



**Response to the
Gas Access Regulator's
Draft Decision on the
Access Arrangement for the
Mid-West and South-West
Gas Distribution Systems**

Submitted 5 May 2000

AlintaGas
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**ALINTAGAS RESPONSE TO THE GAS ACCESS REGULATOR'S DRAFT
DECISION ON THE ACCESS ARRANGEMENT FOR THE MID-WEST AND
SOUTH-WEST GAS DISTRIBUTION SYSTEMS**

5 May 2000

To: The Western Australian Independent Gas Pipelines Access
Regulator
Office of Gas Access Regulation
6th Floor, 197 St Georges Terrace, Perth, Western Australia, 6000

From: Gas Corporation trading as "AlintaGas"
1 William Street, Perth, Western Australia, 6000

Subject: **Submission in Response to the Western Australian Independent
Gas Pipelines Access Regulator's Draft Decision Under Section
2.13 of the National Third Party Access Code for Natural Gas
Pipeline Systems in relation to AlintaGas's Proposed Access
Arrangement for the Mid-West and South-West Gas
Distribution Systems**

Introduction

The schedule to this submission contains AlintaGas's response to your Draft Decision dated 14 March 2000 on AlintaGas's proposed Access Arrangement for the Mid-West and South-West Gas Distribution Systems.

Interpretation

Unless the contrary intention appears, the following interpretation conventions have been used in the schedule:

- (a) References to the "Code" are references to the *National Third Party Access Code for Natural Gas Pipeline Systems* as applied as a law of Western Australia by the *Gas Pipelines Access (Western Australia) Act 1998*;
- (b) References to "sections" are references to sections of the Code;
- (c) A reference to an "Amendment" followed by a number is a reference to an amendment so numbered in the Draft Decision that you have stated is required before the Access Arrangement will be approved;
- (d) Where it is stated that AlintaGas intends to submit a "compliant revision", AlintaGas means that it intends to submit a revised access arrangement under section 2.18 in response to a specified amendment if an amendment of that nature is included in the Final Decision;
- (e) A reference to the "Access Arrangement" is a reference to AlintaGas's proposed Access Arrangement for the Mid-West and South-West Gas Distribution Systems,

submitted to you on 30 June 1999. A reference to “Access Arrangement Information” is a reference to the access arrangement information submitted by AlintaGas in conjunction with the Access Arrangement;

- (f) A reference to the “Draft Decision” is a reference to the “*Draft Decision: Access Arrangement Mid-West and South-West Gas Distribution Systems*” issued by you and dated 14 March 2000;
- (g) A reference to “Part A” or “Part B” is a reference to Part A or Part B of the Draft Decision;
- (h) A reference to a section of the “Act”, is a reference to a section of the *Gas Pipelines Access (Western Australia) Act 1998*;
- (i) A reference to the “Final Decision” is a reference to the final decision that you are required to issue under section 2.16(b) in relation to the Access Arrangement;
- (j) Terms used in the submission have the same meaning that they have in the Access Arrangement and Code; and
- (k) The term “reasons for decision” refers to the text that precedes an amendment in the Draft Decision in which you set out the reasons for your decision to require that amendment.

THE SCHEDULE**Amendment 1 - Technical and Service Requirements****Required Amendment**

In Amendment 1 you state that:

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

AlintaGas Response

AlintaGas objects to Amendment 1 and submits that you should not require such an amendment in the Final Decision. The reasons for AlintaGas’s response are as set out below.

As a matter of principle AlintaGas does not believe that these are matters properly addressed in the terms of the Access Arrangement. As is stated in the Draft Decision, “the duty placed on AlintaGas to meet the appropriate service and technical standards remains a legislative requirement rather than a contractual requirement”. AlintaGas considers that there is no benefit gained by a statement in the Access Arrangement that AlintaGas intends to comply with the law.

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

Amendment 2 - Duration of Reference Services**Required Amendment**

In Amendment 2 you state that:

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

AlintaGas Response

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

Amendment 3 - Gas Quality Specification**Required Amendment**

In Amendment 3 you state that:

“Clause 20 of Chapter 2 of the Access Arrangement should be amended to clarify that, for each gas quality component listed, the most stringent specification contained in the Gas

Standards (Natural Gas) Regulations 1999 and the broadest specification as defined in the Access Arrangement and currently specified in the Dampier to Bunbury Pipeline Regulations 1998 will prevail."

AlintaGas Response

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

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

Amendment 4 - Minimum Prudential and Insurance Requirements

Required Amendment

In Amendment 4 you state that:

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

AlintaGas Response

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

Amendment 5 - Contractual Rights

Required Amendment

In Amendment 5 you state that:

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

AlintaGas Response

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

Amendment 6 - Liability of parties

Required Amendment

In Amendment 6 you state that:

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

AlintaGas Response

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

Amendment 7 - Disclosure of Confidential Information

Required Amendment

In Amendment 7 you state that:

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

AlintaGas Response

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

Amendment 8 – Disclosure of Confidential Information

Required Amendment

In Amendment 8 you state that:

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

AlintaGas Response

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

Amendment 9 – Accuracy Verification

Required Amendment

In Amendment 9, you state that:

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

AlintaGas Response

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

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

Amendment 10 – Provision of Security

Required Amendment

In Amendment 10 you state that:

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

AlintaGas Response

AlintaGas considers that this is implied in the existing provision. Nonetheless AlintaGas will submit a compliant revision in response to Amendment 10.

Amendment 11 – Force Majeure

Required Amendment

In Amendment 11 you state that:

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

AlintaGas Response

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

Amendment 12 – Force Majeure

Required Amendment

In Amendment 12 you state that:

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

AlintaGas Response

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

AlintaGas notes that the:

- (a) The *Gas Distribution Regulations 1996* (WA);
- (b) Epic Energy’s proposed terms and conditions for the use of the Dampier to Bunbury Natural Gas Pipeline;
- (c) Goldfields Gas Transmission’s proposed terms and conditions for the use of the Goldfields Gas Transmission Pipeline; and
- (d) CMS Energy’s proposed terms and conditions for the use of the Parmelia Pipeline,

all contain a similar provision to that proposed by AlintaGas. This indicates that the distribution of risk effected by the proposed provision has been accepted by participants in the gas industry in Western Australia. The proposed provision has become standard industry practice in the State. It is, in consequence, “reasonable” and, given your acceptance of the provision in the case of the Parmelia Pipeline¹, Amendment 12 should be removed from the Final Decision.

Full reasons for AlintaGas’s objection to Amendment 47 are set out in Attachment A.

Amendment 13 - Correction of Payment Errors

Required Amendment

In Amendment 13 you state that:

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

¹ Draft Decision on the Parmelia Pipeline Access Arrangement Part B – Supporting Information, page 32.

AlintaGas Response

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

Amendment 14 - Default by a Party**Required Amendment**

In Amendment 14 you state that:

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

AlintaGas Response

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

Amendment 15 - Duration for Remedying a Default**Required Amendment**

In Amendment 15 you state that:

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

AlintaGas Response

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

Amendment 16 - Notification of Bare Transfers**Required Amendment**

In Amendment 16 you state that:

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

AlintaGas Response

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

Amendment 17 - Notification of Bare Transfers

Required Amendment

In Amendment 17 you state that:

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

AlintaGas Response

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

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

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

Amendment 18 - Provision of Information

Required Amendment

In Amendment 18 you state that:

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

AlintaGas Response

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

Amendment 19 - Provision of Information

Required Amendment

In Amendment 19 you state that:

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

AlintaGas Response

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

Amendment 20 - Reduction in Capacity Sought under Application**Required Amendment**

In Amendment 20 you state that:

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

AlintaGas Response

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

Amendment 21 - Priority of Continuity of Contract and Applications in the Queue**Required Amendment**

In Amendment 21 you state that:

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

AlintaGas Response

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

Amendment 22 - Queuing Policy and the Intent of the Code**Required Amendment**

In Amendment 22 you state that:

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

AlintaGas Response

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

Amendment 23 – Extensions/Expansions policy**Required Amendment**

In Amendment 23 you state that:

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

AlintaGas Response

AlintaGas intends to submit a compliant revision.

However, AlintaGas notes that the Amendment should specifically exclude the levying of surcharges in respect of “standard delivery facilities”, as that term is defined in clause 64(1) of the Access Arrangement.

Amendment 24 - Revisions Submission Date**Required Amendment**

In Amendment 24, you state that:

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

The effect of Amendment 24 is to bring forward the revisions commencement date from the date of 30 June 2004 proposed by AlintaGas to 31 March 2004, thereby providing you with an extra 3 months, or 9 months in total, to assess revisions to the Access Arrangement submitted by AlintaGas. You indicate that you require a 9 month revisions assessment period because regulatory experience throughout Australia indicates that “...a six-month period is inadequate for assessment of a proposed Access Arrangement...”².

AlintaGas Response

AlintaGas intends to submit a compliant revision. However, AlintaGas expresses concern about the reasons underlying your decision to require Amendment 24. Those concerns are set out in Attachment B.

² Part B, 60.

Amendment 25 - Trigger Mechanisms

Required Amendment

In Amendment 25 you state that

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

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

In the first paragraph of the reasons for your decision to require Amendment 25 you indicate that the requirement for Amendment 25 is based upon an exercise of your discretion under section 3.17. You summarise section 3.17 in the following way:

“...section 3.17 of the Code does provide the Regulator with the ability to nominate in advance trigger mechanisms within the Access Arrangement, which can be used to initiate a review”.³

You then proceed to state that changes in company or general taxation arrangements, including changes to the rate of corporate income tax and the introduction of GST, are “appropriate trigger” events. You also state that a trigger mechanism based on actual throughput is appropriate, provided that it does not have an adverse effect on AlintaGas’s incentives to increase network usage.⁴

AlintaGas Response

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

- (a) To the extent that Amendment 25 requires the inclusion in the Access Arrangement of a trigger mechanism that gives you discretion, upon the happening of certain events, about whether or not to conduct a review of the Access Arrangement, it exceeds your power under section 3.17;

³ Part B, at 60.

⁴ Part B, at 60.

- (b) The reasons for decision disclose that you did not, as required by section 3.17, determine whether each of the defined trigger events was necessary having regard to the objectives of section 8.1;
- (c) You have exceeded power under section 3.17 because the events specified in Amendment 25 are not “specific major events”;
- (d) Your approach to trigger mechanisms suggests that you have adopted an overly cautious and intrusive approach to regulation. Rather than having the confidence to allow AlintaGas to operate in the market for a 5 year period as proposed in the Access Arrangement, you have designed trigger mechanisms that will result in full regulatory reviews in the event that any outcome is not as you expect it to be. This is inappropriate and unreasonable. The reservation of increased discretion on your part results in decreased regulatory certainty for AlintaGas.
- (e) The occurrence of the defined trigger events does not justify the imposition of a requirement upon AlintaGas to submit revisions and for you to undertake a full review of the Access Arrangement under section 2.28.
- (f) You have failed to provide sufficient reasons for your decision to include each trigger event, as required under section 7.7.

Full reasons for AlintaGas’s response are as set out in Attachment C.

Amendment 26 - Notice of Curtailment

Required Amendment

In Amendment 26 you state that:

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

AlintaGas Response

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

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

Amendment 27 - Designated Suppliers

Required Amendment

In Amendment 27 you state that:

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

AlintaGas Response

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

Amendment 28 – Initial Capital Base

Required Amendment

In Amendment 28, you state that:

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

AlintaGas had proposed a value for the initial capital base (“the ICB”) of \$530.3 million as at 31 December 1998. The reasons for decision indicate that the value of \$530.3 million corresponded to a figure calculated by you of \$539.4 million at 31 December 1999. The value of \$539.4 million took account of capital costs and depreciation related to the year 1999.⁵

The reasons for decision state that you were not prepared to approve an ICB value of \$539.4 million. Taking into account a number of factors, and as reflected in Amendment 28, you decided that the value of the ICB should be reduced by \$29.0 million (or 5.4%) to a value of \$510.4 million.⁶

AlintaGas Response

AlintaGas objects to Amendment 28 and submits that you should not require such an amendment in the Final Decision. AlintaGas objects to Amendment 28 for the following reasons:

- (a) It is not necessary for you to require a 2% net retail margin for each reference service in each year of the access arrangement period.

⁵ Part B, at 68.

⁶ Part B, at 64.

- (b) As section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* (“section 38”) is not capable of being applied and could not be taken into account in assessing the value of the ICB.
- (c) Even if section 38 were capable of being applied and could have been taken into account in assessing the value of the ICB:
- I. You failed to comply with your obligation to give reasons under section 7.7 because you did not explain your interpretation of section 38 of the *Gas Pipelines Access (Western Australia) Act*.
 - II. Reference tariffs B2 and B3 and the ICB should be accepted as they were proposed because they are consistent with the purpose of section 38, which is to require you to consider fixing distribution and transmission tariffs that are reasonably uniform so as to enable the maintenance of reasonably uniform retail tariffs across the Mid-West and South-West areas of the State.
 - III. Your interpretation of section 38 as requiring the provision of a 2% net retail margin for each reference service is incorrect because it goes beyond the intent of section 38.
 - IV. Even if your interpretation of section 38 were correct, nothing in section 38 requires that you provide a 2% net retail margin for each reference service.
 - V. Even if your interpretation of section 38 were correct, it is unnecessary to provide for a 2% net retail margin by reducing the ICB. Reducing the ICB is only one way of achieving the objective of section 38, and an overall retail margin will provide sufficient incentive for retailers to compete for the custom of small business and retail consumers.
 - VI. If your interpretation of section 38 were correct, in determining the ICB you should take into account the fact that there are other ways in which the AlintaGas retail business can achieve a 2% net retail margin for each reference service, including reducing the costs of retail operations and negotiating more favourable prices for gas purchase and gas transmission.
 - VII. If your interpretation of section 38 is correct, any consideration of extending competition in the supply of gas to small business and residential consumers must be undertaken by reference to the gas purchase, gas transmission and retail costs that would be incurred by a new market entrant - not by the costs of AlintaGas’s retail business.
 - VIII. You have unreasonably attached too much weight to the factors you are required to consider under section 38. As a consequence, you have failed to give appropriate weight to other factors that you are required to consider under section 2.24. You should give other factors, including the legitimate business interests of AlintaGas, greater weight than you did in deciding to include Amendment 28 in the Draft Decision, with the result that you do not require that reference tariff B3 provide a 2% net retail margin.

- IX. You did not reasonably balance the interests of AlintaGas and other participants in the gas market that are in a position to contribute to the achievement of a 2% margin. This has unreasonably subordinated AlintaGas's interests to the interests of other participants in the gas market.
 - X. You may have erred in relation to your comments on a shift in revenue from AlintaGas's retail business to AlintaGas's distribution business.
- (d) The potential estimated valuation uncertainty in the DORC valuation in the order of \$200 million, as highlighted in the draft decision, is incorrect.

The reasons for AlintaGas's response, which are based on its understanding of the reasons for decision, are set out in Attachment D. If AlintaGas's understanding of the reasons for decision is incorrect, AlintaGas's response to Amendment 28 may change.

Amendment 29 - Capital Expenditure

Required Amendment

In Amendment 29 you state that:

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

AlintaGas Response

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

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

In that light, AlintaGas believes that it is proper and necessary for you to consider the comments set out in Attachment E. Given AlintaGas's ODV methodology, AlintaGas would propose to discuss with you the impact of forecast new facilities investment prior to the issue of the Final Decision.

Amendment 30 – Non Capital Costs

Required Amendment

In Amendment 30 you state that:

"The Access Arrangement and Access Arrangement Information should be amended to reflect Non-Capital Costs of \$181.1 million over the Access Arrangement Period, as

described in this Draft Decision and reflecting more rapid implementation of efficiency gains and lower levels of unaccounted for gas."

AlintaGas Response

AlintaGas acknowledges that the assessment of forecast non-capital costs for compliance with section 8.37 requires that judgments be made about a wide range of matters. As a result, AlintaGas accepts that it is open for you to reach conclusions about forecast non-capital costs that are inconsistent with AlintaGas's views about forecast new facilities investment.

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

In that light, AlintaGas believes that it is proper and necessary for you to consider the comments set out in Attachment F in relation to AlintaGas's proposed Non Capital Costs. Given AlintaGas's ODV methodology, AlintaGas would propose to discuss with you the impact of forecast non-capital costs prior to the issue of the Final Decision.

Amendment 31 - WACC Determination

Required Amendment

In Amendment 31 you state that:

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

AlintaGas Response

AlintaGas intends to submit a compliant revision in response to Amendment 31.

AlintaGas does however have some comments in relation to your method of calculation of the WACC. These comments are set out in Attachment G.

Amendment 32 – Depreciation Schedule

Required Amendment

In Amendment 32 you state that:

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

AlintaGas Response

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

AlintaGas considers that your approach to the timing of capital expenditures for the purpose of establishing the depreciation schedule is somewhat unorthodox. AlintaGas also notes that the effect of your proposed “correction” is not material.

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

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

Amendment 33 - Revised Total Revenue

Required Amendment

In Amendment 33 you state that:

“The Access Arrangement and Access Arrangement Information should be amended to reflect a working capital requirement of \$10.0 million in each year of the Access Arrangement Period and a return on working capital determined by multiplication of the level of working capital by the nominal pre-tax rate of return.”

AlintaGas Response

While AlintaGas believes its forecasts are a better indication of the amount of required working capital, the forecasts you proposed are not significantly different to those proposed by AlintaGas.

AlintaGas intends to submit a compliant revision in response to Amendment 33.

Amendment 34 – Revised Total Revenue

Required Amendment

In Amendment 34 you state that:

“The Access Arrangement and Access Arrangement Information should be amended to reflect a Total Revenue requirement as follows:

Year	2000	2001	2002	2003	2004
Revenue (\$million)	95.2	96.9	99.3	102.3	105.1

AlintaGas Response

AlintaGas objects to Amendment 34 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) The major differences in return on capital and depreciation, as determined by you and as determined by AlintaGas result from differences in the ICB; and
- (b) As AlintaGas has objected to the reduction in ICB contained in Amendment 28, the flow-on effect of this is that Amendment 34 should also be removed from the Final Decision.

Full reasons for AlintaGas's objection to Amendment 34 are set out in Attachment H.

Amendment 35 - User Specific Charge

Required Amendment

In Amendment 35, you state that:

"The Access Arrangement should be amended to include a statement of general methodology for the determination of user specific delivery charges, and to indicate the rate of return implicit in amortisation of costs of user specific delivery facilities."

AlintaGas Response

AlintaGas accepts that the Access Arrangement should contain a statement of general methodology with regard to user specific charges.

AlintaGas proposes to include a statement to the effect that:

"User specific charges will be calculated by amortising the value of user specific facilities over an appropriate capital recovery period, using the Nominal Weighted Average Cost of Capital Before Tax."

Amendment 36 - Reference Service A Tariff Structure – Distance Charges

Required Amendment

In Amendment 36, you state that:

"Should AlintaGas wish to maintain differences in demand and usage charges for Reference Service A on the basis of differences in pipeline construction costs, these charges (clause 21 of the Access Arrangement) should be amended to reflect available information on cost differentials."

AlintaGas Response

AlintaGas objects to Amendment 36 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) As the price difference is only applied for each kilometre greater than 10km, on an incremental basis, it does not produce a ratio of 2:1 in terms of overall price; and
- (b) The price ratio for an average customer who is greater than 10km from the transmission line is in the order of 0.7, which is within the range recommended by Connell Wagner.

Full reasons for AlintaGas's objection to Amendment 36 are set out in Attachment I.

Amendment 37 - Gas Distribution Costs under Reference Service A and the Gas Distribution Regulations

Required Amendment

In Amendment 37, you state that:

“Clause 21 of the Access Arrangement should be amended to provide a tariff structure for Reference Service A (or a succession of tariff structures for each year of the Access Arrangement Period) that accommodates a reasonable transition to the Reference Service A tariff from distribution tariffs that would have occurred for Users under the *Gas Distribution Regulations 1996*.”

AlintaGas Response

AlintaGas previously provided information to you in relation to the validity of comparing GDR haulage prices with haulage prices determined in accordance with the Code. In providing that information AlintaGas argued that there are compelling policy reasons as to why you should not undertake such comparisons. In addition, AlintaGas expressed the opinion that it did not believe that the introduction of reference tariff A haulage prices would have an effect on current delivered gas prices.

AlintaGas believes that the arguments previously put before you are correct and that you should not be concerned about the transition from GDR pricing to reference tariff A prices. As such, you should not require Amendment 37.

However, to the extent that it is reasonably possible, AlintaGas also believes that it is important to address perceived issues of equity for users in relation to the transition from GDR prices to reference tariff A. Therefore, while AlintaGas does not resile from its position as to the correctness of its arguments in relation to this matter, and indeed reserves its rights in this regard, it is prepared to explore the development and implementation of a reasonable transitional arrangement.

Full details of AlintaGas’s proposal to address Amendment 37 are set out in Attachment J.

Amendment 38 - Gas Distribution Costs under Reference Services A and B1

Required Amendment

In Amendment 38 you state that:

“Clauses 21 and 22 of the Access Arrangement should be amended to provide tariff structures for Reference Services A and B1 that allow for a reasonably seamless transition in gas distribution charges between these two services.”

The reasons given in support of Amendment 38 were as follows:

- (a) For quantities of gas delivered less than about 35 TJ per year, reference tariff B1 is much higher than reference tariff A;

- (b) This difference in tariffs may be sufficiently large to encourage a user taking delivery of somewhat less than 35 TJ per year to contract with AlintaGas for reference service A (rather than reference service B1); and
- (c) The user may secure a financial benefit from taking the lower priced service even if, to meet the criteria for eligibility for reference service A, it has to purchase additional gas and use that gas inefficiently.

AlintaGas Response

AlintaGas acknowledges the potential for the inefficient use of gas arising from the difference between reference tariff A and reference tariff B1 by users taking delivery of between 25 and 35 TJ per year. AlintaGas has undertaken some preliminary investigations as to how a “reasonably seamless transition” could be achieved, and proposes further discussions with you to address this issue.

As a practical matter, the number of users with gas consumption in this range is expected to be less than 20, and the effect is likely to be small.

Establishing relativities between the reference tariffs of the AlintaGas Access Arrangement is an extremely difficult task. Reference tariffs determined by a service provider in accordance with the Code are to be reflective of the costs incurred in providing the corresponding reference services. Proposed caps on retail gas prices in Western Australia, which appear to have been set without consideration being given to the structure of costs in the gas market, make fully cost reflective distribution charges difficult, if not impossible to achieve. AlintaGas appreciates your recognition of this issue in requiring that the transition be “reasonably” seamless. AlintaGas’s work to date indicates that an approximate outcome is all that can be secured. Given the constraints imposed on reference tariff determination, a continuous transition from reference tariff B1 to reference tariff A cannot be achieved without introducing distortions into other parts of the tariff structure.

Amendment 39 - Retail Margins for Reference Services B2 and B3

Required Amendment

In Amendment 39 you state that:

“Clause 24 of the Access Arrangement should be amended to provide a tariff structure for Reference Service B3 that makes provision for reasonable retail margins for a User providing gas to residential end users of gas, both in total for any residential end user and for any gas quantity block.”

