draft Decision in relation to risk free rates, and suggesting that an alternative approach would be more appropriate under the Code. These submissions are set out in:

- AGN's submission in response to the Draft Decision dated 21 March 2005, under the heading "*The Risk Free Rate*" at paragraphs 81 to 100 of that submission; and
- A separate submission dated 22 April 2005 titled "*Submission to the Economic Regulation Authority Re The Issue of the Risk Free Rate*".

9. The thrust of these submissions is set out at paragraphs 99 and 100 of the 21 March 2005 submission as follows:

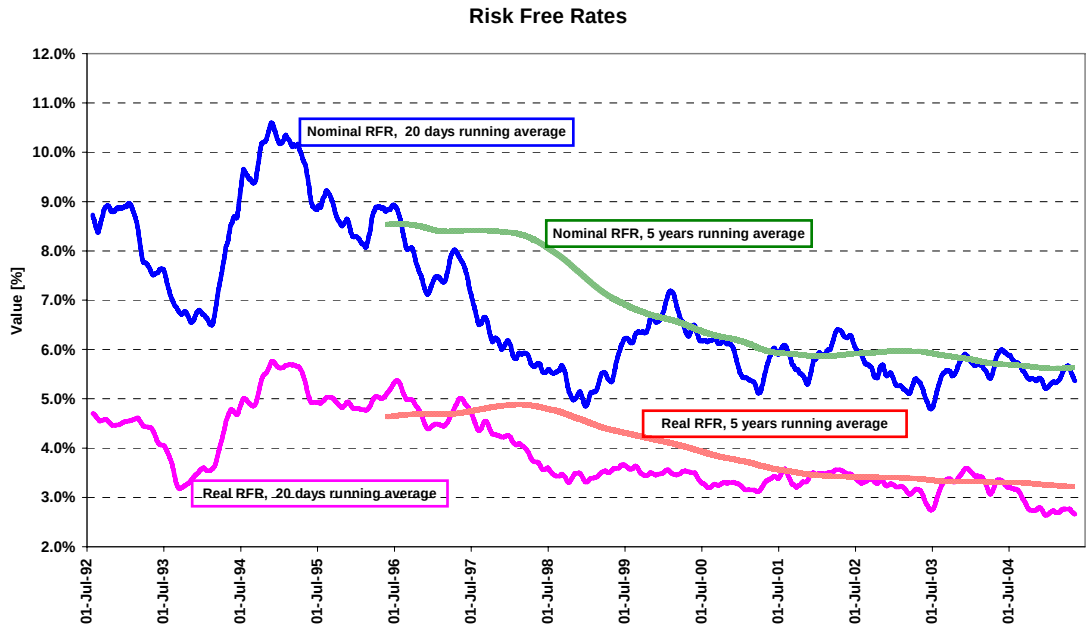
> 99 AGN submits that taking a short term average of the risk free rate does not meet the requirements of the Code provide a rate of return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service.
>
> 100 AGN therefore submits that a long-term average of the risk-free rate would provide a more appropriate solution to the risks involved in delivering the service. In this regard AGN notes that ESCOSA used a five-year average of the risk free rate as part of its regulation of electricity distribution in South Australia. The five-year average of the 2015 indexed bond is 3.3 percent and the nominal figure is 5.7 percent.

10. These AGN submissions argue for using a five year average rather than a 20 day average.

11. To illustrate the difference historic interest rates are presented below as 20 day and 5 year moving averages. More specifically, the graph shows the difference between 20 day and five year averages for the risk free rates based on the 10 year Commonwealth Bond yields over the period July 1992 to May 2005.

[72] Brealey, R.A., Myers, S.C., Partington, G. and Robinson, D., 2001. *Principles of Corporate Finance* 1st Australian edition, Roseville, Australia: McGraw–Hill, p 135.

[73] Australian Competition Tribunal, Application by GasNet Australia (Operations) Pty Ltd [2003] ACompT 6.



12. AGN did not present the argument to use the five year average when it submitted its proposed revised Access Arrangement in March 2004. Adopting the approach proposed by AGN would be inconsistent with the Approach taken by the Authority to date, in particular for its recent DBP Draft Decision and GGP Final Decision.

13. The Authority also notes:

- that risk free rates reflect the market view of future inflation.
- ESCOSA did not choose to use a five year average, the requirement to use a five year average was imposed on the Regulator.

14. The Allen Consulting Group (**ACG**) was engaged to provide the Authority with advice on the AGN submissions of 21 March and 22 April 2005.

15. The advice from ACG was to the effect that the arguments put forward by AGN in its submissions should not be accepted, and that the Authority's approach to calculation of the WACC value should continue to be based on a 20 day average of the 10 year Commonwealth Bond yield.

