

# Draft decision on WA Gas Networks Revisions Proposal for the access arrangement for the Mid-West and South-West Gas Distribution Systems

submitted by WA Gas Networks Pty Ltd

17 August 2010

**Economic Regulation Authority**

WESTERN AUSTRALIA

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## DRAFT DECISION

1. WA Gas Networks Pty Ltd (WAGN) submitted on 29 January 2010 its proposed revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (GDS) to the Economic Regulation Authority (Authority) for approval under the National Gas Access (Western Australia) Act 2009 (NGA).
2. The NGA applies the National Gas (South Australia) Law (**NGL**) (as in force pursuant to section 7 of the NGA), and the National Gas Rules (**NGR**) (as in force pursuant to section 26 of the NGA) as laws of Western Australia. The NGA modifies the effect of the NGL and NGR in certain respects as applicable in Western Australia.
3. The Authority has considered WAGN's proposed revisions pursuant to the requirements of the NGL and NGR, as they apply in Western Australia by virtue of the NGA.
4. As required by rule 59(1) of the NGR, in arriving at its draft decision the Authority considered all of the public submissions received by the Authority within the time allowed in the initiating notice, namely by 12 April 2010. The Authority also considered one public submission received after that date, by Alinta Pty Ltd. The details of the public submissions that were received and considered by the Authority are set out below.
5. The Authority received a late submission from WAGN on 4 June 2010. The Authority has not accepted this submission on the basis that this submission was received at the time the draft decision was being finalised.
6. The Authority's draft decision pursuant to rule 59(2) of the NGR is not to approve the access arrangement proposal as submitted by WAGN. The Authority's detailed reasons for this draft decision are set out in this decision. It should be noted that, in some cases, this draft decision requires WAGN to provide the Authority with further information prior to the final decision in relation to WAGN's proposed revisions.
7. The Authority has indicated in the draft decision 74 amendments required in order to make the proposal acceptable to the Authority. These amendments relate to WAGN's proposed revised access arrangement.
8. In the case of the access arrangement information, the draft decision indicates where this decision differs from the access arrangement information provided by WAGN. The draft decision notes that the Authority intends to consider exercising its power under rule 43(3) of the NGR to require WAGN to amend its access arrangement information at the time the Authority makes its final decision.
9. The amendments required in this draft decision are listed below.

## List of Amendments

### Required Amendment 1

The proposed access arrangement should be amended to include descriptions of the following ancillary services as pipeline services (collectively **ancillary services**):

- a) deregistration service for Services A1, A2, B1, B2 and B3;

- b) apply meter lock service for Services B2 and B3;
- c) remove meter lock service for Services B2 and B3;
- d) disconnection service for Services B2 and B3; and
- e) reconnection service for Services B2 and B3.

The proposed access arrangement should be amended to specify the ancillary services as reference services.

#### Required Amendment 2

Clause 5.2 of the proposed access arrangement should be deleted and replaced with the following clause 5.2:

##### 5.2 Application information

An application for access to a pipeline service must be in writing and must:

- a) state the time or times when the pipeline service will be required and the capacity that is to be utilised; and
- b) identify the entry point where the user proposes to introduce natural gas to the pipeline and the exit point where the user proposes to take natural gas from the pipeline; and
- c) state the relevant technical details (including the proposed gas specification) for the connection to the pipeline, and for ensuring safety and reliability of the supply of natural gas to, or from, the pipeline.

#### Required Amendment 3

Clauses 5.3(a) and 5.3(c) to (h) of the proposed access arrangement should be deleted.

#### Required Amendment 4

Clause 5.5 of the proposed access arrangement should be deleted.

#### Required Amendment 5

Clause 5.7 of the proposed access arrangement should be deleted.

The proposed access arrangement should be amended to include provisions consistent with clauses 28 to 34 of the current access arrangement.

#### Required Amendment 6

The Authority requires clause 9.1(b) of the proposed access arrangement to read:

- (b) For the calculation of the Opening Capital Base for the WAGN GDS for the Next Access Arrangement Period, each of:

- (i) the Opening Capital Base for the Current Access Arrangement Period (adjusted for any difference between estimated and actual capital Expenditure included in that Opening Capital Base);
- (ii) Conforming Capital Expenditure made, or to be made, during the Current Access Arrangement Period;
- (iii) any amounts added to the Capital Base under rule 82, rule 84 and rule 86 of the National Gas Rules;
- (iv) depreciation over the Current Access Arrangement Period (calculated in accordance with paragraph 9.1(a));
- (v) redundant assets identified during the course of the Current Access Arrangement Period; and
- (vi) the value of Pipeline Assets disposed of during the Current Access Arrangement Period;

is to be escalated, at the rate of inflation as measured by the CPI All Groups, Eight Capital Cities, and expressed in the prices prevailing on a date nominated by WAGN (provided that date is a date on or prior to the end of the Current Access Arrangement Period).

#### Required Amendment 7

The Authority requires clauses 3.1(iv)(A) and (B) and 3.1(v) of Annexure B of the proposed access arrangement to be deleted.

#### Required Amendment 8

The Authority requires Annexure A and sections 1 and 2 of Annexure B of WAGN's proposed access arrangement to be amended as follows:

##### Annexure A

Replace the haulage reference tariffs set out under Annexure A with the haulage reference tariffs set out in Table 27.

##### Annexure B (sections 1 and 2)

Inflation - tariffs need to be set to account for inflation by adjusting the real tariffs modelled, using 31 December 2009 dollars, based on CPI (All Groups, Eight Capital Cities) at the end of each modelling period;

Regulatory operating costs - clause 2.3(c), which includes the 2009 regulatory operating costs under the tariff variation mechanism for the 1 July 2011 adjustment, should be deleted;

Regulatory capital costs - references to regulatory capital expenditure should be deleted; and

The real pre-tax rate of return should be amended to 6.89 per cent.

#### Required Amendment 9

The Authority requires clause 11.1(b)(i) of WAGN's proposed access arrangement to be deleted.

#### Required Amendment 10

The Template Haulage Contract should be amended as follows:

- a) Delete clauses 1.1(a)(i), 1.1(a)(ii)(A) and 1.1(a)(ii)(D), and replace with a clause which provides for compliance by the user with the pre-condition to access in clause 5.7 of the access arrangement as a pre-condition to provision of the reference service under the haulage contract.
- b) Delete clauses 1.1 (b), (c), (d), (e), (f).

#### Required Amendment 11

Clause 2(b) of the Template Haulage Contract should be amended to read:

This Haulage Contract:

- b) ends on the earlier of:
  - i) when the access arrangement is revised or expires in accordance with the NGL and NGR and <user> does not agree to continue this Haulage Contract on the basis of the Haulage Contract being varied to incorporate the terms and conditions of the access arrangement which replaces the current access arrangement.
  - ii) when <user> is no longer entitled to take delivery of Gas at any Delivery Point under this Haulage Contract; or
  - iii) when it is terminated under clause 14 or as otherwise provided for under this Haulage Contract.

#### Required Amendment 12

Clauses 4.2(a)(ii), 4.2(a)(iii) and 4.2(b)(v) should be deleted from the Template Haulage Contract.

#### Required Amendment 13

Clause 5.3 of the Template Haulage Contract should be retitled: 'Start Date and End Date for the receipt and delivery of gas'.

#### Required Amendment 14

Clause 5.5(a) of the Template Haulage Contract should be amended as follows:

- (a) Subject to clause 5.5(b), <User> may request <Service Provider> to:
  - i) add a new Delivery Point to the Delivery Point Register;
  - ii) increase the Contracted Peak Rate for a Delivery Point to which Service A1, Service A2 or Service B1 applies; or

iii) change the End Date for a Delivery Point to a date which is later than the End Date specified in the Delivery Point Register for the Delivery Point,

and, if ~~<Service Provider>~~ agrees, **<Service Provider>** must make appropriate adjustments to the Delivery Point Register, subject to **<Service Provider>** withholding consent on reasonable grounds, based on technical or commercial considerations.

Clause 5.5(b)(i) should be deleted.

#### Required Amendment 15

Clause 5.6 of the Template Haulage Contract should be amended as follows:

- Delete clause 5.6(a) and replace with the following:
  - (a) No later than 30 days prior to the End Date, <Service Provider> will give written notice to <user> specifying the procedure to Deregister the Delivery Point.
  - (b) If on the End Date for a Delivery Point no other user is identified as the Current user for the Delivery Point under the Retail Market Rules or <user> has not applied for an extension to the End Date, then <user> must request <Service Provider> to Deregister the Delivery Point.
- Renumber clause 5.6(b) as 5.6(c).

#### Required Amendment 16

Annexure A to the Template Haulage Contract should be amended as follows:

- Delete 1(a) and replace with “the gas specification requirements detailed under the *Gas Standards (Gas Supply and System Safety) Regulations 2000*”.
- *Rename 1(b) to 1(c),*
- *Insert 1(b) as “the gas specification requirements detailed under part 1 of Schedule 1 (Western Australian standard specification) under Gas Supply (Gas Quality Specifications) Regulations 2010”.*
- Delete the table under Annexure A.

#### Required Amendment 17

Clauses 5.8(b) and 5.8(d)(iii) should be deleted from the Template Haulage Contract.

#### Required Amendment 18

Clause 5.9(a) of the Template Haulage Contract should be amended to read:

For each Gas Day, <user> must ensure that it ~~delivers~~ procures the injection of an amount of Gas into each Sub-network that is equal to the ~~<user>~~ <user>’s good faith estimate, acting as a reasonable and prudent person, of the quantity of Gas ~~receives from that Sub-network on that~~ <user> is likely to withdraw from the Sub-network on that Gas Day.

Required Amendment 19

Clause 5.10(a) of the Template Haulage Contract should be deleted.

Required Amendment 20

The words 'be it direct or indirect' should be deleted from clause 5.11(d) of the Template Haulage Contract.

Required Amendment 21

Clause 6.6(e) of the Template Haulage Contract should be amended to read:

Subject to clause 6.6(f) and clause 20.2, <Service Provider> may disclose to an operator of an Interconnected Pipeline information which <Service Provider> determines, as a reasonable and prudent network operator, to be the minimum amount of information required to be disclosed for operational reasons relating to the interconnection of that, or any other, Interconnected Pipeline with the WAGN GDS.

Required Amendment 22

Clause 6.7(b) of the Template Haulage Contract should be amended to read:

If, in the course of installing user Specific Delivery Facilities or Standard Delivery Facilities, <Service Provider> causes damage to land or premises including the opening or breaking up any sealed or paved surface, or damaging or disturbing any lawn, landscaping or other improvement, then <Service Provider> will if necessary and ~~in its absolute discretion~~ acting as a reasonable and prudent person either:

- i) fill in any ground to restore it to approximately its previous level; or
- ii) at <User>'s expense and ~~without~~ after obtaining prior consent from <User>, restore the land or premises including the sealed or paved surface, lawn, landscaping or other improvement to the extent reasonably practicable.

Required Amendment 23

Clause 7.3(b) of the Template Haulage Contract should be amended to read

- b) at any time at least ~~40~~ 30 days after giving <User> written notice,

Required Amendment 24

Clause 7.4 of the Template Haulage Contract should be amended so that clause 7.4(i) is deleted.

Required Amendment 25

Clause 7.5(a) of the Template Haulage Contract should be amended to read:

In order to effect a Curtailment under this Haulage Contract (including under clause 7.2) <Service Provider> ~~may~~ must issue a notice to <User> requiring <user> to:

- i) Curtail receiving Gas at one or more Delivery Points and Curtail delivering Gas to every associated Receipt Point; and
- ii) comply with any other condition necessary to effect the Curtailment or refusal to accept Gas.

#### Required Amendment 26

Clause 7.6(a) of the Template Haulage Contract should be amended to read:

In order to enforce a refusal to accept Gas under clause 7.4, <Service Provider> ~~may~~ must issue a notice to <User> requiring <user> to:

- i) cease delivering Gas to a Physical Gate Point or Receipt Points and Curtail taking delivery from any and all associated Delivery Points; and
- ii) comply with any other condition necessary to effect the Curtailment or refusal to accept Gas.

#### Required Amendment 27

Clause 7.8(a) of the Template Haulage Contract should be amended to read:

When exercising its rights under clauses 7.2, 7.3 or 7.4, <Service Provider> shall determine, ~~in its absolute discretion~~ acting as a reasonable and prudent service operator:

- i) which Delivery Points it will Curtail and the order of that Curtailment; or
- ii) the quantity of Gas that it refuses to accept delivery of and Receipt Points at which it will refuse to accept,

as the case may be.

#### Required Amendment 28

Insert a new clause as 7.8(d) to read:

Existing clause 7.8(d) should consequentially be renumbered as clause 7.8(e).

#### Required Amendment 29

Clause 9.1 of the Template Haulage Contract should be amended to delete clause 9.1(c) which sets out WAGN's proposed revised invoicing procedure.

Clause 9.1 of the Template Haulage Contract should be amended to include an invoicing procedure consistent with clause 30(2) of Part C of the current access arrangement.

#### Required Amendment 30

Clause 9.2(a) of the Template Haulage Contract should be amended to provide that the user should:

- i) be given at least 10 (rather than 3) business days to respond to a payment claim as to whether any line items are disputed;
- ii) do so in a single return notice (rather than separate notices); and
- iii) provide details of the reasons for any dispute (which is not provided for under WAGN's revisions proposal); and
- iv) if the user does not dispute any line item the user should be taken to agree to pay (rather than having to lodge a payment notice).