AlintaGas Response

AlintaGas strongly objects to Amendment 39 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) Amendment 39 is uncertain because it does not state with sufficient specificity the amendment (or the nature of the amendment) that you require and, therefore, does not satisfy the requirements of section 2.13(b). The uncertainty arises in the following respects:

- I. Amendment 39 refers to “reasonable retail margins” without indicating what you consider to be reasonable; and
 - II. Amendment 39 refers to “reasonable retail margins” but does not specify whether you mean “gross retail margins” or “net retail margins”, or both, as those terms are defined in the reasons for decision.
- (b) For the reasons set out in its response to Amendment 28 in relation to section 38, AlintaGas submits that you should not require that AlintaGas amend reference tariff B3 to provide for a positive gross or net retail margin.
 - (c) Whereas section 38 is concerned with the class of consumers known as small business and residential consumers, you apply section 38 in relation to particular residential consumers and particular gas quantities.
 - (d) It is unreasonable for you to require that AlintaGas amend reference tariff B3 to provide a positive retail margin for every residential customer, regardless of the level of gas that the customer consumes.
 - (e) You should take into account the fact that there are other ways in which AlintaGas’s retail business can contribute to the achievement of the perceived objective of a positive retail margin for every residential customer, regardless of the amount of gas consumed by that customer, before determining that it is necessary to fix distribution tariffs.
 - (f) Any consideration of the extension of competition in the supply of gas to small business and residential consumers must be undertaken by reference to the costs of new retailers, not by reference to the costs of AlintaGas’s retail business.
 - (g) The emphasis you have placed upon section 38 indicates that you have unreasonably attached too much weight to the fixing of reference tariff B3 in order to provide a retail margin for every residential customer regardless of the amount of gas consumed by that customer. As a consequence, you have failed to give appropriate weight to other factors that you are required to consider under section 2.24.
 - (h) The emphasis that you have placed upon section 38 also indicates that you have attached insufficient weight to the interests of AlintaGas as against the interests of other participants in the gas market, particularly retailers.

Full reasons for AlintaGas’s response are set out in Attachment K.

Amendments 40, 41 & 42 - Regulatory Approval Of Changes To Reference Tariffs

Required Amendments

In Amendment 40 you state that:

“Clause 1 of schedule 2 and clause 2 of schedule 3 of the Access Arrangement should be amended to make variations to Reference Tariffs and the pass through of changes in taxation and regulation subject to the approval of the Regulator.”

In Amendment 41 you state that:

“Clause 1 of schedule 2 and clause 2 of schedule 3 of the Access Arrangement should be amended so as to not impose obligations on the Regulator in respect of decisions by the Regulator to approve or not approve proposed variations to Reference Tariffs or pass through of changes in taxation and regulation, other than as provided for by the Code in respect of a review of an Access Arrangement.”

In Amendment 42 you state that:

“Clauses 1(6) of schedule 2 and 2(4) of schedule 3 of the Access Arrangement should be amended to remove provisions for AlintaGas to seek a review of a decision by the Regulator to not approve changes to Reference Tariffs as though such a decision was a decision to which section 38 of Schedule 1 of the Gas Pipelines Access (WA) Act applies.”

AlintaGas Response

AlintaGas objects to Amendments 40, 41 and 42 and submits that you should not require such amendments in the Final Decision for the following reasons:

- (a) The reasons for decision are deficient.
- (b) The effect of Amendments of 40, 41 and 42 will be to significantly undermine regulatory certainty and increase associated regulatory costs for AlintaGas, contrary to its legitimate business interests.
- (c) In relation to Amendments 40, 41 and 42, you have not reasonably or correctly considered AlintaGas’s legitimate business interests in respect of reference tariff variations.
- (d) AlintaGas proposed Schedules 2 and 3 in the exercise of its discretion under section 8.3 and in this regard:
 - I. Schedules 2 & 3 comply with the elements of section 8.3 and are consistent with the objectives of section 8.1;
 - II. Pursuant to section 8.3 it is at AlintaGas’s discretion to include Schedules 2 and 3 in the reference tariff policy within the Access Arrangement;
 - III. You may not refuse to approve the Access Arrangement for the reasons you have given in relation to section 8.3; and
 - IV. The issues of the imposition of obligations, approval and appeal do not appear to be relevant to a consideration of the objectives of section 8.1.
- (e) AlintaGas submits that your decision to not allow the Access Arrangement to impose obligations upon you is ill-founded. It is entirely proper and within the ambit of section 8.3 for a service provider to specify the manner in which reference tariffs are to vary.
- (f) If implemented, Amendments 40, 41 and 42 will make it impossible for AlintaGas to realise its objectives in relation to Schedules 2 and 3. If you are not prepared to move from the views set out in the reasons for decision, AlintaGas suggests

replacing all references to “the Regulator” in Schedules 2 and 3 with the words “an independent auditor appointed by AlintaGas”.

- (g) Amendment 42 is incorrect in so far as it is based on a judgement that Schedules 2 and 3 seek to “extend” section 38 of Schedule 1 of the *Gas Pipelines Access (Western Australia) Act*.

Full reasons for AlintaGas’s objection to Amendments 40, 41 and 42 are set out in Attachment L.

Amendments 43, 44 & 45 – CPI-X Price Cap

Required Amendments

In Amendment 43 you state that:

“Schedule 2 of the Access Arrangement should be amended to remove provisions for re-balancing of Reference Tariffs and to implement a price-cap mechanism for the variation of Reference Tariffs.”

In Amendment 44 you state that:

“Clause 15 of schedule 2 of the Access Arrangement should be amended such that the “X” value in a CPI-X price cap mechanism is not less than 2.62 percent.”

In Amendment 45 you state that:

“Clause 14 of schedule 2 of the Access Arrangement should be amended such that the Consumer Price Index (CPI) refers to the Eight Capital City, All-Groups CPI measure, exclusive of the impact of the goods and services tax, as published by the Australian Bureau of Statistics.”

AlintaGas Response

AlintaGas objects to Amendments 43, 44 and 45 and submits that you should not require these amendments in the Final Decision for the following reasons:

- (a) In relation to Amendment 43 you have taken into account only one of the factors you are required to take into account under section 2.24 and you have failed to give consideration to any of the objectives of section 8.1 for the design of a reference tariff and a reference tariff policy.
- (b) In relation to Amendment 43, you:
 - I. interpreted section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* in an unreasonable and, therefore, inappropriate way; and
 - II. failed to take into account facts which, if they had been properly taken into account, would have led you to not proposing Amendment 43.
- (c) In relation to Amendment 43, your reasons for rejecting the revenue yield form of incentive mechanism proposed by AlintaGas in Schedule 2 of the Access

Arrangement appear to be without foundation, and their use in supporting the amendment does not appear to have a clear rationale.

- (d) In relation to Amendment 43, your assertion that the revenue yield form of incentive mechanism proposed by AlintaGas, in Schedule 2 of the Access Arrangement, is complex and potentially expensive to regulate and administer is largely unsubstantiated.
- (e) In relation to Amendment 44, AlintaGas notes that your method of calculating the value of “X” in the CPI-X formula flows from Amendment 43. As AlintaGas objects to the imposition of simple price caps as proposed by Amendment 43, it also opposes Amendment 44.
- (f) In relation to Amendment 45:
 - I. The CPI measure proposed by AlintaGas is the appropriate measure of inflation to be used in the Access Arrangement;
 - II. Amendment 45 has been based on irrelevant considerations; and
 - III. As a Western Australian regulator, appointed to ensure that appropriate consideration is given to local issues, you should examine the merits of AlintaGas’s use of the All Groups Perth CPI within the scope of sections 2.24 and 8.24 of the Code and not propose a change only because that change achieves consistency with the decisions of regulators in other jurisdictions.

AlintaGas notes the comment made in the reasons for decision supporting Amendment 45 to the effect that you are considering an efficiency requirement in addition to that provided by the X factor in the CPI-X mechanism. AlintaGas would strongly object to such an additional requirement on the grounds that:

- (a) it can see no basis for your assertion that the proposed price control is comparatively lenient; and
- (b) there is no scope under the Code for imposition of arbitrary incentives for unachievable levels of efficiency improvement.

Full reasons for AlintaGas’s response are as set out in Attachment M.

Amendment 46 - Nature of Fixed Principles

Required Amendment

In Amendment 46, you state that:

“Clauses 38(1)(e) and 38(1)(f) of the Access Arrangement should be amended to indicate whether the Fixed Principles of the Depreciation Schedule and the allocation of revenue between services comprise principles or methodologies within the meaning indicated in the definition of a structural element in section 10.8 of the Code.”

AlintaGas Response

AlintaGas objects to Amendment 46 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) there is uncertainty about what you require in the amendment and, to the extent that you require statements of clarification to be included in the Access Arrangement, such a requirement is unsatisfactory for legal and policy reasons;
- (b) you have not complied with the requirement under section 7.7 to provide reasons to support your decision; and
- (c) the Depreciation Schedule and “allocation of revenue between services” are both principles within the meaning of “structural element” in section 10.8.

Full reasons for AlintaGas’s objection to Amendment 46 are set out in Attachment N.

Amendment 47 - Duration of the Fixed Period
Required Amendment

In Amendment 47 you state that:

“Clause 38(2) of the Access Arrangement should be amended to provide for a Fixed Period of no greater than five years starting on the Commencement Date.”


AlintaGas Response

AlintaGas objects to Amendment 47 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) You did not have regard to AlintaGas’s interests as required by section 8.48. If you did have regard to the interests of AlintaGas, you did not record them in the reasons for decision and you have accordingly failed to comply with your obligation to give reasons for decisions under section 7.7.
- (b) Your conclusion that a fixed period in excess of the access arrangement period is potentially contrary to the interests of users and prospective users is inconsistent with the very notion of fixed principles under sections 8.47 and 8.48. The effect of this conclusion is to incorrectly render sections 8.47 and 8.48 largely redundant.
- (c) The effect and intent of sections 8.47 and 8.48 is that the fixed period should be a period that extends beyond a single access arrangement period. Consistent with, and to give effect to, sections 8.47 and 8.48, you should approve a fixed period that spans a number of access arrangement periods. As specified by AlintaGas in clause 38(2) of the Access Arrangement, the appropriate fixed period is 10 years.
- (d) Your decision to not allow the fixed period of 10 years proposed by AlintaGas will result in increased regulatory risk contrary to the legitimate business interests of AlintaGas.

- (e) It is unreasonable for you to undermine the operation of sections 8.47 and 8.48 because of regulatory inexperience and market uncertainties. Those uncertainties were known at the time the Code was designed, and were implicitly accepted as risks.
- (f) It is unreasonable for you to attach more weight to the potential adverse effect on consumers than you attach to the definite adverse effect on AlintaGas's legitimate business interests.

Full reasons for AlintaGas's objection to Amendment 47 are set out in Attachment O.



Attachment A

Amendment 12 – Force Majeure

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 12

You have asserted that the ongoing liability of a user to pay charges under a haulage contract when the distribution service is interrupted by a force majeure event is “unreasonable”. The fact that you consider the existing provision “unreasonable” is the only justification given for the Amendment.

2. GENERAL COMMENTS

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

3. GROUND FOR OBJECTION

AlintaGas objects to Amendment 12. AlintaGas notes that the:

- (a) *Gas Distribution Regulations 1996* (WA);
- (b) Epic Energy’s proposed terms and conditions for the use of the Dampier to Bunbury Natural Gas Pipeline;
- (c) Goldfields Gas Transmission’s proposed terms and conditions for the use of the Goldfields Gas Transmission Pipeline; and
- (d) CMS Energy’s proposed terms and conditions for the use of the Parmelia Pipeline,

all contain a similar provision to that proposed by AlintaGas. This indicates that the distribution of risk effected by the proposed provision has been accepted by participants in the gas industry in Western Australia. The proposed provision has become standard industry practice in the State. It is, in consequence, “reasonable” and, given your acceptance of the provision in the case of the Parmelia Pipeline⁷, Amendment 12 should be removed from the Final Decision.

4. EXPLANATION OF GROUNDS FOR OBJECTION

4.1 GAS DISTRIBUTION REGULATIONS

The relevant provision in the Access Arrangement is schedule 7, clause 28. This provision is based on regulation 75 of the *Gas Distribution Regulations 1996* (WA) the regulation provides:

“The demand price and the service price are to be payable even if for any reason (including the operation of force majeure on the corporation or the user) the user wholly or partially does not utilise gas distribution capacity.”

⁷ Draft Decision on the Parmelia Pipeline Access Arrangement Part B – Supporting Information, page 32.

4.2 DAMPIER TO BUNBURY NATURAL GAS PIPELINE

AlintaGas notes that Epic Energy's proposed access terms and conditions for the Dampier to Bunbury Natural Gas Pipeline contain the following equivalent provision:

"The Shipper is not relieved of its obligation to pay the Capacity Charges by the occurrence of an event of Force Majeure (whether claimed by Epic Energy or the Shipper)."

4.3 GOLDFIELDS GAS PIPELINE

AlintaGas notes that Goldfields Gas Transmission's proposed general terms and conditions for the Goldfields Gas Pipeline contain the following equivalent provision:

"Notwithstanding clause 17.1 the User shall not be relieved from liability to pay moneys due (including the Toll Charge and the Capacity Reservation Charge which shall continue to accrue and be payable notwithstanding the Force Majeure) or to give any notice which may be requires to be given pursuant to the Service Agreement."⁸

4.4 PARMELIA PIPELINE

AlintaGas also notes that CMS's access arrangement for the Parmelia Pipeline included a similar provision to that proposed by AlintaGas in Schedule 7, clause 28 of the Access Arrangement. Your response to that provision was that:

" In view of the absence of a uniform practice in respect of waiving of reservation charges in events if interrupted gas transportation, the Regulator considers that the proposal for CMS to not waive reservation charges is reasonable practice is the industry."⁹

Accordingly, you decided that the provision was allowed to be maintained in the access arrangement for the Parmelia Pipeline. AlintaGas contends that, as the provision in CMS's access arrangement is in effect the same as that proposed in AlintaGas's Access Arrangement, you should provide a consistent approach and not require Amendment 12 in the Final Decision.

4.5 REASONABLENESS OF THE PROVISION

AlintaGas submits that the inclusion of a similar force majeure provision in:

- (a) the *Gas Distribution Regulations 1996* (WA);
- (b) Epic Energy's proposed terms and conditions for the use of the Dampier to Bunbury Natural Gas Pipeline;
- (c) Goldfields Gas Transmission's proposed terms and conditions for the use of the Goldfields Gas Transmission Pipeline; and
- (d) CMS Energy's proposed terms and conditions for the use of the Parmelia Pipeline;

⁸ Goldfields Gas Transmission Pty Ltd, Access Arrangement, Appendix 3 – General Terms and Conditions, page 30.

⁹ Draft Decision on the Parmelia Pipeline Access Arrangement, Part B, page 32.

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

Attachment B

Amendment 24 – Revisions Submission Date

Although AlintaGas has agreed to submit a compliant revision in response to Amendment 24, it does have some concerns about the reasons underlying your decision to require the amendment.

While AlintaGas believes that it is prudent to allow a realistic period of time for the assessment of revisions to an access arrangement, it submits that a period of 9 months is too long a period for the following reasons:

- (a) The regulatory experience to which you refer is regulatory experience in relation to the assessment of proposed access arrangements. AlintaGas submits that the assessment of new access arrangements is a much larger and time consuming task than the assessment of revisions to an existing, and previously approved access arrangement. It follows, then, that the assessment of revisions should take significantly less time than 9 months.
- (b) Prior to the introduction of the Code, there had been little experience in the independent regulatory assessment of third party access regimes in Australia. The submission and assessment of the first proposed access arrangements under the Code was, therefore, bound to take significant amounts of time as regulators established offices and infrastructure and developed experience and expertise. AlintaGas submits that as regulatory expertise develops the time taken to undertake assessments should correspondingly decrease. AlintaGas expects that the duration of assessments would ultimately contract to the period of 6 months specified in sections 2.21 and 2.43.
- (c) Sections 2.21 and 2.43 provide a firm indication of the Parliament's intention to restrict the time it should take to assess access arrangements and revisions to access arrangements to 6 months. While there is an ability to extend that period by one or more periods of up to 2 months, AlintaGas submits that the use of such extensions should be reserved for extraordinary events. In the normal course of events, particularly as experience and expertise develops, regulators should strive to provide final decisions within the 6 month timeframe. The achievement of such an objective will provide to service providers greater certainty and will result in greater regulatory efficiency. Accordingly, although you wish to give yourself a 9 month assessment period in the future, you should not believe that AlintaGas agrees that that is an acceptable timeframe for assessments.

Attachment C

Amendment 25 – Trigger Mechanisms

1. GENERAL COMMENTS

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

2. GROUNDINGS FOR OBJECTION

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

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

3. EXPLANATION OF GROUNDINGS FOR OBJECTION

3.1 REGULATOR’S ROLE IN RESPECT OF THE TRIGGER MECHANISMS

Amendment 25 implies that you can, under section 3.17, require the inclusion of a trigger mechanism that gives you discretion about whether or not to conduct a review of the Access Arrangement. This implication is drawn from the first sentence of the paragraph, which states:

“Chapter 8 of the Access Arrangement (Review Date) should be amended to include trigger mechanisms enabling the Regulator, if the Regulator wishes, to initiate a review of the Access Arrangement...” (emphasis added)

AlintaGas submits that section 3.17 does not empower you to require the inclusion of a trigger mechanism that gives you discretion about whether or not to conduct a review. To the extent that Amendment 25 seeks to impose such an obligation, you have exceeded your powers.

The wording of section 3.17 is clear. It provides that you may require the inclusion of:

“...specific major events that trigger an obligation upon the Service Provider to submit revisions prior to the Revisions Submission Date.”

Section 3.17 does not permit you to require the inclusion of specific major events that trigger, if you wish, a review of the Access Arrangement. Under the section, the only permissible trigger you can require is the occurrence of a defined, specific major event. If a defined, specific major event occurs, a service provider must submit revisions to its access arrangement to you: see section 2.28. Once that occurs, sections 2.31 to 2.48 require you to undertake a full review of the access arrangement, including public consultation, the consideration of submissions and the issue of draft and final decisions. Under section 2.48, your decision in relation to the proposed revisions would then be amenable to merits review before the Gas Access Review Board at the request of any person with standing.

Accordingly, if you require the inclusion of trigger events, you cannot retain discretion about whether to undertake a full review of the Access Arrangement if the event occurs. If a defined specific major event occurs, AlintaGas will be automatically obligated to submit proposed revisions to you and you will have an obligation to undertake a full access arrangement review.

AlintaGas submits that the need to undertake full reviews of the Access Arrangement, thereby decreasing certainty as to access arrangement period, is not in the best interests of AlintaGas or users or prospective users.

3.2 REQUIREMENT FOR “NECESSITY”

Section 3.17 states that you may require the inclusion of trigger events in the Access Arrangement. It is also the case, however, that section 3.17 provides that this may only occur where you consider it “...necessary having regard to the objectives of section 8.1”.

Your reasons for decision indicate that you did not consider whether the inclusion of trigger events was “necessary having regard to the objectives of section 8.1”. AlintaGas submits that a consideration that it may be “appropriate” to include trigger events does not demonstrate that it is “necessary” to include trigger events generally or particular trigger events.

Even if “appropriate” could be taken to mean “necessary”, you have not have not considered whether each trigger event is necessary having regard to the objectives in paragraphs (a) to (f) of section 8.1.

The reasons for including the trigger event based on actual throughput did contain some discussion of the inaccuracies of forecasting over a 5 year period and contained a proviso that the trigger not have an adverse effect on incentives to increase network usage. This might be taken to constitute consideration of paragraph (f) of section 8.1. It does not, however, constitute consideration of the factors outlined in paragraphs (a) to (e) of section 8.1.

As such, AlintaGas submits that you do not have any basis for the requirement for the inclusion of trigger events in the Access Arrangement pursuant to section 3.17.

3.3 SPECIFIC MAJOR EVENTS

3.3.1 Introductory Comments

Section 3.17 provides that you are entitled to require that “specific major events” be defined that trigger an obligation on AlintaGas to submit revisions to the Access Arrangement prior to the revisions submission date. The Code does not provide a definition of specific major event, and the Outline to the Code is also of no assistance in this regard.

In the absence of assistance from the Code, it is appropriate to turn to ordinary English usage to assist in understanding the phrase “specific major event”. The Collins Dictionary defines “specific” as meaning “explicit, particular or definite”. It defines “major” as meaning “very serious or significant”¹⁰, and “event” as meaning “anything that takes place, esp. something important; an incident”. Accordingly, AlintaGas submits that a specific major event is an explicit, particular or definite, and very serious or significant thing that takes place.

It is also useful to contrast the use of the term “specific major event” with the term “event” used in with section 3.18 (which deals with mechanisms to address forecasting inaccuracies when an access arrangement period exceeds 5 years). Section 3.18(a) states that one such “mechanism” would be to require a service provider to submit revisions if certain “events” occur, and provides two examples of such events. The examples are fairly broad in scope, indicating that the drafter intended that the word “event” be given a broad interpretation.

Notably, paragraph (a) of section 3.18 refers only to “events”. In contrast to section 3.17, it does not restrict the trigger events by the use of the words “specific” and “major”. This strongly suggests that the drafter intended that the type of event that could be specified as a trigger event in section 3.17 would be significantly narrower than the type of trigger event contemplated by section 3.18. Under section 3.17, a specific major event can be specified, whereas under section 3.18 a mere event can be specified. If the drafter had intended otherwise, he or she would not have used different terms in the two sections.

¹⁰ Note that the Concise Oxford Dictionary defines major as being something “unusually important or serious or significant”.

This has significant consequences in terms of the types of events that can be specified for the purposes of section 3.17. One would expect that trigger events under section 3.17 would be significantly narrower than the types of examples given under section 3.18. They would, in effect, need to be more specific (as in explicit, particular or definite) than section 3.18 trigger events. It would also be the case that they would have to be confined to major events (as in very serious or significant).

This approach to the definition of trigger events is consistent with the policy behind sections 3.17 and 3.18. AlintaGas submits that section 3.17 provides certainty to service providers as to the term of an access arrangement in that it allows the service provider to nominate the access arrangement period. Coupled with sections 2.49 and 2.28, this gives the service provider certainty that it can proceed in implementing and operating under its access arrangement without regulatory intervention until the end of the access arrangement period. At the same time, section 3.17 recognises that there may be a need for a review (other than at the request of the service provider) of an access arrangement if specific major events occur. In order to preserve, to the greatest extent possible, regulatory certainty for a service provider, section 3.17 restricts the types of events that may trigger such a review to only specific and major events – the occurrence of an event that is not specific or major cannot trigger a review.

A further matter in the interpretation of “specific major event” concerns that question as to what the word “major” is to be judged in relation to. AlintaGas submits that a major event is one that is major, in the sense of being very serious or significant, in relation to the operation of an access arrangement.

That being the case, it is necessary to examine the particular trigger events specified in Amendment 25 to ascertain whether they are specific major events.

3.3.2 Submission Of Change Statement

As indicated below, AlintaGas is unclear about the meaning of “change statement”. For present purposes, it assumes that “change statement” refers to a notice given by AlintaGas under Schedule 2 or Schedule 3 of the Access Arrangement for the purposes of varying reference tariffs or passing through changes in taxation or regulatory costs.

AlintaGas accepts that the event is, subject to the statement immediately above, reasonably specific. However, AlintaGas does not believe that the submission of a notice under Schedule 2 or 3 entailing an increase in reference tariffs will necessarily be a major event.

AlintaGas submits that a reference tariff increase effected in accordance with the terms of an access arrangement will not constitute a major event. Such occurrences will not be unusually important or very serious or significant. Rather, they will be minor procedural events in relation to the operation of the access arrangement. While they may have very serious or

significant consequences for users, that is not a relevant consideration in the application of the test of specific major event. AlintaGas further submits that it is unlikely that the drafter of the Code would have intended that increases in reference tariffs consistent with the provisions of an access arrangement would trigger a full review of the access arrangement.

Without prejudice to the submission above, even if one assumes that a reference tariff increase could constitute a major event, the mere fact that increase will occur is not necessarily very serious or significant to the operation of the Access Arrangement. Whether or not a reference tariffs increase is a major event will depend on the magnitude of the increase. Some increases will be very significant and others will not.

For these reasons AlintaGas submits that the first trigger event defined in Amendment 25 is not a specific major event. It is beyond your discretion under section 3.17 to require that it be included as a trigger event.

3.3.3 Changes To Taxation Arrangements

The proposed trigger event in relation to changes in taxation arrangements is extremely broad in scope. It refers to “changes to taxation arrangements affecting AlintaGas, including any change to the rates of the goods and services tax or corporate income tax.” The scope of taxation arrangements affecting AlintaGas is virtually without limit and could be taken to refer to changes to any tax law that affects AlintaGas or any tax arrangement that affects AlintaGas. The trigger event, therefore, is not specific in that it is not sufficiently particular or explicit. Further, it is no more specific than the type of example given in paragraph (a) of section 3.18.