16. In particular, ACG noted the following matters relevant to the assessment of AGN's proposal:

> AGNs proposal is that rather than adopt the 'arbitrary' approach of the UK in adding 25 basis points to the top of the range for the real risk free rate (i.e. adding 12.5 basis to the average), the Authority should simply calculate an average of the last 5 years of observed real risk free rates. If the Authority did accept such a proposal, it is not clear why a period of 5 years should be applied for the averaging process.
>
> There is no guidance from theory for an appropriate averaging period, since theory justifies the use of a spot rate, or an adjustment to the spot rate that accounts for short-term volatility. Any choice of number of years for averaging is arbitrary, as is the choice of a 5-year averaging period as suggested by AGN. Indeed, Ofgem's proposal can be considered less arbitrary than the one proposed by AGN. Ofgem has taken a view based on its views about

> the likely effects of a reversal in the institutional investment policy prescribed by the UK Government, and presumably other factors that might influence its future movement. ACG does not, however, agree with this approach in the context of the regulatory framework applied by the Authority. In an efficient market, the yield of the bonds should already take account of expectations of the probability of such a reversal in policy.
>
> If a 5 year averaging approach were adopted by the Authority and this average was significantly higher than the current spot rate, and if all other WACC parameters were to be held at their estimated levels, the effect would be to raise the annual revenue requirement above what it would otherwise be. The approach would create an issue of inconsistency with the other parameters used, since they are also based on spot rates or current views of the future.
>
> For example, whilst it can be argued that the forward-looking beta estimate is actual (sic) an estimate derived from five years of historical data, it is in effect a spot estimate given the greater inherent volatility in beta estimates. The market's opinion on a company or sector's beta cannot be gauged in any other way. Thus, betas are based on the latest available information. The estimation of the cost of equity would not be undertaken on a consistent basis if the risk free rate component in the CAPM equation were based on a historical average, while the beta and the market risk premium are forward looking.

17. The Authority proposes to accept ACG's advice on this matter.

18. The separate AGN submission of 22 April 2005 on risk free rates has been placed on the ERA website and an e-mail was sent to interested parties that this submission had been received. No other submissions were received by the Authority on this matter.

19. In summary, the Authority proposes not to accept the thrust of AGN's submission and for the purpose of the Final Decision to maintain the approach of using a 20 day average for the risk free rates based on the 10 year Commonwealth Bond yield.

20. Consistent with the methodology applied for the purposes of the Draft Decision, the Authority has derived an estimate of the risk free rate from averages of bond rates over 20 consecutive trading days to 30 June 2005. The averages of observed rates of return on 10 year government bonds indicate a nominal risk free rate of 5.15 percent, a real risk free rate of 2.58 percent and an implied future inflation rate of 2.51 percent.

Market Risk Premium

Draft Decision

21. In the Access Arrangement Information as originally submitted, AGN proposed that a market risk premium of 7 percent per annum be used, based upon KPMG's conclusion that there is "strong support for an MRP in the range of 6 percent to 8 percent".[74]

22. In considering the proposals and submissions of AGN, including the KPMG Report, for the purpose of the Draft Decision, the Authority took into account available evidence on the value of the market risk premium, including a detailed consideration

[74] KPMG Report, p 26.

of the market risk premium by the ESC of Victoria in 2002[75] and detailed references to recent market and academic evidence contained in the December 2004 draft decision of the IPART of New South Wales in relation to revisions to the access arrangements for AGL Gas Networks[76]. This evidence comprised historical measurements of the market risk premium and surveys of expectations of financial practitioners, participants in financial markets and investors. The Authority also considered the ACG Rate of Return Report.

23. In the Draft Decision, the Authority referred to a table, which is reproduced below as Table 14, which summarised the Australian historical data available to the Authority on the realised historical market risk premium.

Table 14: Historical Realised Market Risk Premium in Australia[77]

Time Period of Estimation	Average Market Risk Premium	Standard Deviation	Standard Error of the Mean
1882-2001	7.19 percent	16.97 percent	1.55 percent
Differing End Point			
1882-1950	8.00 percent	11.11 percent	1.34 percent
1882-1970	8.16 percent	13.70 percent	1.45 percent
1882-1990	7.40 percent	17.33 percent	1.66 percent
Different Beginning Point			
1900-2001	7.14 percent	17.94 percent	1.78 percent
1950-2001	6.51 percent	22.60 percent	3.13 percent
1970-2001	3.37 percent	24.38 percent	4.31 percent

24. In the Draft Decision the Authority noted that the ability to draw conclusions from this historical evidence is limited by large standard errors of the estimates. The Authority referred to some suggestions from the historical data that more recent estimates of the realised market risk premium are lower than the measurements for earlier periods, suggesting a decline in values over the period since 1882.

25. The Authority noted further that there are difficulties inherent in inferring the appropriate forward-looking market risk from historical data of stock market returns. The size of the market risk premium is dependent on the absolute level of risk represented by the stock market proxy, which will be influenced by the industrial structure of the stock market's composition. One hundred years ago the Australian stock market was dominated by resources stocks and of a very different composition

[75] ESC, October 2002, *Review of Gas Access Arrangements: Final Decision*, p 324, citing unpublished data of Professor Robert Officer and Officer, R., 'Rates of Return to shares, bond yields and inflation rates: An historical perspective', in Share Markets and Portfolio Theory; Readings and Australian Evidence, 2nd edition, University of Queensland Press, 1992.

[76] IPART, December 2004, *Draft Decision, Revised Access Arrangement for AGL Gas Network*, December 2004, pp 80-81.

[77] ESC, October 2002, Review of Gas Access Arrangements: Final Decision, p 324, citing unpublished data of Professor Robert Officer and Officer, R., 'Rates of Return to shares, bond yields and inflation rates: An historical perspective', in Share Markets and Portfolio Theory; Readings and Australian Evidence, 2nd edition, University of Queensland Press, 1992.

than in more recent decades, and there is no reason to consider that the market risk premium has remained constant over that period, or will do so into the future.