Clause 9.2 of the Template Haulage Contract should be amended to delete clause 9.2(b) regarding the giving of a resolution notification by WAGN, and all provisions contingent on that notification, namely 9.2(c) to (h).

Clause 9.2 of the Template Haulage Contract should be amended to be consistent with the provisions of:

- i) clauses 30(3) & (4) of Part C of the current access arrangement with respect to adjustments for payments under disputed invoices;
- ii) clause 32(1) of Part C of the current access arrangement with respect to the interim payment of disputed invoices; and
- iii) clauses 32(2) and (3) of Part C of the current access arrangement with respect to the payment of interest on resolution of invoice disputes.

#### Required Amendment 31

Clause 9.4 of the Template Haulage Contract should be amended to delete clause 9.4(a) regarding the giving of a retrospective resolution notification by WAGN, and all provisions contingent on that notification, namely 9.4(b) to (i).

Clause 9.4 of the Template Haulage Contract should be amended to be consistent with the provisions of clause 33 of Part C of the current access arrangement with respect to correction of payment errors.

#### Required Amendment 32

Clause 9.5 of the Template Haulage Contract should be amended to delete clause 9.5(a) regarding the giving of a retrospective error notification by WAGN, and all provisions contingent on that notification, namely 9.5(b) and 9.5(c).

Clause 9.5 of the Template Haulage Contract should be amended to be consistent with the provisions of clause 33 of Part C of the current access arrangement with respect to correction of payment errors.

#### Required Amendment 33

Clauses 9.6(a) and 9.6(b) of the Template Haulage Contract should be deleted.

#### Required Amendment 34

Clauses 10.1 and 10.2 of the Template Haulage Contract should be deleted.



Required Amendment 35

Clause 11 of the Template Haulage Contract should be amended by inserting under a new clause 11(c), the equivalent of clause 37(3) of the current access arrangement.

Clause 11(b) should also be amended so that it is subject to clause 11(c).

Required Amendment 36

Clause 12.1(b) of the Template Haulage Contract should be amended by deleting the words '10 Business Days' in the first line and inserting the words '20 Business Days'.

Required Amendment 37

Clauses 12.2, 12.3, and 12.4 should be deleted from the Template Haulage Contract.

Required Amendment 38

Clause 12.5 should be deleted from the Template Haulage Contract.

Required Amendment 39

Clause 12.6 should be deleted from the Template Haulage Contract.

Required Amendment 40

Clause 12.7 should be deleted from the Template Haulage Contract.

Required Amendment 41

Clause 12.8 should be deleted from the Template Haulage Contract.

Required Amendment 42

Clause 12.9 should be deleted from the Template Haulage Contract.

Required Amendment 43

Clause 13.3(c)(i) of the Template Haulage Contract should be amended to read:

(i) Third Party making an Application under and the transfer being subject to, the Application Procedure ~~(including in particular the pre-conditions to and restrictions on the provision of Pipeline Services specified in the Access Arrangement);~~

Clause 13.3(c)(ii) should read:

(ii) Third Party complying with one or more pre-conditions to and restrictions on the provision of Pipeline Services specified in the ~~Access Arrangement~~ Template Haulage Contract, as directed by **<Service Provider>** in writing;

Required Amendment 44

Clause 13.5(c) of the Template Haulage Contract should read:

- (c) A quote provided under clause 13.35(b) does not limit the costs which must be reimbursed under clause 13.5(a) provided that it is prepared in good faith.

Required Amendment 45

- Clause 13.6(a) of the Template Haulage Contract should read:
  - (a) <User> may novate this Haulage Contract with <Service Provider>'s prior written consent, and such consent must not be unreasonably withheld. <Service Provider>'s consent will not be unreasonably withheld if it is withheld on the ground that, if the novation occurred, there would be, in <Service Provider>'s opinion acting as a reasonable and prudent person, an increase in the commercial or technical risk to <Service Provider>.
- Clause 13.6(b)(i) of the Template Haulage Contract should read:
  - (i) the person to whom it is proposed the Haulage Contract will be novated to complying with one or more pre-conditions to and restrictions on the provision of Pipeline Services specified in the ~~Access Arrangement~~ Template Haulage Contract, as directed by **<Service Provider>** in writing;

Required Amendment 46

Clauses 13.7(b)(iii) and 13.7(c) should be deleted.

Required Amendment 47

Clause 14.2(b) should be amended to read:

- (b) if <user> is in default under any other Haulage eContract between the parties ~~with the <Service Provider>~~;

Required Amendment 48

Clauses 15.2(c) to 15.2(k) of the Template Haulage Contract should be deleted.

Annexure B to the Template Haulage Contract should be deleted.

Required Amendment 49

Clause 15.3 of the Template Haulage Contract should be amended to delete clauses 15.3(a) to 15.3(c) and to replace these clauses with insurance requirements consistent with clause 61 of Part C of the current access arrangement.

Required Amendment 50

Clause 16.1(b)(i) and (ii) of the Template Haulage Contract should be amended to read:

- (i) any refusal to accept gas at a Receipt Point or Curtailment of Gas deliveries to <user>, undertaken in accordance with the terms of this Haulage Contract or otherwise pursuant to Law;
- (ii) any non-delivery of Gas into the WAGN GDS where non-delivery has not been caused, or contributed to, by the <Service Provider>;

#### Required Amendment 51

Clause 16.4 of the Template Haulage Contract should be amended to delete any reference to the 'Upstream Person'.

#### Required Amendment 52

Clause 16.8 of the Template Haulage Contract should be deleted.

#### Required Amendment 53

Clauses 17.1 to 17.3 of the Template Haulage Contract should be deleted and replaced with equivalent provisions to those in clause 60 of Part C of the current access arrangement.

#### Required Amendment 54

Clause 18.2 of the Template Haulage Contract should be amended to revert back to the two alternatives for the parties to proceed to arbitration as set out in clause 56 of Part C of the current access arrangement, with appropriate references to the NGL.

#### Required Amendment 55

Clause 18.3(f) of the Template Haulage Contract should be deleted.

#### Required Amendment 56

Clause 20.1 of the Template Haulage Contract should be deleted.

#### Required Amendment 57

Clause 20.2 of the Template Haulage Contract should be deleted.

#### Required Amendment 58

Clause 20.4 of the Template Haulage Contract should be amended to read:

(b) Where information is not exchanged in accordance with clause 20.4(a), **<Service Provider>** or **<User>** may recover from the person providing or requesting the information the reasonable additional costs involved in dealing with the information.

#### Required Amendment 59

Clause 20.5 of the Template Haulage Contract should be deleted.

#### Required Amendment 60

Clause 21.4 of the Template Haulage Contract should be deleted.

#### Required Amendment 61

Clause 22.1 of the Template Haulage Contract should be amended as follows:

1) The definition of CPI should refer to 'CPI All Groups Eight Capital Cities'.

2) The following definitions should read the same as the corresponding definitions in the NGL and NGR:

- a) Access Arrangement;
- b) Delivery Point;
- c) End user;
- d) National Gas Rules;
- e) Receipt Point;
- f) Regulator; and
- g) User.

3) The following definitions should read as follows:

- a) 'REMCo' means the Retail Energy Market Company Limited (ABN 15 103 318 556), or any other corporation managing the retail energy market.
- b) 'REMCo Registry' has the meaning given to that term in the Retail Market Rules, as amended from time to time, or any other rules applying to the retail energy market.
- c) 'Retail Market Rules' means the rules applying under the Retail Market Scheme, as amended from time to time, or any other scheme applying to the retail energy market.
- d) 'Retail Market Scheme' means the retail market scheme, including the Retail Market Rules, approved under section 11ZOJ of the *Energy Coordination Act 1994* (WA) as applying in respect of the WAGN GDS, as amended from time to time, or any other scheme applying to the retail energy market.

4) The terms 'Service Provider' and 'Covered Pipeline Service Provider' should read:

**'Service Provider'** has the meaning given to that term under the National Gas Access Law and for the purposes of this Haulage Contract, WAGN is the Covered Pipeline Service Provider for the WAGN GDS.

**'Covered Pipeline Service Provider'** means a service provider that provides or intends to provide pipeline services by means of a covered pipeline.

Required Amendment 62

Clause 22.2 of the Template Haulage Contract should be deleted.

Required Amendment 63

The following clauses of the Template Haulage Contract:

- a) Clauses 2(c) of Schedules 1 and 2;
- b) Clause 2(d) of Schedule 3; and

- c) Clauses 2(b) of Schedules 4 and 5

should be amended to read as follows:

Required Amendment 64

The following clauses of the Template Haulage Contract should be deleted:

- a) Clauses 2(e) of Schedules 1 and 2;
- b) Clause 2(f) of Schedule 3;
- c) Clauses 2(d) of Schedules 4 and 5;
- d) Clauses 9(c)(ii) of Schedules 1 and 2;
- e) Clauses 8(c)(ii) of Schedules 3 to 5;
- f) Clauses 7(c)(ii) of Schedules 4 and 5;
- g) Clauses 9(c)(ii) of Schedules 4 and 5;
- h) Clauses 10(c)(ii) of Schedules 4 and 5; and
- i) Clauses 11(c)(ii) of Schedules 4 and 5.

Required Amendment 65

Clauses 4(b) of Schedules 1 to 3 of the Template Haulage Contract should be amended as follows:

- b) Notwithstanding clause 4(a) of this Schedule the pressure described at clause 4(a) of this Schedule will be amended from time to time to the pressure that **<Service Provider>** and **<User>** agree ~~determines, in its absolute discretion from time to time~~, as the minimum nominal operating pressure for the main to which the Delivery Point is connected.

Required Amendment 66

Clause 5(b) of Schedules 1 and 2 of the Template Haulage Contract should read:

- (b) **<Service Provider>** will ~~endeavour to~~ take such Telemetry readings each day.

Required Amendment 67

Required Amendment 68

The following clauses of the Template Haulage Contract should be deleted:

- a) clause 9 of Schedules 1 and 2
- b) clause 8 of Schedule 3; and
- c) clauses 7 of Schedules 4 and 5

#### Required Amendment 69

Clause 6.4(a)(ii) of the proposed access arrangement should be deleted.

#### Required Amendment 70

Clauses 7.1, 7.2 and 7.3 of the proposed access arrangement should be deleted and replaced with the following:

##### 7.1 Extensions of high pressure pipelines

- i) If WAGN proposes a high pressure pipeline extension of the covered pipeline it must apply in writing to the Authority for a decision on whether the proposed extension will be taken to form part of the covered pipeline and will be covered by this access arrangement. The application must describe the extension and set out why the extension is necessary.
- ii) The application referred to in (i) above must be made before the proposed high pressure pipeline extension comes into service.
- iii) After considering WAGN's application and undertaking such consultation as the Authority considers appropriate the Authority will inform WAGN of its decision.
- iv) The Authority's decision referred to in (iii) above may be made on such reasonable terms as determined by the Authority and will have the effect stated in the decision.
- v) An extension under this clause 7.1 will not affect reference tariffs during a current access arrangement period.

##### 7.2 Extensions of medium and low pressure pipelines

- i) Any low or medium pressure pipeline extension of the covered pipeline will be treated as part of the covered pipeline and accordingly covered by this access arrangement.
- ii) No later than 20 business days following the expiration of the financial year WAGN must notify the Authority of all low and medium pressure pipeline during that year including all extensions commenced in progress or completed.
- iii) The notice must describe each extension and set out why the extension was necessary.
- iv) An extension under this clause 7.2 will not affect reference tariffs during a current access arrangement period.

##### 7.3 Expansions

- i) All expansions of the capacity of the covered pipeline carried out by WAGN will be treated as part of the covered pipeline and accordingly covered under this access arrangement.
- ii) No later than 20 business days following the expiration of the financial year WAGN must notify the Authority of all expansions of the covered pipeline during that year including all expansions commenced, in progress or completed.

iii) The notice must describe each expansion and set out why the expansion was necessary.

iv) An expansion under this clause 7.2 will not affect reference tariffs during the current access arrangement period.

#### Required Amendment 71

The second sentence of clause 8.1(a) of the proposed access arrangement should be deleted.

Clause 8.1(a)(iv) of the proposed access arrangement should be deleted.

The Template Haulage Contract should be amended to insert a term in identical terms to clause 8 of the proposed access arrangement as amended in this draft decision.

#### Required Amendment 72

The definition of CPI in clause 12 of the proposed access arrangement should be amended to CPI All Groups, Eight Capital Cities.

#### Required Amendment 73

The following definitions should be amended to read the same as the corresponding definitions in the NGL and NGR:

- a) Delivery Point;
- b) National Gas Access (WA) Legislation;
- c) National Gas Regulations
- d) National Gas Rules;
- e) Receipt Point;
- f) Reference Tariff Variation Mechanism; and
- g) User.

#### Required Amendment 74

Retail Market Rules' means the rules applying under the Retail Market Scheme, as amended from time to time, or any other scheme applying to the retail energy market. '

'Retail Market Scheme' means the retail market scheme, including the Retail Market Rules, approved under section 11ZOJ of the Energy Coordination Act 1994 (WA) as applying in respect of the WAGN GDS, as amended from time to time, or any other scheme applying to the retail energy market.

