

**ATCO Gas Australia Pty Ltd - Economic
Regulation Authority Price
Determination: A report prepared by
Brent Stewart, November 2014**

Appendix 6.8

27 November 2014

Response to the ERA's Draft Decision on required
amendments to the Access Arrangement for the Mid-
West and South-West Gas Distribution System



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1. Overview

The following is a report based on my expert opinion in relation to the matter of ATCO Gas Australia Pty Ltd (ATCO Gas) and the Economic Regulation Authority (ERA) Price Determination (the matter). The opinions expressed in this report are based on my review of the relevant published documentation in the matter (refer Appendices) and my relevant experience and qualifications as a marketing professional generally and specific experience in relation to the marketing of utilities and monopolies (refer Section 2 'Qualifications and Experience').

I have been engaged by ATCO Gas to prepare an expert report that requires me to:

“Review and provide my opinion as to ATCO Gas’ BDM strategy and its alignment with ATCO Gas’ target market (B2 and B3 customers), and the ERA’s Draft Decision in relation thereto” (Appendix A, page 2).

A copy of the precise Terms of Reference for this report is attached in Appendix A. I understand that it is intended that my report will be submitted by ATCO Gas to the ERA with its response to the Draft Decision. I also understand that my report must be expressed such that it may be relied upon by both ATCO Gas and ERA.

In the preparation of this report, I acknowledge that I have read, understood and complied with the guidelines issued in Practice Note CM 7.

2. Qualifications and Experience

I am a marketing professional with over 30 years of experience in the marketing services industry as a practitioner and executive. I am currently the Executive Chairman of Waveride Capital Ltd, a company I established in 2011 to assist enterprises with strategy, growth and investment. Before establishing Waveride Capital, I was a Global CEO with Synovate – one of the world’s largest marketing intelligence and research companies, with revenues in excess of \$US1Bn and over 6,000 employees. In this role, I was responsible for the commercial leadership of Synovate’s Geographies, including more than 100 offices throughout 64 countries. I was also responsible for the development and implementation of Synovate’s global strategy and business plans, overall commercial leadership of Global Client Relationships and personally oversaw the Company’s largest client, the Unilever Group. I joined Synovate as the CEO of Australia and New Zealand in 2005 and resigned from my Global CEO role in 2011.

Prior to joining Synovate, I was the Chairman and Chief Executive of Market Equity, a company I founded in 1992 which grew to become one of Australia’s largest privately owned marketing and research companies. Market Equity was acquired by Synovate in 2005 to establish the Company’s market research presence in Australia and New Zealand.

In my 30 years as a marketing, strategy and research consultant, I have advised numerous Australian and International companies and Government instrumentalities across a wide range of industries including technology, energy, agribusiness, retail, manufacturing and services. My professional expertise includes strategic planning, market research and consumer behaviour. I have expertise and experience in the design and conduct of strategic market research and marketing plans, including within the energy and utilities domain. Specifically, I have previously conducted work for Alinta Energy, Western Power, the Water Corporation and the Office of Energy.

In addition to my consulting experience, my general commercial experience includes Board level appointments for a range of Companies and Government instrumentalities. I am currently the Chairman of PDC Global Pty Ltd, Surgical Specialties Pty Ltd, Etherington and The WorkFocus Group Pty Ltd. I am also a Non-Executive Director of Argonaut Ltd. My previous Board experience includes Chairman roles for the Western Australian Egg Marketing Board, Novo Foods Ltd, Herdsman Fresh Essentials Pty Ltd and Maxim Litigation Consultants Pty Ltd. I have also served on several West Australian government committees and working groups, including as Chairman of the Pearling Industry Advisory Committee, the Western Australian Beef Strategy Group and Partnership WA – a reference group advising a former Premier on branding and positioning opportunities for the State.