26. In view of the difficulties in using historical data to predict a market risk premium for the future, the Authority also took into account the views of financial practitioners and the market participants, including institutional investors, as to the market risk premium to be factored into investment decisions. In this regard, the Authority took into account a Jardine Capital Partners survey of views on the market risk premium that indicates an average of market participants' views on the historical market risk premium of 5.87 percent, and expectations about the future market risk premium about 1 percentage point below this level. [78]

27. The Authority also noted the recent IPART Draft Decision on the revised Access Arrangements for AGL's Gas Networks, which provided evidence in support of a market risk premium of 6 percent or below[79].

28. Taking this information into account along with the positions put by AGN in the Access Arrangement Information as originally submitted and the KPMG and ACG Rate of Return Reports, the Authority took the view in the Draft Decision that a value of no more than 6 percent would be commensurate with prevailing conditions in the market for funds and the risk in providing Reference Services.

29. The Authority noted further that AGN's proposed value for the market risk premium of 7 percent is inconsistent with all past regulatory decisions under the Code that had approved Access Arrangements and associated Reference Tariffs, all of which had been determined on the basis of a market risk premium of 6 percent or less. By contrast a market risk premium of 6 percent would be consistent with the most recent regulatory decisions on this issue, namely IPART's December 2004 draft decision on the AGL Gas Networks distribution system in NSW and the ICRC's October 2004 final decision on the ActewAGL gas distribution system in the ACT and neighbouring areas of NSW. IPART accepted a range for the market risk premium of 5.5 percent to 6.5 percent proposed by the Service Provider, and the ICRC considered 6.0 percent as supported by available information following its consideration of empirical evidence and regulatory practice.

30. Further, the Authority noted that it was not aware of any evidence that investment in the gas pipeline industry has been distorted on account of regulated Rates of Return being based on a market risk premium of 6.0 percent or less in approved Access Arrangements under the Code.

31. On balance, the Authority proposed to adopt a market risk premium of 6.0 percent which it considered to be the upper bound of a range complying with section 8.30 and 8.31 of the Code.

[78] Jardine Fleming Capital Partners Ltd, (September 2001) *The Equity Risk Premium – An Australian Perspective*, Trinity Best Practice Committee.

[79] IPART, December 2004, *Draft Decision, Revised Access Arrangement for AGL Gas Network*, pp 80-81.

Final Decision

32. AGN made submissions on this matter in paragraphs 74 to 80 of its submission dated 21 March 2005 in response to the Draft Decision. Essentially AGN argued that the Authority should use a Market Risk Premium of 7 percent on the basis that it "falls within the range of rates commensurate with the prevailing market conditions and the relevant risk in delivering the service" (paragraph 80).

33. The data relied upon in support of this conclusion included:

- long and short term averages of realised market premia (depending on the period of chosen) exceeding 7 percent;
- a submission by NECG to the Productivity Commission criticising regulatory approaches to assessing market risk premia and suggesting a range in the order of 6-8 percent; and
- statements by Professor Robert Bowman to a similar effect.

34. The Authority notes that AGN's contention of the market risk premium being greater than a value of 6 percent and within a range of up to 8 percent is based on evidence of historically realised market risk premiums. The Authority does not accept that sole reliance on such evidence is appropriate in determining an appropriate assumption for the market risk premium, which should be directed at an assumption of the *expected* market risk premium at the current time. The Authority considers that estimates of realised market risk premiums should be considered in the context of numerous factors that suggest a decline in the market risk premium over the last century[80] and analysis that suggests that, internationally, historically realised market risk premiums are likely to be in excess of those currently required or expected by investors.[81] Moreover, the Authority considers that attention should be given to values assumed for the market risk premium by investors and financial analysts at the current time, and to *ex ante* estimates of the market risk premium.

35. Values assumed for the market risk premium at the current time are revealed in a survey of financial market participants cited by the Authority in the Draft Decision and indicate that an average of survey respondents' views on the historical market risk premium was 5.87 percent and an average of future expectations of the market risk premium of about 1 percent less.[82]

36. *Ex ante* estimates of the market risk premium have been made for Australian equity markets using the dividend-growth-model methodology. Estimates made are also

[80] These factors are discussed in "The Allen Consulting Group (March 2004), *Review of Studies Comparing International Regulatory Determinations*, Report to the Australian Competition and Consumer Commission".

[81] Dimson, Elroy, Marsh, Paul and Mike Staunton (2000), "Risk and Return in the 20th and 21st Centuries," *Business Strategy Review*, Vol. 11, Issue 2.

[82] Essential Services Commission, October 2002, Review of Gas Access Arrangements: Final Decision, pp332-356, citing Jardine Fleming Capital Partners Limited, (September, 2001) *The Equity Risk Premium – An Australian Perspective*, Trinity Best Practice Committee.

below estimates of historically realised market risk premiums, with values ranging between 4.5 percent and 5.9 percent, with an average of 5.4 percent.[83]

37. Taking into account all of these estimates, the Authority considers that the value for the market risk premium could reasonably be assumed to be within the range of 5 to 6 percent. This is consistent with the Authority's Draft Decision which specified 6 percent as the upper bound of the reasonable range for the market risk premium.

Equity Beta

Draft Decision

38. The application of the CAPM requires an equity beta, βe, to be determined for the GDS business. The equity beta value for a business reflects that business' exposure to systematic risk, which relates to that portion of the variance in the return on an asset that arises from market-wide economic factors that affect returns on all assets, and which cannot be avoided by diversifying a portfolio of assets.