## Introduction and Overview

### Mid-West and South-West Gas Distribution Systems

10. WA Gas Networks Pty Ltd (**WAGN**) owns the Mid-West and South-West Gas Distribution Systems (**GDS**). The GDS comprises the majority of the reticulated gas infrastructure in Western Australia.
11. The GDS is a system of non-contiguous gas distribution pipelines and associated facilities located in the Perth metropolitan area (including Ellenbrook, Rockingham and Mandurah), and in a number of regional centres in the south-west of Western Australia. The regional centres in which the GDS is located are Geraldton, Eneabba, Pinjarra, Harvey, Kemerton, Bunbury, Capel and Busselton.
12. Discrete pipeline segments, or sub-networks, make up the GDS. As at 29 January 2010, these comprised approximately 12,500 kilometres of high pressure, medium pressure, medium/low pressure, and low pressure gas pipelines. Gas is delivered into each of these sub-networks from 16 receipt points immediately downstream of meter stations on the Dampier to Bunbury Natural Gas Pipeline, and from one receipt point on the Parmelia Pipeline. The GDS delivers gas to some 608,000 delivery points.
13. The GDS distributes natural gas transported by the Dampier to Bunbury Natural Gas Pipeline (**DBNGP**) and the Parmelia Pipeline to industrial, commercial, small business and residential customers in the mid-west and south-west coastal regions of Western Australia.
14. Over the last five years the annual growth of these networks has been approximately 260km with an average annual new customer connection rate of 20,000.
15. WA Network Holdings Pty Ltd, owner of WAGN, is 74.1 per cent owned by Prime Infrastructure with the remaining 25.9 per cent owned by Diversified Utility Energy Trusts.
16. WestNet Energy Services Pty Ltd (**WestNet Energy**) provides asset management, operational, construction and maintenance services to WAGN with respect to the GDS.

### Regulatory background

17. Under Schedule A of the National Third Party Access Code for Natural Gas Pipelines (**Code**) the GDS (then known and described as the Alinta Gas Distribution Systems) was specified as a covered pipeline for the purpose of section 1.1 of the Code.
18. Under the Code, the Authority was responsible for approving access arrangements for covered pipelines, including the GDS.
19. On 18 July 2000, the predecessor to the Authority (the Independent Gas Pipelines Access Regulator) approved an initial access arrangement for the GDS under the Code. On 10 August 2005, the Authority approved revisions to the access



arrangement for the GDS under the Code. The revisions were specified to apply from 25 August 2005 until the earlier of a date set following a revisions trigger event, and 1 January 2010. Under this approval, if there was no revisions trigger event further revisions to the access arrangement to apply from 1 January 2010 were to be submitted to the Authority before 31 March 2009.

20. In January 2009, WAGN asked the Authority to exercise its discretion under section 7.19 of the Code and grant an extension of the time for lodgement of revisions. On 12 February 2009, the Authority approved a new Revisions Submission Date of 30 September 2009.
21. WAGN subsequently applied for a further extension of the revisions submission date to 31 January 2010. The Authority approved the new date on 24 September 2009.
22. The National Gas Access (Western Australia) Act 2009 (**NGA**) came into effect on 1 January 2010 (with the exception of sections 1 and 2 which had taken effect earlier).
23. The NGA applies as laws of Western Australia the National Gas (South Australia) Law (**NGL**) (as in force pursuant to section 7 of the NGA), and the National Gas Rules (**NGR**) (as in force pursuant to section 26 of the NGA). The NGA modifies the effect of the NGL and NGR in certain respects as they apply in Western Australia.
24. Clause 7 of Schedule 3 to the NGL deems a distribution pipeline which was covered under a scheme of the Code to be a covered pipeline which is a distribution pipeline on commencement of the NGL.
25. As the GDS was covered under the scheme of the Code as at 1 January 2010, the GDS is a covered pipeline for the purposes of the NGL and NGR.
26. Section 132 of the NGL requires that a covered pipeline service provider submit to the Authority for approval under the NGR revisions to an access arrangement that is a full access arrangement in respect of the pipeline services the service provider intends to provide.
27. WAGN noted in its supporting information, that section 132 of the NGL requires that a "covered pipeline service provider must submit ... revisions to an applicable access arrangement ... within the time period specified by the Rules."
28. WAGN also noted in its supporting information that it owns the WAGN GDS, is the relevant party to all of the contracts under which "pipeline services" are provided to "users" and is the "covered pipeline service provider" for the WAGN GDS.
29. In a notice published on its website on 15 February 2010, the Authority noted that it had identified three entities as service providers for the GDS under the NGL. These are WAGN, WA Network Holdings Pty Ltd and Westnet Energy. The NGL only places an obligation on service providers to submit an access arrangement if they fall into the category of being a covered pipeline service provider. In the case of the GDS, the Authority considers that only WAGN is a covered pipeline service provider and therefore has an obligation to submit revisions to the GDS access arrangement.
30. Section 132(1) of the NGL provides:

‘A covered pipeline service provider must submit to the AER, for approval by the AER under the Rules, a full access arrangement or revisions to an applicable access

arrangement that is a full access arrangement, in respect of the pipeline services the provider provides or intends to provide—

- a) in the circumstances specified by the Rules; and
- b) within the period of time specified by the Rules.’

31. Rule 52(1) of the NGR provides as follows:

‘A service provider must, on or before the review submission date of an applicable access arrangement, submit an access arrangement revisions proposal to the AER.’

32. Section 2A of Schedule 1 of the NGA provides that a reference to the **AER** in these provisions, insofar as they apply to Western Australia, is a reference to the Authority.

33. The effect of these provisions (when read with relevant definitions in the NGL) is that on the NGA commencing on 1 January 2010, WAGN became obliged to submit an access arrangement revisions proposal to the Authority on or before 31 January 2010 for approval under the NGL and NGR.

## Decision making framework

34. The Authority is responsible for the economic regulation of covered natural gas distribution pipelines in Western Australia, including the access arrangement for the GDS.

35. In this draft decision the Authority has considered proposed revisions to an access arrangement for the GDS lodged with the Authority for approval under section 132 of the NGL.

36. The Authority’s functions and powers with respect to this draft decision are set out in both the NGL and NGR.

37. Section 28(1) of the NGL states that when performing or exercising an economic regulatory function or power, the Authority must do so in a manner that will or is likely to contribute to the achievement of the national gas objective.

38. Section 23 states that the national gas objective is:

‘... to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.’

39. Under section 28(2)(a) of the NGL, the Authority must also take into account the revenue and pricing principles when exercising its discretion in approving or making those parts of an access arrangement relating to a reference tariff.

40. Section 28(2)(b) of the NGL also provides that the Authority may also take the revenue and pricing principles into consideration in its performance or exercise of any other economic regulatory function or power where it considers this appropriate.

41. The revenue and pricing principles are set out in section 24 of the NGL.

42. The NGR sets out the provisions the Authority must apply in exercising its regulatory functions and powers when making the draft decision in relation to the access arrangement proposal.
43. The effect of rule 41(2) of the NGR provides that if the Authority withholds its approval to any element it cannot approve the proposal.
44. Rule 40 of the NGR provides that discretion in relation to individual access arrangement elements is one of either full discretion, limited discretion or no discretion. Full discretion allows the Authority to substitute its own preferred alternative, even if the service provider's submission is compliant with the law. Limited discretion does not allow such substitution. No discretion means that the Authority must accept the proposal. The NGR sets out which kind of discretion the Authority has in relation to each element. In making this draft decision the Authority has considered each access arrangement element and reached a conclusion regarding the relevant level of discretion, and has made its draft decision accordingly.
45. WAGN's access arrangement for 1 July 2005 to 1 January 2010 inclusive (current access arrangement) is a transitional access arrangement in accordance with schedule 1 of the NGR. This means that the transitional arrangements set out in schedule 1 of the NGR apply to the review of WAGN's access arrangement proposal dated 29 January 2010 (proposed access arrangement) for the period 1 January 2010 to 30 June 2014 (forthcoming access arrangement period).
46. The Ministerial Council on Energy Standing Committee of Officials released the Second Exposure Draft of the National Energy Customer Framework (**NECF**) on 27 November 2009. The NECF includes completed rule provisions for the new gas connections framework. The details of the final framework, the timing of the new regulatory framework and transitional provisions that may apply are not yet finalised and it is uncertain what impact, if any, the new framework might have on access arrangements. Rule 65 of the NGR allows variations of applicable access arrangements and is available to service providers if changes to the access arrangement are required following the introduction of the NECF.

## REASONS

### The Draft Decision

47. Rule 59(1) of the NGR provides that after considering the submissions made within the time allowed in the initiating notice and any other matters the Authority considers relevant, the Authority must make an access arrangement draft decision.
48. Rule 59(2) of the NGR provides that an access arrangement draft decision indicates whether the Authority is prepared to approve the access arrangement proposal as submitted and, if not, the nature of the amendments that are required in order to make the proposal acceptable to the Authority.
49. Rule 59(5) of the NGR provides that when the Authority makes an access arrangement draft decision, it must:
  - a) give a copy of the decision to the service provider; and

- b) publish the decision on the Authority's website and make it available for inspection, during business hours, at the Authority's public offices; and
- c) publish on its website and in a newspaper circulating generally throughout Australia a notice:
  - i) stating that an access arrangement draft decision has been made and giving reference to a website at which the relevant access arrangement proposal and the relevant draft decision may be inspected; and
  - ii) if a period has been allowed for revision of the proposal – specifying the revision period; and
  - iii) inviting written submissions within the time allowed in the notice (which must be at least 20 business days from the end of the revision period).

## Requirements as to the manner of making draft decision

- 50. Section 28 of the NGL contains provisions regarding the manner in which the Authority must perform its economic regulatory functions and powers. Section 28(1) contains requirements in relation to the national gas objective in section 23 of the NGL, and section 28(2) contains requirements regarding the revenue and pricing principles in section 24 of the NGL.
- 51. Under the NGL the emphasis of both the national gas objective and the revenue and pricing principles is on economic considerations such as achieving a commensurate rate of return and the potential for under and over investment by a service provider.
- 52. The specific requirements relating to the national gas objective and the revenue and pricing principles may be considered separately, although they have the same focus on economic efficiency and the long term interests of consumers as a result.

### National gas objective

- 53. Section 28(1) of the NGL provides that the Authority must in performing or exercising an “economic regulatory function or power” perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national gas objective. An “economic regulatory function or power” is broadly defined in section 2 of the NGL to mean a function or power performed or exercised by the Authority that relates to the economic regulation of pipeline services provided by a service provider by means of or in connection with a scheme pipeline and includes a function or power performed or exercised by the Authority that relates to, inter alia, an applicable access arrangement decision or an access determination.
- 54. Rule 100 of the NGR further provides that the provisions of an access arrangement must be consistent with the national gas objective.
- 55. Section 23 of the NGL sets out the national gas objective as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

56. The requirement in rule 100 of the NGR that “the provisions” of an access arrangement must be consistent with the national gas objective, in the Authority’s opinion means that, each and every provision, and the access arrangement as a whole, must be looked at from the point of view of whether or not there is any inconsistency with the national gas objective. This, when coupled with the provision in section 28(1), requires the Authority to adopt a methodical decision-making approach under which each provision of the access arrangement is explicitly considered by reference to the national gas objective.

### Revenue and pricing principles

57. Section 28(2)(a) of the NGL provides that “in addition” to the requirements under section 28(1) of the NGL regarding the national gas objective, the Authority must take into account the revenue and pricing principles when exercising a discretion in approving or making those parts of an access arrangement relating to a reference tariff or when making an access determination relating to a rate or charge for a pipeline service. Section 28(2)(b) of the NGL provides that the Authority may take into account the revenue and pricing principles when performing any other economic regulatory function or power, if the Authority considers it appropriate to do so. In the present case, this may be in relation to the non-price terms and conditions of WAGN’s proposed revisions.
58. As far as the content of the revenue and pricing principles is concerned, section 24(1) of the NGL provides that the revenue and pricing principles are the principles set out in subsections 24(2) to 24(7) inclusive of the NGL. Subsections 24(2) to 24(7) provide as follows:
- “2) A service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs in –
    - c) providing reference services; and
    - d) complying with a regulatory obligation or requirement or making a regulatory payment.
  - 3) A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services that service provider provides. The economic efficiency that should be promoted includes –
    - a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and
    - b) the efficient provision of pipeline services and
    - c) the efficient use of the pipeline.
  - 4) Regard should be had to the capital base with respect to a pipeline adopted –
    - a) in any previous –
      - i) full access arrangement decision; or
      - ii) decision of a relevant Regulator under section 2 of the Gas Code;
    - b) in the Rules.
  - 5) A reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the reference service to which the tariff relates.

- 6) Regard should be had to the economic costs and risks of the potential for under and over investment by a service provider in a pipeline with which the service provider provides pipeline services.
  - 7) Regard should be had to the economic costs and risks of the potential for under and over utilisation of a pipeline with which a service provider provides pipeline services.”
59. There is also reference to these principles in a limited number of rules that require the Authority to take the revenue and pricing principles into account in relation to those rules. These are rule 50(4) – review submission dates and revision commencement date; rule 93(2)(c) – allocation of costs between reference services and other services; and rule 98(3) – incentive mechanism.
60. The Authority also needs to take account of the *National Gas Access (WA) (Local Provisions) Regulations 2009 (WA Local Regulations)*. These regulations contain provisions, under Part 2, which deal with the impact of reference tariffs on ‘small users’ (retailers) and ‘small use customers’<sup>1</sup>.

## Access arrangement proposal

### Pre-submission consultation

#### Requirements of the NGL and the NGR

61. Rule 57 of the NGR provides that a service provider may, in the course of preparing a full access arrangement proposal, by notice to the Authority, request a pre-submission conference with representatives of the Authority to discuss questions affecting the proper formulation of the proposal. The Authority must comply with such a request unless the request appears unreasonable.