By way of professional qualifications, I am a former Chairman of the Market Research Society of Australia in Western Australia and have served on the National Board of Directors of both the Australian Market and Social Research Society and the Association of Market Research Organisations. I was also an Associate Fellow of the Australian Marketing Institute, a professional member of the American Marketing Association and a member of ESOMAR, the European Society of Marketing Research. I have obtained QPMR status (Qualified Practicing Market Researcher) and was previously a registered Marketing Consultant with the former Department of Commerce and Trade, a licensed Business Planning and Export Marketing consultant under the Federal Government's AusIndustry program and a Foundation Member of the Marketing Skills Program, a Federal Government initiative to enhance the marketing orientation of Australia's export industries. I am a Fellow of the Australian Institute of Company Directors.

By way of educational qualifications, I have obtained Bachelor of Science and Bachelor of Psychology degrees from the University of Western Australia.

3. Summary of the Matter

ATCO Gas has been the operator of the Mid-West and South-West Gas Distribution System (the Network) since 1st August, 2011. ATCO Gas is a subsidiary of the ATCO Group, an experienced international operator of regulated utilities. ATCO Gas' stated long term strategy is 'to increase throughput across the Network, encouraging wider use of gas in homes and commercial businesses whilst continuing to support the rapidly-expanding Perth metropolitan area' (Appendix B, Page 8).

The ERA is an independent statutory authority established by the Parliament of Western Australia. The stated purpose of the ERA is to benefit the WA community by promoting an efficient and customer focused economy (<http://www.erawa.com.au/about-us/fact-sheets/what-we-do>).

The ERA approves the terms and conditions that gas pipeline owners/operators can offer companies wanting to use their infrastructure.

The terms and conditions for "access" define the benchmark price and basic terms and conditions that parties can fall back on if they are unable to negotiate.

Reasonable terms and conditions for "access" to a gas pipeline are important, as they enable retailers to transport the energy they purchase from gas or electricity suppliers to customers. While parties can negotiate other arrangements, an access arrangement sets the price and basic terms and conditions for a typical service that would be sought (<http://www.erawa.com.au/about-us/fact-sheets/our-energy-related-work>).

There have been three approved Access Arrangements since the gas regulatory regime commenced in 1999. The most recent review commenced in 2010 and was completed in 2012. The access arrangement review for the 2014 to 2019 period (AA4) commenced in March 2014. The prior Access Arrangement (AA3) covering 2010-2014 took effect in May 2011 (<http://www.erawa.com.au/gas/gas-access/mid-west-and-south-west-gas-distribution-system/access-arrangements>).

Under the provisions of the National Gas Rules (NGR), the ERA is required to make a draft decision that indicates whether it is prepared to approve the access arrangement revision proposal as submitted and, if not, the nature of amendments that are required in order to make the proposal acceptable to the Authority. An access arrangement draft decision must include a statement of the reasons for the decision (Appendix C, Paragraph 10).

On 17 March 2014, ATCO Gas submitted its proposed revised access arrangement, access arrangement information and other supporting information for the Network to the ERA.

On 14 October 2014, the ERA published its Draft Decision on ATCO Gas' Access Arrangement Review Proposal. The draft decision of the ERA was to not approve the access arrangement revision proposal. The ERA's reasons for not approving the access arrangement revision proposal are set out in their Draft Decision. The proposed amendments to the access arrangement revisions before the ERA will approve it are also set out in their Draft Decision (Appendix C, Paragraph 25).

A fundamental aspect of the Access Arrangement review and the Draft Decision is the ERA's assessment of the efficiency of proposed expenditure. ATCO Gas proposes to spend operating expenditure of \$24.61 million on business development and marketing (BDM) for the fourth access arrangement period, a substantial increase over the actual BDM expenditure in the third access arrangement period (Appendix D, 7.6.1, Page 160).

ATCO Gas also forecasted growth in the number of customers and consumption per customer (of 2.1% each) in the fourth access arrangement period, including as a result of ATCO Gas' increased BDM activities.