39. For its proposed revisions to the Access Arrangement as originally submitted, AGN determined the Rate of Return on the basis of an equity beta value of 1.0, with an assumed gearing (debt to asset ratio) of 60 percent.

40. In its Draft Decision the Authority was mindful of the cautionary approach adopted recently by other Australian regulators in recognising a relative lack of empirical data on equity beta values for Australian gas pipeline companies, and the volatility of equity beta data, in its consideration as to whether to adopt the proposed equity beta value of 1.0.[84]

41. Taking into account the empirical evidence on beta values for gas transmission and distribution companies, the positions taken by other Australian regulators in the face of this empirical evidence, and the information presented by AGN in the Access Arrangement Information as originally submitted and in the KPMG Report and the ACG Rate of Return Report, the Authority took the view in its Draft Decision that it is appropriate to determine Reference Tariffs using an equity beta value of 1.0 for an assumed gearing of 60 percent.

Final Decision

42. Unlike other parameters used as inputs to the CAPM, AGN did not make any submissions in relation to the Authority's Draft Decision as to the equity beta, β_e, to

[83] Davis, K., 18 March 1998. The Weighted Average Cost of Capital for the Gas Industry, Report Prepared for: Australian Competition and Consumer Commission and Office of the Regulator General. Lally, M., June 2002, The Cost of Capital Under Dividend Imputation, Prepared for the Australian Competition and Consumer Commission. SFG Consulting, September 2003, Issues in Cost of Capital Estimation. All cited in The Allen Consulting Group (March 2004), *Review of Studies Comparing International Regulatory Determinations*, Report to the Australian Competition and Consumer Commission.

[84] ESC, October 2002, *Review of Gas Access Arrangements: Final Decision*; ACCC, 13 November 2002, *Final Decision: GasNet Australia Access Arrangement Revisions for the Principal Transmission System;* IPART, December 2004, *Draft Decision, Revised Access Arrangement for AGL Gas Network* (accepted a range of 0.8 to 1.0 as reasonable).

be determined for the GDS business. In AGN's Access Arrangement Information submitted in response to the Draft Decision dated 27 May 2005 AGN indicated that it considered the appropriate equity beta to be 1.0, consistent with AGN's proposal as originally submitted and the Authority's Draft Decision.

43. The Draft Decision did not cite any detailed evidence which might be relevant to the determination of the range of reasonable parameters for the equity beta (as opposed to the single point estimate specified in the Draft Decision). Having regard to the Authority's approach in this Final Decision, to consider the ranges of values appropriate for the Rate of Return and other parameters relevant to Total Revenue, it is appropriate for the Authority to specify the range which it regards as reasonable for the equity beta in this case.

44. The Authority notes that for the purpose of the Draft Decision, Allen Consulting Group were commissioned to prepare a report on the appropriate WACC for the AGN GDS (**ACG Rate of Return Report**)[85]. The ACG Rate of Return Report was published with the Authority's Draft Decision. Chapter 6 of the ACG Rate of Return Report considered the detailed evidence available in relation to the appropriate equity beta for use in relation to a distribution system like the AGN GDS. In this regard, the ACG Rate of Return Report concluded as follows:

> In conclusion, the empirical evidence in support of an equity beta of 1.0 as provided by the KPMG Report is not strong. KPMG's evidence is based on some data observations that are not comparable with the gas network operations of Alinta. Whilst some more recent empirical evidence for Australian gas pipeline companies sourced from Bloomberg by Deloitte provides more consistent estimates which are still significantly less than 1.0.
>
> However, while market evidence continues to suggest that the equity beta of traded comparable companies could substanially less than 1.0 (sic), The Allen Consulting Group agrees with KPMG that an equity beta of 1.0 is reasonable at this time in the absence of rigorous evidence indicating another value is more appropriate[86].

45. The Authority has had regard to ACG's conclusion and the evidence presented in the ACG Rate of Return Report to support it. On this basis, the Authority considers that in view of the available evidence, a range of values of 0.8 at the lower bound and 1.0 at the upper bound is appropriate for the GDS business.

Cost of Debt

Draft Decision

46. For the revisions to the Access Arrangement as originally submitted, AGN proposed a debt margin of between 1.4 to 1.8 percent (rounded) comprising:

- 105 to 116 basis points for the margin on debt funding for the distribution system, based upon CBASpectrum data over 20 days to 9 December 2003 for an investment grade credit rating for AGN of BBB to BBB+ as estimated by KPMG;

[85] The Allen Consulting Group, May 2004, AlintaGas Networks Revised Access Arrangement: Proposed Rate of Return, Report to the Economic Regulation Authority (**ACG Rate of Return Report**).

[86] ACG Rate of Return Report, p 26.

- an allowance of between 20 and 50 basis points for a CPI swap hedging cost margin; and

- an allowance of 12.5 basis points for debt establishment costs.

47. The particular value for debt margin within the range which was chosen by AGN as an input into the CAPM calculation to arrive at its proposed WACC figure was not identified in the Access Arrangement Information.