#### Pre-submission consultation process

62. Between July 2009 and lodgement of the proposed access arrangement, the Authority and WAGN participated in pre-submission consultation meetings, in accordance with rule 57 of the NGR.

### Lodgement of access arrangement proposal and access arrangement information

63. WAGN lodged its proposed access arrangement for the GDS together with the access arrangement information and a confidential version of its supporting information on 29 January 2010. A public version of the supporting information, including a public version of its tariff model in excel format, was lodged on 11 February 2010.

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<sup>1</sup> ‘Small users’ are retailers who sell to ‘small use customers’. The ‘small use customer’ is the final gas consumer. See Part 2(4) and Part 2(7) of the *NGA (WA) Local Provisions Regulations 2009* for precise definitions of small retailers and small use customers.



## Permitted extension

64. The Authority exercised its discretion under section 7.19 of the Code to grant an extension of time for the submission of revisions to the access arrangement for the WAGN GDS. The Authority extended the revision submission date set out in the current access arrangement from 31 March 2009 to 31 January 2010.
65. WAGN's reason for requesting the extension was because the Government of Western Australia introduced into State Parliament legislation to implement the NGL and NGR in June 2008 but this legislation was not passed by 31 March 2009. It was not until 1 September 2009 that the National Gas Access (WA) Act 2009 received Royal assent, with operative sections of the NGA not coming into operation on 1 January 2010. WAGN was able to lodge under the Code but requested the extensions in order to lodge under the NGL.

## Initiating notice

66. Rule 58(1) of the NGR provides that as soon as practicable after receiving a full access arrangement proposal the Authority must publish an initiating notice on its website and in a newspaper circulating generally throughout Australia:
- a) notifying receipt of the proposal; and
  - b) describing the proposal and giving the address of a website at which the proposal can be inspected; and
  - c) inviting written submissions on the proposal by a date specified in the notice (which must fall at least 20 business days after the first publication of the notice).
67. WAGN lodged its proposed access arrangement for the GDS on 29 January 2010. The Authority published the proposed access arrangement, access arrangement information and the public version of the supporting information on the Authority's website [www.erawa.com.au](http://www.erawa.com.au) on 15 February 2010.
68. The Authority invited submissions from interested parties on the proposed access arrangement submitted by WAGN on 15 February 2010 by placing a notice on its website and in the West Australian and The Australian newspapers. The closing date for submissions was 12 April 2010.
69. The Authority released an issues paper on 26 February 2010 on the WAGN proposal to assist interested parties with making submissions.

## Submissions

70. Section 65 of the NGL provides that if the Authority, in accordance with the NGL or the NGR, publishes a notice inviting submissions in relation to the making of an economic regulatory decision, the Authority, in making the decision:
- a) must consider every submission it receives within the period specified in the notice; and
  - b) may, but need not, consider a submission it receives after the period specified in the notice expires.

71. The Authority received five submissions from interested parties that it has considered in the draft decision on the proposed access arrangement.
72. The following four submissions were received on or before the date specified in the initiating notice, 12 April 2010.
- a) Marilyn Robertson (published on 15 March 2010);
  - b) R L Steele (published on 18 March 2010);
  - c) Electricity Retail Corporation trading as Synergy (dated 12 April 2010);  
and
  - d) Office of Energy (dated 12 April 2010).
73. The Authority received one public submission after 12 April 2010 from Alinta Pty Ltd (dated 19 April 2010). The Authority has also considered this submission in making its draft decision.

### **Consultants used by the Authority**

74. The Authority requested a report from EnergySafety (the technical and safety regulator of the gas distribution system), a division of the Department of Commerce of the Government of Western Australia (**EnergySafety**). Energy Safety provided advice on prudence, efficiency, safety, technical integrity, regulatory requirements and capacity to service existing levels of demand under rules 79(1)(a) and 79(2)(c) of the NGR. This advice dealt with WAGN's actual capital expenditure over the period of the current access arrangement period and forecast capital expenditure on the GDS over the period of the forthcoming access arrangement. The EnergySafety report is available on the Authority's website.
75. The Authority also requested Frontier Economics Pty Ltd Australia (**Frontier**) to provide advice on WAGN's proposed revisions relating to the application of the economic criteria under rule 79(2)(a), (b) and (d) of the NGR, to actual capital expenditure over the current access arrangement period and forecast capital expenditure over the forthcoming access arrangement period. The Frontier report is available on the Authority's website.

## **Other issues**

### **Basis for dealing with inflation**

#### **Context**

76. WAGN has proposed using the Consumer Price Index (**CPI**) (All Groups, Perth) for the calculation of inflation and is also proposing to model the effects of inflation based on the mid-point of the modelling period. This is different from the approach under the current access arrangement where inflation has been calculated using CPI (All Groups, Eight Capital Cities) and modelling of the effect of inflation has been based on the end of each modelling period.



## Requirements of the NGL and the NGR

77. Rule 73(1) of the NGR provides that financial information must be provided on the basis of one of three methods for dealing with the effects of inflation. The method used must be stated in the access arrangement information (see rule 73(2) of the NGR) and all financial information must be provided, and all calculations made, consistently on the same basis.

## Access arrangement information

78. WAGN stated at page 3 of the access arrangement information that financial information contained in the access arrangement information is provided on a real basis and expressed in constant prices at December 2009 escalating, where necessary, at the rate of inflation as measured by changes in the CPI (All Groups, Perth).
79. Table 2 (page 3) of the access arrangement information provides the CPI (All Groups, Perth) for the December and June quarters for the years 2005-2009. WAGN further noted that for the period 2005 to 2009, financial data has been reported on a calendar basis, based on the June CPI. From the period 1 January 2010 onwards, financial data is reported on a financial year basis, based on the December CPI.
80. Further, WAGN's comments regarding Table 2 (page 3) also note that escalation for the period 2005 to 2009 has been based on the June CPI as this represents the mid-point of the year. For the period 1 January 2010 onwards, escalation has been based on the on the December CPI as this represents the mid-point of the financial year.

## Public submissions

### *Alinta's submission*

81. Alinta, in Attachment A to its submission dated 19 April 2010 (pages 2-4), noted that WAGN has changed the measurement for the rate of inflation from CPI (All Groups, Eight Capital Cities) used in the current access arrangement to CPI (All Groups, Perth) in the proposed access arrangement. Alinta submitted that standard regulatory practice, including in Western Australia, has been to define the CPI as the CPI (All Groups, Eight Capital Cities).
82. Alinta noted that WAGN derived its estimate of forecast inflation, used in establishing the rate of return, as the geometric mean of the Reserve Bank of Australia's inflation forecasts for the next ten years. Alinta stated that as this forecast is 'an Australia-wide forecast', WAGN's proposal would be internally inconsistent if CPI (All Groups, Perth) was also used. Alinta considered that WAGN's proposal may not comply with rule 73(3) of the NGR which requires that all financial information must be provided, and all calculations made, consistently on the same basis. Alinta considered that in the absence of WAGN explaining why it has adopted the CPI (All Groups, Perth) measurement, the objectives of the NGR will be best achieved by requiring WAGN to apply CPI (All Groups, Eight Capital Cities).

## Authority's assessment

83. Under the current access arrangement, the Authority approved the calculation of reference tariffs based on the use of the Australian Bureau of Statistics Weighted Average of CPI (All Groups, Eight Capital Cities). This index was used for all inflation related calculations including WACC and incurred expenditure rolled into the capital base. This is also consistent with the Authority's long-standing practice for all access arrangements.
84. Further, the Authority has in previous access arrangements for the WAGN GDS modelled all transactions at the end of the modelling period and has used the relevant CPI index at the end of the modelling period. This accords with the Authority's long-standing regulatory practice for access arrangements.
85. The Authority notes that WAGN has proposed to depart from this practice and to use CPI (All Groups, Perth) and the relevant index at the mid-point of each modelling period in the forthcoming access arrangement.
86. WAGN's proposal as the basis for dealing with inflation is compliant with the requirements of rule 73 of the NGR. However, the Authority has full discretion in relation to this provision, and the Authority is entitled to withhold its approval to WAGN's proposed revisions concerning the manner of dealing with inflation if it is satisfied that there is a preferable alternative that complies with the applicable requirements of the NGL and NGR, and is consistent with applicable prescribed criteria.
87. In circumstances where the approach proposed by WAGN is different from the standard regulatory practice adopted by the Authority in relation to regulated gas pipelines in Western Australia it would be preferable, having regard to the national gas objective, to continue the standard regulatory practice.
88. The Authority notes Alinta's submission that CPI (All Groups, Eight Capital Cities) should be adopted and further notes that WAGN has not provided any substantive submissions justifying a change in the measurement of CPI nor the use of the mid-point index.
89. The Authority considers that the national gas objective will be best achieved by requiring WAGN to apply CPI (All Groups, Eight Capital Cities) and to use the index at the end of each modelling period rather than the mid-point. The Authority notes that each of the values used in the determination of the reference tariffs needs to be based on the December Quarter CPI values to adjust for the effects of inflation as set out in Table 1.

**Table 1 Consumer Price Index**  
**(Weighted average of eight capital cities) 2004-2009**

	2004	2005	2006	2007	2008	2009
December quarter	146.5	150.6	155.5	160.1	166.0	169.5

**Draft decision**

90. The Authority requires WAGN's proposed revisions to adopt the use of CPI (All Groups, Eight Capital Cities) instead of CPI (All Groups, Perth) and to model the effects of inflation using the index at the end of each modelling period, not the mid-point.
91. Where WAGN's proposed revisions use CPI (All Groups, Perth) as at the mid-point of the modelling period, the Authority's draft decision below sets out the adjustments to the access arrangement or access arrangement information based on the use of changes in the CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.

***Confidential information submitted by WAGN*****Requirements of the NGL and the NGR**

92. Division 1 of Part 2 of Chapter 10 of the NGL (sections 324 to 329 of the NGL) sets out provisions concerning the disclosure of confidential information held by the Authority.
93. Under section 324, the Authority is authorised to disclose information given to it in confidence in, or in connection with, the performance or exercise of its functions and powers under the NGL or NGR in accordance with Division 1.
94. Division 1 provides for disclosure of confidential information by the Authority with written consent of the party giving the information (section 325) or for the purposes of court and tribunal proceedings and to accord natural justice (section 326).
95. Under section 327 the Authority may disclose information provided to it voluntarily with confidential information omitted and under section 328 the Authority may disclose information which is confidential but which if publicly disclosed would not identify any person to whom the information relates.
96. However, despite sections 327 and 328 of the NGL, under section 329, the Authority may disclose information provided in confidence if the Authority is satisfied that the disclosure would not cause detriment to the discloser or the person who provided it to the discloser, or although it would cause such detriment, the public interest in disclosure outweighs that detriment. A procedure is prescribed for disclosure under this provision.

**Access arrangement proposal**

97. WAGN's proposed revisions do not contain any confidential information, nor does the access arrangement information submitted by WAGN. However, WAGN's submission to the Authority dated 29 January 2010 does contain information in various parts, and annexed to the submission, in respect of which WAGN has claimed confidentiality. The Authority has published on its website a non-confidential version of this submission provided by WAGN with the confidential sections omitted.

## Public submissions

### *Synergy's submission*

98. Synergy submitted that as it does not have access to sufficient information, it is unable to determine whether the proposed access arrangement meets the various requirements of the NGR. Synergy further commented that, to the extent it has been able to, it has expressed its views on certain areas where it has particular concerns. Synergy requested that, given the lack of information publicly available, the Authority needs to carefully review the sufficiency of the information provided by WAGN and provide detailed reasons of the process adopted in forming its view of whether the proposed access arrangement meets the NGR requirements.

### *Alinta's submission*

99. Alinta, in Attachment A to its submission dated 19 April 2010 (pages 1-2), submitted that WAGN's submission does not contain the information that is reasonably necessary for users and prospective users to understand either:
- (a) the background to the access arrangement or the proposed access arrangement; and
  - (b) the basis and derivation of the various elements of the access arrangement or the proposed access arrangement
- as required by rule 42(1) of the NGR.
100. Alinta stated that this may be because either the information has not been provided by WAGN, or because the public version of WAGN's submission suppresses information that is claimed to be confidential.
101. Alinta provided two examples, on pages 1-2, where WAGN's submission excluded information and submitted that the suppression of this information means that users and prospective users cannot reasonably be expected to understand the basis and derivation of the proposed access arrangement.
102. Alinta further submitted that it is not apparent why some of the information suppressed is either confidential or, even if the information were to be confidential, how public disclosure of the information could reasonably be expected to cause undue harm to WAGN's legitimate business interests.
103. Alinta submitted that the Authority should review the information that WAGN has suppressed by applying the tests set out in rule 43(2) of the NGR.

## Authority's assessment

104. The Authority notes that WAGN agreed, for the purpose of the draft decision, to the release of information previously claimed as confidential. The Authority requested the release of consultants' reports supporting WAGN's proposed rate of return, in particular the report from Value Advisor Associates, the NERA report on value of imputation credits for a regulated gas distribution business, the NERA report on estimates of the cost of equity and part of the SOFA report on estimation of debt risk margin. These reports are available on the Authority's website.