In the Draft Decision, the ERA determined that ATCO Gas' proposed BDM campaign would not have the impact on customer usage that was forecast by ATCO Gas, and that the forecast increase in customer numbers would be achieved without the increase in BDM spending (Appendix C, Paragraphs 118 and 120).

4. Professional Opinion and Basis for This Opinion

Review and provide my opinion as to ATCO Gas' BDM strategy and its alignment with ATCO Gas' target market (B2 and B3 customers), and the ERA's Draft Decision in relation thereto (Appendix A, page 2)"

ATCO Gas' long term strategy is 'to increase throughput across the Network, encouraging wider use of gas in homes and commercial businesses whilst continuing to support the rapidly-expanding Perth metropolitan area' (Appendix B, Page 8). ATCO Gas' proposed BDM strategy and investment is intended to cover the following functions:

- Develop and execute initiatives to grow connection and throughput growth.
- Commercial management.
- Business case development and evaluation.
- Stakeholder relationship development and management with retailers, builders, commercial, residential land development and customers.

ATCO Gas asserts that these BDM activities and investment are required to execute ATCO Gas' strategy in response to an observed decline in the average consumption per customer and marginal growth rates in new connections (Appendix B, Page 74). ATCO Gas attributes this decline to a myriad of factors, including the mild to hot climate, housing design, subsidised electricity tariffs, the penetration of reverse cycle air conditioners, energy efficient building code requirements for new home construction and competition from other energy forms such as solar hot water systems and photovoltaic cells.

To address declining consumption, in 2012 ATCO Gas Australia conducted research and planning for a gas marketing strategy that aimed to increase awareness of the benefits of natural gas and increase the number of connections. This strategy included an increase in resources dedicated to marketing and business development as well as specific marketing campaigns and incentive initiatives to encourage the use of and connection to natural gas. This strategy commenced in mid-2013 (Appendix B, Page 76).

In reviewing and providing my opinion as to ATCO gas BDM strategy and its alignment with ATCO Gas' target market, I have been provided with four documents which together inform ATCO Gas' BDM strategy:

- ATCO Gas Strategic Marketing Plan Project, prepared by Churchill Consulting, March 2012 (Appendix E);
- ATCO Gas Qualitative Research, prepared by Meerkats, October 2012 (Appendix F);
- ATCO Infill Program Focus Group Report, prepared by Right Group, January 2013 (Appendix G);
- ATCO Gas Marketing Plan, prepared by ATCO Gas, June 2013 (Appendix H).

The foundation for the gas marketing strategy adopted by ATCO Gas is the first body of work conducted by Churchill Consulting in March 2012 (Appendix E). The approach to the development of the resultant marketing strategy and plan is outlined on pages 3 and 4 along with the objectives and scope.

From a methodological standpoint, the report employs a 'top down' approach to the development of marketing strategy, first examining the macro industry and market characteristics before defining the current and desired business state. This is accompanied by both quantitative and qualitative analysis to inform market segmentation and targeted marketing strategies and initiatives. Strategy development employs a framework that identifies four strategic themes – awareness, influence, knowledge and innovation. This closely assimilates the widely used AIDA marketing and communications model of awareness, interest, desire and action, first published by Professor Edward K Strong in the "Psychology of Selling and Advertising" in 1925. The report also identifies a marketing delivery model which provides a clear roadmap for implementation and outlines specific roles and responsibilities.