In addition, it is not possible to ascertain whether the trigger event could be considered to be a major event. Events that fall within its scope will include events that are not major in that they are not very serious or significant to the operation of the Access Arrangement. An example of this can be drawn from the express inclusion in the trigger event of “any change” in the rates of the GST or corporate income tax. A small rate change may not have a major effect on the Access Arrangement, but AlintaGas would nevertheless be subject to a full review of the Access Arrangement.

For these reasons AlintaGas submits that the second trigger event defined in Amendment 25 is not a specific major event. It is beyond your discretion under section 3.17 to require that it be included as a trigger event.

3.3.4 Actual Throughput

This trigger event would be set off if the quantity of gas distributed increases by more than 50% of the forecast increase used in the determination of reference tariffs. In 2001 an inaccuracy of 20.5 TJ (or 0.07% of 2000 volumes) would trigger a full review of the Access Arrangement. In 2004, an inaccuracy of 242.5 TJ (or 0.84% of 2003 volumes) would trigger a full review.

AlintaGas submits that inaccuracies of the magnitude specified would not constitute major events. They would not be unusually significant or very serious in relation to the operation of the Access Arrangement. Indeed, as you note in the reasons for decision, there is implicit uncertainty in forecasting. The fact that such uncertainty is normal suggests that the occurrence of the trigger event is not a major event.

AlintaGas also notes that the trigger event is no more specific than example (I) in section 3.18. AlintaGas also submits that the trigger event is not specific as to the time period over which such a variation is to be measured.

AlintaGas submits that the third trigger event defined in Amendment 25 is not a specific major event. It is beyond your discretion under section 3.17 to require that it be included as a trigger event.

3.3.5 Changes In Law

A change in the provisions or administration of any Act or other law which, in your view, necessitates a review of the Access Arrangement would trigger a full review of the Access Arrangement.

AlintaGas submits that you do not have the power under section 3.17 to require the inclusion of trigger events that only trigger at your discretion. Under section 3.17, you may only require the inclusion of a trigger event. AlintaGas commented on your discretion to trigger a review above.

This trigger mechanism is not specific, in that it is not explicit or particular. AlintaGas submits that it is extremely and unreasonably broad. The trigger events fail the test of specificity in the following ways:

- (a) The trigger refers to “any Act or other law”. This is very broad and has virtually unlimited scope. Such changes may also have no connection with the Access Arrangement;
- (b) The trigger refers to a change in the “administration” of any Act or other law. This, again, has virtually unlimited scope; and
- (c) A review will be triggered at your discretion based on your opinion. Thus, events that trigger a review are not particular or explicit.

Further, because of the extreme breadth of the trigger event, it follows that the event cannot be considered to be a major event. Under the trigger event, even small changes in the administration of an Act could trigger a review.

For these reasons AlintaGas submits that the fourth trigger event defined in Amendment 25 is not a specific major event. It is beyond your discretion under section 3.17 to require that it be included as a trigger event.

3.4 THE JUSTIFICATION FOR REQUIRING TRIGGER EVENTS

AlintaGas views certainty as to the access arrangement period as a key regulatory risk issue. The model of regulation implemented under the Code was intended to be light-handed and to offer service providers incentives to develop the market for gas distribution services. Under that model, a service provider would submit an access arrangement to a regulator, who would approve the access arrangement for a certain term (usually 5 years). The service provider would then be free to operate in the market within the confines of the approved access arrangement secure in the knowledge that the access arrangement would not be subject to regulatory review until the end of the approved term. The only exceptions to this were to be when the service provider felt it necessary to submit revisions (under section 2.28) or when certain defined, specific major events occurred.

AlintaGas submits that the trigger mechanism you intend to require is inconsistent with the Code model. Its effect is to maximise the scope for regulatory intervention prior to the end of an access arrangement period by means of extremely broadly defined trigger events. This decreases regulatory certainty for AlintaGas, which will not be confident about the length of the access arrangement period and the security of its Access Arrangement.

AlintaGas further submits that your approach to trigger mechanisms suggests that you have adopted an overly cautious and intrusive approach to regulation. Rather than having the confidence to allow AlintaGas to operate in the market for a 5 year period, you have designed trigger mechanisms that will result in full regulatory reviews in the event that any outcome is not as you expect it to be. This is inappropriate and unreasonable. The reservation of increased discretion on your part results in decreased regulatory certainty for AlintaGas.

For the reasons outlined above, particularly in relation to regulatory certainty, AlintaGas submits that you should exercise caution in imposing trigger events in the Access Arrangement. Indeed, you should not impose them unless there are compelling reasons to do so.

AlintaGas's comments on your reasons for including the specific trigger events follow.

3.4.1 Change Statement

The statements preceding Amendment 25 make no mention of the reasons for requiring the inclusion of the first trigger mechanism. As such, you have not given reasons for your decision as required by section 7.7. AlintaGas notes that you discuss reference tariff variation issues at pages 189 to 197 of Part B of the Draft Decision. It is not clear, however, whether that discussion is intended to provide reasons for your decision in relation to the trigger events.

It is, therefore, not possible to understand the merits of your decision. AlintaGas considers itself to be considerably disadvantaged in responding to this aspect of the draft decision. In the absence of clear reasons for your

decision, AlintaGas submits that you have failed to justify the inclusion of the trigger mechanism.

AlintaGas is also unclear about whether “change statement” refers to a change statement submitted under Schedule 3 of the Access Arrangement, or whether it is also intended to refer to variation proposals under Schedule 2. If it does refer to variation proposals under Schedule 3, you would need to carry out a review of the Access Arrangement on an annual basis. This would increase regulatory risk and costs for AlintaGas, and could result in increased financing costs in future periods.

AlintaGas submits that, having regard to the objectives of section 8.1, it is not necessary to have such a trigger mechanism. Changes to the Access Arrangement in accordance with its terms are not contrary to any of the objectives outlined in paragraphs (a) to (f) of section 8.1. Indeed, including the trigger mechanism may be contrary to the objectives of section 8.1. Accordingly, AlintaGas submits that under section 3.17 the submission of a change statement should not constitute a trigger event.

AlintaGas is not aware of a similar requirement in any other access arrangement decision or draft decision in Australia.

3.4.2 Changes To Taxation Arrangements

The reason for the inclusion of changes in taxation arrangements as a trigger event is given as being that you consider it appropriate. AlintaGas submits that merely stating that you consider something is appropriate does not describe the reasons for your decision as required by section 7.7.

As a result, AlintaGas is unable to comment on the merits of your decision and submits that this event should not be trigger mechanism. The mere fact that taxation arrangements change is not a reason to trigger a full review of the Access Arrangement.

Given the imminent imposition of the GST to AlintaGas’s operations on 1 July 2000 it is appropriate to consider the practical implication of Amendment 25 if it proceeds in its current form.

The introduction of the GST represents a change in taxation arrangements affecting AlintaGas. Under Amendment 25, this event will trigger a full review of AlintaGas’s access arrangement now with its attendant costs in terms of time, AlintaGas resources, OffGAR resources, independent consultants, public consultation period, draft decision and final decision.

AlintaGas, like all other market participants, has no option about whether it collects the GST or not, nor does it have any influence on the rate applied. For the Regulator to have the right to reject the flow through of this taxation impost would be totally unreasonable especially when the Federal Government has made provision to ease the transition within the economy from wholesale sales tax regime to a goods and services tax regime.

AlintaGas will provide further comments upon other regulatory decisions prior to the issue of the Final Decision.

3.4.3 Actual Throughput

The reasoning supporting this trigger mechanism is that you consider that it is necessary to overcome the risks associated with the “implicit uncertainty” associated with forecasting because the Access Arrangement employs a price path approach to reference tariff variation. You further state that an actual throughput mechanism is to be introduced provided it does not have an adverse effect on AlintaGas’s incentives to increase network usage.

AlintaGas does not believe that the fact that it uses a price path methodology, which carries with it a forecasting risk, is sufficient reason to impose the proposed trigger mechanism. The use of a price path is explicitly acknowledged by section 8.3. At the same time, the structures of sections 3.17 and 3.18 suggest that the drafters of the Code were not concerned about forecasting risk within an access arrangement period of less than 5 years. The fact that section 3.18 expressly addresses the issue of forecasting risk for access arrangements of greater than 5 years, whereas section 3.17 does not, indicates that the drafters of the Code intended that forecasting risk in shorter access arrangement periods was factor to be addressed in the setting of initial reference tariffs and the tariff path. It was not a specific major factor to be addressed by means of a trigger event under section 3.17. This is further reinforced by the fact that section 8.2(e) specifically deals with a requirement that you must be satisfied in approving reference tariffs that any forecasts represent best estimates arrived at on a reasonable basis.

It is also the case that you do not provide reasons as to why the proposed trigger mechanism will not have an adverse effect on AlintaGas’s incentives to increase network usage. The reasons simply state the proviso without applying it. In addition, as the trigger event is narrowly defined to operate on 50% of forecast increases, it will have an adverse effect on AlintaGas’s incentives to increase network usage. If AlintaGas increases network usage by amounts as little as approximately 1% of total throughput, it will be obligated to submit revisions to you.

In the final paragraph of the reasons for decision you state that your consideration of applying an actual throughput trigger event is consistent with recent draft decisions issued by IPART and the ACCC on covered pipelines in New South Wales. AlintaGas submits that you should not rely on authority presented in draft decisions because they are subject to change in a final decision. Notwithstanding this, AlintaGas will provide further comments on the decisions cited by you prior to the issue of the Final Decision.

3.4.4 Changes In Law

The reasons for decision do not provide any explanation of why you have decided to include this trigger event. To that extent, you have not complied with the requirements of section 7.7 to give reasons. As a consequence, AlintaGas's ability to respond on this matter has been adversely affected.

This trigger event is unreasonable. It is contrary to the objectives of the Code and light-handed regulation for you to reserve to the right to trigger a review to the Access Arrangement as the result of such a broadly defined event.

AlintaGas is not aware of a similar requirement in any other access arrangement decision or draft decision in Australia.

Attachment D

Amendment 28 – Initial Capital Base

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 28

AlintaGas proposed a value for the initial capital base (“the ICB”) of \$530.3 million as at 31 December 1998. The reasons for decision indicate that the value of \$530.3 million corresponded to a figure calculated by you of \$539.4 million at 31 December 1999. The value of \$539.4 million took account of capital costs and depreciation related to the year 1999.¹¹

The reasons for decision state that you were not prepared to approve an ICB value of \$539.4 million. Taking into account a number of factors, and as reflected in Amendment 28, you decided that the value of the ICB should be reduced by \$29.0 million (or 5.4%) to a value of \$510.4 million.¹²

Based upon its reading of the reasons for decision, AlintaGas understands that the key factors that led you to reduce the ICB to \$510.4 million were essentially as follows:

- (a) AlintaGas proposed an ICB valuation methodology under which asset values were nominally based on a “depreciated optimised replacement cost” (“DORC”) valuation methodology. However, the nominal asset values were reduced so that, to use the statement made by AlintaGas in the Access Arrangement Information, the:

“...extent of th[e] downward adjustment [was] just sufficient to achieve estimates of prices in the retail market that [were] consistent with the level of prices expected to prevail in that market during the period of the Access Arrangement”.¹³

The extent of the reduction was not uniform across all classes of assets. The largest reductions were made to asset classes used to provide services under reference tariffs B2 and B3.

- (b) You stated that the ICB valuation approach adopted by AlintaGas was:

“...inextricably linked to the methodology used to determine a schedule of Reference Tariffs and the associated assumptions as to the rate of return, and allocation of costs across services. Furthermore, the valuation is dependent upon the assumptions as to costs and margins, other than the costs of gas distribution, that underlie retail gas prices.”¹⁴

You further asserted that, under the valuation methodology, forecast gross retail revenues were calculated and from them were deducted forecast gas, gas transmission and retail costs, and a retail margin. The residual amount

¹¹ Part B, at 68.

¹² Part B, at 64.

¹³ Access Arrangement Information, 3.1.3, at 24.

¹⁴ Part B, at 67.

represented the implicit distribution revenue. The present value of the implicit distribution revenue was then calculated and an ICB value determined so that it returned the same present value for the target total revenue, taking into account non-capital costs, capital expenditure, depreciation and return on capital.¹⁵ You summarised the process, as you understood it, in the following terms:

“The methodology used to value the [ICB] involved setting values of these parameters and solving for an [ICB] so as to return a predetermined level of distribution revenue. Lower costs of providing distribution services, or a lower rate of return, would result in a higher value being ascribed to the [ICB]”.¹⁶

- (c) AlintaGas stated that its valuation methodology resulted in an “optimised deprival value” (“ODV”). Although you described the approach as “unconventional”, you accepted that it produced values that were generally indicative of a deprival value.¹⁷ Further, you accepted the methodology generally.¹⁸
- (d) Despite your acceptance of the ODV methodology, you did not agree with the way in which AlintaGas applied it.¹⁹ In particular, you indicated that the following matters were significant:
 - I. You indicated that there were several areas of technical concern with the DORC valuation of \$707 million made by Gutteridge Haskins & Davey Pty Ltd (“GHD”) and employed by AlintaGas. Based on those technical concerns, you held that the DORC value proposed by AlintaGas may be overstated by approximately \$85 million, leading to a DORC value in the range of \$620 million to \$707 million.
 - II. You stated that AlintaGas assumed declining retail margins over the access arrangement period. You asserted that the retail margins declined as the result of an unreasonable transfer of revenue from AlintaGas’s retail business to AlintaGas’s Distribution business.²⁰ In your view, any reduction in retail margins should occur by virtue of a reduction in retail market prices, rather than an increase in distribution prices.²¹

You revised AlintaGas’s assumptions to provide for a forecast overall net retail margin, and net retail margins for each service, of 2% of forecast retail revenues.²² The driving factor for this change was explained as follows:

¹⁵ Part B, at 68.

¹⁶ Part B, at 72.

¹⁷ Part B, at 70, 79.

¹⁸ Part B, at 69, 99.

¹⁹ Part B, at 70.

²⁰ Part B, at 71, 83 and 95.

²¹ Part B, at 83.

²² Part B, at 71.

“...in the fixing of charges for gas transmission and distribution, the Regulator has a specific obligation under Section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* to take into account extension of effective competition in the supply of natural gas to residential and small business customers. Acceptance of AlintaGas’s assumptions as to retail margins for Reference Services B2 and B3 are considered to be inconsistent with this obligation.”²³

- III. You asserted that there were some difficulties in respect of the way in which AlintaGas had calculated forecasts for retail revenues, gas costs, gas transmission costs and retail costs for AlintaGas’s retail business. Ultimately, you accepted the forecasts.
- IV. As required under section 8.10(d), you examined the advantages and disadvantages of each valuation methodology applied under paragraphs (a), (b) and (c) of section 8.10.²⁴ You concluded that neither DAC nor DORC values are an obvious choice as a valuation methodology. You then stated:

“In the absence of a unique value of the [ICB] that has some economic justification, the derivation of a value must depend upon a balance between the interests of the Service Provider and Users of the distribution systems. Striking such a balance of interests was the justification provided by AlintaGas for the nominated [ICB] with the criterion of a balance of interests being that distribution tariffs would not exceed the current distribution charges implicit in retail gas prices. This approach of maintaining a status quo depends, however, upon a presumption of reasonableness of the current distribution charges.”²⁵

In that context, you again accepted the reasonableness of AlintaGas’s ODV methodology.²⁶ You then considered the reasonableness of the implicit, current distribution tariffs by reference to charges under the *Gas Corporation Act 1994* and *Gas Distribution Regulations 1996*, and the *Gas Corporation (Charges) By-Laws 1996*. You observed that the average reference tariffs proposed by AlintaGas (at an ODV of \$540 million) were close to implicit charges for gas distribution, with the exception of reference tariff A. You also observed that there is a higher average tariff for gas distribution over all reference services.

You also considered the reasonableness of determining an ICB to maintain current revenues. Based on comparative data, you concluded that an ICB of \$510 million would give rise to relatively high capital costs per gigajoule of gas delivered. On the other hand, you observed that the capital assets per customer and capital costs per customer would be lower than equivalent ratios for other Australian distribution systems considered.²⁷

²³ Part B, at 83.

²⁴ Part B, at 84 – 89.

²⁵ Part B, at 89.

²⁶ Part B, at 91.

²⁷ Part B, at 95 – 97.

Finally, you assessed the impact on AlintaGas of an ICB value of \$510 million by reference to financial indicators.²⁸ You concluded that the financial ratios indicate that an ICB of \$510 million would be consistent with an investment grade credit rating.

2. GENERAL COMMENTS

AlintaGas objects to Amendment 28 and submits that you should not require such an amendment in the Final Decision. The reasons for AlintaGas's response, which are based on its understanding of the reasons for decision, are as set out below. If AlintaGas's understanding of the reasons for decision is incorrect, AlintaGas's response to Amendment 28 may change.

Before providing the reasons for its response, AlintaGas expressly notes that neither you nor officers from OffGAR discussed ICB related issues with AlintaGas prior to the release of the draft decision. While OffGAR officers advised AlintaGas of OffGAR's likely position on the ICB, AlintaGas was not provided with an opportunity to discuss with OffGAR or you the reasons and fundamental assumptions concerning the determination of the ICB. Accordingly, this is the first time that AlintaGas has been able to inform you of AlintaGas's position in relation to the ICB. AlintaGas submits that it should not be prejudiced by this fact and trusts that you are prepared to consider fully AlintaGas's submissions unconstrained by the position set out in the Draft Decision.

3. GROUND FOR OBJECTION

AlintaGas objects to Amendment 28 for the following reasons:

- (a) It is not necessary for you to require a 2% net retail margin for each reference service in each year of the access arrangement period.
- (b) Section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* ("section 38") is not capable of being applied and could not be taken into account in assessing the value of the ICB.
- (c) Even if section 38 were capable of being applied and could have been taken into account in assessing the value of the ICB:
 - I. You failed to comply with your obligation to give reasons under section 7.7 because you did not explain your interpretation of section 38 of the *Gas Pipelines Access (Western Australia) Act*.
 - II. Reference tariffs B2 and B3 and the ICB should be accepted as they were proposed because they are consistent with the purpose of section 38, which is to require you to consider fixing distribution and transmission tariffs that are reasonably uniform so as to enable the maintenance of reasonably uniform retail tariffs across the Mid-West and South-West areas of the State.

²⁸ Part B, at 97 – 99.

- III. Your interpretation of section 38 as requiring the provision of a 2% net retail margin for each reference service is incorrect because it goes beyond the intent of section 38.
 - IV. Even if your interpretation of section 38 were correct, nothing in section 38 requires that you provide a 2% net retail margin for each reference service.
 - V. Even if your interpretation of section 38 were correct, it is unnecessary to provide for a 2% net retail margin by reducing the ICB. Reducing the ICB is only one way of achieving the objective of section 38, and an overall retail margin will provide sufficient incentive for retailers to compete for the custom of small business and retail consumers.
 - VI. If your interpretation of section 38 were correct, in determining the ICB you should take into account the fact that there are other ways in which the AlintaGas retail business can achieve a 2% net retail margin for each reference service, including reducing the costs of retail operations and negotiating more favourable prices for gas purchase and gas transmission.
 - VII. If your interpretation of section 38 were correct, any consideration of extending competition in the supply of gas to small business and residential consumers must be undertaken by reference to the gas purchase, gas transmission and retail costs that would be incurred by a new market entrant - not by the costs of AlintaGas's retail business.
 - VIII. You have unreasonably attached too much weight to the factors you are required to consider under section 38. As a consequence, you have failed to give appropriate weight to other factors that you are required to consider under section 2.24. You should give other factors, including the legitimate business interests of AlintaGas, greater weight than you did in deciding to include Amendment 28 in the Draft Decision, with the result that you do not require that reference tariff B3 provide a 2% net retail margin.
 - IX. You did not reasonably balance the interests of AlintaGas and other participants in the gas market that are in a position to contribute to the achievement of a 2% margin. This has unreasonably subordinated AlintaGas's interests to the interests of other participants in the gas market.
 - X. You may have erred in relation to your comments on a shift in revenue from the AlintaGas retail business to the AlintaGas distribution business.
- (d) The potential estimated valuation uncertainty in the DORC valuation in the order of \$200 million, as highlighted in the draft decision, is incorrect.

4. EXPLANATION OF GROUNDS FOR OBJECTION

As noted above, you revised AlintaGas's assumptions to provide for a forecast overall net retail margin, and a net retail margin for each reference service, of 2% of forecast retail revenues. You did so by reducing the value of the ICB from \$539.4 million to \$510.4 million.

AlintaGas understands that you see the existence of an overall 2% net retail margin as desirable to the promotion of competition in the retail gas market. AlintaGas does not, however, accept that it is necessary for you to require a 2% net retail margin for each reference service in each year of the access arrangement period.

4.1 NECESSITY FOR A 2% NET RETAIL MARGIN FOR EACH REFERENCE SERVICE

As noted above, your requirement that each reference tariff provide a 2% net retail margin stems from your interpretation and application of section 38 of the *Gas Pipelines Access (Western Australia) Act 1998*.²⁹ AlintaGas does not agree with either your interpretation or application of the section and, therefore, does not believe it requires that you provide a 2% net retail margin for each reference service.

4.1.1 Section 38 Cannot Be Applied

Where it applies, section 38(2) requires you to take into account the fixing of "appropriate charges". Section 38(3) states that the reference to appropriate charges is to charges for the use of a pipeline to transport "small quantities" of natural gas to residential and small business consumers.

Section 38(4) defines the term "small quantities" as meaning "...a quantity for the time being prescribed by the Minister by order published in the *Gazette*...". The section also provides limits on what may be a small quantity by stating it must be in every case less than 1 TJ in any period of 12 consecutive months and for transport to a single metered connection.

To the best of AlintaGas's understanding, the Minister has, not for the purpose of section 38(4), prescribed by order published in the *Gazette* a quantity as being a "small quantity". Accordingly, there is currently no "small quantity" and nothing in respect of which you can take into account the fixing of appropriate charges.

AlintaGas, therefore, submits that section 38 is currently incapable of application. As a consequence, it is clear that section 38 cannot be validly relevant to your consideration of the Access Arrangement and that you must disregard it. AlintaGas suggests that the Minister should make the appropriate order if he wants section 38 to have effect.

²⁹ In this Attachment, references to "section 38" are references to section 38 of the *Gas Pipelines Access (Western Australia) Act*.

Now that the matter has now been raised, AlintaGas expects that the Minister will publish a section 38(4) notice in the Gazette prior to the issue of the Final Decision. Without prejudice to any rights AlintaGas may have in relation to this matter, the comments that follow proceed on the assumption that the Minister does so and that section 38 can be validly applied in considering the Access Arrangement.

4.1.2 Interpretation of Section 38

The reasons for decision do not explain your interpretation of section 38. They merely indicate that AlintaGas's assumptions as to retail margins for reference services B2 and B3 are "considered to be inconsistent" with the obligation imposed by section 38.³⁰

From that statement, the paragraph in which the statement appears and other comments in relation to retail margins, AlintaGas has constructed what it understands to be your interpretation of section 38. AlintaGas notes, however, that the failure of the reasons for decision to state how you have interpreted section 38 have made it difficult for AlintaGas to understand the basis for Amendment 28 and to respond to you. AlintaGas submits that you have, therefore, failed to comply with your obligation to give reasons under section 7.7.