48. In relation to AGN's margin on debt funding, for the purpose of the Draft Decision the Authority examined more recent CBASpectrum data. In this regard, the Authority assumed that the appropriate benchmark would be a regulated energy utility with 60 percent gearing and a credit rating of BBB+, consistent with the Standard & Poors standard ratios for transmission and distribution companies. [87]

49. The Authority noted that since the third quarter of 2002, when a number of regulatory decisions allowed debt margins of 1.5 percent to 1.6 percent, the CBASpectrum indicator rate for this benchmark had reduced considerably. At the end of April 2004, the CBASpectrum indicator rate for a BBB+ rated bond was in the order of 105 basis points. Further, more recently the CBASpectrum indicator rate had declined and as at 27 October 2004 the equivalent data for BBB+ rated bonds was 100.7 basis points.[88]

50. The Authority recognised, however, in its Draft Decision that this indicator of the debt margin should be treated with caution. Rates provided by the CBASpectrum service are not actual market observations, but rather a prediction of yields based on an econometric model, and the market observations upon which the predictions are based are very thin.

51. The Authority therefore also considered for the purpose of the Draft Decision observations in the domestic market for debt bonds, with particular attention to regulated utilities that match their debt exposure to the length of the regulatory cycle.

- On 31 July 2003, GasNet announced a $150 million, 5 year Medium Term Note (**MTN**) issue timed for refinancing after the next ACCC regulatory determination in December 2007.[89] It was issued at an interest rate of 6.25 percent. Since the market differential between a 5 and 10 year tenor has

[87] As cited in the letter from Nick Wade, Director, Credit Research, UBS Warburg to Jim Lamborn, Treasurer, SPI PowerNet, 28 November 2001, and contained in Appendix F of SPI PowerNet's Revenue Cap Application submitted to the ACCC, 11 April 2002. Standard & Poors indicate that gearing of 55 percent and an interest cover ratio of 3.25 is consistent with an "A" rating, and a gearing of 65 percent and an interest cover ratio of 2.0 is consistent with a "BBB" rating. A "BBB+" rating for a benchmark gearing assumption of 60 percent is derived by interpolation. The Authority has also considered the findings of the ACT in the EAPL Decision in respect of the assumptions made by the ACCC for an assumed credit rating for the Moomba to Sydney Pipeline. The Authority considers that the findings of the Tribunal are specific to the reasoning expressed by the ACCC in its respective decisions and are not determinative of an appropriate assumption in respect of a credit rating for AGN's GDS.

[88] The Allen Consulting Group, January 2005, Report to the Economic Regulation Authority, *Electricity Networks Access Code: Advance Determination of a WACC Methodology*, p 44.

[89] GasNet Australia, 31 July 2003, Press Release: *GasNet closes early A$150 million medium term note issue due August 2008*.

recently averaged around 30 to 40 basis points, this implies that a 10 year note could potentially have been issued at an interest rate of around 6.65 percent.

- In September 2003 the Australian Pipeline Trust completed an issue of US and Australian bonds at an average tenor of 11 years at an "all in" cost of BBSW + 94 basis points.

- The only long term (9 year) BBB+ rated bond traded in Australia is Snowy Hydro's 6.5 percent coupon MTN, which at 3 May 2004 was trading at BBSW + 89. This represents a margin of around 80 basis points over the average 10 year bond rate calculated over the 20 business days to 29 April 2004.

52. This market evidence suggested to the Authority in its Draft Decision that the values indicated by the CBASpectrum data should be regarded as being at the top of the range. The Authority therefore adopted for the purposes of this Draft Decision a cost of corporate debt at 100 basis points for corporate bonds issued by the benchmark entity attracting a BBB+ credit rating. The Authority anticipated that the indicator rate will be updated for this benchmark at the time of the Final Decision.

53. In relation to the proposed allowance for CPI swap hedging costs, following the Authority's consideration of information submitted by AGN in the Access Arrangement Information as originally submitted, and the advice provided to the Authority by ACG in its report, the Authority considered this allowance to be inappropriate for inclusion as a component of the debt margin.

54. In relation to AGN's proposed allowance for debt raising costs of 12.5 basis points, KPMG advanced in its report an indicative range of between 0 and 20 basis points for this allowance, while recognising that a then recent decision by the ACCC in respect of GasNet adopted an allowance of 12.5 basis points[90].

55. The Authority noted further that regulatory practice is to accept that there should be an allowance for debt raising costs, although the amount of that allowance has differed. Recent decisions which have accepted 12.5 basis points are the final decision by the ACCC with respect to GasNet[91], ICRC's final decision in relation to ActewAGL's ACT distribution network[92], and IPART's draft decision with respect to the revised access arrangements for the AGL Gas Network[93].

56. On the other hand, the Authority noted the orders giving effect to the Australian Competition Tribunal's decision, in its findings of December 2003 on appeal of the ACCC's GasNet decision, which stated that 10 year bond rates are appropriate and include increasing the allowance for debt raising costs from 12.5 basis points in the

[90] KPMG Report, p 39.

[91] ACCC, 13 November 2002, *Final Decision: GasNet Australia Access Arrangement Revisions for the Principal Transmission System*.

[92] ICRC, October 2004, *Final Decision, Review of Access Arrangement for ActewAGL Natural Gas System in ACT, Queanbeyan and Yarrowlumla.*

[93] IPART, December 2004, *Draft Decision, Revised Access Arrangement for AGL Gas Networks*, p 82.

ACCC's final decision to 25 basis points[94]. The Authority noted, however, that the Australian Competition Tribunal's decision was based upon an agreed position reached between the parties without the Tribunal making a determination of an appropriate allowance.