In the development of the marketing strategy and plan, the following is a summary of the key conclusions in the report:

- ATCO Gas should take a proactive stance through strategic marketing to minimise future earnings reduction risk and maximise market growth potential.
- All market segments present an opportunity for connection and consumption growth. (Appendix E, Page 10).
- A significant opportunity exists to influence those who recommend, guide or advise buying decisions which impact on Natural Gas connections and consumption.
- A significant opportunity exists to directly influence Commercial buyers of Gas through direct and remote relationship management.
- The establishment of an authoritative "voice" on Natural Gas would be welcomed at large by the Market.
- The growth in integrated home outdoor entertainment provides all season Gas consumption growth opportunity, especially with regard to:
 - Outdoor kitchen cooking appliances.
 - Outdoor space heating.
 - Swimming pool.(Appendix E, Page 33)

- Capitalise on establishing and leveraging a market position of “the experts in Natural Gas” through:
 - Growing awareness of the benefits of Natural Gas.
 - Influencing those who buy or who influence energy source decisions, by adding value.
 - Create and share a rich repository of knowledge and information of Natural Gas benefits, uses, comparisons and sources.
 - Facilitate market awareness and penetration of innovative and high volume Gas appliances.
 (Appendix E, Page 37)
- A focus on the Residential market and an associated target of arresting the slowing of growth is of critical importance.
- A focus on growing residential consumption, while at least maintaining current connections growth, will be key.
- A focus on the Commercial segment to source new connections and consumption growth will play a key role in offsetting any growth barriers experienced in the Residential market, plus create a base for future growth for the business. (Appendix E, Page 44).
- It is recommended that ATCO Gas does assume a lead role in the marketing of Natural Gas, but does this in a highly selective and managed way. (Appendix E, Page 46).

The second of these documents, ATCO Gas Qualitative Research, reports on qualitative research conducted by the advertising agency, Meerkats, through a series of 6 focus groups with different target segments of the residential market in Perth. According to the author of the report, the research undertaken by Meerkats was specifically structured to provide insights on the following ATCO objectives:

Business: Drive connection and consumption of natural gas.

Marketing: Raise awareness of ATCO Gas.

Communication: Allow the residential level to understand the role ATCO Gas plays in the delivery of gas to their home and how/when to contact them.

The nature of this research report is more exploratory than conclusive in any way but it does provide several useful insights into the target market segments, including:

- The claimed savings from gas versus electricity did not appear to be well known or understood amongst the target segments.
- The claimed savings from gas versus electricity was well received by the target segments.
- There appeared to be little spontaneous awareness or recognition of gas communications amongst the target segments.
- Highlighting a range of perceived strengths and weaknesses of gas amongst the target segments.

The third of the three reviewed documents is also based on qualitative research conducted by the Right Group in January 2013. Two focus groups were conducted for the research, one with Perth residents connected to the gas pipeline but not using gas and one with Perth residents not connected to the gas pipeline. According to the author of the report, the key aim of the research was to identify and recommend which promotional strategies will be most likely to convert non-users to install gas hot water systems.

The stated research objectives of the report are:

- Feedback on promotional concepts:
 - Why consumers like/dislike promotional concepts.
 - Which promotional concepts are likely to be successful & why.
 - Pricing, timing & media for promotional offers.
- Barriers/enablers to switching to gas HWS.
- Decision-making process for choosing HWS.
- General perceptions of gas versus electricity.

The reported insights from the Right Group report are:

- Switching to a gas HWS is most likely under circumstances where hot water supply is salient in people's minds and there is motivation to change.
- Regardless of promotion type, the packaging of gas connection and installation with purchase of the unit is attractive to people and may encourage switching to gas.
- Providing information on all costs and potential savings may encourage switching as this is the number one consideration when deciding which HWS to purchase.
- The promotions most likely to encourage switching once it is salient in people's minds and they have a motivation to switch are a rebate, trade-in or a no interest repayment.
- Encouraging solar users to switch to gas is most likely to be successful if the aim is to encourage a gas-boosted solar HWS.