AlintaGas understands that your interpretation of section 38 would work as follows:

- (a) Section 38(1) basically states that section 38(2) applies when you are assessing an access arrangement in order to determine whether to approve it and for that purpose you are required by the Code to take the public interest into account. You are currently assessing the Access Arrangement in order to determine whether to approve it. Further, you are required by section 2.24 of the Code to take into account the public interest before approving the Access Arrangement. Section 38, therefore, applies to your consideration of the Access Arrangement.
- (b) Section 38(2) requires you 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. Under section 38(3), "appropriate charges" are charges for the use of a pipeline to transport small quantities of natural gas that will enable suppliers to compete for the custom or residential and small business consumers.
- (c) Reference tariffs B2 and B3 are charges for the use of AlintaGas's distribution pipelines to transport small quantities of natural gas. It is, therefore, appropriate for you to take into account fixing reference tariffs B2 and B3 so as to enable suppliers to compete for the custom of residential or small business consumers as a means of extending effective competition in the supply of gas to those consumers.

³⁰ Part B, at 83.

- (d) In your view, to enable suppliers to compete for the custom of residential or small business consumers it is necessary that reference tariffs B2 and B3 each provide a 2% net retail margin for a user or prospective user. Providing a 2% net retail margin for each of reference tariffs B2 and B3 is a means of extending effective competition in the market for small business and residential consumers.
- (e) Reference tariff B3 does not provide a 2% net retail margin. As this is inconsistent with your view that the reference service must provide a 2% net retail margin, reference tariffs B3 is unacceptable and must be changed so that it provides a 2% margin. The change is effected by a reduction in the value of the ICB.

If this interpretation accurately states why you decided to require a 2% net retail margin for each reference tariff, particularly reference tariff B3, AlintaGas accepts paragraphs (a), (b) and (c) of the interpretation. AlintaGas does not, however, accept paragraphs (d) and (e) of the interpretation.

In relation to paragraph (d), AlintaGas submits that nothing in the language of section 38 requires that reference services B2 and B3 each provide a 2% margin. The requirement for a 2% margin is, in effect, the result of your interpretation that a 2% margin for each reference service is necessary to enable suppliers to compete for the custom of small business and residential consumers.

In this context, AlintaGas notes that section 38(3) is expressed in general terms and provides little guidance about what the legislature intended by the use of the phrase “charges...that will enable suppliers to compete for the custom of residential and small business consumers”. In interpreting the section it is, therefore, appropriate to consider what was said in Parliament during the Second Reading Speech on 18 June 1998. The Minister for Energy outlined the purpose of section 38 in the following way:

“The Government is well aware that the Western Australian community places a high priority on there being, wherever practical, uniform charges for water, electricity and gas, at the residential and small business end of the market. Currently for gas, some price variations exist between the south west and mid west distribution systems connected to the Dampier to Bunbury natural gas pipeline, and the stand alone Albany system and the Kalgoorlie system. However, within these systems uniform charges exist for gas to residential and small business consumers.

It is intended that when full competition in gas exists for south west and mid west residential and small business consumers, the existing “uniform tariff” approach will become a maximum delivered price approach.

The desired outcome is for all of these customers to be valued customers for the organisations competing for their business. This would be facilitated if there were a uniform cost of transporting gas via transmission and distribution systems. In assessing access arrangements under the code the regulator will be obliged to take into consideration these different costs as well as a variety of other factors in setting reference tariffs across each system.

For this reason [section 38] clarifies for the regulator that one of those factors to consider is the extension of effective competition in the supply of gas to domestic and small business customers. Acting independently, the regulator is therefore expected to give proper consideration to the impact reference tariffs may have on the supply of gas to the small consumer end of the market and to seek a pipeline tariff outcome that enhances competition between suppliers...The Government envisages such an outcome to provide for small consumers a single gas distribution tariff across an individual distribution area."³¹

It is apparent from the Second Reading Speech that Parliament's reason for including section 38 in the *Gas Pipelines Access (Western Australia) Act* was to ensure that you take into account the State Government's objective of maintaining reasonably uniform prices in the supply of gas to small business and residential consumers within the Mid-West and South-West areas of the State. To that end, Parliament required that you take into account the fixing of distribution and transmission tariffs which preserve, to the greatest extent possible, reasonably uniform retail market prices for small business and residential consumers. This would require that you consider fixing distribution and retail tariffs that apply reasonably uniformly across at least the Mid-West and South-West areas of the State.

The Minister for Energy stated that doing this would mean that all small business and residential consumers would be valued customers. In making this statement AlintaGas submits that the Minister was asserting that setting distribution and transmission charges on a uniform basis would mean that suppliers would be equally willing to compete for them regardless of their location. To use the words of section 38, the uniform charges would enable suppliers to compete for the custom of residential and small business consumers in a market in which reasonably uniform retail prices apply, thereby making possible the extension of effective competition for the supply of natural gas to those consumers.

It follows, therefore, that the purpose of section 38 is to require you to consider fixing distribution and transmission tariffs that are reasonably uniform so as to enable the maintenance of reasonably uniform retail tariffs across the State. As such, a distributor or transmission operator that proposes reference tariffs that are reasonably uniform in their application across the State will have complied with the objectives and purpose of section 38. As you are aware, AlintaGas's proposed reference tariffs B2 and B3 are uniform throughout the Mid-West and South-West areas of the State. AlintaGas submits that reference tariffs B2 and B3 are consistent with the purpose and objectives of section 38. You should accept the reference tariffs without requiring that reference tariff B3 provide a 2% net retail margin.

It follows from this that Parliament did not intend that the provision would have a broader operation. As such, a requirement for the provision of a 2% net retail margin for reference service B3, as outlined in paragraphs (IV) and (V) above, goes beyond the intent of section 38.

³¹ *Parliamentary Debates (Hansard)*, Thirty-Fifth Parliament First Session 1998, (Parliament House, Perth – 18 June 1998) at 4270.

Without derogating from the comments made above, AlintaGas submits that your interpretation is also incorrect for another important reason. In particular, the requirement for charges that will enable suppliers to compete for the custom of residential and small business consumers must be read in the context of the literal objective of section 38. That objective is expressed in section 38(2) as being the extension of effective competition in the supply of natural gas to small business and residential consumers. Accordingly, such charges must be charges that not only enable suppliers to compete for custom – they must also be charges that contribute to the extension of effective competition. In this sense, effective competition can be viewed as competition that is characterised by rivalrous conduct by two or more market participants coupled with the threat of market entry.³²

A requirement for a 2% net retail margin is only one way of addressing the literal objective of section 38. In fact, in AlintaGas's view, a requirement for a 2% net retail margin for each reference service is inappropriate. Due to the nature of retail gas markets, what is essential is that suppliers service a range of consumers, including small business and residential consumers and larger consumers. This requires that there be an overall net retail margin across the market that can sustain retailing operations. Suppliers do not require, and it is unnecessary for you to require, that each reference service provide a 2% net retail margin in order to induce to competition for the custom of small business and residential consumers.

AlintaGas submits that an overall net retail margin will produce sufficient incentive for retailers to compete for the custom of small business and retail consumers. This is the case despite the fact that reference tariff B3 will not return a 2% margin because the provision of an overall margin will, consistent with the operation of retail gas markets, provide incentives for parties to enter the market and supply gas to as many consumers as possible, including small business and residential consumers. In addition, the application of an overall margin will promote the extension of sustainable effective competition in the supply of gas to those consumers.

It is clear to AlintaGas that a decision to impose a 2% net retail margin for reference services B2 and B3 must be taken only after consideration of all means of achieving the literal objective of section 38 and an appropriate balancing of all relevant interests. This is particularly the case because the selection and weighting of alternative means of achieving the literal objective is a matter of judgment.

If you do not accept the submissions set out in this part of the Attachment and apply paragraphs (IV) and (V) of your interpretation, as outlined above, AlintaGas makes the submissions that follow. The submissions should not be taken as derogating from AlintaGas's submissions on the interpretation of section 38.

³² See *Butterworth's Encyclopedic Australian Legal Dictionary*; *TPC v Ansett Transport Industries Pty Ltd* (1978) 32 FFLR 305; *Ansett Transport Industries (Operations) Pty Ltd v The Commonwealth* (1977) 139 CLR 54.

4.3 THE ACHIEVEMENT OF A 2% NET RETAIL MARGIN

If you believe that it is necessary for retailers to have a 2% net retail margin for each reference service in each year of the access arrangement period, one way of contributing to that objective is to fix distribution reference tariffs at a level that provides a retailer with a 2% margin between forecast revenues and costs (including gas, transmission, retail and distribution costs). If retail tariffs are taken to be at the maximum levels permitted by government policy, this raises a question as what are the relevant costs to be considered in deciding whether a retailer is provided with a 2% margin.

If the relevant retailer costs are the current costs of the AlintaGas retail business, fixing distribution tariffs to provide the AlintaGas retail business with a 2% margin can only be achieved by reducing the value of the ICB for the Mid-West and South-West gas distribution systems. A reduction in the value of the ICB has an adverse effect on the legitimate business interests of AlintaGas.

There are ways in which AlintaGas's retail business can achieve a 2% net retail margin for each reference service. These include reducing the costs of retail operations and negotiating more favourable prices for gas purchase and gas transmission. The production and maintenance of the required margin is not, therefore, an objective that can only be brought about by fixing distribution reference tariffs and lowering AlintaGas's ICB. AlintaGas submits that you should take this into account before deciding to require an amendment such as Amendment 28 in the Final Decision.

More importantly, it is the case that the cost structures for new market entrant retailers will be different from the cost structure of AlintaGas's retail business. Indeed, as they are likely to already operate in other markets and have existing customer service facilities, new retailers will probably compete for customers on a marginal cost basis. Accordingly, the relevant costs for new retailers can be expected to be lower than those of AlintaGas's retail business. Flowing from this, it may already be the case that AlintaGas's proposed reference tariffs provide new retailers with a 2% margin for each reference service. As an example of this, AlintaGas notes that retailers that are proposing to supply gas into the distribution system from CMS's Parmelia Pipeline³³ are likely to have gas purchase and gas transmission costs that are lower than those for retailers supplying gas into the distribution system from the DBNGP. These retailers may already achieve 2% margins for each reference service.

AlintaGas submits, therefore, that any consideration of retail market costs must be undertaken by reference to the gas purchase, gas transmission and retail costs that would be incurred by new market entrants - not AlintaGas. As the central issue in your determination of the ICB appears to concern the public interest in having competitive markets and in extending competition in the supply of natural gas to small business and residential consumers under section 38, AlintaGas submits that the retail costs that you should consider are those that will be incurred by a prospective retailer. If, as AlintaGas believes, these costs are lower than AlintaGas's retail costs, AlintaGas's retail margins are irrelevant to extending

³³ AlintaGas and CMS are currently negotiating an agreement for the interconnection of the distribution system and the Parmelia pipeline.

competition. In these circumstances there is no case for reducing the ICB of the AlintaGas distribution business to lower distribution reference tariffs and provide AlintaGas with net retail margins of 2%. AlintaGas submits that this is a fundamental issue that you must take into account before deciding to require Amendment 28 in the Final Decision.

4.4 THE WEIGHT GIVEN TO SECTION 38

In the reasons for decision, you attach significant weight to section 38. As a consequence, you seem to make section 38 the primary consideration in establishing the ICB, driving as it does the particular requirement for a 2% net retail margin for each reference service, particularly reference service B3. The weight you attach to section 38 appears to stem from a view that section 38 imposes a “specific obligation” and that you are obligated to fix charges to achieve the objectives of section 38.³⁴

AlintaGas submits that you have unreasonably attached too much weight to the factors you are required to consider under section 38. As a consequence, you have failed to give appropriate weight to other factors that you are required to consider under section 2.24. Consistent with this, AlintaGas submits that you should give other factors, including the legitimate business interests of AlintaGas, greater weight than you did in deciding to include Amendment 28 in the Draft Decision with the result that you do not require that reference tariff B3 provide a 2% net retail margin.

AlintaGas asserts that you have given section 38 unreasonable weight for the following reasons:

- (a) As noted above, you refer to section 38 as imposing a “specific obligation”. While it is not entirely clear what you mean by this, AlintaGas assumes that you mean that the obligation is “specific” in the sense that it appears in the *Gas Pipelines Access (Western Australia) Act*, rather than the Code that is set out in Schedule 2 of that Act.

AlintaGas is aware of a view that section 38 is a more important consideration than other considerations set out in the Code because it appears in the Act, rather than the Code in Schedule 2. It follows from that view that section 38 should be given more weight than other considerations that are specified in the Code.

AlintaGas submits that such a view is incorrect. The fact that the provision is a section of the Act, rather than part of Schedule 2 is not relevant to any consideration of the weight that should be attached to it. AlintaGas submits that the provision appears in the Act because, due to procedural difficulties associated with amending the Code, it was easier for the Parliament to include the provision in the Act than the Code.

More importantly, giving precedence to the provisions of the Act at the expense of the Schedule to the Act is based on an implicit assumption that a schedule of an Act is inferior to the Act itself. AlintaGas submits that this is

³⁴ Part B, at 83.

wrong as a matter of law³⁵, and that section 38 should be read as having no greater weight than the Code contained in Schedule 2.

Based on this, AlintaGas submits that the reasons for decision disclose, by referring to a “specific obligation”, that you have attached unreasonable weight to section 38.

- (b) As noted above, section 38(1) provides that your obligation under section 38 applies when you are considering the public interest as part of assessing an access arrangement to determine whether to approve it. That situation arises under section 2.24, which provides that you must take the following into account:
- I. the Service Provider's legitimate business interests and investment in the Covered Pipeline;
 - II. firm and binding contractual obligations of the Service Provider or other persons (or both) already using the Covered Pipeline;
 - III. the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline;
 - IV. the economically efficient operation of the Covered Pipeline;
 - V. the public interest, including the public interest in having competition in markets (whether or not in Australia);
 - VI. the interests of Users and Prospective Users;
 - VII. any other matters that the Relevant Regulator considers are relevant.

Thus, section 38 is a factor that must be considered in the context of the public interest along with six other relevant factors that you are obligated to consider. In undertaking that consideration, consistent with the comments made in paragraph (I) above, section 38(1) should not be given more weight than the other six factors merely because it appears in the Act. Thus, you should seek to balance, in particular, the interests of AlintaGas and the public interest in the matters outlined in section 38 before making a decision.

Based on its reading of the reasons for decision, AlintaGas submits that you did not do this. Rather than considering the interests of AlintaGas and the public interest represented by section 38 together, you attached significant weight to section 38. The reasons for decision indicate that your primary task was to achieve the objectives of section 38. Your consideration of AlintaGas's interests was limited to a review as to whether achieving the section 38 objective, as you perceived it, would have the result of lowering AlintaGas's credit rating below investment grade.

A balanced and full review of AlintaGas's interests, conducted in parallel with (rather than as subordinate to) your consideration of section 38, would have resulted in a different balance of interests. In particular, AlintaGas's legitimate interests in having an ICB of sufficient value would, AlintaGas

³⁵ Pearce, D C, and Geddes, R S, *Statutory Interpretation in Australia*, Fourth Edition (Butterworths, North Ryde – 1996) at 18.

submits, cause you to not require a 2% net retail margin in the Final Decision and to approve an ICB of \$539.4 million.

- (c) The obligation imposed by section 38(2) is an obligation to “take into account” the fixing of “appropriate charges”. It is not an obligation to “fix the appropriate charges”. That this is the case reflects the structure of section 2.24 of the Code, which also imposes an obligation to “take into account” various other factors.

There is, therefore, no requirement upon you to actually fix appropriate charges if your consideration of the factors under section 2.24 leads you to the conclusion that you should not. For example, you are free to conclude that the interests of AlintaGas can require that you not fix the charges in a particular way.

If there is any doubt about the degree of your discretion to not fix appropriate charges, it is instructive to consider the Second Reading Speech for the *Gas Pipelines Access (Western Australia) Act*, during which the Minister for Energy stated:

“For this reason [section 38] clarifies for the regulator that one of those factors to consider is the extension of effective competition in the supply of gas to domestic and small business consumers.”³⁶ [emphasis added].

It follows from this that you may also decide to fix charges that achieve the objectives of section 38 only in part.

In contrast, the reasons for decision suggest that you believe that you are under an obligation to actually fix “appropriate charges”. The fact that you hold such a view suggests that you have given unreasonable weight to section 38 at the expense of other factors you are bound to consider under section 2.24, the most notable of which is the interests of AlintaGas. AlintaGas submits that you must, therefore, reconsider all elements before issuing the Final Decision.

AlintaGas further submits that the factors noted above also indicate that you did not reasonably balance the interests of AlintaGas and other participants in the gas market. As discussed above, those participants (in particular retailers) are in a position to contribute to the achievement of a 2% margin in a number of ways.

In considering net retail margins, AlintaGas took into account its legitimate business interests³⁷, the economically efficient operation of its distribution network³⁸, the public interest in having competition in markets³⁹ and in extending effective competition in the supply of natural gas to small business

³⁶ *Parliamentary Debates (Hansard)*, Thirty-Fifth Parliament First Session 1998, (Parliament House, Perth – 18 June 1998) at 4271.

³⁷ Section 2.24(a).

³⁸ Section 2.24(d).

³⁹ Section 2.24(e).

and residential customers⁴⁰, and the other factors listed under section 2.24 of the Code. In doing so, AlintaGas determined a reasonable balance between the interests of all gas market participants – producers, transmission operators, AlintaGas, users and prospective users, and consumers. It also considered what might reasonably be achieved by its retail business. That balance of interests was reflected in the ICB value proposed by AlintaGas in accordance with its Optimised Deprival Value (“ODV”) methodology.

Your decision to require a 2% net retail margin for each reference service by means of a reduction in the ICB means that AlintaGas is the only gas market participant required to contribute to the increased net retail margin. Other parties, such as gas producers, other transmission operators, users and prospective users will not be required to contribute to margins that you consider appropriate in the retail sector of the gas market once proposed retail price caps have been imposed. In effect, AlintaGas will be the only party in the market to be “squeezed” in order to produce the retail margins you believe are necessary for the implementation of the policy requirement of section 38. AlintaGas submits that the subordination of its legitimate business interests in this way is unreasonable.

AlintaGas’s difficulties with your decision in relation to the balance between AlintaGas’s legitimate business interests and the interests represented by section 38 and the interests of other gas market participants are exacerbated by the fact that the some retailers may already be capable of earning a 2% net retail margin under each reference tariff. The reasons for this are discussed above.

In considering this submission, AlintaGas requests that you take particular note of the fact that in proposing the ICB of \$530.3 million AlintaGas had voluntarily written down the ICB value from the DORC value of approximately \$700 million, a reduction of approximately \$170 million.⁴¹ In doing this, AlintaGas had of its own accord taken the position that it should contribute to pursuit of the evolution of competition in retail markets on a reasonable basis. This fact was expressly recognised by Australian Energy Advisers in its submission. They stated that:

“The recognition that a network operator is not necessarily justified in seeking the maximum possible notional asset value and the maximum possible return on assets is admirable, (and a ground breaking first in Australia).”⁴²

AlintaGas is disappointed that you have not recognised the same and that you now seek to further reduce the ICB whilst other market participants are not expected to contribute to the development of competitive markets.

⁴⁰ Section 38, *Gas Pipelines Access (Western Australia) Act*.

⁴¹ AlintaGas’s response on the DORC appears below.

⁴² Australian Energy Advisers, *Access Arrangement for the AlintaGas Gas Distribution Network Proposed By AlintaGas July 1999 Submission Made by Australian Energy Advisers*, (www.offgar.gov.au – 5 August 1999) at 8.

4.5 SHIFT IN REVENUE

AlintaGas is puzzled by your remarks about a shift in revenue between the distribution and retail business.

Information was provided to you by AlintaGas about the margins used for modelling purposes. The information appears to have led to a misconception that any reductions in margins were assumed to be totally absorbed in increased distribution revenues. That is not the case.

AlintaGas used a number of assumptions in modelling the effect of the proposed reference tariffs and competition. One of the most significant assumptions was that retail prices would decrease for certain tariff classes as a result of contestability to a point where they would reflect the costs of distribution, gas, transmission and retail, plus a retail margin. Thus, reductions in margins at contestability were largely the result of assumptions regarding reducing retail prices. They were not due to a shift in revenue from the retail to the distribution business. The evidence to support this lies in the fact that the distribution tariffs are only a function of returns on and of capital, capital costs and non capital costs.

4.6 CALCULATION OF RETAIL COST ELEMENTS

As noted above, the reasons for decision indicate that you have concerns about the way in which AlintaGas calculated certain retail cost elements in applying the ODV methodology. AlintaGas would be pleased to discuss these matters with you prior to the issue of the Final Decision.

4.7 DEPRECIATED OPTIMISED REPLACEMENT COST

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

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

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

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

As mentioned in the GHD report, the adopted optimisation was based on a system built using modern engineering equivalent assets and complying with industry best practice standards, including standards for security of supply.

GHD has confirmed that the standards used for the design and construction of the distribution assets within AlintaGas are appropriate, comply with the relevant Australian standards, and are similar to standards used by all other gas businesses in Australia.

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

- (b) The asset list included low-pressure systems only for the purpose of identifying the existing systems. As described in the GHD report, all low-pressure system networks were optimised to operate at medium pressure. Also, as discussed above all low and low medium pressure systems are currently operating at capacity and there are limited opportunities for further optimisation in these systems.
- (c) The five year growth projection was based on Ministry of Planning data and historical usage records from AlintaGas's Retail Marketing & Sales division. The growth projection was the same as that adopted by AlintaGas's marketing department for the purpose of retail marketing strategies.
- (d) The unit rates adopted were generally comparable to those adopted by other utilities after taking into consideration locational and geographical factors.
- (e) The unit rates for "brown-field" replacement of domestic services and meters used in the valuation, were appropriate and compatible with rates applied elsewhere in Australia. The unit rates used for capital expenditure budgeting purposes were generally appropriate for those works in the newer subdivision areas, where the majority of new connections occur. Those rates are not generally representative of brown-field conditions that affect the installation of new assets, as used in the DORC valuation.
- (f) The diversified consumption figures for residential and small commercial customers were derived from a 1999 load survey conducted for the distribution system, using results evaluated from flow and pressure data logging equipment located in the surveyed network areas. The field results corresponded closely with the diversified figures used in AlintaGas's computer modelling of the system and also with surveys conducted in previous years.

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

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

- (a) Temperature variation generally has more significant impact on transmission pressure systems than on distribution systems and has relatively minor impact

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

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

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

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

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

Attachment E

Amendment 29 – Capital Expenditure

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 29

In general, you consider that the forecast new facilities investment is inadequately substantiated in terms of the requirements set out in section 8.16 of the Code. Notwithstanding this, you accept that new facilities investment of the nature proposed by AlintaGas may meet the requirements of section 8.16(b) of the Code, in respect of net benefits accruing from that investment.

You accept AlintaGas’s proposed new facilities investment for the purposes of determining reference tariffs, but have revised it downwards to reflect unit rates considered to be consistent with efficient costs.

2. GENERAL COMMENTS

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

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

In that light, AlintaGas believes that it is proper and necessary for you to consider the comments set out below. Given AlintaGas’s ODV methodology, AlintaGas would propose to discuss with you the impact of forecast new facilities investment prior to the issue of the Final Decision.

3. SPECIFIC COMMENTS

3.1 RE-LAYING PROGRAM

In the reasons for decision under the heading “Re-laying program”, you state that:

“The galvanised steel mains re-laying program has not been approved by the AlintaGas Board at the time of submission of the Access Arrangement, and AlintaGas has not provided justification for the proposed expenditure. On this basis, the Regulator considers that AlintaGas has not demonstrated that the proposed expenditure for the galvanised steel medium/low pressure mains re-laying program would be invested by a prudent Service Provider acting efficiently, in accordance with accepted good industry practice, and to achieve the lowest sustainable cost of delivering Services, as required by section 8.16(a) of the Code.

The Regulator considers that AlintaGas has failed to adequately justify the proposed Capital Expenditure for the relaying program in terms of the requirements of section 8.16 of the Code. However, given that the proposed

expenditure is intended to reduce unaccounted for gas, and has been proposed on the basis of several reports, the Regulator is prepared to accept the proposed expenditure for the purposes of the Access Arrangement and determination of Reference Tariffs.”

Notwithstanding, the comment, that you are “prepared to accept the proposed expenditure for the purposes of the Access Arrangement and determination of Reference Tariffs”, you have reduced the proposed new facilities investment for the relaying program by \$6.8m over the period of the Access Arrangement. AlintaGas submits that this is unreasonable.