57. In the circumstances, taking into consideration the matters referred to at paragraphs 54 to 56 the Authority concluded in its Draft Decision that 12.5 basis points would be an appropriate upper bound for debt raising costs.

58. Taking into account the Authority's further conclusion that a debt margin of 100 basis points should be regarded as an upper bound of a reasonable range, adopting a 12.5 basis points allowance for debt raising costs would produce an upper bound for total debt margin of 1.125 percent.

59. The Authority then noted that the range for debt margin proposed by AGN of 1.4 to 1.8 percent is above the upper bound of a range which in the Authority's view complies with section 8.30 and 8.31 of the Code as being commensurate with prevailing conditions in the market for funds and the risk involved in delivering Reference Services.

60. Accordingly, the Authority adopted for the purposes of the Draft Decision a debt margin for the GDS business of 1.125 percent, which it considered to be the upper bound of a range complying with section 8.30 and 8.31 of the Code. This debt margin was based upon the sum of the debt margin for BBB+ bonds of 100 basis points and an allowance of 12.5 basis points for debt raising costs.

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61. In response to the Draft Decision on this point, the Authority has received the following further submissions from AGN:

- a submission headed "*The Debt Margin*" at paragraphs 101 to 125 of AGN's submission in response to the Draft Decision dated 21 March 2005;
- a stand alone submission on the cost of debt from AGN dated 2 June 2005, comprising a covering letter and a report entitled "*Critique of available estimates of the credit spread on corporate bonds*" by the National Economic Research Associates (**NERA**) dated May 2005 (**NERA Report**). The NERA Report was prepared at the request of the Energy Networks Association, the national representative body for gas and electricity distribution network businesses, of which AGN is a member;
- submissions incorporated as part of the revised Access Arrangement Information submitted on 27 May 2005 which contained arguments supporting the conclusions reached in the NERA Report.

[94] *Application by GasNet Australia (Operations) Pty Ltd* [2003] ACompT 6.

62. Following receipt of the most recent submission (dated 2 June 2005 and providing a copy of the NERA Report) the Authority commissioned the Allen Consulting Group (**ACG**) to provide advice on the cost of debt issue.

63. As indicated above, when AGN submitted its proposed revised Access Arrangement in March 2004 it proposed a debt margin of 140 to 180 basis points (including debt raising costs).

64. The Draft Decision used a figure of 112.5 basis points for the debt margin (including debt raising costs), as follows (see paragraph 338):

> Accordingly, the Authority proposes to adopt for the purposes of this Draft Decision a debt margin for the GDS business of 1.125 percent, which it considers to be the upper bound of a range complying with section 8.30 and 8.31 of the Code. This debt margin is based upon the sum of the debt margin for BBB+ bonds of 100 basis points and an allowance of 12.5 basis points for debt raising costs.

65. The Authority has given further consideration to this conclusion in light of AGN's further submissions, and in particular the NERA Report prepared for the ENA provided by AGN in support of its submissions. The NERA Report concluded that its best estimate of the appropriate adjustment to CBA Spectrum estimates of yields on 10 year debt, rated A or below, is to add 25.6 basis points (excluding debt raising costs). In its advice to the Authority, ACG noted that this adjustment would result in a 131.9 basis points debt margin based on relevant CBA Spectrum data for the 20 business days ending 30 May 2005.

66. In AGN's revised Access Arrangement Information submitted on 27 May 2005, AGN noted that it considered an adequate range for the cost of debt to be between 112.5 and 133.9 basis points (including debt raising costs of 12.5 basis points).

67. ACG has evaluated AGN's further submissions including the NERA report and in light of that material has recommended that the Authority reconsider and increase the allowance for debt margin from that used in the Draft Decision. The basis for this advice is the acceptance by ACG, using its own independent research, of NERA's assessment that the methodology applied by CBASpectrum to predict fair yields is flawed with respect to long dated, low rated issues.

68. On this basis ACG's advice to the Authority was that a range of 123 to 133 basis points over the 10 year government bond rate would be an appropriate range for the debt margin cost (not including debt raising costs). Notwithstanding the earlier advice as discussed in paragraph 51 of this Appendix 3 above concerning the rates in the domestic market for debt bonds, with particular attention to regulated utilities, the Authority proposes to accept this more recent advice from ACG as discussed in paragraph 67 of Appendix 3 above, as the basis for the Final Decision in this matter.

69. The further issue which needs to be considered is the appropriate range to be used for debt raising costs, expressed as a mark-up to the debt premium. In the Draft Decision the Authority used a point estimate of 12.5 basis points. The Authority's advice, also

from ACG, that an appropriate range is between 8 and 12 basis points.[95] On this basis, the Authority considers that an allowance of between 8 and 12.5 basis points (consistent with substantial regulatory precedent in Australia) is reasonable.

70. Taking these ranges together, the Authority adopts for the purpose of this Final Decision a debt margin range of 131 to 145.5 basis points.

Gearing

Draft Decision

71. In its Access Arrangement Information as originally submitted, AGN proposed a gearing ratio of 60 percent to apply to the proposed revisions to the Access Arrangement.