The fourth of the reviewed documents is the ATCO Gas Marketing Plan prepared by ATCO Gas. It draws heavily from the ATCO Strategic Marketing Plan prepared by Churchill Consulting and references both of the aforementioned research report findings. Appropriately, the document articulates both strategy and tactics and includes specific details around execution and resource implications. The stated objectives in the document are:

Increase connections and volume of gas flowing through AGA System, by:

1. Raising the awareness of the value in the use of natural gas.
2. Promoting gas connections for existing and new builds:
 - In geographic locations where the gas network is expanding.
 - In geographic locations with a large volume of potential infill customers.
3. Promoting gas appliances:
 - Residential: hot water systems, cooktops and ovens, space heating.
 - Commercial & Industrial: generation, heating and cooling, natural gas vehicles.
4. Engaging market enablers and influencers to promote natural gas:
 - Natural gas retailers, builders, land developers, government, regulatory bodies, associations and other industry influencers.
5. Research new technologies:
 - Such as gas fired air-conditioning and gas fuel cells.

The key elements of the marketing strategy in the ATCO Marketing Plan are:

1. Brand Awareness:
 - ATCO Gas Australia Brand growth in Perth metro.
 - Leading with the many benefits of natural gas, communicate how AGA is bringing home WA's natural gas to enrich the lives of Western Australians.
2. Tactical Elements:
 - ATCO Natural Gas Blue Flame Kitchen.
 - Supporting brand activity through experiential activity at specific events, to communicate our message in a novel way and generate free media through social interaction.
3. Targeted Retail campaign:
 - Aimed at infill areas of the Perth metro. Reiterating the benefits of natural gas with an incentive to convert.

The marketing strategy articulated in the document is supported by action plans for each target market segment, targets in relation to connections, volumes and earnings impact and a process of measurement complete with a dashboard of targets. The document also contains a proposed calendar of activity, specific campaign executions and a detailed marketing budget.

In reviewing the four previously referenced documents, it is my opinion that the ATCO Gas Strategic Marketing Plan by Churchill Consulting is professionally prepared and sound by way of both method and conclusions. It provides a strong foundation for ATCO Gas' BDM strategy and articulates an alignment with ATCO Gas' target market (B2 and B3 customers) with a clear weighting towards residential customers. The only deficiency in the report in my opinion is the absence of a marketing budget allocation but this is addressed in the subsequent ATCO Gas Marketing Plan prepared by ATCO Gas in June 2013.

The ATCO Gas Qualitative Research, prepared by Meerkats research is more exploratory than conclusive in any way but it does provide several insights into the target market segments that could be useful in forming marketing hypotheses. Similarly, the ATCO Infill Program Focus Group Report, prepared by Right Group can only be considered as exploratory given that its findings are based on two focus groups only with a total of 17 respondents.

It is my opinion that neither of these reports can be relied upon as conclusive although both serve to help understand the perceptions, attitudes and behaviour of segments of the target market. In relation to ATCO Gas' BDM strategy, it is logical for exploratory consumer research to have been conducted to better understand the target market.

The ATCO Gas Marketing Plan, prepared by ATCO Gas is in my opinion a reasonable expression of the work conducted to date in relation to the development of ATCO Gas' BDM strategy and planned marketing initiatives. Apart from internal organisational knowledge, it draws from the ATCO Strategic Marketing Plan prepared by Churchill Consulting along with the findings of market research conducted by Meerkats and the Right Group. It is also my opinion that the ATCO Gas Marketing Plan would benefit from additional quantitative, primary market research that could usefully test alternative marketing hypotheses and help to quantify the market potential for increased connections and consumption amongst the target market.

Based on the above, it is my opinion that ATCO Gas' BDM strategy is based on sound marketing principles, follows acceptable marketing strategy development process and is aligned with ATCO Gas' target market of B2 and B3 customers.

My opinion is based on the following facts and observations:

- 4.1 ATCO Gas has employed professional external experts to assist with the development of its BDM strategy and this forms the basis for ATCO Gas' marketing plan.
- 4.2 ATCO Gas has conducted market research through external third parties to better understand the target market.
- 4.3 The findings of the market research could reasonably lead ATCO Gas to conclude that advertising and promotion that promotes the benefits of natural gas along with financial incentives could lead to increases in consumption and new connections.
- 4.4 ATCO Gas has developed a marketing plan that logically draws from the abovementioned body of work and sets out a clear path of execution, including planned advertising and promotion to raise the awareness of the benefits of natural gas and offer financial incentives for new connections.
- 4.5 Collectively, the actions set out above form a credible basis for the development of ATCO Gas' BDM strategy that conforms with acceptable marketing practice.