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

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

- (a) AlintaGas considers that the relaying or replacement of ageing parts of the network is in accordance with good industry practice and is a normal part of a prudent service providers ongoing capital works program;
- (b) The program is considered essential for minimising gas losses, and thereby minimising the environmental impact of the network, improving the overall integrity of the network and ensuring public safety;
- (c) The redundant parts of the network are generally operated at low pressures to minimise losses and the relaying program allows the upgrading of these systems to medium pressure and for the connection of more customers. Without such a program further customer connections to these parts of the network would not be possible; and
- (d) The current cast iron relay program was extended to 2008 after subsequent investigations indicated that it was prudent to include the replacement of galvanised and unprotected steel mains and services that were considered to be in poor condition.

AlintaGas has reasonably forecast the ongoing replacement of ageing parts of the system and strongly objects to the \$6.8 million reduction of new facilities investment in relation to the relaying program.

3.2 MAINS EXTENSIONS FOR NEW CUSTOMERS

You have stated that you do not consider that AlintaGas has adequately demonstrated that the proposed unit rate is consistent with efficient costs. You have adjusted the proposed rates by taking the historic unit rates and adjusting them for inflation.

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

AlintaGas does not agree with your methodology. Firstly, it is AlintaGas’s view that the your approach is inappropriate as it is based on historic rates which do not always serve well as a guide to future costs. AlintaGas submits that you should not

rely solely on historic rates. The fact that certain unit rates may have been incurred in the past does not mean that they will be incurred in the future. For that reason, in accordance with sound financial practice, AlintaGas did not rely solely on historic unit rates in determining forecast new facilities investment.

AlintaGas has already provided information to OffGAR to support MP/LP unit rates. That information indicated that historical rates for MP/LP Mains laying are not good indicators of future laying rates. It also clearly shows that laying rates vary considerably.

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

- (a) ground conditions;
- (b) location (that is, rural versus urban);
- (c) laying technique (that is, whether common trenching is used)
- (d) the mix of anticipated work between periods; and
- (e) contingency for increases in unit rates.

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

AlintaGas also contends that CPI is not the only factor to affect the cost of laying the pipes. For example:

- (a) recent increases in the price of raw materials has resulted in increases in prices for PVC and PE pipe and fittings ranging from 20% to 54%; and
- (b) rates for laying of mains by common trenching contractors are yet to be finalised, as rate increases requested by the contractors are yet to be negotiated.

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

AlintaGas submits that your approach of basing MP/LP Mains new facilities investment on an historic unit rate is not appropriate. A prudent service provider acting in accordance with the requirements of the efficiency test under section 8.16 would base its proposed investment on the factors considered by AlintaGas. You should, therefore, accept the proposed new facilities investment for MP/LP Mains proposed by AlintaGas.

Attachment F

Amendment 30 – Non Capital Costs

1. GENERAL COMMENTS

AlintaGas acknowledges that the assessment of forecast non-capital costs for compliance with section 8.37 requires that judgments be made about a wide range of matters. As a result, AlintaGas accepts that it is open for you to reach conclusions about forecast non-capital costs that are inconsistent with AlintaGas's views about forecast new facilities investment.

AlintaGas does not, however, accept that your conclusions are reasonable or have been arrived at on a reasonable basis. AlintaGas did not put forward an "ambit claim" with respect to forecast non-capital costs and submits that its proposal was reasonable, arrived at on a reasonable basis and is accordance with section 8.37.

In that light, AlintaGas believes that it is proper and necessary for you to consider the comments set out below. Given AlintaGas's ODV methodology, AlintaGas would propose to discuss with you the impact of forecast non-capital costs prior to the issue of the Final Decision.

2. SPECIFIC COMMENTS

2.1 **PRODUCTIVITY/EFFICIENCY GAINS HIGHLIGHTED IN THE PA BUSINESS EFFICIENCY REVIEW**

The reasons for decision refer to a *Business Efficiency Review* report written by PA Consulting Group. The report identified the potential for reductions in the level of non-capital costs in AlintaGas's distribution business. In the reasons for decision you noted that AlintaGas had incorporated those reductions into its determination of proposed reference tariffs.

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

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

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

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

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

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

The level and timing of the savings attributable to the implementation of efficiency gains was identified and discussed by PA Consulting in its independent expert report entitled *Review of operating And Maintenance Costs*.⁴³ PA Consulting signed off on the report by concluding that it believed that the forecast non-capital costs proposed by AlintaGas in the Access Arrangement (including the implementation of the proposed reductions identified in the *Business Efficiency Review* report over a five year period) met the requirements of section 8.37 of the Code.

AlintaGas believes that your proposal to implement the PA Consulting gains in 3, rather than 5 years, is unreasonable.

You appear to have ignored PA Consulting Group's independent *Review of Operating and Maintenance Costs* even though it was based on a more detailed review of non-capital costs than the *Business Efficiency Review*. AlintaGas submits that you should have regard to, and accept, the findings of the later and

⁴³ Dated 29 March 1999, at Appendix D.

more detailed report and require that the efficiency gains be implemented over 5, rather than 3, years.

2.2 OPEN ACCESS MANAGEMENT

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

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

2.3 BILLING AND CUSTOMER PROFILING

Based on the reasons for decision it is not clear that you have appreciated the reason as to why AlintaGas will need to incur “billing and customer profiling” non capital costs. It is also clear that you have not understood the likely magnitude of these costs.

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

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

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

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

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

2.4 UNACCOUNTED FOR GAS

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

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

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

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

- (a) Replacement of the cast iron system enables AlintaGas to increase capacity by upgrading areas to medium pressure. Such upgrades are required to provide additional capacity to cater for urban infill (unit developments, subdivision of blocks, etc.) as well as the general increases in per household gas consumption. As a result of the increased pressure, the leakage rate will increase in the remaining areas of the network.
- (b) It should be appreciated that there is a significant uncertainty in both the calculation of UAFG and the factors driving it. Whilst the published figures may seem fairly constant there are large variations in UAFG on a month to month basis and this is a good indication that the calculation has a high uncertainty, possibly in the range of +/- 10-20 %.
- (c) One significant factor not in AlintaGas’s control is fluctuations in HHV. This is due to the proliferation of gas suppliers and field sources experienced in recent years, widening of gas quality limits, increased flows for the new entrants and the commissioning of new gas sources for the established players. This has completely changed the previous picture of almost constant gas quality and has had a significant impact on DBNGP measurement uncertainties and UAFG. This is likely to deteriorate further in the near future with the commissioning of the interconnection with the Parmelia Pipeline which introduces a new gas supply with a significantly differing HHV and is likely to further increase measurement uncertainty.

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

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

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

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

State	South Australia	Victoria	New South Wales	Queensland	AlintaGas ⁴⁴		
Year	1997	1997	1997	1997	1996	1997	1998 ⁴⁵
UAFG [GJ/km]	241	188	150	287	64.4	69.0	71.8

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

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

2.5 ADDITIONAL COSTS

Since the forecasts of non capital costs were prepared, a number of additional costs have become apparent which will be borne by AlintaGas's distribution business which are clearly associated with the delivery of reference services. None of these costs were included in the Access Arrangement forecasts of non capital costs.

⁴⁴ Based on mains lengths of 9,586, 9795 and 10,125 kilometres respectively.

⁴⁵ Data for the financial year 1997 - 1998 as data for the calendar year 1998 cannot yet be calculated

The more significant of these costs include:

- (a) GST implementation costs;
- (b) costs associated with the development of the current Access Arrangement;
- (c) costs for interconnection of other distribution or transmission systems; and
- (d) settlement and system issues.

These costs should be taken into consideration when you recommend reductions in non capital costs or the imposition of even further efficiency improvements.

2.5 CONCLUSION

As a result of the facts discussed above in relation to the implementation of the efficiency reviews over 5, rather than 3 years, the facts presented in relation to unaccounted for gas levels and the likelihood of AlintaGas bearing additional non capital costs which were not incorporated into the Access Arrangement, AlintaGas submits that you should accept its forecast non capital costs.. To not do so allocates all risk to AlintaGas rather than equitably among all stakeholders.

Attachment G

Amendment 31 - WACC

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

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

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

Your comments that:

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

are both incorrect.

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

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

Attachment H

Amendment 34 – Revised Total Revenue

1. GENERAL COMMENTS

AlintaGas objects to Amendment 34 and submits that you should not require such an amendment in the Final Decision.

2. GROUND FOR OBJECTION

AlintaGas objects to Amendment 34 for the following reasons:

- (a) the major differences in return on capital and depreciation, as determined by you and as determined by AlintaGas result from differences in the ICB; and
- (b) as AlintaGas has objected to the reduction in ICB contained in Amendment 28, the flow-on effect of this is that Amendment 34 should also be removed from the Final Decision.

3. EXPLANATION OF GROUNDS FOR OBJECTION

The Total Revenue requirements for the period 2000 to 2004 specified in Amendment 34 are, for each year, determined as the sum of four components: return on capital, depreciation, return on working capital, and non-capital costs.

The major differences in return on capital as determined by AlintaGas, and as determined by you and set out on page 156 of Part B the Draft Decision, result from differences in the Initial Capital Base.

For the reasons given above in relation to Amendment 28 AlintaGas objects to the reduction of the Initial Capital Base as required by Amendment 28, and submits that the Final Decision should not require such an amendment. If Amendment 28 is not required in the Final Decision, the return on capital in each year of the access arrangement period will not be the figure shown on page 156 of the Draft Decision. In addition, it will not be the figure included in the sum of components of Total Revenue set out in Amendment 34. Accordingly you should not require Amendment 34 in the Final Decision.

As noted above in relation to Amendment 32, the major differences in depreciation as determined by AlintaGas, and as determined by you (and set out in the reasons supporting Amendment 32), also result from differences in the level of the Initial Capital Base.

For the reasons given in relation to Amendment 28, AlintaGas objects to the reduction of the Initial Capital Base, and submits that the Final Decision should not require such an amendment.

Attachment I

Amendment 36 – Reference Service A Tariff Structure – Distance Charges

1. GENERAL COMMENTS

AlintaGas objects to Amendment 36 and submits that you should not require such an amendment in the Final Decision.

2. GROUND FOR OBJECTION

AlintaGas objects to Amendment 36 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) as the price difference is only applied for each kilometre greater than 10km, on an incremental basis, it does not produce a ratio of 2:1 in terms of overall price; and
- (b) the price ratio for an average customer who is greater than 10km from the transmission line is in the order of 0.7, which is within the range recommended by Connell Wagner.

3. EXPLANATION OF GROUNDS FOR OBJECTION

3.1 OBJECTIVE OF WEIGHTING FOR DISTANCE

The objective of adopting a declining block structure with two distance based blocks was to provide better cost reflectivity in the tariff. It was estimated that delivery points that are greater than 10km from the nearest Transmission line are usually delivery points in urban fringe and rural areas, where the costs of laying pipelines is significantly cheaper than pipe laying in more densely populated areas.

The cost differential of 0.5 (or a ratio of 2:1), was arrived at after mainly considering the differential in construction costs. However, AlintaGas believes that prices are fairly weighted and give an overall result which is acceptable.

3.2 PRICE EFFECT OF WEIGHTING

The block weighting provides some difference in price for users who are greater than 10 km from the nearest transmission line to reflect the construction costs difference. However, the difference in price is only applied on a marginal basis (that is, for each km greater than 10km). Users greater than 10km pay the <10km price for the first 10 km and then a reduced price thereafter. The result of this is that it does not produce a 2:1 ratio in terms of overall price.

The table below provides a comparison of charges (excluding standing charges) for notional Tariff A customers with the same volume and maximum hourly quantity ("MHQ"), at distances of 10, 20 and 25 km from the nearest transmission

line. The average distance from a transmission line for delivery points located greater than 10km from a transmission line is approximately 25km.

**Price per \$/GJ (Demand & Usage only) for Users at 10, 20 & 25km
Volume, 100GJ/pa and MHQ, 35GJ/hr.**

	10km	20km	25km
\$/GJ	.877	1.315	1.534
Distance Ratio (to 10km)	N/a	2:1	2.5:1
Price Ratio (to 10km)	N/a	1.5:1	1.75:1
Distance Ratio/Price Ratio		1.33:1(.75)	1.43:1(.70)

The above table applies the 0.5 (or 2:1) price ratio between less than 10 km and greater than 10 km for users 20 km and 25 km from the transmission line. The table demonstrates that due to the marginal operation of the charge, an actual price ratio of 0.75 (1.33:1) or 0.7 (or 1.43:1) results. This figure is within the range of appropriate ratios suggested by Connell Wagner.

AlintaGas therefore submits that the price differential proposed in the Access Arrangement achieves the desired outcome of the tariffs being more cost reflective, and should therefore remain unchanged.

Attachment J

Amendment 37 – Gas Distribution Costs under Reference Service A and the Gas Distribution Regulations

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 37

The Draft Decision states that you consider that large changes in average costs of gas distribution in the transition from the *Gas Distribution Regulations 1996* (“GDRs”) tariff to reference service A tariff are inconsistent with equity considerations for Users. You, therefore, require Amendment 37.

You recognise that Amendment 37 may not, in itself, be accomplished in a manner that is revenue neutral for AlintaGas and that consideration may need to be given to transitional arrangements in cost allocation.

2. GENERAL COMMENTS

AlintaGas believes that reference tariff A will not have an effect on the current delivered price of gas to customers supplied by users of reference service A. However, AlintaGas acknowledges that the prices payable by users for gas haulage under reference tariff A may, in some cases, be higher than prices that those users would have anticipated paying had GDRs prices continued in existence.⁴⁶

AlintaGas previously provided information to you in relation to the validity of comparing GDR haulage prices with haulage prices determined in accordance with the Code. In providing that information AlintaGas argued that there are compelling policy reasons as to why you should not undertake such comparisons. In addition, AlintaGas expressed the opinion that it did not believe that the introduction of reference tariff A haulage prices would have an effect on current delivered gas prices.

AlintaGas believes that the arguments previously put before you are correct and that you should not be concerned about the transition from GDR pricing to reference tariff A prices. As such, you should not require Amendment 37.

However, to the extent that it is reasonably possible, AlintaGas also believes that it is important to address perceived issues of equity for users in relation to the transition from GDR prices to reference tariff A. Therefore, while AlintaGas does not resile from its position as to the correctness of its arguments in relation to this matter, and indeed reserves its rights in this regard, it is prepared to explore the development and implementation of a reasonable transitional arrangement.

AlintaGas’s views as to the key elements of a reasonable transitional arrangement are set out below.

⁴⁶ The GDRs will be repealed upon the commencement of the Access Arrangement: Schedule 3 of the *Gas Pipelines Access (Western Australia) Act 1998*.

3. IMPORTANT FACTORS FOR CONSIDERATION

Before outlining the key elements of a reasonable transitional arrangement, it is important to take a number of factors into account.

3.1 REFERENCE TARIFF A CHARGES

AlintaGas acknowledges that the charges calculated under reference tariff A may, in some cases, be higher than those calculated under the GDRs. Whether this means that end consumers would pay more for delivered gas is an open question - however, it is AlintaGas's view that they would not.

The higher distribution charges obtained by applying the reference tariff principles of the Code are more cost reflective than the tariffs under the GDRs. AlintaGas has previously provided detailed information to OffGAR in relation to this issue.

The reference tariffs of the Access Arrangement have been structured to provide a rational basis for recovery of all distribution system costs. In this respect, they are unlike the existing retail tariffs which (as AlintaGas has previously described to OffGAR) are not reflective of AlintaGas's cost structure. Furthermore, the reference tariffs are not, unlike the GDR tariffs, directed at cost recovery for only a part of the distribution system. The reference tariffs have been designed to recover the costs of all parts of the system. AlintaGas would, therefore, caution against undue focus on one particular reference tariff - reference tariff A – and the components of that tariff.

3.2 1998/99 GDR PRICES

In comparing the reference tariff A prices to the last published GDR price, it must be pointed out, that the GDR prices used in the comparison related to the 1998/99 year. The last price re-determination undertaken under the GDR regime occurred in July 1998.

It is relevant to point out that a subsequent GDR price re-determination was not undertaken due to the impending implementation of the Access Arrangement. The decision to not undertake a re-determination balanced the interests of users and AlintaGas and was intended to minimise costs, avoid dedication of resources to a regime which was to be superseded and avoid confusing prospective users by publishing GDR prices which were different than those contained in the Access Arrangement.

Whilst AlintaGas accepted the 1998/99 prices would apply for an extended period, it was an interim arrangement which was to be formalised the making of regulations to amend the *Gas Distribution Regulations*. AlintaGas understands that the Office of Energy is close to finalising the amending regulations.

AlintaGas submits that this was a practical approach, which generally achieved the outcomes proposed. However, it should not compromise any comparison to the proposed reference tariff A prices. AlintaGas has continued to invest capital in the high pressure network and this should be factored in to any comparison.

In support of the comparison, AlintaGas has undertaken a preliminary price re-determination to establish the GDR prices that it believes would be applicable for 2000/2001. It indicates that GDR prices would have conservatively increased by approximately 19% from 1998/1999 to 2000/2001.

AlintaGas, therefore, submits that the revised prices should be used in any comparison.

3.3 EXPECTATIONS OF PROSPECTIVE USERS

As highlighted above, the last GDR price re-determination was published in August 1998. As AlintaGas's proposed Access Arrangement was submitted and made publicly available in July 1999, it provided prospective users with a clear indication of future access prices. This should have affected expectations about the continuation of future GDR prices.

AlintaGas submits that the practical approach adopted in relation to the GDR price re-determinations clearly avoided heightening price expectations. The proposed prices have now been in the public domain for some 10 months. In addition, the majority of users should be well aware of the adoption of the Code and the principles contained therein. AlintaGas believes that prospective users would have been aware of the substantial differences in the pricing regimes and that user expectations should have been based on the Access Arrangement prices.

4 ALINTAGAS'S PROPOSAL

The key elements of a reasonable transitional arrangements are as follows:

- (a) It would apply for a 2 year period;
- (b) Standing charges for reference tariff A would be discounted by 100% in year 1, 50% in year 2 and be fully applied for year 3 and thereafter;
- (c) The discount in standing charges would be applied only to the extent that the price payable by a user under reference tariff A is greater than the estimated 2000/2001 GDR price. In instances where users are within close proximity of a transmission line a 100% waiver of the standing charge would result in reference tariff A being below the GDR price;
- (d) The "discount" to reference tariff A would be a discount on the published reference tariff A and, although not revenue neutral to AlintaGas, would not result in a reduced Initial Capital Base; and
- (e) The discount would apply only to delivery points from which contestable customers are supplied with gas on the date of the commencement of the Access Arrangement. "Contestable customer" has the meaning given to it in section 92 of the *Gas Pipelines Access (Western Australia) Act 1998*.

Attachment K

Amendment 39 – Retail Margins for Reference Services B2 and B3

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 39

The reasons for decision indicate that the basis for Amendment 39 is as follows:

- (a) Section 38 of the *Gas Pipelines Access (Western Australia) Act*⁴⁷ applies to the delivery of gas under reference services B2 and B3.
- (b) You have:

“...interpreted the obligations of section 38 of the Act as requiring that the level and structure of distribution tariffs for Reference Services B2 and B3 are consistent with a retail market in the supply of gas that is sufficiently large to enable gas traders to enter the market for gas supply to small-business and residential customers”.⁴⁸
- (c) Reviews by the Independent Pricing and Regulatory Tribunal (“IPART”) have contemplated a “gross retail margin” of 6.6% as being appropriate for the NSW electricity industry, and a “net retail margin” of 2% as being appropriate for the NSW gas industry.
- (d) Prices for the supply of gas to small business and residential customers are regulated under the *Gas Corporation (Charges) By-Laws 1996*.⁴⁹ While regulated retail prices for gas remain in force, retail margins and consequences for contestability and competition in retail gas markets will be an ongoing matter of concern for in the regulation of distribution tariffs.
- (e) Your analysis shows that retail margins for reference service B3 are relatively high for the first 15 GJ/a of gas delivered. For the 15 – 30 GJ per annum gas quantity block, the gross retail margin is 1%. For gas quantity blocks of 47 to 100 GJ/a and greater than 100 GJ/a, the gross retail margin is negative. The total gross margin declines with increasing gas consumption, becoming negative for gas consumption of greater than 100 GJ/a.

⁴⁷ The operation of section 38 of the Act is discussed in detail in relation to Amendment 28 concerning the ICB.

⁴⁸ Part B, at 186.

⁴⁹ AlintaGas notes that the Gas Corporation (Charges) By-Laws 1996 (“the By-Laws”) were made by AlintaGas pursuant to section 124 of the *Energy Corporations (Powers) Act 1979*. Once the By-Laws are made they must be approved by the Governor and published in the Gazette. The By-Laws will be repealed upon the proposed sale of AlintaGas. At that time, the State Government is expected to introduce tariff cap regulations that apply to all trading licensees in respect of the sale of gas to “small use consumers”, as that term is defined in the *Energy Coordination Act 1994*. The tariff cap regulations are planned to perpetuate caps at existing retail price levels for the sale of gas (but not for ancillary services) until 2002 for business consumers and indefinitely for residential consumers. The level of price increases will be generally consistent with the increases discussed in the Draft Decision, save that there will be no regulation of average prices and that there will be an allowance for the impact of GST.

- (f) You consider that low or negative retail margins for certain gas quantity blocks in the supply of gas to residential customers under Reference Service B3 would impede the development and continuation of effective competition, particularly for residential consumers consuming more than 45 GJ/a. This is consistent with your interpretation of what section 38 of the Act requires.

2. GENERAL COMMENTS

AlintaGas strongly objects to Amendment 39 and submits that you should not require such an amendment in the Final Decision. The reasons for AlintaGas's response, which are based on its understanding of the reasons for decision, are set out below. If AlintaGas's understanding of the reasons for decision is incorrect, AlintaGas's response to Amendment 39 may change.

3. GROUNDS FOR OBJECTION

AlintaGas objects to Amendment 39 for the following reasons:

- (a) Amendment 39 is uncertain because it does not state with sufficient specificity the amendment (or the nature of the amendment) that you require and, therefore, does not satisfy the requirements of section 2.13(b). The uncertainty arises in the following respects:
 - I. Amendment 39 refers to "reasonable retail margins" without indicating what you consider to be reasonable; and
 - II. Amendment 39 refers to "reasonable retail margins" but does not specify whether you mean "gross retail margins" or "net retail margins", or both, as those terms are defined in the reasons for decision.
- (b) For the reasons set out in its response to Amendment 28 in relation to section 38, AlintaGas submits that you should not require that AlintaGas amend reference tariff B3 to provide for a positive gross or net retail margin.
- (c) Whereas section 38 is concerned with the class of consumers known as small business and residential consumers, you apply section 38 in relation to particular residential consumers and particular gas quantities.
- (d) It is unreasonable for you to require that AlintaGas amend reference tariff B3 to provide a positive retail margin for every residential customer, regardless of the level of gas that the customer consumes.
- (e) You should take into account the fact that there are other ways in which AlintaGas's retail business can contribute to the achievement of the perceived objective of a positive retail margin for every residential customer, regardless of the amount of gas consumed by that customer, before determining that it is necessary to fix distribution tariffs.
- (f) Any consideration of the extension of competition in the supply of gas to small business and residential consumers must be undertaken by reference to the costs of new retailers, not by reference to the costs of AlintaGas's retail business.

- (g) The emphasis you have placed upon section 38 indicates that you have unreasonably attached too much weight to the fixing of reference tariff B3 in order to provide a retail margin for every residential customer regardless of the amount of gas consumed by that customer. As a consequence, you have failed to give appropriate weight to other factors that you are required to consider under section 2.24.
- (h) The emphasis that you have placed upon section 38 also indicates that you have attached insufficient weight to the interests of AlintaGas as against the interests of other participants in the gas market, particularly retailers.