72. The Authority noted in its Draft Decision that in Australia, regulators under the Code have generally approved Access Arrangements with Reference Tariffs determined using an assumption of gearing of 60 percent[96]. Further, that this assumption had been supported by studies undertaken in 2002 by the Victorian ESC in relation to assessment of revisions to Access Arrangements for the Victorian Distribution Systems.[97] More recent data for listed Australian companies with ownership of regulated gas pipelines was obtained by the Authority from Bloomberg Financial Services and was presented in tabular form in the Draft Decision and is reproduced below in Table 15

Table 15: Australian Gas Pipeline Companies - Total Debt/Enterprise Value

Company	Financial Year				
	2000	2001	2002	2003	May 2004
AGL	36.0 percent	46.0 percent	38.7 percent	28.5 percent	
Alinta		39.1 percent	33.8 percent		22.1 percent
APT		55.0 percent	57.6 percent	51.8 percent	53.7 percent
Envestra	84.4 percent	81.6 percent	78.0 percent	72.8 percent	72.6 percent
GasNet		73.1 percent	71.1 percent		66.7 percent

73. The Authority considered it worth noting the companies that are closer to "pure play" regulated pipeline businesses (Australian Pipeline Trust, GasNet and Envestra) have higher gearing levels than those with a broad mix of regulated and unregulated activities (AGL and Alinta).

74. Based on this evidence, the Authority proposed to adopt the 60 percent level of gearing proposed by AGN for the purpose of determining Reference Tariffs.

[95] The Allen Consulting Group, January 2005, *Electricity Networks Access Code: Advance Determination of a WACC Methodology*, report to the Economic Regulation Authority, p 45.

[96] E.g. most recently, IPART, December 2004, *Draft Decision, Revised Access Arrangements for AGL Gas Networks*, p 82.

[97] ESC, October 2002, *Review of Gas Access Arrangements: Final Decision*.

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75. AGN did not call into question the Authority's conclusion on this parameter in its submissions in response to the Draft Decision.

76. Recognising that the Code provides for a benchmark assumption of financial structure to be used in the determination of the Rate of Return, the Authority maintains the view that an appropriate assumption for the financial structure is a gearing level of 60 percent debt to total assets, consistent with regulatory precedent and, generally, with observed levels of gearing of Australian pipeline companies. In view of data suggesting that businesses that are close to pure-play pipeline businesses have higher levels of gearing, the Authority considers this assumption to be suitably conservative.

Company taxation liabilities

Draft Decision

77. Regulatory practice under the Code to date has typically been to determine Total Revenue on a pre-tax basis, including a pre-tax Rate of Return on the Capital Base. Derivation of a pre-tax Rate of Return requires conversion of the post-tax WACC to a pre-tax WACC.

78. The first tax issue is the method used to estimate company taxation liabilities associated with the regulated activities.

79. In the Draft Decision the Authority noted that some Australian regulators had been concerned about the potential for use of a pre-tax real WACC as a Rate of Return in determination of Reference Tariffs to over-compensate the owners of infrastructure assets due to tax benefits that are not considered in determination of the pre-tax WACC. The alternative approach noted by the Authority would be to model the tax effects explicitly in cash flows and apply a post-tax nominal analysis[98].

80. An alternative to the post-tax nominal analysis, as described in paragraph 77 of Appendix 3 above, is to use a simple transformation of a nominal post-tax WACC to a real pre-tax WACC, based on one of the following transformation methods:

- forward transformation, involving division of the post-tax nominal WACC by 1 - *T*, where *T* is the statutory taxation rate, and then deducting inflation (using the Fisher equation[99]) to derive the pre-tax real WACC; and
- reverse transformation, involving first deducting inflation from the post-tax nominal WACC, and then grossing up the real post-tax WACC by one minus the statutory taxation rate.

81. The Authority noted that changes to the company taxation regime in Australia, implemented as of 1 July 2000, were likely to have narrowed the gap between the

[98] ACG Rate of Return Report, p 10.

[99] $Real\ WACC = \frac{1 + nominal\ WACC}{1 + i} - 1$, where i is the inflation rate.

statutory and effective tax rates for infrastructure firms in Australia. This supported the use of a simple pre-tax transformation and in particular the forward transformation for the calculation of the WACC.

82. For the revised Access Arrangement, AGN had proposed the forward transformation methodology to derive a pre-tax WACC, assuming a corporate tax rate of 30 percent and an implied inflation rate of 2.2 percent. In the circumstances, the Authority accepted as consistent with the Code the use of the forward transformation methodology.

83. A second issue in relation to taxation is the assumption that is made about the value ascribed to imputation or franking credits, which may reduce the effective rate of tax on returns to equity.

84. Franking credits, or imputation credits, are an allowance under the Australian taxation system that permit taxation liabilities of shareholders to be offset by the value of company tax already paid on profits from which the dividend payments are made.

85. In the Draft Decision the Authority noted that the approach for reflecting the value of franking credits that has emerged as standard practice is to use a market (equity) risk premium that assumes that Australia has a classical tax system (i.e. no franking credits), then to adjust the WACC or cash-flows directly to reflect the non-cash benefits associated with franking credits. The mechanism used to achieve this – the gamma or "γ" term in the Officer WACC formula as described in paragraph 337 above – can be interpreted as the value of each franking credit that is created by the firm, as a proportion of the face value of that franking credit. A low gamma implies that shareholders do not obtain much relief from corporate taxation through imputation and therefore require a higher pre-tax rate of return to earn the same effective return on investment, and vice versa.