105. The Authority has considered other confidential information submitted by WAGN. In this draft decision, where confidential information has been taken into account with respect to any particular matter the general nature of the confidential information has been noted in the Authority's reasoning without revealing the specifics of the confidential information so as not to compromise its confidentiality.
106. For the purpose of this draft decision the Authority considers that WAGN has submitted sufficient information in its access arrangement information to enable interested parties to understand both the background to the proposed access arrangement and the basis and derivation of the various elements of the access arrangement proposal (rule 42 of the NGR).
107. The Authority is satisfied that there is no basis for revealing further confidential information under sections 324 to 329 of the NGL. In particular, the Authority has considered, for each element or aspect of this draft decision, whether or not the public interest in obtaining access to any or all of the confidential information outweighs the detriment to WAGN from the information being revealed. The Authority is satisfied that for the purpose of this draft decision the public interest is sufficiently served through the references in the draft decision to the confidential information.
108. Finally, the Authority notes the submissions from both Synergy and Alinta with respect to the lack of publicly available information provided by WAGN. The Authority notes the submissions from these users that they have been unable to determine whether the proposal meets various requirements of NGR due to the lack of publicly available information provided by WAGN in its supporting submission.
109. Alinta submitted that the Authority should address this issue by requiring WAGN to reveal the confidential information in its submission rather than in its access arrangement information. Alinta's submission was that the Authority should consider whether or not to reveal the confidential information by reference to the provisions of rule 43(2) of the NGR which is based on whether or not the confidential information in the access arrangement information should be revealed to enable users and prospective users to understand the basis and derivation of the various elements of WAGN's proposed revisions.
110. The Authority does not accept Alinta's argument with respect to the release of confidential information. WAGN is not required to submit any supporting information other than the applicable access arrangement information. Where confidential information is submitted voluntarily in addition to the access arrangement information (as in WAGN's case) the issue of whether or not the Authority should require the information to be revealed is to be determined by reference to the NGL (sections 324 to 329) referred to above, and not rule 43(2) of the NGR as submitted by Alinta. Rule 43(2) of the NGR is a provision which sets out the tests to be applied where the Authority is considering revealing confidential access arrangement information. WAGN has not sought to make confidential any of the access arrangement information and so rule 43(2) is not applicable.

#### **Draft decision**

111. The Authority does not require WAGN to reveal any additional confidential information submitted with WAGN's proposed revisions under the provisions of sections 324 to 329 of the NGL. In particular, in relation to each element or aspect of the draft decision, the Authority has considered for the purpose of section 329 whether or not the public interest in obtaining access to any or all of the confidential

information outweighs the detriment to WAGN from the information being revealed. The Authority is satisfied that for the purpose of this draft decision the public interest is sufficiently served through the references in the draft decision to the confidential information.

112. WAGN has not sought to make confidential any of the access arrangement information submitted with WAGN's proposed revisions. The Authority is satisfied that the issue raised by Alinta's and Synergy's submission, namely whether the Authority should exercise its power under rule 43(2) to reveal access arrangement information which is provided confidentially does not arise. Rule 43(2) of the NGR is a provision which sets out the tests to be applied where the Authority is considering revealing confidential access arrangement information. WAGN has not sought to make confidential any of the access arrangement information and so rule 43(2) does not arise for consideration.

### **Access arrangement information**

113. The Authority notes that it has power under rule 43(3) of the NGR to require WAGN to amend its access arrangement information if it is satisfied that the information is deficient in its comprehensiveness or in any other respect. The Authority intends to consider exercising this power at the time it makes its final decision in relation to the access arrangement information necessary to be consistent with the final decision on the access arrangement under rule 62 of the NGR.

## **Pipeline Services and Access to Pipeline Services**

### **Requirements of the NGL and the NGR**

114. Rule 48(1) of the NGR provides that a full access arrangement must specify certain information in relation to pipeline services, including reference services. For this purpose:
- a) pipeline services include haulage services, interconnection services and ancillary services (section 2 of the NGL); and
  - b) reference services are defined in rule 101(2) of the NGR as pipeline services that are likely to be sought by a significant part of the market.
115. Under rule 48(1) of the NGR an access arrangement must:
- a) identify the pipeline to which the access arrangement relates and a website at which a description of the pipeline can be inspected;
  - b) describe the pipeline services the service provider proposes to offer to provide by means of the pipeline; and
  - c) specify the reference services.
116. Rule 101(1) of the NGR provides that a full access arrangement must specify all reference services.
117. Rule 112 of the NGR sets out a number of provisions concerning the form and content of requests by prospective users for access to pipeline services generally.



**Access arrangement information**

118. There are no specific access arrangement information requirements for an access arrangement proposal concerning the pipeline services and access to pipeline services. The only access arrangement information required for these provisions is that in rule 42 of the NGR this being that which is reasonably necessary for users and prospective users to understand:
- a) the background to the access arrangement proposal; and
  - b) the basis and derivation of the access arrangement proposal.

**Access arrangement proposal**

119. For the purpose of rule 48(1)(a) of the NGR clause 3 of the proposed access arrangement specifies the GDS as the pipeline to which the access arrangement relates.
120. Clause 4 of the proposed access arrangement provides for WAGN to offer the following pipeline services by means of the GDS to prospective users:
- a) reference services, being the haulage services; and
  - b) non-reference services.
121. The reference services to be offered under the proposed access arrangement are Services A1, A2, B1, B2 and B3. WAGN also proposes to offer non-reference services under the access arrangement, the terms and conditions of which (including price) WAGN is prepared to negotiate with prospective users. The non-reference services include services providing for, or facilitating, the interconnection of pipelines.
122. The Authority's assessment of the proposed access arrangement with respect to the pipeline and pipeline services is discussed below by reference to individual services and provisions of the proposed access arrangement.

**Reference services****Access arrangement proposal**

123. The descriptions of the five reference services under the proposed access arrangement are set out in clauses 4.2 (Service A1), 4.3 (Service A2), 4.4 (Service B1), 4.5 (Service B2) and 4.6 (Service B3).
124. In summary, the proposed reference services are pipeline services applicable in the following circumstances:
- a) Service A1: At the time of application the user reasonably anticipates taking delivery of gas at a delivery point on the GDS of 35 TJ/year or more and requests a contracted peak rate of 10 GJ/hour or more. User Specific Delivery Facilities are required.
  - b) Service A2: At the time of application the user reasonably anticipates taking delivery of gas at a delivery point on the GDS of between 10 and 35 TJ/year, requests a contracted peak rate of less than 10 GJ/hour.

- c) Service B1: At the time of application the user reasonably anticipates taking delivery of gas at a delivery point on the GDS of less than 10 TJ/year or requests a contracted peak rate of less than 10 GJ/hour or both, and the user requests user specific delivery facilities.
  - d) Service B2: The user requests delivery of gas at a delivery point on the medium pressure/low pressure system using standard delivery facilities which include a standard 12 m<sup>3</sup>/hr meter.
  - e) Service B3: The user requests delivery of gas at a delivery point on the medium pressure/low pressure system using standard delivery facilities which include a standard 8 m<sup>3</sup>/hr meter.
125. The reference tariffs are Tariff A1, A2, B1, B2 and B3 which correspond to Services A1, A2, B1, B2 and B3 respectively.
126. The other terms and conditions on which the reference services are to be supplied are set out in the Template Haulage Contract which is Annexure C to the proposed access arrangement. The Template Haulage Contract contains a schedule setting out terms and conditions specific to each reference service (Schedules 1, 2, 3, 4 and 5 correspond to Services A1, A2, B1, B2 and B3 respectively).

### **Public submissions**

#### *WAGN submission*

127. In its submission dated 29 January 2010 WAGN (page 8) noted that the reference services are materially the same as those offered in the current access arrangement. WAGN noted further that it has not received requests from prospective users for other pipeline services which might be sought by a significant part of the market.

#### *Other submissions*

128. There were no other public submissions going to the definition of the reference services and the likely demand for pipeline services relevant to that issue. Other submitting parties did make submissions about the pricing and other terms and conditions of the reference services as defined in the proposed access arrangement that are considered below in this draft decision.

### **Authority's assessment**

129. No submissions have been received suggesting, nor has the Authority any other reason to believe, that the reference services under the current or proposed access arrangement do not provide for reference services that are likely to be sought by a significant part of the market as required by rule 101(2) of the NGR.

### **Draft decision**

130. The Authority approves the definitions of the reference services as set out in clauses 4.2 to 4.6 of the proposed access arrangement.



## Non-reference services (excluding interconnection services)

### Access arrangement proposal

131. Clause 4.7 of the proposed access arrangement provides that WAGN will negotiate the tariff or charge, and other terms and conditions, for a non-reference service with a prospective user.

### Public submissions

#### *WAGN submission*

132. In its submission dated 29 January 2010 (page 10) WAGN stated that it is prepared to negotiate the terms and conditions, including prices, for other pipeline services – non-reference services – which might be sought by prospective users. WAGN noted that non-reference services include services providing for, or facilitating, the interconnection of pipelines and made submissions about such services (page 11). Interconnection services are dealt with separately below in this draft decision.

#### *Other submissions*

133. There were no other public submissions regarding non-reference services.

### Authority's assessment

134. The Authority has no information available to it which suggests that the negotiated services (excluding interconnection services) have been or are likely to be sought by a significant part of the market. Therefore, the Authority considers that these services are non-reference services. On that basis, it is inappropriate for the proposed access arrangement to prescribe the price or terms and conditions on which negotiated services will be supplied. The Authority is satisfied that the proposed access arrangement does not prescribe such prices or terms and conditions (nor is there any submission suggesting that they do so), and so the proposed access arrangement regarding non-reference services complies with the NGL and NGR.

### Draft decision

135. The Authority approves clause 4.7 of the proposed access arrangement.

## Interconnection services

### Access arrangement proposal

136. The current access arrangement in clause 25 of Part A makes specific provision for access by users to an interconnection service. There is no equivalent of clause 25 of Part A of the current access arrangement in the proposed access arrangement.
137. As noted above, however, under clause 4.7 of the proposed access arrangement WAGN will make available non-reference services on terms and conditions including price to be negotiated. A non-reference service is defined in the proposed access arrangement (clause 12) to mean a pipeline service that is not a haulage service. A pipeline service is defined as having the same meaning as in the NGL.

A pipeline service is defined in the NGL (section 2) to include a service providing for, or facilitating, the interconnection of pipelines.

138. The combined effect these definitions is that WAGN's proposed revisions provide for an interconnection service which is available to users on negotiated terms and conditions and, therefore, makes equivalent provision to clause 25 of Part A of the current access arrangement.
139. Consistent with the interconnection service being a non-reference service, while some of the terms and conditions on which reference services are offered refer to interconnection arrangements (e.g. clauses 6.6(b), 7.4(g) and 17.1(m)(ii) of the Template Haulage Contract) the proposed access arrangement does not prescribe the terms and conditions, including price, on which interconnection with the GDS (being a non-reference service) will be offered by WAGN.

### **Public submissions**

#### *WAGN submission*

140. In its submission dated 29 January 2010 WAGN (page 11) stated that the non-reference services include services providing for, or facilitating, the interconnection of pipelines. WAGN noted that it has three contracts for interconnection services with other pipeline operators. Further, each of these contracts recognises the specific technical circumstances of interconnection at a particular location. WAGN went on to submit that the need to recognise the specific circumstances of interconnection means that a generic interconnection contract would have little content, and that establishing a scheduled price for interconnection service is not feasible.

#### *Other submissions*

141. There were no other public submissions regarding the definition of interconnection services or whether they are sought by a significant part of the market and should be offered as reference services.

### **Authority's assessment**

142. Rule 48(1) requires that an access arrangement must specify the pipeline services to be offered. By reason of the definitions set out 137 above, interconnection service is a pipeline service and must be specified in the proposed access arrangement. Clause 4.7 of the proposed access arrangement satisfies this requirement by specifying that non-reference services (the definitions of which include interconnection services) are to be offered on negotiated terms and conditions.
143. This has the consequence that in the event that a dispute arises between WAGN and a party seeking to interconnect with the GDS, that dispute may be arbitrated in accordance with Chapter 6 of the NGL.
144. In relation to the further question of whether the interconnection service should be specified as a reference service, the Authority notes that it has no information before it, by way of submission or otherwise, to suggest that the upstream or downstream interconnection with the GDS is likely to be sought by a significant part of the market during the forthcoming access arrangement period. There is no basis,

therefore, to require that the interconnection service, whether upstream or downstream, should be a reference service.

### **Draft decision**

145. The Authority approves that interconnection with the GDS is a non-reference service which is specified in the proposed access arrangement as required by rule 48(1) of the NGR.

## **Ancillary services**

### **Requirements of the NGL and the NGR**

146. Section 2 of the NGL defines a pipeline service to mean:
- a) a service provided by means of a pipeline including a haulage service; and
  - b) a service ancillary to the provision of a service referred to in paragraph (a)
147. Rule 101(1) of the NGR provides that a full access arrangement must specify all reference services. Rule 101(2) defines a reference service to mean a pipeline service that is likely to be sought by a significant part of the market.

### **Access arrangement proposal**

148. The proposed access arrangement does not include a definition or description of any services ancillary to services provided by means of the GDS. The proposed access arrangement does not specify any ancillary service as a reference service.
149. However, the specific terms and conditions for Service A1, A2, B1, B2 and B3 respectively in Schedules 1, 2, 3, 4 and 5 to the Template Haulage Contract annexed to the proposed access arrangement respectively, allow a user to request deregistration of a delivery point and provide a charge for such deregistration.
150. Further, the specific terms and conditions for Service B2 and B3 set out in Schedules 4 and 5 to the Template Haulage Contract annexed to the proposed access arrangement respectively, allow a user to request and or all of:
- a) application of a meter lock service to a meter at a delivery point;
  - b) removal of a meter lock which has been applied to a meter at a delivery point;
  - c) disconnection of a delivery point; and
  - d) reconnection of a delivery point.
151. In each case there is a charge specified for WAGN meeting the user's request.

