Economic Regulation Authority

Western Australia

NOTICE

FINAL DECISION
MID-WEST AND SOUTH-WEST GAS DISTRIBUTION SYSTEMS

The Economic Regulation Authority today issued its Final Decision on the revisions proposed by AlintaGas Networks Pty Ltd (AGN) to the Access Arrangement for its Mid-West and South-West gas distribution systems.

An Access Arrangement sets out the terms and conditions, including prices, for third party use of a gas pipeline. It should be noted, however, that an Access Arrangement is not directly related to retail gas tariffs. Third party access to such pipelines is provided for under the *National Third Party Access Code for Natural Gas Pipeline Systems* (Code).

The AGN gas distribution systems consist of approximately 11,300 km of pipelines. These pipelines distribute natural gas sourced from the Dampier to Bunbury Natural Gas Pipeline (DBNGP) and the Parmelia Pipeline to industrial, commercial, small business and residential customers in the mid and south western coastal areas of Western Australia. The distribution systems stretch from Perth to Geraldton in the north and to Busselton in the south.

The Authority issued its Draft Decision on 28 February 2005. AGN and other interested parties have made submissions on the Draft Decision. The issues raised in these submissions are addressed in the Final Decision.

The Final Decision of the Authority is to not approve the proposed revisions to the Access Arrangement. The reasons for the Authority's decision are based on the information made available by AGN and submissions from interested parties.

The decision by the Authority requires AGN to make amendments to its proposed tariffs and to the terms for access to its Mid-West and South-West gas distribution systems.

KEY ASPECTS OF THE FINAL DECISION

The key areas of difference between the Authority's Final Decision and AGN's proposed revisions to the Access Arrangement are the rate of return and the incentive mechanism.

The Authority's Final Decision is that a real pre-tax rate of return for the gas distribution systems of 6.60 percent is consistent with the Code. This rate of return is lower than the figure of 7.75 percent proposed by AGN in its response to the Draft Decision. The reduced rate of return in the Authority's Final Decision is due to a number of factors including a fall in interest rates (i.e. risk free rate) which has occurred over the period since AGN lodged its initial proposed revisions to the Access Arrangement on 31 March 2004.

The fall in interest rates was partially offset by the Authority's acceptance of a submission from AGN that the debt risk premium values used by the Authority in calculating the rate of return should be higher. The basis for AGN's submission was a report titled "*Critique of available estimates of the credit spread on corporate bonds*" by the National Economic Research Associates dated May 2005. This report, together with advice obtained by the Authority from the Allen Consulting Group on the report, have been released with the Final Decision.

AGN proposed an incentive mechanism under which it would be entitled to carry forward efficiency cost savings made during the Access Arrangement period for 10 years. The Authority has accepted that AGN may retain efficiency gains under future Access Arrangements, but has concluded that a carry-forward period of 5 years is appropriate under the Code.

The Authority has considered the total revenue (in present value terms) which AGN would earn over the Access Arrangement period under the proposed tariffs for gas distribution and has concluded that an amount of $459.0 million is consistent with the Code. Calculated on a comparable basis, AGN submitted a figure of $495.6 million in May 2005. Approximately 90 percent of the difference between these amounts is explained by the lower rate of return provided in the Authority's decision.

Under the Authority's Final Decision, tariffs for gas distribution remain at their current levels for 2005 and for the remainder of the Access Arrangement period (i.e. 2006-2009) are expected to fall annually by 0.4 percent compared with 1.5 percent under the Draft Decision.

AGN proposed that it be given flexibility to vary the prices for individual tariff elements annually to enhance economic efficiency subject to remaining within the overall limit on total revenue used in calculating tariffs for the 2005 to 2009 period. The Authority has accepted AGN's proposal, subject to certain constraints on how the tariff elements may be varied. These constraints are intended to ensure that under any tariff increases the allocation of revenue is fair and reasonable and such increases are consistent with extending effective competition in the supply of gas to residential and small business consumers.

In accepting AGN's response to the Authority's Draft Decision with respect to the terms and conditions, including tariffs, to apply to new connections between the gas distribution system and the DBNGP and Parmelia Pipeline or increased volumes through existing connections, the Authority has concluded that such connections would have system-wide benefits (such as greater security of supply) and may enhance competition.

The Authority decided that the consequential costs of such pipeline connections within the gas distribution system (such as the costs of managing gas of different heating values) should be recoverable from all users of the gas distribution systems through the Access Arrangement. AGN has proposed, and the Authority has accepted, that any such costs are to be recovered via a tariff adjustment mechanism.

In its revisions to the Access Arrangement, AGN proposed an Access Arrangement period of 5 years commencing on 1 January 2005 and ending on 31 December 2009. This period has been accepted by the Authority.

BACKGROUND

The first Access Arrangement commenced on 18 July 2000 and at that time AlintaGas was government owned. Following privatisation in October 2000, AlintaGas become a public company (now known as Alinta Ltd) listed on the Australian Stock Exchange. AGN is 74 percent owned by Alinta Ltd and 26 percent owned by Diversified Utility and Energy Trusts.

Approximately 80 percent of the revenue generated from tariffs set under the Code comes from transporting gas for retail companies to small-use customers (i.e. households and small businesses). AlintaGas Sales Pty Ltd, which is 100% owned by Alinta Ltd, is currently the only company using the AGN gas distribution system to retail gas to small-use customers. However, since 31 May 2004, the market for small-use gas customers has become contestable and the Access Arrangement will, therefore, provide the terms and conditions, including tariffs, upon which retailers may transport gas to all customers, including small-use customers.

AGN TO SUBMIT AMENDED REVISIONS

AGN is required to submit revisions to the Access Arrangement which, by agreement with AGN, is close of business on 27 July 2005.

FURTHER INFORMATION

A copy of the Final Decision is available on the Authority's website http://www.era.wa.gov.au/. Printed copies of the Final Decision are available from the Authority on request at a cost of $25.00 by telephoning the Authority on (08) 9213 1900.

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