4. EXPLANATION OF THE GROUNDS FOR OBJECTION

4.1 THE CERTAINTY OF AMENDMENT 39

AlintaGas found it difficult to understand what Amendment 39 requires. In particular, AlintaGas had difficulty with the following aspects of the amendment:

- (a) Amendment 39 refers to making provision for “reasonable retail margins”. It does not, however, indicate what you consider to be a “reasonable retail margin”. While the reasons for decision note what IPART considers to be an appropriate margin, it is unclear whether you concur with that view. Given your comments in relation to Amendment 28 about a requirement to have a 2% net margin for each reference service, one can infer that you may agree with IPART’s view. However, such an inference does not provide sufficiently certain ground on which to base analysis or a response to the amendment.
- (b) Likewise, the amendment does not specify whether the term “retail margin” refers to “gross retail” or “net retail” margins, or both. The reasons for decision discuss both, but your analysis focuses on gross retail margins.

AlintaGas wishes to point out that these matters of uncertainty have the potential to have a significant impact upon AlintaGas. Due to the nature of AlintaGas’s ODV methodology, the magnitude of the retail margin you believe to be reasonable, and whether the margin is a gross or net margin, could significantly affect the value of the ICB.

Accordingly, AlintaGas wrote to you on 28 March 2000 to seek clarification of this point. On or about 10 April 2000, Peter Kolf from OffGAR wrote to AlintaGas seeking to clarify OffGAR’s understanding of Amendment 39. Despite OffGAR’s response and a subsequent meeting, AlintaGas remains unclear about what you require in relation to Amendment 39. However, AlintaGas appreciates your comments at the Public Forum held on 2 May 2000 encouraging AlintaGas to discuss this matter further with OffGAR officers.

Notwithstanding these events subsequent to the issue of the Draft Decision, AlintaGas has been prejudiced in its ability to both understand and respond to Amendment 39. AlintaGas submits that, because it is so uncertain, Amendment 39

does not state the amendment, or the nature of the amendment, you require. It therefore does not satisfy the requirements of section 2.13(b).

The comments that follow are based on the conservative assumption that you require reference tariff B3 to be changed to provide a gross retail margin and a net retail margin of 2%. AlintaGas has not made an assumption about the level of gross retail margins you require because the reasons for decision only refer to gross margins for the electricity industry.

4.2 SECTION 38 AND THE REQUIREMENT FOR A RETAIL MARGIN

The reasons for decision clearly indicate that Amendment 39 is driven by a desire to satisfy the objectives of section 38.⁵⁰

AlintaGas's views on section 38 and your interpretation and application of that section are discussed in relation to Amendment 28. They are equally relevant to Amendment 39 to the extent that Amendment 39 requires the provision of a retail margin for reference services B2 and B3. Accordingly, for the reasons set out in its response to Amendment 28 in relation to section 38⁵¹, AlintaGas submits that you not require that AlintaGas amend reference tariff B3 to provide for a positive gross or net retail margin.

4.3 PARTICULAR GAS CUSTOMERS AND PARTICULAR GAS QUANTITY BLOCKS

The reasons for decision indicate that you have interpreted section 38 as requiring that the level and structure for reference service B3 is consistent with a retail margin that is sufficiently large to enable gas retailers to enter the market for gas supply to "small businesses and residential customers". In that context it is quite clear that you refer to small business and residential customers as being a class of consumers.

Amendment 39, however, requires a reasonable retail margin "both in total for any residential end user and for any gas quantity block". AlintaGas takes that statement to mean that reference tariff B3 should provide for a positive margin for any particular residential end user for any particular level of gas consumption.

4.3.1 Interpretation of Section 38

The reasons for decision do not disclose the basis for a transition from a general objective of providing a sufficient retail margin for the class of consumers known as small business and residential consumers to the objective (reflected in Amendment 39) of providing a sufficient retail margin for every residential consumer for every level of consumption. In AlintaGas's view, it is a rather large step to move from an objective of extending effective competition in the supply of gas to a class of customers to having an objective of extending effective competition in the supply of every customer, regardless of consumption level.

⁵⁰ In this part of the paper, references to "section 38" are references to section 38 of the *Gas Pipelines Access (Western Australia) Act*. See Part B, at 185.

⁵¹ Applying *mutatis mutandis*. In particular refer to sections 3, 4.1, 4.2, 4.3 and 4.4 of Attachment D of this response.

Indeed, AlintaGas submits that section 38 does not contemplate such a transition. It is notable that section 38 refers to the extension of effective competition to “residential and small business consumers”⁵². AlintaGas submits that this is clearly a reference to small business and residential customers as a class of consumers. Thus, rather than requiring that effective competition be extended to every consumer, section 38 concerns itself with the extension of effective competition to the relevant class of consumers. Accordingly, nothing in the language of section 38 requires that every residential consumer provide a positive margin for a gas supplier. To suggest otherwise stretches the limits of interpretation too far.

There may be a view that it is necessary to ensure that every consumer provides a positive net margin in order to extend effective competition in the supply of gas to the class of consumers, and that, in that sense, section 38 requires that every consumer be provide a positive retail margin for every level of gas consumption. AlintaGas submits, however, that such a view reflects a misunderstanding of how retail gas markets operate. As AlintaGas explained with respect to Amendment 28, retail gas suppliers generally secure gas supply contracts with a broad range of gas consumers. Some of those consumers will return positive margins and others will not. What is important to gas retailers is not that each customer is profitable, but that they earn an overall positive retail margin.

4.3.2 Reasonableness

In addition, it is unreasonable to require the provision of a retail margin (by means of a further, significant reduction in AlintaGas’s ICB) for every residential consumer regardless of the level of gas consumed by that consumer. It is well known that some residential consumers will never provide a positive retail margin when viewed on an individual basis. If average retail costs for a consumer are approximately \$50 per annum and the regulated fixed charge a gas supplier can recover is \$30 per annum, a customer that consumes only a small quantity of gas will not provide a gas supplier with a positive retail margin.

It is impossible for AlintaGas, through reference tariff B3, to make such consumers provide a positive retail margin. AlintaGas would effectively have to pay retailers for the use of reference service B3 to provide a positive margin. In fact, assuming that cost allocations and other key elements of the Access Arrangement are not changed, AlintaGas believes that it could not fully address this issue even if it were to write down to zero the value of those assets used to service residential consumers.

The assertion that consumers using more than 45 GJ/year will not provide positive retail margins is not a factor of AlintaGas’s creation. It occurs because the third step of the regulated retail tariff⁵³ for the supply of gas to residential consumers is not reflective of the costs of actually providing gas, gas transmission and gas distribution services. The third step of the tariff was designed to provide incentives to residential consumers to use gas as a means of ameliorating

⁵² Section 38(2) and (3).

⁵³ This regulation will occur into the future under the tariff cap regulations intended to be made by the Governor before 1 July 2000.

SECWA's position under take-or-pay gas purchase contracts that were structured to support the development of the gas market in the State. That original objective is inappropriate in the current gas market.

The fact that the State Government has decided to continue to regulate prices with a low third step of the retail gas tariff is not something for which AlintaGas has responsibility. AlintaGas's legitimate business interests require that it charge prices for the third step of reference tariff B3 that are reflective of the costs of providing the service. If the State Government wishes to maintain an inappropriate cap on what retailers charge for that part of the service, then it has implicitly decided to restrict the extent to which effective competition for such consumers can emerge. It should not be taken to represent a requirement to sacrifice the legitimate business interests of AlintaGas⁵⁴ by a further significant reduction in the ICB.

4.3.3 Balance of Interests

If, despite the above, you believe that it is appropriate to require that AlintaGas amend reference tariff B3 to provide a positive margin, AlintaGas wishes to re-emphasise some of the points it made on the achievement of a 2% net retail margin and the weighting given to section 38 with respect to Amendment 28.⁵⁵ The points apply with equal force to the requirement for a retail margin for every customer regardless of the level of gas consumed by that customer. In summary, the points are:

- (a) The fixing of reference tariff B3 is only one of a number of possible ways of achieving the objective of section 38, as you perceive that objective. Retailers can also contribute to the achievement of the perceived objective. You should take this into account before determining that it is necessary to fix distribution tariffs.
- (b) New retailers will have costs that are different to , and probably lower than, the costs of AlintaGas's retail business. In fact, the reference tariff B3 proposed by AlintaGas may already provide a sufficient retail margin for such parties. Any consideration of retail market costs must be undertaken by reference to the costs of such new retailers, not AlintaGas's Retail business.
- (c) The emphasis you have placed upon section 38⁵⁶ indicates that you have unreasonably attached too much weight to the fixing of reference tariff B3 in order to provide a retail margin for every residential customer regardless of the amount of gas consumed by that customer. As a consequence, you have failed to give appropriate weight to other factors that you are required to consider under section 2.24. AlintaGas submits that you should give other factors, particularly the legitimate business interests of AlintaGas greater weight with the result that you do not require that reference tariff

⁵⁴ A separate legal entity under the *Gas Corporation Act 1994* , the business of which is currently in the process of being sold.

⁵⁵ See section 4.3 of Attachment D.

⁵⁶ For an explanation of the reasons for this assertion, see section 4.4 of Attachment D of this response.

B3 provide a positive retail margin for every residential customer regardless of the level of gas consumption.

- (d) The emphasis that you have placed upon section 38 indicates that you have attached insufficient weight upon the interests of AlintaGas as against the interests of other participants in the gas market, particularly retailers. The requirement that Amendment 39 alone provide for the retail margin for every residential consumer renders AlintaGas the only party obligated to contribute to the margin. The subordination of AlintaGas's legitimate business interests in this way is unreasonable.

Finally, in structuring reference tariff B3 AlintaGas aimed to deliver a balance of interests between competing interests. AlintaGas believes that reference tariff B3 delivered on that objective. The application of Amendment 39 could unreasonably re-balance those interests.

Attachment L

Amendments 40, 41 & 42 – Regulatory Approval of Changes to Reference Tariffs

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENTS 40, 41 AND 42

The reasons for decision indicate that you required Amendments 40 and 41 to address concerns about:

- (a) A perceived lack of flexibility in Schedules 2 and 3 for you to undertake detailed audits and reviews of proposed variations to reference tariffs⁵⁷, particularly in relation to complex “pass-through” issues. The lack of flexibility is perceived as arising due to two factors. The first is that Schedules 2 and 3 impose timeframes within which you are required to give approval to changes to reference tariffs. The second is that Schedules 2 and 3 do not make provision for you to seek public submissions on proposed change statements.
- (b) The fact that Schedules 2 and 3 unacceptably impose obligations upon you.

The reasons for decision also indicate that you required Amendment 42 because you believe that AlintaGas’s proposal to provide for administrative review of your decisions with respect to tariff changes is inappropriate as it seeks to extend the appeal provisions of the *Gas Pipelines Access (Western Australia) Act*.

2. GENERAL COMMENTS

AlintaGas objects to Amendments 40, 41 and 42 and submits that you should not require such amendments in the Final Decision. The reasons for AlintaGas’s response, which are based on its interpretation of the reasons for decision is incorrect, are set out below. If AlintaGas’s understanding of the reasons for decision is incorrect, AlintaGas’s response to the amendments may change.

3. GROUND FOR OBJECTION

AlintaGas objects to Amendments 40, 41 and 42 for the following reasons:

- (a) The reasons for decision are deficient.
- (b) The effect of Amendments of 40, 41 and 42 will be to significantly undermine regulatory certainty and increase associated regulatory costs for AlintaGas, contrary to its legitimate business interests.
- (c) In relation to Amendments 40, 41 and 42, you have not reasonably or correctly considered AlintaGas’s legitimate business interests in respect of reference tariff variations.
- (d) AlintaGas proposed Schedules 2 and 3 in the exercise of its discretion under section 8.3 and in this regard:

⁵⁷ The term “variation to reference tariffs” is used to refer to changes to initial reference tariffs made under Schedules 2 and 3 of the Access Arrangement.

- I. Schedules 2 & 3 comply with the elements of section 8.3 and are consistent with the objectives of section 8.1;
 - II. Pursuant to section 8.3 it is at AlintaGas's discretion to include Schedules 2 and 3 in the reference tariff policy within the Access Arrangement;
 - III. You may not refuse to approve the Access Arrangement for the reasons you have given in relation to section 8.3; and
 - IV. The issues of the imposition of obligations, approval and appeal do not appear to be relevant to a consideration of the objectives of section 8.1.
- (e) AlintaGas submits that your decision to not allow the Access Arrangement to impose obligations upon you is ill-founded. It is entirely proper and within the ambit of section 8.3 for a service provider to specify the manner in which reference tariffs are to vary.
- (f) If implemented, Amendments 40, 41 and 42 will make it impossible for AlintaGas to realise its objectives in relation to Schedules 2 and 3. If you are not prepared to move from the views set out in the reasons for decision, AlintaGas suggests replacing all references to "the Regulator" in Schedules 2 and 3 with the words "an independent auditor appointed by AlintaGas".
- (g) Amendment 42 is incorrect in so far as it is based on a judgment that Schedules 2 and 3 seek to "extend" section 38 of Schedule 1 of the *Gas Pipelines Access (Western Australia) Act*.

These reasons are explained in full below.

4. EXPLANATION OF GROUNDS FOR OBJECTION

4.1 REASONS FOR DECISION

AlintaGas had difficulty following and understanding the reasons for decision in relation to the following matters:

- (a) In the first paragraph of page 196 of Part B, you refer to "the approval of tariffs". The significance of the approval of tariffs in the context of Amendments 40 and 41 is unclear because Schedules 2 and 3 do not address the approval of tariffs. Rather, they address the manner in which reference tariffs are to be varied within the access arrangement period through the implementation of the reference tariff policy, pursuant to section 8.3. This distinction is important because it demonstrates that Schedules 2 and 3 deal with the variation of initial reference tariffs, not with the approval of the initial reference tariffs.
- (b) The reasons for decision indicate that your flexibility to review proposed tariff variations would be constrained by time-lines imposed by Schedules 2 and 3. The reasons for decision then conclude that tariff variations should be subject to your approval, free of any time constraints. AlintaGas does not understand it is necessary to totally abandon time-lines in order to address a concern that a 30 day time-line will reduce your audit flexibility. AlintaGas submits that it would be more reasonable and proportional response to extend the time-line for approval.

In any event, AlintaGas does not believe that a period of 30 days to assess compliance with the provisions of Schedules 2 and 3 is unduly restrictive. In respect of variations under both Schedules 2 and 3, it will be known well in advance of the event that a change needs to be made. AlintaGas would expect to work with OffGAR prior to preparing change statements or variation notices, thereby reducing any time pressure created by the 30 day limitation.

- (c) The reasons for decision do not disclose the basis for the judgment that the auditing of tariff variations will involve complex issues. Variations in accordance with the CPI-X methodology will not be unduly complex and will not require significant regulatory review. You would only need to review to ensure the proposed tariffs comply with the price path.⁵⁸ Further, most pass-through variations will require changes to reference tariffs in response to discrete and certain events, and the pass through should only require an a review of the mechanical application of pass-through amount to reference tariffs. For example, the effect of the pass-through of the costs of funding your office is certain and there will be nothing complex about varying reference tariffs in response to it.
- (d) AlintaGas acknowledges that you may, on certain occasions, decide that it is appropriate to consult with interested parties about a tariff variation in response to a pass-through event. For such a purpose, section 2.1 provides that you may undertake public consultation in relation to any matter relevant to your functions under the Code. As there is nothing in schedule 3 that would prevent such public consultation from occurring, AlintaGas submits that you have sufficient flexibility under schedule 3 in respect of public consultation.
- (e) In relation to Schedule 3, the reasons for decision state that the need to undertake public consultation would “...preclude the automatic pass through of taxation or regulatory changes, as suggested by Western Power”⁵⁹. The reasons for decision do not state why this is so. AlintaGas submits that you can comfortably approve the adjustment of reference tariffs in accordance with the price path established under section 8.3 and, as part of you approval process, conduct public consultation with respect to the matters specified in clause 4 of Schedule 3. If it is accepted that the definition of pass through events in schedule 3 is appropriate, there is no need to conduct public consultation with respect to whether or not a pass through event should in fact be passed through to users by a variation in reference tariffs. Wider public consultation is only necessary if it is not accepted that the range of pass through events specified in Schedule 3 is inappropriate.
- (f) The reasons for decision state that you consider that it is “not acceptable” for a service provider to impose obligations upon you within an access arrangement. The reasons for decision do not, however, disclose why you consider this to be the case. Thus, the reasons state a conclusion without giving any reasons as to why that conclusion was reached. Accordingly, AlintaGas submits that you have substantially failed to comply with your obligation under section 7.7 to give reasons. This has made it difficult for AlintaGas to understand and respond to the Draft Decision. Without prejudice to its rights in relation to this matter, AlintaGas notes that nothing in sections 8.3, 8.1 or 2.24 give any indication as to why you

⁵⁸ If an amendment such as Amendment 43 appears in the Final Decision, requiring a straight price cap, your role will become even less complex than under AlintaGas’s revenue yield methodology.

⁵⁹ Part B, at 196.

might have formed that conclusion. AlintaGas further addresses this matter below.

- (g) The reasons for decision state that you do "...not consider it appropriate..." for an access arrangement to seek to extend appeal rights beyond those available under the *Gas Pipelines Access (Western Australia) Act* and the Code. As with the issue of imposing obligations described above, the reasons for decision do not, however, disclose why you consider this to be the case. Accordingly, AlintaGas also submits that you have substantially failed to comply with your obligation under section 7.7 to give reasons. This has made it difficult for AlintaGas to understand and respond to the Draft Decision. AlintaGas's provides substantive comments on this matter below.

4.2 THE EFFECT OF THE AMENDMENTS

Based on AlintaGas's reading of the Draft Decision, the impact of Amendments 40, 41 and 42 would essentially be to require AlintaGas to remove from Schedules 2 and 3:

- (a) provisions that impose an obligation on you to approve variations to reference tariffs and an obligation on you approve variations to reference tariffs within a specified time period; and
- (b) provisions that confer upon AlintaGas administrative rights of review from a decision by you under the relevant schedule.

The deleted provisions would be replaced by a provision which states that AlintaGas cannot vary reference tariffs under Schedules 2 and 3 unless the variation is approved by you. You would have no obligations under Schedules 2 and 3, "other than as provided for by the Code in respect of a review of an Access Arrangement".⁶⁰

If that is the effect of the amendments, AlintaGas would be in a position in which Schedules 2 and 3 provide price path mechanisms that allow for the variation of reference tariffs in accordance with a CPI-X formula and, or, in response to taxation and regulatory pass through events. If AlintaGas wished to vary the reference tariffs in accordance with Schedule 2 or 3, it would submit a relevant statement to you proposing a change in the reference tariffs. However, you would be under no obligation to make a decision to approve the proposed variation, either absolutely or within a certain amount of time. In fact, you could choose to not even consider the variation, even though it was calculated in accordance with an agreed price path. Alternatively, you could choose to consider the variation proposal but refuse to approve of it. Further, you could choose to consider the variation proposal but take a significant amount of time to do so, thereby preventing appropriate additional revenue recovery by AlintaGas.

In the event that such things did occur, AlintaGas would have no administrative review rights. Ultimately, it seems that the only way AlintaGas could require you to actually make a decision within a reasonably certain time period would be to trigger a review of the Access Arrangement under section 2.28. AlintaGas would

⁶⁰ Amendment 41.

then need to rely upon you exercising discretion under section 2.33 to dispense with requirements for access arrangement information and public consultation. Under section 2.33, you could only exercise that discretion if you considered the change to be immaterial – a matter which you would presumably judge on a case by case basis⁶¹. If you did not exercise that discretion, you would need to undertake a full review.

As a result, AlintaGas believes that the certainty offered by Schedules 2 and 3 would be significantly undermined. If AlintaGas chose to rely on the mechanisms in existence under Schedules 2 and 3, it would not have certainty with respect to whether you will make a decision, or when you will do so. It would not have certainty as to the quality of any decision by you and would have no rights of administrative appeal. The most certain option for AlintaGas in changing reference tariffs would be to submit revisions to its Access Arrangement under section 2.28 in the expectation that you will exercise the discretion under section 2.33. Under AlintaGas's proposed CPI-X tariff variation mechanism, this could result in annual revisions to the Access Arrangement.

AlintaGas, therefore, submits that the effect of Amendments of 40, 41 and 42 would be to undermine regulatory certainty and probably increase associated regulatory costs for AlintaGas. This would not only be contrary with the legitimate business interests of AlintaGas that you are required to consider under section 2.24, but also with the provisions of section 8.3, as discussed below.

AlintaGas recognises that it could be argued that Schedules 2 and 3 will, despite the uncertainties outlined above, nevertheless provide AlintaGas a more convenient way of obtaining approval of variations to reference tariffs than submitting revisions under section 2.28. While that may be so, AlintaGas submits that the uncertainty associated with Schedules 2 and 3 would make decisions about how to vary reference tariffs an unnecessarily complex commercial and legal issue. It also does not mitigate the extent to which Amendments undermine section 8.3.

For these reasons, AlintaGas submits that you should not require amendments such as Amendments 40, 41 and 42 in the Final Decision.

4.3 CONSIDERATION OF THE INTERESTS OF ALINTAGAS

Section 2.24 requires that in assessing the Access Arrangement you must consider, among other things, AlintaGas's legitimate business interests. In relation to Amendments 40 and 41, the reasons for decision note that you accept that "some certainty" with respect to the approval of tariffs is desirable.⁶² That statement is made, however, in the course of asserting the importance of your flexibility to audit reference tariff variation proposals.

AlintaGas submits that you have not reasonably or correctly considered AlintaGas's legitimate business interests in respect of reference tariff variations.

⁶¹ AlintaGas notes that one of the proposed trigger events specified under Amendment 25 is the submission of a change statement entailing an increase in reference tariffs. This indicates that you are unlikely to consider increases in reference tariffs as being immaterial.

⁶² Part B, at 196.

In particular, the statement cited above indicates that you have understated the importance of regulatory certainty to AlintaGas's legitimate business interests. In addition, in contradistinction to your statement, AlintaGas asserts that regulatory certainty as to reference tariff variation proposals is absolutely vital to AlintaGas's legitimate business interests.

In relation to Amendment 42, you do not consider AlintaGas's legitimate business interests. AlintaGas submits that this constitutes a failure to comply with your obligations to do so under section 2.24. AlintaGas requests that you consider its legitimate business interests, particularly with respect to its interest in having access to an independent review of your decisions.

4.4 COMPLIANCE WITH SECTION 8.3

Section 8.3 clearly provides that the manner in which reference tariffs may vary within an access arrangement period, through the implementation of the reference tariff policy, is within the discretion of AlintaGas. The main limitation upon that discretion is that you be satisfied that the manner in which reference tariffs are to be varied is consistent with the objectives of section 8.1.

AlintaGas designed and proposed Schedules 2 and 3 in the exercise of its discretion under section 8.3. The schedules comply with the key elements of section 8.3 in the following way:

- (a) Schedules 2 and 3 are incorporated in the reference tariff policy by clause 25 of the Access Arrangement. The application of the schedules will constitute an implementation of the reference tariff policy.
- (b) Schedules 2 and 3 set out the manner in which reference tariffs may be varied. That is, reference tariffs A, B1, B2 and B3 may be varied by going through the processes, and applying the principles, set out in Schedules 2 and 3, where Schedule 2 permits variation in accordance with a CPI-X formula and Schedule 3 permits variation in response to taxation and regulatory pass through events; and
- (c) Schedules 2 and 3 apply only to vary reference tariffs within the access arrangement period. They do not extend to vary reference tariffs beyond the access arrangement period.

Furthermore, AlintaGas also believes that Schedules 2 and 3 are consistent with the objectives of section 8.1. They provide AlintaGas the opportunity to earn a stream of revenue that recovers the efficient costs of delivering reference services over the expected life of the AlintaGas distribution network, they replicate the outcome of a competitive market, they are consistent with ensuring the safe and reliable operation of the distribution system, they will not distort investment decisions in relevant markets, they provide for efficiency in terms of the level and structure of reference tariffs, and they provide incentives for AlintaGas to reduce costs and to develop the market for reference and other services. AlintaGas notes that you did not express any opinion suggesting that schedules 2 and 3 are inconsistent with the objectives of section 8.1.