Based upon my review and interpretation of the ERA Draft Decision (Appendix C), it does not appear that ATCO Gas' BDM strategy and alignment with ATCO Gas' target market is called into question. The EMCa assessment (see Appendix D), upon which the Draft Decision in part relies, provides in principle albeit qualified support (paragraphs 554 and 555) for ATCO's BDM strategy. It goes on to point out, however, that the proposed expenditure must satisfy rule 91 (1). In this respect, the Draft Decision references EMCa's conclusion in paragraph 255 "EMCa has advised that ATCO has not demonstrated to a sufficient level of confidence that the proposed expenditure will lead to lower sustainable costs for consumers. Nor has ATCO demonstrated that the proposed expenditure is consistent with rule 91 of the NGR." The ERA Draft Decision therefore appears not to question ATCO Gas' BDM strategy but rather the proposed expenditure.

In paragraph 255 of the ERA decision, reference is made to EMCa's analysis of ATCO Gas' Net Present Value (NPV) analysis as the basis for advising that "ATCO has not demonstrated to a sufficient level of confidence that the proposed expenditure will lead to lower sustainable costs for consumers". I have not been requested to provide an opinion on the NPV analysis and it is therefore beyond the scope of this report.

In the subsequent paragraph, the ERA Draft Decision goes on to reference EMCa's conclusion that the BDM expenditure that ATCO has chosen to spend from 2011 to 2013 can be considered a reasonable and efficient level, based on ATCO's commercial incentives to incur operating expenditure at an efficient level and to try and increase demand (Appendix D, paragraph 256). EMCa goes on to state that "EMCa considers that the amount that ATCO has spent on business development and marketing in 2013 provides a reasonable basis for forecast expenditure for the fourth access arrangement period" (Appendix D, paragraph 256). I can find no supporting rationale provided for EMCa's conclusion in this regard.

It is my opinion that the available data to support or refute whether maintaining ATCO Gas' BDM expenditure at 2013 levels is equivocal. I am of the opinion that the ERA's Draft Decision to maintain expenditure at 2013 levels (Appendix C, paragraph 118) is without proper foundation. Specifically, I can find no compelling evidence for the statement "the Authority considers that the adjusted business development and marketing operating expenditure would still deliver ATCO's proposed marginal increase in the number of customers" (Appendix C, paragraph 118).

5. Concluding Comments

In the preparation of this report, I have made all reasonable inquiries that I deem to be desirable, relevant and appropriate and I believe that no matters of significance that I regard as relevant have, to my knowledge, been withheld from this report.

Yours sincerely

A handwritten signature in black ink, appearing to read 'B. Stewart', with a long horizontal flourish extending to the right.

Brent Stewart

- Appendix A: ATCO Gas Terms of Reference – Economic Regulation Authority Price Determination, prepared by Brent Stewart, November 2014
- Appendix B: ATCO Gas Access Arrangement Information Submission, March 2014
- Appendix C: Draft Decision on Proposed Revisions to the Access Arrangement for the Mid-West and South-West Gas Distribution System, October 2014
- Appendix D: EMCa Review of Technical Aspects of the Proposed Access Arrangement, Report to ERA (Redacted), June 2014
- Appendix E: ATCO Gas Strategic Marketing Plan Project, March 2012
- Appendix F: ATCO Gas Qualitative Research, prepared by Meerkats, October 2012
- Appendix G: ATCO Infill Program Focus Group Report, prepared by Right Group, January 2013
- Appendix H: ATCO Gas Marketing Plan, prepared by ATCO Gas, June 2013