### **Public submissions**

#### *WAGN submission*

152. In its submission dated 29 January 2010 (pages 9-10) WAGN stated that the current access arrangement provided five 'ancillary services'. These services were the apply meter lock service, the remove meter lock service, the deregistration service,

the disconnection service and the reconnection service. WAGN noted that the deregistration service was available to all users, and the disconnection and reconnection services were available only in respect of delivery points at which a user was provided with Service B2 or B3. The apply meter lock and remove meter lock services were only available to users provided with Service B3.

153. WAGN then went on to submit that in its view separately identifying certain services as 'ancillary services' is not consistent with the concept of 'pipeline service' used in the NGL and NGR. WAGN submitted that it has therefore incorporated each of the five services previously designated as ancillary services 'into the scheme of the pipeline services to be offered as reference services'. As mentioned above, in the proposed access arrangement, the specific terms and conditions for each reference service set out in the Template Haulage Contract provide for a user to request deregistration of a delivery point. The specific terms and conditions for Service B2 and Service B3 set out in Schedules 4 and 5 of the Template Haulage Contract respectively allow a user to request application or removal of a meter lock at, and disconnection or reconnection of, a delivery point (page 10).

#### *Other submissions*

154. There were no other public submissions regarding the definition and specification of ancillary services in the proposed access arrangement.

#### **Authority's assessment**

155. The Authority does not accept WAGN's submission that deregistration of a user, application and removal of a meter lock at a delivery point and the connection and disconnection of a delivery point are not within the meaning of a pipeline service as defined under the NGL and NGR. Each involves a request by the user for, and the provision in response thereto, of a service to a user which is ancillary to the provision of a haulage service.
156. It is necessary, therefore, for the proposed access arrangement to be amended to include a description of these services as pipeline services, in order for the proposed access arrangement to comply with the requirements of rule 48(1)(b) of the NGR, which requires a full access arrangement to 'describe the pipeline services the service provider proposes to offer to provide by means of the pipeline'.
157. The further issue is whether the ancillary services are reference services. The relevant test is under rule 101(2) of the NGR which defines a reference service to mean a pipeline service that is likely to be sought by a significant part of the market.
158. In its final decision dated 12 July 2005, at paragraph 54-55, the Authority concluded that given the ubiquitous nature of the ancillary services and the essential functions that are being performed for users to facilitate the effective utilisation of reference services the ancillary services are likely to be sought by a significant part of the market. The Authority has no submissions or evidence before it at this time to suggest that the relevant market conditions have changed since its 2005 final decision, or that its conclusion as set out in the previous 2005 final decision was unsound. The Authority, therefore, concludes that the ancillary services are likely to be sought by a significant part of the market and as such are reference services. Rule 101(1) requires a full access arrangement to specify 'all' reference services and, therefore, the proposed access arrangement should be amended to specify the ancillary services as reference services.

159. The final issue that arises is whether or not a reference tariff should be specified for the ancillary services. In approving the current access arrangement, consistent with section 3.3 of the Code, the Authority did not require a reference tariff for each ancillary service because the costs associated with the provision of the services could be adequately recovered through standalone 'user pays' charges set out in the terms and conditions for each service.
160. Under rule 48(1) of the NGR a full access arrangement 'must specify for each reference service the reference tariff and other terms and conditions on which the reference service will be provided.'
161. The Authority concludes that the ancillary services are reference services for which a reference tariff and other terms and conditions must be specified in the access arrangement. Consideration is given by the Authority to consequential amendments to WAGN's proposed revisions for reference tariffs and reference service terms and conditions in the relevant parts of the draft decision below.

**Draft decision**

162. The Authority considers that services ancillary to the reference services are pipeline services for the purpose of the NGL and NGR and should be specified as reference services.
163. The proposed access arrangement should be amended to include a description of the ancillary services as pipeline services as required by rule 48(1)(b) of the NGR and to specify the ancillary services as reference services as required by rule 48(1)(c) of the NGR.
164. The proposed access arrangement should be amended to specify a reference tariff and terms and conditions for each ancillary service offered as required by rule 48(1)(c) of the NGR. The required amendments to achieve this are discussed and are set out in the later sections of this draft decision regarding reference tariffs and the terms and conditions for reference services.

#### Required Amendment 1

The proposed access arrangement should be amended to include descriptions of the following ancillary services as pipeline services (collectively **ancillary services**):

- a) deregistration service for Services A1, A2, B1, B2 and B3;
- b) apply meter lock service for Services B2 and B3;
- c) remove meter lock service for Services B2 and B3;
- d) disconnection service for Services B2 and B3; and
- e) reconnection service for Services B2 and B3.

The proposed access arrangement should be amended to specify the ancillary services as reference services.

## Application procedure

### *Form and content of requests for access*

#### **Requirements of the NGL and the NGR**

165. Rule 112(1) of the NGR provides that a prospective user 'may' request a scheme pipeline service provider to provide a pipeline service for the prospective user.
166. Rule 112(2) of the NGR sets out the content of such a request. The request 'must be in writing' and must:
- a) state the time or times when the pipeline service will be required and the capacity that is to be utilised;
  - b) provide certain information in relation to the relevant entry or exit points or both; and
  - c) state certain technical details for the connection to the pipeline.

#### **Access arrangement proposal**

167. Clause 5.1 of the proposed access arrangement provides that a prospective user 'must apply to obtain access to a pipeline service by making an application in accordance with this Application Procedure'.
168. 'Application Procedure' is defined in clause 12 of the proposed access arrangement to mean the procedure under which a prospective user wishing to obtain access to a pipeline service must submit an application.
169. Clause 5.2 provides that the information required for an application 'will be specified by WAGN on request from a prospective user. The required information will include

anything specified in the National Gas Access Law or National Gas Rules, and may also include:

- a) information as to the Prospective user's compliance with WAGN's minimum prudential and insurance requirements; and
- b) a proposed System Pressure Protection Plan.'

### Public submissions

170. Alinta, in Attachment B to its submission dated 19 April 2010 (page 19), submitted in relation to clause 5.2(a) that WAGN's minimum prudential and insurance requirements should be subject to a reasonableness test and should be relative to the maximum amount that could be outstanding from the user to the service provider at any time, considering the service provider's rights of curtailment and termination.
171. No other submissions were received in relation to clauses 5.1 and 5.2 of the proposed access arrangement.

### Authority's assessment

172. Rule 112(2) of the NGR requires that a request for access to a pipeline service 'be in writing' and that the request contain the information specified in rule 112(2)(a), (b) and (c) referred to above. The Authority considers that these are the only requirements which a prospective user must comply with in making an application for access in order to be entitled to access the pipeline service.
173. The Authority considers that clause 5.2 of the proposed access arrangement imposes requirements in relation to the form and content of a request for access which go beyond those prescribed by rule 112(2) of the NGR and which could limit a user's access to a pipeline service contrary to the national gas objective, by creating a potential barrier to entry.
174. In particular:
- a) the prefatory words of clause 5.2 require the application to include all information 'specified by WAGN' (which can include any information which WAGN specifies in its absolute discretion and, therefore, potentially additional to that required under rule 112(2) of the NGR);
  - b) clause 5.2(a) requires information to be included regarding the prospective user's compliance with WAGN's minimum prudential and insurance requirements; and
  - c) clause 5.2(b) requires the applicant to provide a system pressure protection plan.
175. The Authority considers that these additional requirements should not be approved. If a prospective user was to submit an application without this required information, then WAGN could refuse access. This would be contrary to the NGL and NGR because the prospective user would be refused access to a pipeline service, contrary to right of third party access given to users, on the ground of non-compliance with requirements extraneous to the NGL or NGR.



## Draft decision

176. Clauses 5.2 of the proposed access arrangement should be amended to be consistent with rule 112(2) of the NGR in relation to the form and content of an application for a pipeline service.

### Required Amendment 2

Clause 5.2 of the proposed access arrangement should be deleted and replaced with the following clause 5.2:

#### 5.2 Application information

An application for access to a pipeline service must be in writing and must:

- a) state the time or times when the pipeline service will be required and the capacity that is to be utilised; and
- b) identify the entry point where the user proposes to introduce natural gas to the pipeline and the exit point where the user proposes to take natural gas from the pipeline; and
- c) state the relevant technical details (including the proposed gas specification) for the connection to the pipeline, and for ensuring safety and reliability of the supply of natural gas to, or from, the pipeline.

## *Application procedure for prospective users*

### Requirements of the NGL and the NGR

177. Rule 112(3) sets out the procedure for the service provider to respond to the request for pipeline services. The service provider must, within 20 business days after the date of the request:
- a) inform the prospective user whether the service provider can provide the requested pipeline service and if so, the terms and conditions on which the service provider is prepared to provide the requested pipeline service;
  - b) inform the prospective user that the service provider needs to carry out further investigation to determine whether it can provide the requested pipeline service and setting out the proposal for carrying out the further investigation including:
    - i) a statement of the nature of the investigation;
    - ii) a plan for carrying out and completing the investigation; and
    - iii) a statement of the reasonable costs of the investigation the prospective user would be required to meet.



178. Rule 112(4) provides that if the service provider informs the prospective user that it cannot provide the requested pipeline service, the service provider must:
- a) provide written reasons explaining why the pipeline service cannot be provided; and
  - b) if there is some prospect that it will become possible to provide the requested service at some time in the future, give details of when the service is likely to become available.

### **Access arrangement proposal**

179. Clause 5.3(a) of the proposed access arrangement states that a prospective user may request WAGN to provide pipeline services by lodging an application with WAGN in 'the form specified by WAGN'.
180. Clause 5.3(b) sets out requirements for WAGN's response to a request for access. Clauses 5.3(c) to (h) then sets out a detailed procedure to be followed in relation to the making and acceptance of an offer by WAGN for access to a pipeline service.

### **Public submissions**

181. No submissions were received on clause 5.3 of the application procedure.

### **Authority's assessment**

182. Clause 5.3(a) of the proposed access arrangement provides for a prospective user to submit an application in 'the form specified by WAGN' in order to request access to a pipeline service. However, the content of this application form has not been included in WAGN's proposed revisions for assessment by the Authority, so the Authority is not in a position to assess the compliance of the proposed form with the NGL and NGR and the national gas objective.
183. Further, the requirements as to the form and contents of a request for access are prescribed by rule 112(1) and (2) of the NGR. As WAGN's application form is not restricted as to content, it would be possible for WAGN to require the provision of information in relation to a request for access which goes beyond the prescribed content. Clause 5.3(a) should be deleted as contrary to the requirements of rule 112(1) and (2) of the NGR. These requirements as to the form and content of requests for access are addressed above by the required amendment to clause 5.2 of the proposed access arrangement discussed above so there is no need for any requirement to amend clause 5.3(a) if it is deleted in accordance with this draft decision.
184. Clause 5.3(b) of the proposed access arrangement regarding WAGN's response to a request for access to a pipeline service is in sufficiently similar terms to the requirements of rules 112(3) and (4) of the NGR so as to comply with those rules, and should be approved.
185. Clauses 5.3(c) to (h) of the proposed access arrangement concerning the making of an access offer by WAGN and the acceptance thereof by the prospective user do not correspond to any provision regarding the procedure for gaining access under the NGL or NGR. As such, clauses 5.3(c) to (h) potentially impose restrictions on the gaining of access to pipeline services which are not required under the NGL or NGR and which, therefore, the Authority should not approve.

### **Draft decision**

- 186. Clause 5.3(a) of the proposed access arrangement regarding the form of the application for access is inconsistent with rule 112(2) of the NGR and should be deleted.
- 187. Clause 5.3(b) of the proposed access arrangement regarding WAGN's response to a request is in sufficiently similar terms to rules 112(3) and (4) of the NGR so as to comply with those rules, and is therefore approved.
- 188. Clauses 5.3(c) to (h) of the proposed access arrangement are inconsistent with the provisions of rule 112 of the NGR regarding requests for access and so should be deleted.

#### **Required Amendment 3**

Clauses 5.3(a) and 5.3(c) to (h) of the proposed access arrangement should be deleted.

### ***Access disputes – process and timing***

#### **Requirements of the NGL and the NGR**

- 189. Chapter 6, containing sections 178 to 216 of the NGL, deal with access disputes. In the event of a dispute between a prospective user of a pipeline service specified under an access arrangement in relation to any one or more aspect of access to a pipeline services, then either party may notify an access dispute for arbitration in accordance with Chapter 6.

#### **Access arrangement proposal**

- 190. Clause 5.4 of the proposed access arrangement states that any access dispute between WAGN and a user or prospective user may be dealt with under Chapter 6 of the NGL.

#### **Public submissions**

- 191. No submissions were received on clause 5.4 of the proposed access arrangement.

#### **Authority's assessment**

- 192. Clause 5.4 of the proposed access arrangement simply specifies that an access dispute may be dealt with in accordance with Chapter 6 of the NGL, which is the position between a prospective user and a service provider independently of the terms of the access arrangement. While the provision is superfluous there is no consequence of accepting WAGN's proposal to include it in the access arrangement.

### **Draft decision**

- 193. Clause 5.4 of the proposed access arrangement is approved.