Pursuant to section 8.3 it is, therefore, at AlintaGas's discretion to include Schedules 2 and 3 in the reference tariff policy within the Access Arrangement. That being the case, under section 2.24 you may not refuse to approve the Access Arrangement for the reasons you have given in relation to section 8.3.⁶³

In making this submission, AlintaGas stresses that the wording of section 8.3 is clear. It provides AlintaGas with a discretion, subject to the objectives of section 8.1. As the reasons for decision with respect to the imposition of obligations, approval and appeal do not appear to be relevant to a consideration of the objectives of section 8.1, they should not be considered.

AlintaGas also draws to your attention that section 8.3 deals with the issue of the manner of varying reference tariffs within an access arrangement period. It is implicit within the section that reference tariffs can be varied within the access arrangement period. The only question for consideration is "how" they may be varied. The examples given in paragraphs (a), (b) and (c) show that the drafter had in mind that reference tariffs would vary within an access arrangement period. In this respect, Schedules 2 and 3 are entirely within the spirit and intendment of section 8.3 and should be approved in the form in which they are proposed.

4.5 YOUR VIEW ABOUT IMPOSING OBLIGATIONS

As noted above, the reasons for decision do not explain why you believe it is not acceptable for the Access Arrangement to impose, and for you to accept, obligations in relation to the manner of varying reference tariffs within the access arrangement period. AlintaGas submits that your decision to not allow the Access Arrangement to impose obligations upon you is ill-founded. It is entirely proper and within the ambit of section 8.3 for a service provider to specify the manner in which reference tariffs are to vary. If the manner of doing so imposes obligations upon you to do certain things, AlintaGas submits that section 8.3 permits those obligations to be imposed.

4.6 ALINTAGAS'S OBJECTIVES IN RESPECT OF SCHEDULES 2 AND 3

In developing and proposing Schedules 2 and 3 AlintaGas sought to provide mechanisms by which it could vary reference tariffs within the access arrangement period consistent with its permitted discretion under section 8.3. A key objective of doing so was to provide an expeditious, efficient and certain reference tariff change process. Correspondingly, AlintaGas wished to avoid the need to submit revisions and trigger full review processes and to avoid expensive and protracted evaluation processes within the access arrangement period.

At the same time, AlintaGas recognised the interests of users and prospective users in ensuring that variations to reference tariffs are implemented in accordance with Schedules 2 and 3. To address this issue, AlintaGas believed it was appropriate that an independent person review AlintaGas's varied reference tariffs to ensure compliance with Schedules 2 and 3.

Consistent with its discretion under section 8.3, AlintaGas could have nominated any independent person to undertake the audit role. For example, AlintaGas could

⁶³ The legitimate business interests of AlintaGas under section 2.24 issues are addressed above.

have specified that variations were not take effect until independent auditor agreed that AlintaGas had complied with Schedules 2 and 3. Such an approach would have guaranteed that variations were quickly reflected in reference tariffs and were in accordance with approved reference tariff variation mechanisms.

However, in the circumstances, AlintaGas felt that there would be benefit in having you undertake the audit role. The benefit would arise due to the independence of your office and expertise in regulatory matters. In specifying you as the “auditor” under Schedules 2 and 3, AlintaGas intended that your role would be one of assessing, in a fairly mechanistic way, proposals for variations. It would also impose deadlines and obligations to make decisions, and provide administrative appeal rights to ensure that variations were assessed fairly and within a reasonable timeframe.

AlintaGas is, then, disappointed by Amendments 40, 41 and 42. If implemented, the amendments will make it impossible for AlintaGas to realise its objectives for Schedules 2 and 3.

If you are not prepared to move from the views set out in the reasons for decision, AlintaGas wishes to suggest replacing all references to you in Schedules 2 and 3 with the words “an independent auditor appointed by AlintaGas”. This approach would have the advantage of avoiding perceived difficulties with respect to the imposition of obligations and allow AlintaGas to retain variation mechanisms under section 8.3 that are expeditious, efficient and certain.

4.7 GOODS AND SERVICES TAX

AlintaGas notes the effect of Amendments 40 and 41 would be to require AlintaGas to seek your approval to pass through the impact of the goods and service tax (“GST) to reference tariffs. This could mean that you would undertake a process of public consultation before deciding whether to approve the pass through or not. For the reasons discussed in relation to Amendment 25, this is unreasonable.

4.8 ADMINISTRATIVE APPEAL RIGHTS

The reasons for decision assert that clause 1(6) of Schedule 2 and clause 3 of Schedule 3 seek to “extend” the provisions of section 38 of Schedule 1 of the *Gas Pipelines Access (Western Australia) Act*. This appears to be the only ground upon which Amendment 42 is based.

AlintaGas submits that the relevant clauses do not seek to “extend” the provisions of the Act. Rather, they seek to provide an avenue for administrative review that is additional to any right that exists under the Act. It would confer a review opportunity that is outside the ambit of the Act. This reflects the fact that the decision from which the review would be sought would not be a decision under the Act.

As the reason for the decision is incorrect, AlintaGas submits that an amendment such as Amendment 42 should not appear in the Final Decision.

Attachment M

Amendments 43, 44 & 45 – CPI-X Price Cap

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENTS 43, 44 AND 45

Amendment 43 is preceded by a discussion of the revenue yield form of price control proposed in the Access Arrangement. That discussion raises a concern about AlintaGas’s ability to re-balance its reference tariffs and sets out a form of simple price cap which precludes re-balancing. The Draft Decision then goes on to show that, were AlintaGas to adopt this form of simple price cap, “X” in the price capping mechanism would have a value of about 2.63 per cent.

2. GENERAL COMMENTS

AlintaGas objects to Amendments 43, 44 and 45 and submits that you should not require these amendments in the Final Decision.

3. GROUND FOR OBJECTION

AlintaGas objects to Amendments 43, 44 and 45 for the following reasons:

- (a) In relation to Amendment 43 you have taken into account only one of the factors you are required to take into account under section 2.24 and you have failed to give consideration to any of the objectives of section 8.1 for the design of a reference tariff and a reference tariff policy.
- (b) In relation to Amendment 43, you:
 - I. interpreted section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* in an unreasonable and, therefore, inappropriate way; and
 - II. failed to take into account facts which, if they had been properly taken into account, would have led you to not proposing Amendment 43.
- (c) In relation to Amendment 43, your reasons for rejecting the revenue yield form of incentive mechanism proposed by AlintaGas in Schedule 2 of the Access Arrangement appear to be without foundation, and their use in supporting the amendment does not appear to have a clear rationale.
- (d) In relation to Amendment 43, your assertion that the revenue yield form of incentive mechanism proposed by AlintaGas in Schedule 2 of the Access Arrangement is complex and potentially expensive to regulate and administer is largely unsubstantiated.
- (e) In relation to Amendment 44, AlintaGas notes that your method of calculating the value of “X” in the CPI-X formula flows from Amendment 43. As AlintaGas objects to the imposition of simple price caps as proposed by Amendment 43, it also opposes Amendment 44.

(f) In relation to Amendment 45:

- I. the CPI measure proposed by AlintaGas is the appropriate measure of inflation to be used in the Access Arrangement;
- II. Amendment 45 has been based on irrelevant considerations; and
- III. As a Western Australian regulator, appointed to ensure that appropriate consideration is given to local issues, you should examine the merits of AlintaGas's use of the All Groups Perth CPI within the scope of sections 2.24 and 8.24 of the Code and not propose a change only because that change achieves consistency with the decisions of regulators in other jurisdictions.

AlintaGas notes the comment made in the reasons for decision supporting Amendment 45 to the effect that you are considering an efficiency requirement in addition to that provided by the X factor in the CPI-X mechanism. AlintaGas would strongly object to such an additional requirement on the grounds that:

- (a) it can see no basis for your assertion that the proposed price control is comparatively lenient; and
- (b) there is no scope under the Code for imposition of arbitrary incentives for unachievable levels of efficiency improvement.

An explanation of these reasons is set out below.

4. EXPLANATION OF GROUNDS FOR OBJECTION

4.1 FORM OF PRICE CONTROL - AMENDMENT 43

4.1.1 Removal of Re-balancing Provisions and Implementation of a Price Cap

The reasons for decision deal at some length with the considerations supporting the requirements of Amendment 43 that Schedule 2 of the Access Arrangement be amended to:

- (a) remove provisions for the re-balancing of the reference tariffs; and
- (b) implement a price cap mechanism for the variation of those reference tariffs.

In the reasons for decision you note that, in principle, "it is desirable for AlintaGas to have the ability to re-balance reference tariffs during the Access Arrangement Period", and that the form of revenue yield price control to be used in conjunction with re-balancing has desirable incentive properties. However, you go on to argue that there are several well-documented problems with "revenue yield" and that re-balancing may be used to restrict competition in particular sectors of the retail market.

The latter concern – that re-balancing may be used to restrict competition in particular sectors of the retail market – appears to be the primary reason supporting Amendment 43.

AlintaGas's understanding of that reason is as follows.

- (a) Section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* applies where you are assessing a proposed access arrangement to determine whether it should be approved under the Code and, for that purpose, you are required by the Code to take the public interest into account. Subsection 38(2) directs you, in these circumstances, to take into account the fixing of appropriate charges as a means of extending effective competition in the supply of natural gas to small business and residential customers. Subsection 38(3) gives meaning to the phrase “appropriate charges” in subsection 38(2). Appropriate charges are 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.⁶⁴
- (b) On the basis of the obligation imposed by section 38, you contend that, during the period in which retail market for gas supply to residential and small business customers remains non-contestable, and in which maximum retail gas tariffs for these customers are regulated, AlintaGas has a strong incentives to raise distribution tariffs in contestable sectors of the market, and to lower them in non-contestable sectors. Furthermore, if all sectors of the retail market for gas are made contestable, but retail tariffs continue to be regulated, AlintaGas will have incentives to raise reference tariffs B2 and B3, thereby reducing retail margins to levels that would limit potential retail competition.
- (c) While the CPI + Y constraint on tariff re-balancing proposed by AlintaGas would limit the extent to which AlintaGas could strategically alter reference tariffs to restrict competition, there would still be substantial scope for doing so over the five years of the access arrangement period.
- (d) In these circumstances, the provisions for tariff re-balancing should be removed from the Access Arrangement, and a simple price cap form of price control should be implemented as required by Amendment 43.

AlintaGas submits that in proposing Amendment 43 you have taken into account only one of the factors you are required to take into account under section 2.24, and that you have failed to give consideration to any of the objectives of section 8.1 for the design of a reference tariff and a reference tariff policy. Of critical concern to AlintaGas is your failure to consider its legitimate business interests despite your explicit recognition of the desirability of AlintaGas being able to re-balance distribution system reference tariffs.

⁶⁴ The interpretation of section 38 is discussed in relation to Amendment 28. The comments made in relation to Amendments 43, 44 and 45 are made without prejudice to the views put by AlintaGas in relation to section 38 as discussed in relation to Amendment 28. Indeed, they apply equally here, *mutatis mutandis*.

AlintaGas's concern in respect of this issue is heightened by its perception that you:

- (a) have interpreted section 38 of the *Gas Pipelines Access (Western Australia) Act 1998*⁶⁵ unreasonably and, therefore, in an inappropriate way; and
- (b) have failed to take into account facts which, if they had been properly taken into account, would have led you to not proposing Amendment 43.

AlintaGas notes that section 38 requires of you only that you take into account the fixing of distribution and transmission tariffs as a means of extending effective competition in the supply of natural gas to small business and residential customers. It does not impose an obligation to actually ensure the extension of effective competition in the supply of natural gas through your setting of pipeline tariffs.

The reasons for decision supporting Amendment 43 indicates that you have interpreted section 38 as requiring that you use the fixing of pipeline charges to extend effective competition in the supply of natural gas to small business and residential customers. Nowhere in the reasoning for decision is there any consideration of the broader issues involved in extending effective competition. There is no consideration of the structure of each of the production, transmission and retail sectors of the gas market, and of regulation governing each sector, to ascertain the extent to which effective competition may be extended in the supply of natural gas to small business and residential customers. There is no consideration of a broader context against which you might take into account the fixing of pipeline charges as a means of extending effective competition. You simply assume that you must use the fixing of AlintaGas's distribution system charges to extend effective competition. This, AlintaGas submits, is an unreasonable and inappropriate interpretation of section 38.

Even if your interpretation of section 38 could be sustained, the reasoning supporting Amendment 43 is, in AlintaGas's view, inherently defective because it fails take into account facts which, if they had been properly taken into account, would have led to that amendment not being proposed.

The reasons for decision supporting Amendment 43 assumes that, by increasing its distribution system charges, albeit within the CPI + 2% re-balancing constraint of Schedule 2 of the Access Arrangement, AlintaGas could make entry into the retail sector unprofitable and, therefore unattractive. This appears to follow from a view that with distribution reference tariffs at the levels derived from a total revenue consistent with the lower capital base, lower rate of return and lower capital and non-capital costs proposed by you, AlintaGas's retail business would achieve margins in each sector of the retail market considered appropriate for a competitive retailer. Those margins would be about 2 per cent in each sector. If charges to users of the distribution system supplying gas to small

⁶⁵ In this part of the response, references to "section 38" are references to section 38 of the *Gas Pipelines Access (Western Australia) Act 1998*.

business and residential customers were then to rise, retail margins would fall. For AlintaGas, this would imply only an internal transfer of profit from the its retail business to its distribution business. For retailers proposing to enter the market and supply gas to small business and residential customers, the higher distribution charges would imply margins lower than would normally be earned in a competitive market. Entry would not, therefore, take place.

This argument implicitly assumes that the costs relevant to an economically viable entry decision are the retail costs of AlintaGas's retail business. A potential entrant with those retail costs, and faced with higher distribution system charges, would be deterred from entering the market because it could not earn a competitive margin on its retail operation. This is manifestly incorrect. The costs relevant to an economically viable entry decision are not the costs of AlintaGas's retail business; they are the retail costs of the potential entrant. The reasoning supporting Amendment 43 has failed to take into account those costs.

AlintaGas is unable to quantify the retail costs of a potential entrant. It is, however, aware of the competitive threats it faces once restrictions on entry into the retail market for gas are removed. Potential entrants include gas retailers currently operating in markets elsewhere in Australia, and at least one electricity supplier, Western Power Corporation. Those entrants are already recovering the substantial fixed costs of retail operations.

Furthermore, in the case of Western Power, the potential entrant is a major buyer of natural gas in Western Australia. Western Power is likely to be able to purchase gas for resale at prices significantly below those offered to a new gas retailer seeking to purchase the small volumes required for market entry.

Those organisations that pose a real competitive threat to AlintaGas in the retail sector of the gas market in Western Australia will be able enter that market with retail costs that are lower than the retail costs of AlintaGas's retail business.

It is not sufficient for you to assume that a hypothetical potential entrant into the market for supply of gas to small business and residential customers will have the same costs as AlintaGas's retail business. You must examine real prospects for entry and ascertain the retail costs of those entrants, and the margins they are likely to earn.

The reasons for decision indicates that this has not been done. You have failed to take into account material facts in your reasoning supporting Amendment 43.

2.1.2 Rejection of Revenue Yield Incentive Mechanism

Although the primary reason supporting Amendment 43 appears to be AlintaGas's ability to use re-balancing of reference tariffs to restrict competition in particular sectors of the retail market, the Draft Decision

gives other reasons for rejecting the revenue yield form of price control proposed in the Access Arrangement.

These other reasons for rejecting the revenue yield form of price control, and hence for your proposing Amendment 43, are:

- (a) revenue yield motivates inefficient pricing in the sense of tariffs for particular services, or components of tariffs, not accurately reflecting the costs of service provision; and
- (b) revenue yield is complex and potentially expensive to regulate and administer.

These reasons appear to AlintaGas to be without foundation, and their use in supporting Amendment 43 does not appear to have a clear rationale in terms of:

- (a) the matters to be considered in designing a reference tariff and a reference tariff policy under section 8.1 of the Code; and
- (b) the matters to be taken into account by you in assessing a proposed access arrangement in accordance with section 2.24.

All forms of price control (including the price capping mechanism proposed by you in Amendment 43) involve a somewhat mechanical escalation of reference tariffs over a defined period which may result in prices varying from costs during that period. The purpose of this mechanical escalation of reference tariffs is to avoid costly annual tariff resetting, and to provide incentives for a service provider to expand its market and reduce its costs of delivering reference services. The incentive properties of the price control benefit the service provider in the short term and, in the longer term, benefit both the service provider and users of the services it provides. These longer term benefits are achieved at the expense of some deviation of prices from costs, and hence at the expense of some short term disbenefit to users. The extent of the deviation of prices from costs in the short term is limited by the period over which the price control is to apply.

AlintaGas acknowledges that revenue yield may motivate inefficient pricing in the sense that tariffs for particular services, or components of tariffs, may not accurately reflect the costs of service provision. This is, however, not a problem unique to the revenue yield form of price control. It is a problem associated with all common forms of price cap price controls, including the form of price cap mechanism proposed by you in Amendment 43. To focus on it ignores the benefits price caps offer over other forms of regulation in terms of providing incentives for a service provider to expand its market and reduce the costs of delivering reference services.

Your contention that the form of price path proposed by AlintaGas is complex and potentially expensive to regulate and administer is largely

unsubstantiated. The reasons for decision do not support this claim. Nor is it supported by the statement that the problems of revenue yield have been described in detail by the Victorian Office of the Regulator-General in the context of its review of electricity distribution prices. The Victorian Regulator-General expressed a number of opinions on revenue yield (in Consultation Paper No. 3). These were the unsubstantiated opinions of the Regulator General, and were questioned by those who subsequently made submissions to the Office on Consultation Paper No. 3.

Recent research permits a stronger argument to be raised against revenue yield. That research shows that the static (but not the dynamic) economic efficiency properties of the tariff basket form of price path are superior to those of revenue yield. Furthermore, the tariff basket form avoids some of the complexity of the revenue yield. These issues are referred to in the Draft Decision, but are not examined in detail. You appear intent on imposing a very restrictive form of price capping on AlintaGas's distribution business.

- (a) AlintaGas submits that, in proposing Amendment 43, you have: taken into account only one of the factors you are required to take into account under section 2.24 of the Code, and have failed to give consideration to any of the objectives of section 8.1 for the design of a reference tariff and a reference tariff policy;
- (b) interpreted section 38 of the *Gas Pipelines Access (Western Australia) Act 1998* in an unreasonable and, therefore, in an inappropriate way; and
- (c) failed to take into account facts about potential entry and the retail costs of potential entrants which, if they had been properly taken into account, would have resulted in Amendment 43 not being proposed.

In consequence, Amendment 43 should not appear in the Final Decision.

2.2 DETERMINATION OF THE X FACTOR FOR THE PROPOSED CPI – X PRICE PATH – AMENDMENT 44

In the reasons for decision supporting amendment 44 you argued that the way in which AlintaGas has determined the “X” factor for the proposed “CPI – X” price cap in its revenue yield price control may result in an upward bias being given to tariff variations in the second and subsequent years of the access arrangement period. A corrected X factor calculation, taking into account other changes required by various amendments in the Draft Decision and, in particular, by Amendment 34, is provided.

On the basis of this corrected X factor calculation, Amendment 44 of the Draft Decision requires that Schedule 2 of the proposed Access Arrangement be amended so that the value of X for the CPI – X price cap mechanism is not less than 2.62 percent.

AlintaGas acknowledges that the method it has used for the determination of X may impart an upward bias to tariff variations in the second and subsequent years of the access arrangement period. Were AlintaGas to revise its Access

Arrangement, it would include an X redetermined in such a way that the upward bias to tariff variations in the second and subsequent years of the access arrangement period was removed.

For the reasons set out earlier, AlintaGas objects to the imposition of simple price caps as proposed by Amendment 43. If Amendment 43 is not included in the Final Decision, an X not less than 2.62 per cent, as proposed in Amendment 44, will not be appropriate. X must be redetermined in a way that is consistent with the form of price control adopted, and with other amendments which might be made to the Access Arrangement. In these circumstances, you should not require Amendment 34 in the Final Decision.

AlintaGas notes that your method for determining X, while eliminating the possibility of bias in future tariff variations, is similar in principle to its own. The method seeks to establish an X which, when used in a CPI – X price control, ensures that the present value of the revenues generated over the access arrangement period does not exceed the present value of the costs of providing reference services. If, as the Code requires, these costs satisfy the requirements of sections 8.16(a) (for new facilities investment) and section 8.37 (for non-capital costs), there can be no basis for you asserting that the price control is comparatively lenient, and for proposing that, prior to issue of the Final Decision, you will consider whether an additional incentive for efficiency gains is warranted. If the market forecasts on which AlintaGas has based the costs reflected in the determination of the reference tariffs are reasonable, and the costs themselves satisfy the efficiency criteria of sections 8.16(a) and 8.37, there can be no scope for imposition of arbitrary incentives for unachievable levels of efficiency improvement.

2.3 THE CONSUMER PRICE INDEX SHOULD BE THE EIGHT CAPITAL CITY, ALL-GROUPS CPI - AMENDMENT 45

The reason given for requiring AlintaGas to amend the Access Arrangement by replacing, in Clause 14 of Schedule 2, “Consumer Price Index (All Groups, Perth)” with “Eight Capital City, All-Groups CPI” is that:

“The general regulatory approach in Australia is to use a measure of economy-wide inflation, such as the Eight Capital City, All-Groups CPI measure as published by the Australian Bureau of Statistics”.

Support for this reasoning is drawn from the draft *Statement of Principles for the Regulation of Transmission Revenues* issued by the Australian Competition and Consumer Commission (ACCC)⁶⁶ in May 1999. In discussing use of a CPI measure in the context of CPI – X regulation, the ACCC noted:

“The general consensus is that it is appropriate to use a measure of economy wide price fluctuations rather than an industry specific measure or other derived price index. It is to be appreciated that the Consumer Price Index (CPI) does have a number of limitations, however the CPI is widely accepted as a compromise measure. The CPI produced by the Australian Bureau of Statistics (ABS) has the further advantage of not being revised. Moreover, it also provides a measure of economy wide

⁶⁶ Australian Competition and Consumer Commission, *Draft Statement of Principles for the Regulation of Transmission Revenues* (Commonwealth of Australia, Canberra – 1998).

price changes that equity investors in a regulated business must consider when undertaking an investment decision.”

The ACCC’s focus here, and in its proposal for use of the most recently published eight capital cities weighted average all groups CPI, is on:

- (a) an economy-wide measure of inflation rather than an industry specific measure;
- (b) a published measure that is not subject to revision; and
- (c) a measure that equity investors must consider when making an investment decision.

The national electricity market spans eastern and south eastern Australia. It is economic conditions in this extended market area, and not in any one State, that must be considered by equity investors when undertaking transmission investment decisions. Accordingly, the relevant economy-wide measure of inflation for use in CPI – X regulation of electricity transmission revenues is the eight capital cities weighted average all groups CPI.

Use of the eight capital cities index in this specific context does not in any way imply that its use is appropriate in all regulatory settings. Furthermore, there is no suggestion in the ACCC’s reasoning that use of the eight capital cities index is, or should be, general regulatory practice in Australia.

AlintaGas acknowledges the other aspects of the ACCC’s reasoning. The price index to be used in CPI – X regulation should be a broad measure of inflation, not an industry specific measure. A broad measure will be of relevance to equity investors, and the measure should be a published measure not subject to frequent revision.

The Consumer Price Index (All Groups, Perth) is just such a broad measure. It is not an industry specific measure. It is a measure of inflation in the Western Australian economy relevant to investors making decisions to invest in the State, and it is a published measure not subject to frequent revision.

Recognising, as does the ACCC, that all CPI measures have a number of limitations, AlintaGas submits that the Consumer Price Index (All Groups, Perth) is an adequate measure for use in CPI – X regulation of the reference tariffs of its Access Arrangement.