86. AGN referred in the Access Arrangement Information as originally submitted to the KPMG Report as advancing a "γ" within a range of 0.3 to 0.5, although in the conclusion to that report "γ" is given as 0.5 in the set of parameter estimates used by KPMG in the estimation of a pre-tax real WACC figure.

87. The Authority's Draft Decision referred to the fact that in Australia, regulators under the Code have generally adopted a "γ" value of 0.5, based on the 1999 study by Hathaway and Officer, which estimates gamma at close to 0.5.[100] The Authority, therefore, took the view that this assumption would be appropriate for the GDS.

Final Decision

88. The only aspect of the Authority's Draft Decision in relation to taxation issues which was the subject of further submissions by AGN was the value of gamma. This was addressed in paragraphs 126 to 134 of AGN's submission in response to the Draft Decision dated 21 March 2005 under the heading "*The Value of Gamma*".

[100] Hathaway N. and Officer, R., 1999, *The Value of Imputation Tax Credits*, Unpublished manuscript, Graduate School of Management, University of Melbourne.

89. In that submission, AGN referred to updated work by Hathaway and Officer to the 1999 study referred to in the Draft Decision. AGN's submission in relation to the relevance of this work was as follows:

> 126 The ERA should be aware that Hathaway and Officer recently updated their analysis in a paper entitled "The Valuation of Imputation Credits Update 2004". In other words, this revised version of their work contains updated data and more detailed and careful analysis, but the same approach.
>
> 127 They now conclude that
>
> > *the access factor is 71 percent and about 50 percent of distributed credits are being redeemed. Overall, about 35 percent of company tax is actually a pre-payment of personal tax.*
>
> 128 In other words, the update of their work reduces gamma from the 0.5 it has previously estimate to 0.35. A copy of Hathaway and Officer's analysis is available on request.
>
> 129 The value attributed to gamma consists of two elements – the rate at which franking credits are distributed by the firm ("**distribution rate**") and the rate at which franking credits are utilised by shareholders ("**utilisation rate**").
>
> 130 Regulators have typically previously adopted a distribution rate assumption of 82 percent. This assumption was based upon the study by Hathaway and Officer (1996), which found that the value of franking credits distributed in each year averaged 82 percent of the value of credits created.
>
> 131 The update of this study using more recent data and improved analysis estimates the appropriate value at 71 percent.
>
> 132 AGN has previously argued that this approach to estimating gamma has significant limitations (e.g. relevance to the marginal investor). However, if the ERA is going to rely solely on this approach, as its Draft Decision implies, then AGN submits that the ERA should have regard to Hathaway and Officer's updated conclusions, rather than to their previous but now outdated work.
>
> 133 AGN submits that Gamma should be between 0.3 and 0.35 as provided for in the latest study on the matter on the ground that this best meets the requirements of the Code.

90. As noted in the Draft Decision, in Australia, regulators under the Code have to date generally adopted a γ value of 50 percent, based on the 1999 study by Hathaway and Officer, which estimated gamma at close to 0.50.[101] The Authority took the view in the Draft Decision that this assumption is appropriate for the AGN GDS. The Authority acknowledges, as noted by AGN in its recent submission, that this study has recently been updated by the authors. The estimate of gamma by these authors has been revised to between 0.28 and 0.36.[102]

[101] Hathaway, N. and R.R. Officer (1999), *The Value of Imputation Tax Credits*, Unpublished Manuscript, Graduate School of Management, University of Melbourne.

[102] Hathaway, Neville and Officer, Bob (2004), *The Value of Imputation Tax Credits: Update 2004*, Capital Research Pty Ltd, p. 8.

91. However, the Authority also notes that the appropriate value to be assumed for the value of imputation credits is highly contentious. The principal issues in the debate about the appropriate value for imputation credits have been canvassed recently in two recent reports:

- advice from KPMG to GGT on the Rate of Return for the Goldfields Gas Pipeline[103] ; and
- advice obtained by the Authority from ACG in relation to the Rate of Return for the AlintaGas Networks Mid-West and South-West Gas Distribution Systems.[104]

92. The matters of debate as illustrated by these reports include:

- methodologies for empirical estimation of the value of imputation credits;
- the "identity" of the marginal investor and the interdependency of the assumed value of imputation credits and assumptions as to the market risk premium and beta values, and the need for internal consistency in applying either a domestic CAPM model (with the marginal investor being Australian and able to utilise imputation credits) or international CAPM model (with the marginal investor being foreign and unable to utilise imputation credits); and
- inconsistent practice amongst financial practitioners in assumptions as to the value of imputation credits.

93. The Authority notes the absence of consensus amongst researchers on the appropriate value for gamma in a WACC calculation and of any consistent precedent by financial practitioners. However, the Authority also notes that while many financial practitioners do not ascribe a value to franking credits, these same financial practitioners also generally take a view of the expected market risk premium being substantially below the value of 6.0 that the Authority has considered as the upper limit of a reasonable range for this parameter. As such, the Authority takes the view that if the reasonable range for the market risk premium is taken as 5.0 to 6.0, then it is unreasonable not to ascribe some value to franking credits. In this regard, while the Authority does not consider that the value of gamma in the CAPM should be valued at the extremes of zero or one, the Authority considers that a reasonable estimate of the value of gamma may lie in the range of 0.3 to 0.6.

[103] KPMG, November 2004, Goldfields Gas Transmission Pty Ltd: Weighted Average Cost of Capital.

[104] ACG Rate of Return Report.