## ***Pre-conditions to and restrictions on the provision of pipeline services***

### **Requirements of the NGL and the NGR**

194. Section 132(1) of the NGL requires a covered pipeline service provider to submit to the Authority, for approval by the Authority under the NGR, a full access arrangement or revisions to an applicable access arrangement.
195. An access arrangement is defined in section 2 of the NGL to mean an arrangement setting out terms and conditions about access to pipeline services provided or to be provided by means of a pipeline.
196. These provisions confer a right on a user or prospective user to gain access to pipeline services on the terms and conditions and in the circumstances set out in an approved access arrangement complying with the NGL and NGR.
197. There are no express provisions of the NGL or NGR providing for an access arrangement to impose pre-conditions or restrictions on the right of access to pipeline services of a prospective user or user.

### **Access arrangement proposal**

198. Clause 5.5 of the proposed access arrangement provides that WAGN will only be obliged to provide a pipeline service to a user if:
  - a) it would not prevent a user from obtaining a sufficient amount of pipeline service under a contract (consistent with section 188 NGA);
  - b) it would not have the effect of preventing a user from obtaining, by the exercise of a pre-notification right, a sufficient amount of pipeline service to be able to meet the users actual requirements (consistent with section 188 NGA);
  - c) it would not have the effect of depriving a person of a relevant protected contractual right (consistent with section 188 NGA);
  - d) the pipeline service could not be provided on a genuinely competitive basis by a person other than WAGN (consistent with section 187 NGA);
  - e) it can provide the pipeline service consistently and safely and in accordance with accepted practices in the industry;
  - f) the prospective user provides evidence that it will comply with the System Pressure Protection Plan;
  - g) the service agreement identifies the receipt point or points at which one or more related shippers will deliver gas into the sub-network for transportation to the delivery point;
  - h) the delivery point will be of sufficient capability to accommodate the contracted peak rate requested;
  - i) the receipt point will be of sufficient capability to accommodate the prospective users requirements having regard to the current contracted entitlements;

- j) either there is or will be sufficient spare capacity to accommodate the prospective user's requirements or any necessary extension or expansion complies with the extension and expansion requirements;
- k) prospective user satisfies WAGN's reasonable minimum prudential and insurance requirements; and
- l) the prospective user agrees that all gas it delivers into the WAGN GDS will comply with any gas quality specifications.

### **Public submissions**

199. No submissions were received on clause 5.5 of the proposed access arrangement.

### **Authority's assessment**

200. As noted above, there are no express provisions of the NGL or NGR providing for an access arrangement to impose pre-conditions or restrictions on the right of access to pipeline services of a prospective user or user.
201. Under the NGL and NGR the terms and conditions of access (including any terms or conditions which may impose a pre-condition or restriction of access) of non-reference services are a matter for commercial negotiation between the parties. It would be inconsistent with the NGL and NGR, therefore, for pre-conditions or restrictions on access to be prescribed in the access arrangement for non-reference services.
202. With respect to reference services, the reverse is the case. That is, the terms and conditions of access, including any pre-conditions or restrictions on access, are to be set by a regulator in accordance with the criteria set down in the NGL and NGR. This means that the pre-conditions or restrictions on access to reference services (if any) proposed by the service provider must be set out in the proposed access arrangements or revisions and assessed by the regulator against the criteria in the NGL and NGR.
203. The Authority notes that the pre-conditions and restrictions in clause 5.5 of the proposed access arrangement apply equally to non-reference and reference services. Therefore it is not possible for the Authority to assess the proposal as different criteria apply to non-reference and reference services.
204. Further, the Authority notes that the Template Haulage Contract, which sets out the terms and conditions of supply for reference services, contains in clause 1.1 a number of pre-conditions and restrictions on access to reference services, in terms which overlap but are not identical with those in clause 5.5 of the proposed access arrangement. The Authority considers that the appropriate course is to assess the proposed pre-conditions and restrictions on access to reference services in the context of assessing clause 1.1 of the Template Haulage Contract. The Authority's assessment is set out below.
205. In relation to clause 5.5 of the proposed access arrangement, in so far as the clause purports to impose pre-conditions on or restrict access to non-reference services, the Authority concludes there is no provision in the NGL or NGR which empowers the Authority to approve the clause, which should be deleted in its entirety.

206. The Authority notes WAGN's proposal is that the pre-conditions in clause 5.5(a)(i), (ii), (iii) and (iv) are consistent with the NGL. It would appear that WAGN considers that section 187 or 188 of the NGL provides a justification for the pre-conditions or restrictions proposed. However, sections 187 and 188 in Chapter 6 of the NGL concern access disputes and the arbitration thereof. These provisions provide restrictions on the determination of access disputes by the arbitrator. They do not provide any support for the imposition of a pre-condition or restriction on a user or prospective user's access to a pipeline service.
207. Finally, the Authority notes that a number of WAGN's proposed pre-conditions and restrictions are consistent with or reflect pre-conditions or restrictions contained in the queuing policy under the current access arrangement. However, this does not provide a basis for these pre-conditions or restrictions to be approved. However, the Authority notes that, for the reasons discussed below, the proposed access arrangement does not contain any queuing requirements. Therefore, the previous justification for a number of the pre-conditions in clause 5.5 of the proposed access arrangement falls away and there is no other basis for their approval by the Authority.

### Draft decision

208. Clause 5.5 of the proposed access arrangement should be deleted.

#### Required Amendment 4

Clause 5.5 of the proposed access arrangement should be deleted.

### *User may extend service agreement or increases in contracted peak rate only by a new application*

#### Requirements of the NGL and the NGR

209. There are no express provisions of the NGL or NGR for an access arrangement to restrict the availability of extensions to service agreements or increases in contracted peak rate only by a new application.

#### Access arrangement proposal

210. Clause 5.6(a) of the proposed access arrangement provides that a user and WAGN may not extend the duration or period of the service agreement or increase a user's contracted peak rate above that specified in the service agreement other than by way of an application by the user for the extended duration or incremental amount of contracted peak rate.
211. Clause 5.6(b) provides that 5.6(a) does not prevent:
- a) a user transferring or assigning its contracted peak rate under the applicable capacity trading requirements;
  - b) a user extending the duration of a service agreement by duly exercising an option granted as part of the terms and conditions of the service agreement; or

- c) WAGN or a user from exercising their respective rights under a provision of the service agreement.

### **Public submissions**

212. No submissions were received on the application procedure.

### **Authority's assessment**

- 213. Clause 56(1) of Part A of the current access arrangement, in the queuing policy, contains provisions in substantially the same terms as clause 5.6(a) of the proposed access arrangement.
- 214. The Authority notes that, for the reasons discussed below, the proposed access arrangement does not contain any queuing requirements.
- 215. Therefore, the previous justification for the pre-condition in clause 5.6(a) of the proposed access arrangement (i.e. to respond to the obligation to include queuing requirements) is not available.
- 216. Clause 5.6 of the proposed access arrangement, however, simply makes provision for certain variations to the service agreement for a pipeline service to be by way of application under the proposed access arrangement. This provision, therefore, provides an orderly process for access, and therefore is consistent with the national gas objective in particular the efficient operation of the gas pipeline. There have been no submissions challenging this proposed clause and it should be approved.

### **Draft decision**

217. Clause 5.6 of the proposed access arrangement is approved.

## ***System pressure protection plan***

### **Requirements of the NGL and NGR**

- 218. There are no express provisions of the NGL or NGR for an access arrangement to refuse to provide access to a pipeline service until the prospective user provides and the service provider acting as a reasonable person approves, a written system pressure protection plan.
- 219. Under rule 100(a) of the NGR, the provisions an access arrangement must be consistent with the national gas objective.
- 220. The national gas objective is set out in section 23 of the NGL and is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

### **Access arrangement proposal**

- 221. Clause 5.7(a) of the proposed access arrangement provides that WAGN will only provide or agree to provide a pipeline service to a prospective user if the prospective user provides a written system pressure protection plan which WAGN approves in writing, acting as a reasonable person.



- 222. Clause 5.7(b) provides that a system pressure protection plan must ensure that the prospective user of a pipeline service has sufficient contractual entitlements to firm gas transportation capacity on one or more interconnected pipelines for delivery to one or more receipt points to meet the aggregate of all the contracted peak rates requested by the prospective user at the delivery points.
- 223. Clause 5.7 of the proposed access arrangement applies to access to all pipeline services provided by means of the covered pipeline, whether such services are reference or non-reference services.
- 224. There are a number of provisions in the terms and conditions of access to reference services specified in the Template Haulage Contract which relate to the terms and conditions regarding the system pressure protection plan namely clauses 5.9(d), 5.10, 7.2(e), 15.1(b) and 17.1(a).

### **Public submissions**

- 225. In attachment B to its submission dated 19 April 2010 (page 19), Alinta submitted in relation to clause 5.7 that if a system pressure protection plan ensures that the prospective user has sufficient contractual entitlements to firm gas transportation capacity to meet the aggregate of all of the contracted peak rates required by the prospective user at the delivery points then the system pressure protection plan should be treated as an approved system pressure protection plan. Any requirement for WAGN to be satisfied with it in that circumstance should be dispensed with. There were no other public submissions.

### **Authority's assessment**

- 226. Under the current access arrangement the protection of system pressure in relation to the provision of pipeline services generally is addressed by clauses 28 to 34 of Part A. Clauses 28 to 31 apply to users seeking to enter into new service agreements, while clauses 32 to 34 apply to users with existing service agreements.
- 227. These clauses were inserted to address the risks associated with sudden system de-pressurisation following the repeal of the designated supplier provisions (which had been reflected in the provisions of the then current access arrangement). The nature of the risk is of an imbalance occurring within the GDS when the amount of gas being drawn out by the user is greater than that being injected by the designated supplier. Where an imbalance is substantial there is a risk of system de-pressurisation. System de-pressurisation carries significant safety risks and costs of restoring supply.
- 228. The designated supplier provisions had previously addressed this risk. With the introduction of full retail contestability on 31 May 2004, however, small use customers became fully contestable by users of the GDS, and therefore it became impractical to designate a supplier for each of the multiple delivery point on the GDS, and another mechanism to address the risk of sudden system de-pressurisation was required.
- 229. The proposed solution of the service provider was to insert into the access arrangement a requirement that a user of a pipeline service have sufficient firm upstream capacity to meet the user's contracted peak usage for each delivery point.
- 230. While the Authority accepted that this was a means of addressing the risk of sudden system de-pressurisation the Authority considered that such a requirement was

inconsistent with the Code. In particular, the Authority considered that a requirement to hold sufficient firm capacity had the potential to hamper competition, by restricting users' full use of available upstream interruptible or spot transportation capacity. Further, the Authority considered that the proposed requirement could create a barrier to entry particularly for smaller retailers who may not have the means to negotiate firm upstream contracts, and may need to rely heavily on the spot and interruptible markets (paragraphs 814 and 815 of the final decision dated 12 July 2005).

231. The Authority noted that there were means, other than through the imposition of a firm upstream capacity requirement on users, for the service provider to address the risk of system de-pressurisation, without interfering with the development of competition or potentially creating a barrier to entry. The Authority therefore concluded that the service provider should have the ability to seek a firm capacity commitment from users or prospective users, but that users or prospective users not be required to meet such a commitment, but rather would have available to them a menu of other options for addressing the risk of sudden system depressurisation to the reasonable satisfaction of the service provider as a prudent network operator (paragraphs 828 and 829 of the final decision).
232. The provisions in clauses 28 to 34 were proposed by the service provider as part of a framework to address the Authority's position as set out in the previous paragraphs. These provisions contain the 'menu of options' discussed in the Authority's final decision, and were approved as an appropriate means of addressing the safety and technical risks arising from system de-pressurisation in the competitive environment established by the Code.
233. The Authority notes that clause 5.7 of the proposed access arrangement as proposed by WAGN for approval does not reflect the 'menu of options' approach approved by the Authority for inclusion in the current access arrangement. Rather, the user is only given one option, namely the provision and approval of a system pressure protection plan and (in clause 5.7(b) of the proposed access arrangement) it is a requirement of approval of such a plan that it includes a sufficient firm capacity requirement.
234. As the proposed access arrangement would, if approved, require each user as a condition of access to have sufficient firm upstream capacity, this raises for consideration the issues of the development of competition and barriers to entry as dealt with by the Authority in its final decision dated 12 July 2005.
235. The Authority notes that it does not have any evidence before it, nor has it received any submissions, regarding changes in the market to suggest that the Authority's concerns about the development of competition and barriers to entry at that time are no longer present. In the circumstances, the Authority concludes that clause 5.7 of the proposed access arrangement if approved would have the potential to hamper the development of competition and to potentially create barriers to entry. This would be inconsistent with the national gas objective, and the clause should not be approved.
236. The Authority sees no reason why the solution to the issue included in the current access arrangement namely the provision to users of a 'menu of options' as provided for by clauses 28 to 34 should not apply. This solution would, in the Authority's view address the issue in a way consistent with the national gas objective.