AlintaGas has proposed use of a price index adequate for its intended purpose. The reasons given in the Draft Decision for replacing this index with another, as required by Amendment 45 – that it is the general regulatory approach in Australia, and that such an approach has been proposed by the ACCC for the regulation of electricity transmission revenues – do not come within the scope of:

- (a) the matters to be considered in designing a reference tariff and a reference tariff policy under section 8.1 of the Code; and
- (b) the matters to be taken into account by the Relevant Regulator in assessing a proposed access arrangement in accordance with section 2.24.

Amendment 45 has been based on irrelevant considerations. The amendment should not appear in the Final Decision.

AlintaGas is of the view that there is a further reason why Amendment 45 should not stand. A Western Australian regulator was appointed to ensure that appropriate consideration was given to local issues arising in the context of access to gas transmission and distribution systems which do not extend beyond State boundaries. You should, therefore, examine the merits of AlintaGas's use of the All Groups Perth CPI within the scope of sections 2.24 and 8.24 of the Code. It is not sufficient for you to propose a change only because that change achieves consistency with the decisions of regulators in other jurisdictions.

Attachment N

Amendment 46 – Nature of Fixed Principles

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 46

The amendment is preceded by reasons for decision which state that the fixed principles proposed by AlintaGas are generally consistent with the nature of Structural Elements allowed as fixed principles by section 8.48. The reasons state, however, that it is not clear whether the proposed fixed principles for the Depreciation Schedule and the allocation of revenue between services “comprises [sic] a principle or methodology within the meaning indicated in the definition of a structural element in section 10.8...”.

2. GENERAL COMMENTS

AlintaGas objects to Amendment 46 and submits that you should not require such an amendment in the Final Decision. The reasons for AlintaGas’s response are as set out below.

3. GROUND FOR OBJECTION

AlintaGas objects to Amendment 46 for the following reasons:

- (a) There is uncertainty about what you require in the amendment and, to the extent that you require statements of clarification to be included in the Access Arrangement, such a requirement is unsatisfactory for legal and policy reasons;
- (b) You have not complied with the requirement under section 7.7 to provide reasons to support your decision; and
- (c) The Depreciation Schedule and “allocation of revenue between services” are both principles within the meaning of “structural element” in section 10.8.

4. EXPLANATION OF GROUND FOR OBJECTION

4.1 UNCERTAINTY IN THE AMENDMENT

AlintaGas is unclear about what you require in Amendment 46. Taken literally, the amendment seems to require AlintaGas to submit a revised Access Arrangement which indicates (presumably by means of a statement or statements) whether the Depreciation and allocation of revenue between services comprise principles or methodologies in accordance with the definition of “structural element”. If that is the case, AlintaGas submits that the amendment would be unsatisfactory for legal and policy reasons.

4.1.1 Legal

By virtue of section 8.47, the reference tariff policy in an access arrangement may provide that certain principles are fixed principles. In accordance with that section, clause 38 of the Access Arrangement states that certain principles, specified by the reference to the clause in which they are described, are fixed principles. A literal reading of Amendment 46 would, however, require that the Access Arrangement go further and include statements clarifying why two of the principles are principles for the purposes of the definition of structural element. AlintaGas submits that the inclusion of such clarifying, or explanatory statements, is not consistent with what the Code requires of an access arrangement generally, or with what is permissible under section 8.47. In a strict sense, a requirement to include statements clarifying whether an access arrangement complies with Code definitions is probably beyond your powers under section 2.24.

4.1.2 Policy

At a policy level, an access arrangement should, as stated in the Outline to section 2, be "...a statement of the policies and the basic terms and conditions which apply to third party access to a covered pipeline". It should not contain statements that clarify whether its elements comply with Code requirements. Issues of compliance are matters to be clarified and determined outside of the access arrangement during the regulatory assessment process under section 2. An element of an access arrangement, including the fixed principles, either complies with the Code or it does not. If it does, then the element should stand (without clarifying comments) in the access arrangement. If it does not, the element should be struck down as being inconsistent with the Code and be removed from the access arrangement.

AlintaGas therefore submits that Amendment 46 should not appear in the Final Decision. In order to clarify the central concern raised by the amendment – whether the two specified principles are principles within the meaning of structural element – AlintaGas has provided an explanation of the same below.

4.2 ADEQUACY OF REASONS FOR DECISION

The reasons for decision and the amendment itself are expressed in substantively the same terms, - both indicate that it is not clear whether the Depreciation Schedule and allocation of revenue across services constitute principles within the meaning of "structural element" in section 10.8. The reasons do not, however, provide any information about why you believe that this lack of clarity exists.

In AlintaGas's view, the discussion you have provided in the Draft Decision does not indicate the reasons for your decision about the asserted lack of clarity or the reasons for your decision to require the particular amendment you have specified. It is, therefore, impossible for AlintaGas to understand your reasons for decision. AlintaGas submits, therefore, that you have substantially failed to comply with your obligation to provide reasons under section 7.7. Accordingly, AlintaGas is considerably disadvantaged in its ability to respond to the amendment.

4.3 CLARIFICATION OF PRINCIPLES

Section 10.8 of the Code provides that “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.” (emphasis added).

As the definition expressly states that the Depreciation Schedule is included within the meaning of structural element, AlintaGas finds it difficult to understand why Amendment 46 questions whether the Depreciation Schedule is a structural element. Notwithstanding that, AlintaGas will demonstrate why the Depreciation Schedule and allocation of revenue between services are structural elements.

4.3.1 The Depreciation Schedule

Clause 38(1) of the Access Arrangement provides that the Depreciation Schedule referred to in clause 31 of the Access Arrangement is a fixed principle. Clause 31(1) states that depreciation has been calculated using a Depreciation Schedule which is the basis upon which the assets that form the AlintaGas Network have been depreciated for the purposes of determining the reference tariffs (it was used under clause 27 to calculate total revenue for the purpose of determining reference tariffs). Clause 31(4) states that the Depreciation Schedule has been designed in accordance with the objectives set out in section 8.33. The Depreciation Schedule is set out in table 3.5 of the Access Arrangement Information.

It is important to appreciate that the Depreciation Schedule is the methodology and set of principles used to determine depreciation for reference tariff calculation purposes. Values that are calculated in accordance with the methodology or principles are not the Depreciation Schedule as that term is employed in the Access Arrangement – they are the result of the application of the Depreciation Schedule.

4.3.2 “Allocation Of Revenue Between Services”

Clause 38(1) of the Access Arrangement states that the “allocation of revenue between services” as described in clause 33 of the Access Arrangement is a fixed principle. Clause 33 provides that the portion of total revenue (determined under clause 27) 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 ... that are directly attributable to each reference service; and
- (b) a share of the total revenue that reflects costs incurred 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 and is otherwise fair and reasonable.”

The “Note” to clause 33 states that a diagram of the allocation described in the clause is contained in the Access Arrangement Information. Figures 2.1 and 2.2 of the Access Arrangement Information diagrammatically demonstrate the application of the methodology by the allocation of total revenue across reference services. Section 2.5 and table 2.2 of the Access Arrangement Information further describe the allocation methodology.

As with the Depreciation Schedule, it is important to note that the “allocation of revenues between services” is a mechanism, or methodology, used to calculate the allocation of revenue between reference services. The values calculated by applying that mechanism are not the “allocation of revenue between services”, as that term is employed in the Access Arrangement.

4.3.3 Principle or Methodology

According to the Concise Oxford Dictionary a “principle” is a general law as a guide to action. A “methodology” is a body of methods, and “methods” are a special form of procedure.

The Depreciation Schedule is clearly a principle or methodology because it provides a general guide or special form of procedure as to how to depreciate the assets that form the AlintaGas network. To this end, clause 31(1) of the Access Arrangement states that the Depreciation Schedule is the basis upon which the assets that form the AlintaGas Network have been depreciated.

Likewise the “allocation of revenue between services” is also a principle or methodology. Clause 33 of the Access Arrangement clearly sets out the principles or methodology by which total revenue is allocated to reference services. To this end, clause 33 acts as a general guide as to how revenue will be allocated. In conjunction with the information provided in the Access Arrangement Information, it serves as a general guide as to the special procedure used to effect the allocation.

4.3.4 Used In The Calculation Of A Reference Service

It is quite clear from the description above, that the Depreciation Schedule and “allocation of revenue between services” are used in the calculation of reference tariffs for reference services A, B1, B2 and B3.

4.3.5 Not A Market Variable Element

A “market variable element” is:

“...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.” (section 10.8; emphasis added)

The key aspects of a market variable are that it is a factor that has a value assumed and that the value of that factor will vary with changing market conditions. In

consequence, a factor that has an assumed value that will not vary with changing market conditions is not a market variable element.

The Depreciation Schedule will not vary with changing market conditions. As stated above, it forms the basis or method upon which assets are depreciated. It is fixed in place at the commencement of the life of the Access Arrangement and will not change unless the methodology for the calculation of depreciation is changed by AlintaGas or you in a review of the Access Arrangement. A change in market conditions will not result in a change to the principles and methodology by which depreciation is calculated. Therefore, the Depreciation Schedule is not a Market Variable Element.

The “allocation of revenue between services”, as that term is employed in the Access Arrangement, is the set of principles and methodology used to allocate revenue across services. The “allocation of revenue between services” methodology outlined in clause 33 of the Access Arrangement and the Access Arrangement Information will not vary with changing market conditions. Changes to factors such as the level of non-capital costs, forecast sales and real interest rates will not result in a change to the “allocation of revenue between services” methodology and principles. Therefore, the “allocation of revenue between services” is not a Market Variable Element.

4.3.6 Structured For Reference Tariff Making Purposes Over More Than A Single Access Arrangement Period

AlintaGas structured its reference services and reference tariffs to apply over more than one access arrangement period. This is evidenced by the fact that AlintaGas specified the structure of the reference tariffs and the method of calculating total revenue as fixed principles in clause 38(1) of the Access Arrangement.

Consistent with that, AlintaGas also structured the Depreciation Schedule and “allocation of revenue across services” for reference tariff making purposes over more than a single access arrangement period. AlintaGas’s objective was to provide as much certainty as possible about the way in which reference tariffs and key components used to calculate reference tariffs, including the Depreciation Schedule and “allocation of revenue across services”, will be calculated over a number of access arrangement periods. In AlintaGas’s view, this will promote efficient outcomes for AlintaGas, users and prospective users.

In light of the above, AlintaGas submits that the Depreciation Schedule and “allocation of revenue between services” are both principles within the meaning of “structural element”, and that you should not require an amendment such as Amendment 46 in the Final Decision.

Attachment O

Amendment 47 – Duration of Fixed Period

1. ALINTAGAS’S UNDERSTANDING OF AMENDMENT 47

The reasons for decision state that section 8.48 indicates that the fixed period may be for all or part of the duration of an access arrangement. They then go on to state that section 8.48 “does not explicitly preclude a fixed period of longer than the Access Arrangement Period”.

The reasons for decision identify the following two particular considerations in relation to the fixed period. The two considerations are:

- (a) Exempting certain underlying parameters of reference tariffs from variation by regulatory decisions over an extended period may reduce financing costs and so reduce long-term charges to customers; and
- (b) There are risks to locking in aspects of the regulatory regime where:
 - I. there is currently little regulatory experience; and
 - II. both the gas industry and market will be subject to substantial change in the future, particularly with regard to the uncertain effects of the current regulatory regime on competition in gas markets.

Ultimately, the reasons for decision conclude that a fixed period in excess of the access arrangement period (in AlintaGas’s case, proposed to be 5 years) is “potentially contrary” to the interests of users and prospective users.

The effect of Amendment 47 is to reduce the fixed period from 10 years, as specified by AlintaGas in clause 38(2) of the Access Arrangement, to 5 years.

2. GENERAL COMMENT

AlintaGas objects to Amendment 47 and submits that you should not require such an amendment in the Final Decision. The fixed period is a fundamental regulatory risk factor for a service provider. Section 8.48 clearly and unambiguously permits, and indeed is constructed on the principle of, the specification of fixed principles for a fixed period that exceeds an access arrangement period. In fact, section 8.48 quite plainly promotes fixed periods which extend beyond access arrangement periods.

3. **REASONS FOR OBJECTION**

AlintaGas objects to Amendment 47 and submits that you should not require such an amendment in the Final Decision for the following reasons:

- (a) You did not have regard to AlintaGas's interests as required by section 8.48. If you did have regard to the interests of AlintaGas, you did not record them in the reasons for decision and you have accordingly failed to comply with your obligation to give reasons under section 7.7.
- (b) Your conclusion that a fixed period in excess of the access arrangement period is potentially contrary to the interests of users and prospective users is inconsistent with the very notion of fixed principles under sections 8.47 and 8.48. The effect of this conclusion is to incorrectly render sections 8.47 and 8.48 largely redundant.
- (c) The effect and intent of sections 8.47 and 8.48 is that the fixed period should be a period that extends beyond a single access arrangement period. Consistent with, and to give effect to, sections 8.47 and 8.48, you should approve a fixed period that spans a number of access arrangement periods. As specified by AlintaGas in clause 38(2) of the Access Arrangement, the appropriate fixed period is 10 years.
- (d) Your decision to not allow the fixed period of 10 years proposed by AlintaGas will result in increased regulatory risk contrary to the legitimate business interests of AlintaGas.
- (e) It is unreasonable for you to undermine the operation of sections 8.47 and 8.48 because of regulatory inexperience and market uncertainties. Those uncertainties were known at the time the Code was designed, and were implicitly accepted as risks.
- (f) It is unreasonable for you to attach more weight to the potential adverse effect on consumers than you attach to the definite adverse effect on AlintaGas's legitimate business interests.

4. **EXPLANATION OF REASONS FOR DECISION**

4.1 **ADEQUACY OF REASONS FOR DECISION**

Section 8.48 states, *inter alia*:

"...in determining a Fixed Period regard must be had to the interests of the Service Provider and the interests of Users and Prospective Users." (emphasis added).

The reasons for decision indicate that in determining the fixed principles you had regard to the interests of users and prospective users. This is evidenced by the final sentence of the second paragraph of the reasons for decision, at which you identify that identified uncertainties are "potentially contrary to the interests of users and prospective users".⁶⁷

⁶⁷ Part B, at 210.

It is apparent, however, that you did not have regard to the interests of AlintaGas in determining the fixed period. Nowhere in the reasons for decision is there any reference to, or consideration of, the interests of AlintaGas.

Accordingly, AlintaGas submits that you have not complied with your obligation under section 8.48 to have regard to the interests of the service provider. For that reason, Amendment 48 cannot be correct at law. Alternatively, if you did have regard for AlintaGas's interests, but did not record them in your reasons for decision, you have failed to comply with your obligation under section 7.7 to give reasons.

In absence of any statement in the reasons for decision that you considered AlintaGas's interests, AlintaGas must conclude that you did not. This constitutes an error of law that AlintaGas submits you must rectify.

Flowing from this error of law, AlintaGas is considerably disadvantaged in its ability to respond to Amendment 47. The comments that follow are given without prejudice to AlintaGas's rights in respect of this error of law.

4.2 INTERPRETATION OF SECTION 8.48

The first paragraph of the reasons for decision sets out your interpretation of what section 8.48 says about the fixed period.⁶⁸ Despite that explanation, AlintaGas is unclear about your interpretation.

AlintaGas is unclear about whether your interpretation distinguishes between the "duration" of an access arrangement, as referred to in section 8.48, and the "access arrangement period" for an access arrangement. AlintaGas submits that this is a fundamental issue with respect to an access arrangement. The duration of an access arrangement is the period between the time when the access arrangement becomes effective and the time it expires or terminates.⁶⁹ An access arrangement period, however, is defined by section 10.8 to be the period from when an access arrangement or revisions to an access arrangement take effect until the next revisions commencement date. Accordingly, the duration of an access arrangement is not the same as the access arrangement period. Within the duration of an access arrangement, there will usually be a number of access arrangement periods.

If one assumes that your interpretation does distinguish between the duration of the Access Arrangement and the access arrangement period, AlintaGas is then unclear as to why the second limb of the first paragraph of the reasons focuses on whether section 8.48 precludes a fixed period longer than an access arrangement period. In dealing with the fixed period, section 8.48 concerns itself with the duration of the access arrangement – it does not touch on the access arrangement period. This lack of clarity is worsened because the reasons state that section 8.48 does not "explicitly" preclude a fixed period longer than the access arrangement period. From that, it is reasonable to imply that you believe there is something "implicit" that precludes a fixed period longer than the access arrangement period.

AlintaGas is perplexed as to where such an implicit inference might be found in section 8.48. As section 8.48 does not address the issue of the access arrangement period, it is

⁶⁸ Part B, at 210.

⁶⁹ See, for example, sections 1.20, 2.28 and 3.20.

difficult to draw any such inference. Indeed, AlintaGas submits that no such inference can be drawn and that the only relevant consideration is whether the fixed period should be for all or only part of the duration of the access arrangement.

In considering the length of the fixed period, the reasons conclude that regulatory and market uncertainties suggest that a fixed period in excess of the access arrangement period is potentially contrary to the interests of users and prospective users.⁷⁰ AlintaGas submits that such a conclusion is inconsistent with very notion of fixed principles under sections 8.47 and 8.48. AlintaGas further submits that the effect of a decision to limit the fixed period to the access arrangement period renders sections 8.47 and 8.48 largely redundant.

Under section 8.47, the fixed period is the period during which a fixed principle may not be changed without the agreement of the service provider. It is evident from a number of features of sections 8.47 and 8.48 that the drafter of the Code envisaged that the fixed period would extend beyond an access arrangement period. Those features are:

- (a) The fact that section 8.48 focuses on the duration of an access arrangement, rather than access arrangement period, strongly suggests that the drafter intended that a fixed principle would cover more than one access arrangement period. If the drafter did not have that intention, he or she could have simply stated that the fixed period was to be no longer than the access arrangement period.
- (b) Under section 8.48, a fixed principle must be a “structural element”⁷¹. For a principle or methodology to qualify as a structural element, it must have been “structured for reference tariff making purposes over more than a single access arrangement period”. The fact that the Code only allows principles to be fixed principles if they were designed to extend over more than one access arrangement period strongly suggests that the intention of sections 8.47 and 8.48 is for fixed principles to be immune from change at the regulator’s discretion for more than one access arrangement period.
- (c) Section 8.47 describes the role of fixed principles and the fixed period in the following way:

“...certain principles are fixed for a specified period and not subject to change when a Service Provider submits reviews to an Access Arrangement...”

These words clearly indicate a concern with the fixing of principles that are not subject to change “when a Service Provider submits reviews”. In the vast majority of cases, reviews submitted by a service provider under section 2.28 will be submitted in compliance with the revisions submissions date specified in the access arrangement. The revisions submissions date always occurs a short time before the end of the access arrangement period. Accordingly, the reviews to which section 8.47 refers are, in the vast majority of cases, reviews that occur at the end of the access arrangement period. Section 8.47 is, therefore, concerned with the fixing of principles beyond an access arrangement period.

⁷⁰ Part B, at 210.

⁷¹ Discussed and defined above; section 10.8.

In this light, the effect and intent of section 8.47 and 8.48 in relation to the fixed period is unambiguous. The effect and intent is that the fixed period should extend beyond a single access arrangement period. In its fullest application, the fixed period could extend to the full duration of an access arrangement.

AlintaGas, therefore, submits that you should not determine a fixed period of the same duration as the access arrangement period. Consistent with, and to give effect to, sections 8.47 and 8.48, you should approve a fixed period that spans a number of access arrangement periods. As specified by AlintaGas in clause 38(2) of the Access Arrangement, the appropriate fixed period is 10 years (or an anticipated two access arrangement periods).

4.3 THE INTERESTS OF ALINTAGAS AND USERS/PROSPECTIVE USERS

As noted above, you did not take into account the interests of AlintaGas is making a decision to impose Amendment 47. AlintaGas would be pleased to discuss with you the nature of its interests in having a fixed period of 10 years.

For present purposes, AlintaGas wishes to submit that its interests are served by the maximisation of certainty in relation to key structural elements of the Access Arrangement. If AlintaGas can operate with certainty that matters such as the structure of reference tariffs, allocation methodologies and depreciation schedules will not be changed by you at reviews of the Access Arrangement for a period of 10 years, it will have greater incentives to invest, develop the market for distribution services, reduce costs and increase efficiency. At the same time, AlintaGas will have confidence that the burdens of regulation will minimised over the fixed period.

A shorter fixed period will necessarily result in a corresponding reduction in levels of certainty and increase in perceptions of regulatory risk. The mere fact that there is opportunity for regulatory reviews that have the potential for changes to fundamental structural elements of the Access Arrangement will affect business certainty for AlintaGas and will carry with it the considerable risk of stifling investment in, and the development of, the gas market. Equally important, it would also result in increased regulatory burdens as AlintaGas may be required to address changes to key structural elements of the Access Arrangement within a relatively short period of time of their introduction.

4.4 REGULATORY UNCERTAINTY

AlintaGas accepts that there are risks in “locking in” aspects of the regulatory regime when there is uncertainty. AlintaGas submits, however, that such risks are no greater now than they were when the Code was drafted and applied as a law of Western Australia. At that time it was known that the introduction of the Code would occur in an environment in which there was little regulatory experience – in fact, it could not have been otherwise. It was also known that the introduction of the Code would occur in the context of, and indeed in conjunction with, the *National Gas Pipelines Agreement* of 1997 and that it would be the dominant cause of, substantial change in the gas market and industry. Yet the Code was drafted and enacted with provisions that offered, by way of fixed principles for a fixed period extending beyond an access arrangement period, regulatory certainty for service providers.

It is, therefore, unacceptable to AlintaGas that you now intend to use regulatory inexperience and market uncertainties to justify closing off one of the few harbours of certainty reserved for service providers in the Code. The uncertainties associated with those things were known at the time the Code was designed, and the Code implicitly accepted them as risks. It is unreasonable for you to now propose to undermine the operation of sections 8.47 and 8.48

4.5 ALINTAGAS'S INTERESTS

The strongest position that the reasons for decision state about the level of risk associated with “locking in” aspects of the regulatory regime for more than one access arrangement period is that the risk is “potentially contrary to the interests of users and prospective users”. This indicates that you have not been able to go so far as to conclude that the risks will be contrary to the interests of users and prospective users.

In contrast, AlintaGas can demonstrate that its interests will be adversely affected by the fixed period you require under Amendment 47. As such, AlintaGas submits that you must conclude that the definite adverse effect on AlintaGas’s interests outweighs the potential adverse effect on users, and ensure that Amendment 47 does not appear in the Final Decision.

4.6 OTHER JURISDICTIONS

AlintaGas is not aware of any other decision or draft decision in relation to any other Australian access arrangement whereby the relevant regulator has stated that the fixed period is not to exceed the access arrangement period.

AlintaGas notes that in the final decision in relation to the Victorian gas distribution systems, the Victorian Office of the Regulator General (“ORG”)stated:

“The definitions of Structural Element and Market Variable Element permit a Fixed Principle to include any principle of methodology that is used in the calculation of a Reference Tariff (such as depreciation methodology), but excluded a factor that will vary with changing market conditions (such as interest rates – see section 9.9 of the Code).”⁷²

“The Office interprets the Code as requiring it to consider whether the benefits that are likely to occur from the reduction in its discretion are likely to outweigh the costs and, if so, whether there is a reasonable sharing of the potential benefits between the Service Provider and Users.”⁷³

AlintaGas notes that ORG allowed a number of fixed principles to apply to the re-determination of reference tariffs for the period to 1 January 2003 (that is, the fixed principles are to apply for two access arrangement periods).⁷⁴

⁷² Office of the Regulator General, Victoria, Access Arrangements- Multinet Energy Pty Ltd & Multinet (Assets) Pty Ltd Westar (Gas) Pty Ltd & Westar (Assets) Pty Ltd Stratus (Gas) Pty Ltd & Stratus Networks (Assets) Pty Ltd – Final Decision, at page 124.

⁷³ Ibid, at page 126

⁷⁴ Ibid at page 131.