237. Finally, the Authority notes that its draft decision will involve the inclusion in the proposed access arrangement of a pre-condition or restriction on the user's right to access pipeline services, by requiring the user to comply with one or other of the 'menu of options' to address the risk of system de-pressurisation before being entitled to access the pipeline service.
238. In its draft decision above, the Authority has noted that there is no express provision in the NGL or NGR for an access arrangement to restrict access by a user to pipeline services generally (although such a restriction could be placed on access to a reference service if the restriction was consistent with the national gas objective). The Authority, however, distinguishes the restrictions which the Authority considers ought to be placed on the user's right to address the system de-pressurisation risk, from other restrictions on access which the Authority, in its draft decision above, has rejected.
239. The point of distinction, in the Authority's view, is that the risk of system de-pressurisation is a safety or technical risk, which unless addressed through appropriate means in the access arrangement generally could potentially undermine the service provider's ability to provide pipeline services at all, or at least on a sustainable basis. The proposed restrictions to address this risk are consistent with the national gas objective. In particular, the absence of provisions reasonably addressing the risk of system de-pressurisation could provide a disincentive to investment by service providers in gas pipelines, and it could be contrary to 'the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas'.
240. The Authority notes that as a consequence of its draft decision there may be users of reference services who choose to address the system depressurisation issue in ways other than through approval of a system pressure protection plan. As a consequence, the other provisions of the Template Haulage Contract listed above, relating to the approval and operation of a system pressure protection plan, will have no application to those users and may, therefore, be deleted from the Template Haulage Contract at the time it is negotiated and entered into. There are also conditions precedent to a user's request for a reference service contained in clause 1.1 of the Template Haulage Contract. Those conditions are discussed below.

### Draft decision

241. Clause 5.7 of the proposed access arrangement should be deleted as it is not consistent with the national gas objective. The proposed access arrangement should be amended to include provisions consistent with clauses 28 to 34 of the current access arrangement which the Authority considers would address the risk of system de-pressurisation in a manner consistent with the national gas objective.

#### Required Amendment 5

Clause 5.7 of the proposed access arrangement should be deleted.

The proposed access arrangement should be amended to include provisions consistent with clauses 28 to 34 of the current access arrangement.

## Total Revenue (Reference Tariff Building Blocks)

### Requirements of the NGL and the NGR

242. Rule 76 of the NGR provides that total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach in which the building blocks are:
- a) a return on the projected capital base for the years;
  - b) depreciation on the projected capital base for the year;
  - c) if applicable, the estimated cost of corporate income tax for the year;
  - d) increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency; and
  - e) a forecast of operating expenditure for the year.
243. The access arrangement information must specify the total revenue to be derived from the pipeline services for each regulatory year of the access arrangement period (rule 72(1)(m) of the NGR) together with all the information necessary to understand the basis and derivation of the service provider's proposal in respect to total revenue (rule 42 of the NGR).

## Projected capital base

### *Requirements for projected capital base*

### Requirements of the NGL and the NGR

244. The projected capital base is to be calculated in accordance with the formula set out in rule 78 of the NGR.
245. Rule 78 of the NGR provides that the projected capital base for a particular period is to be calculated as follows:
- a) the opening capital base; plus
  - b) forecast conforming capital expenditure for the period; less
  - c) forecast depreciation for the period; and
  - d) the forecast value of pipeline assets to be disposed of in the course of the period.
246. The access arrangement information must contain a forecast of depreciation for the period including a demonstration of how the forecast is derived on the basis of the proposed depreciation method (rule 72(1)(c) of the NGR).
247. The access arrangement information must also include all of the information necessary to understand the basis and derivation of the service provider's proposal in respect of the projected capital base (rule 42 of the NGR).

## ***Opening capital base***

### **Requirements of the NGL and the NGR**

248. The opening capital base as calculated is the baseline for the projected capital base calculation (rule 78(a) of the NGR). The opening capital base is calculated by reference to the formula set out in rule 77(2) of the NGR.
249. Pursuant to rule 77(2) of the NGR, in circumstances where an access arrangement period follows immediately on from the conclusion of a preceding access arrangement period, as is the case with respect to the proposed access arrangement, the opening capital base is to be:
- a) the opening capital base as at the commencement of the current access arrangement period; plus
  - b) conforming capital expenditure; plus
  - c) any amounts to be added to the capital base under rule 82, rule 84 or rule 86; less
  - d) depreciation over the earlier access arrangement period; and
  - e) redundant assets for the earlier access arrangement period; and
  - f) the value of pipeline assets disposed of during the earlier access arrangement period.
250. Rule 72(1)(b) of the NGR provides that the access arrangement information must include how the capital base is arrived at and a demonstration of how it has increased or diminished over the previous access arrangement period.

## ***Opening capital base at commencement of current access arrangement period***

### **Requirements of the NGL and the NGR**

251. Pursuant to rule 77(2)(a) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, the capital base as at the commencement of the current access arrangement period.
252. There are no specific access arrangement information requirements. Accordingly, the relevant requirement is the general requirement that the service provider provides the Authority with all of the information necessary to understand the basis and derivation of the service provider's proposal (rule 42 of the NGR).

### **Access arrangement information**

253. The opening capital base information for the current access arrangement period is provided on pages 6-10 of the access arrangement information, with Table 7 (page 7) showing the opening capital base for the current access arrangement at 1 January 2005 as \$778.569 million, expressed in December 2009 dollars.

## **Public submissions**

254. No public submissions were received in relation to the opening capital base at the commencement of the earlier access arrangement period.

## **Authority's assessment**

255. The Authority considers that WAGN's access arrangement information uses an incorrect figure for the opening capital base at the commencement of the current access arrangement.
256. The capital base stated in the current access arrangement for the WAGN GDS as at 1 January 2005 is \$658.6 million, expressed in December 2004 dollars. WAGN have submitted that the opening capital base as at 1 January 2005 is \$778.569 million, expressed in December 2009 dollars.
257. The Authority requires the capital base at 31 December 2004, approved in the current access arrangement, in December 2004 dollars, to be inflated by the measure of inflation using CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.
258. WAGN have used changes in the CPI (All Groups, Perth) as the measure of the inflation rate in the proposed access arrangement at the mid-point of the modelling period. WAGN also assumed a December 2009 CPI number of 169.4 because the actual CPI number (169.7) had not been released when WAGN prepared its access arrangement proposal. WAGN has proposed an opening capital base of \$658.6 million, expressed in December 2004 dollars, inflated to December 2009 dollars using the CPI (All Groups, Perth). The Authority notes that the inflation value calculated over the five year period from December 2004 to December 2009 using the CPI (All Groups, Perth) is 2.5 per cent higher than using the CPI (All Groups, Eight Capital Cities).
259. Accordingly, the Authority does not approve WAGN's proposed use of CPI (All Groups, Perth) at the mid-point of the modelling period and therefore does not approve WAGN's proposed opening capital base figure of \$778.569 million.
260. The Authority has used a modelling approach that does not permit assets to have negative values at the commencement of an access arrangement. Negative asset values arose in the initial access arrangement because forecast expenditure in some categories (most notably equipment and vehicles) did not occur despite the provision of depreciation for these assets. However, there is no net effect on asset values by 2009 from this asset value correction. This modelling approach also contributes to a difference between the Authority and WAGN in the value used for the opening capital base in WAGN's current proposal. The Authority's financial model, released with this draft decision, contains the details of the Authority's calculation of the opening capital base for the current access arrangement.
261. Table 2 below shows the Authority's draft decision values in relation to the opening capital base as at 1 January 2005 and reproduces for comparison WAGN's values from Table 7 of the access arrangement information.

**Table 2**      **WAGN's proposed capital base and Authority's adjusted capital base - at 1 January 2005 (31/12/2005)**  
**(\$ million, December 2009)**

<b>Asset Category</b>	<b>WAGN</b>	<b>Draft Decision</b>
High pressure mains	201.416	197.322
Medium pressure mains	256.844	251.387
Medium/low pressure mains	121.393	118.814
Low pressure mains	31.977	31.981
Regulators	11.430	11.216
Secondary gate stations	2.122	2.125
Buildings	1.924	1.913
Meters and service pipes	126.946	124.248
Equipment and vehicles	3.417	2.886
Information technology	7.029	6.880
Full retail contestability	14.116	13.816
Land	6.789	6.645
<b>Total</b>	<b>778.569</b>	<b>769.233</b>

### **Draft decision**

262. The Authority does not approve the value for the opening capital base at the commencement of the current access arrangement period in the access arrangement information of \$778.569 million, expressed in December 2009 dollars.
263. The Authority concludes that the opening value for the capital base at the commencement of the current access arrangement should be \$769.233 million calculated in December 2009 dollars.
264. As a consequence of the above and other sections of this draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

### ***Past conforming capital expenditure***

#### **Requirements of the NGL and the NGR**

265. Pursuant to rule 77(2)(b) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, the conforming capital expenditure made, or to be made, during the current access arrangement period.
266. Conforming capital expenditure (rule 79 of the NGR) is expenditure which:
- must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services (rule 79(1)(a)); and
  - is justifiable (rule 79(2)) on one of the following grounds:

- i) the overall economic value of the expenditure is positive; or
  - ii) the present value of the expected incremental revenue to be generated as a result of the expenditure exceeds the present value of the capital expenditure; or
  - iii) the capital expenditure is necessary:
    - 1. to maintain and improve the safety of services; or
    - 2. to maintain the integrity of services; or
    - 3. to comply with a regulatory requirement or obligation; or
    - 4. to maintain the service provider's capacity to meet levels of demand for services existing at the time the capital expenditure is incurred; or
  - iv) the capital expenditure is an aggregate amount divisible into 2 parts, one referable to incremental services and the other referable to a purpose referred to in rule 79(2)(c), and the former is justified under rule 79(2)(b) and the later under rule 79(2)(c).
267. Rule 79(3) of the NGR provides that when the Authority is deciding whether the overall economic value of capital expenditure is positive, consideration is to be given only to economic value directly accruing to the service provider, gas producers, users and end users.
268. Rule 79(4) of the NGR provides that when the Authority is determining the present value of expected incremental revenue:
- a) a tariff will be assumed for incremental services based on (or extrapolated from) prevailing reference tariffs or an estimate of the reference tariffs that would have been set for comparable services if those services had been reference services; and
  - b) incremental revenue will be taken to be the gross revenue to be derived from the incremental services less incremental operating expenditure for the incremental services; and
  - c) a discount rate is to be used equal to the rate of return implicit in the reference tariff.
269. If capital expenditure made during an access arrangement period conforms, in part, with the criteria in rule 79 of the NGR, the capital expenditure is, to that extent, to be regarded as conforming capital expenditure (rule 79(5) of the NGR).
270. When assessing whether capital or operating expenditure is efficient and complies with other criteria, the Authority may, without embarking on a detailed investigation, infer compliance from the operation of an incentive mechanism or on any other basis the Authority considers appropriate (rule 71(1) of the NGR). However, the Authority must consider and give appropriate weight to submissions and comments received when the question whether a relevant access arrangement proposal should be approved is submitted for public consultation (rule 71(2) of the NGR).



## Access arrangement information

271. Table 3 (page 4) of the access arrangement information shows capital expenditure, by asset class, from 2005 to 2009.

## Public submissions

### *WAGN's submission*

272. WAGN stated at page 17 of its submissions that the capital expenditure it has made during the period 2005 to 2009 is conforming capital expenditure that can be added to the opening capital base for the current access arrangement period for the purpose of deriving the capital base from which the total revenue and revised reference tariffs are determined for the forthcoming access arrangement period.
273. WAGN submitted on page 18 that it has developed a cash flow model for the purposes of assessing whether capital expenditure satisfies the incremental revenue test and that it has used this model in showing that its actual capital expenditures for 2005-2009 are conforming.
274. WAGN submitted, at pages 24-25 of its submissions, that it experienced higher connection numbers than approved in the current access arrangement. The high connection numbers meant that WAGN incurred significantly higher growth in capital expenditure from 2005 to 2009. WAGN submitted that as a consequence, it had to revise its other proposed capital expenditure programs such as mains replacement to ensure that the total actual capital expenditure was within the constraints of the benchmark expenditure. WAGN further submitted that the other factors which contributed to the capital expenditure not aligning with the benchmark expenditure included the late approval of the access arrangement and outsourcing of all information technology services.
275. Table 4 (page 26) of WAGN's submission sets out the actual and benchmark capital expenditure for 2005 to 2009. WAGN detailed, at pages 26-30 of its submission, user initiated capital expenditure from 2005 to 2009 together with renewal expenditure for the replacement of mains.
276. WAGN submitted, at page 30-31, the following reasons as to why demand capital expenditure for the period 2005 to 2009 is consistent with the requirements of rule 79(1) of the NGR:
- a) Prudent – demand capital expenditure was required to ensure that the network is able to meet the demand for service and to ensure that the integrity of the network is maintained.
  - b) Efficient – the costs incurred were from actual contractors' costs, material costs, labour charges and overheads.
277. WAGN submitted that the practice of ensuring that the network is able to meet the requirements of gas demand through network planning process is consistent with good industry practice.
278. WAGN submitted that to achieve the lowest sustainable cost of providing the services – augmentation projections were required to ensure that WAGN can continue to meet the required demand and to ensure that there is sufficient capacity for future growth.

279. WAGN further outlined on pages 35-38, why the capital expenditure for the 'other' category, which includes IT and performance projects, is also consistent with the requirements of the NGR.
280. WAGN, at pages 49-50 of its submissions, applied the criteria of rules 79(2)(b) and 79(2)(c) of the NGR. Tables 27, 28 and 29 provided in WAGN's confidential submission, detailed the capital expenditure for the current access arrangement. Table 27 listed the major projects WAGN expected to undertake, Table 28 summarised variable volume capital expenditure forecast and Table 29 summarised the forecast capital expenditure on information technology. Table 30 in WAGN's confidential submissions summarised capital expenditure by type of expenditure for asset management and planning for the 2005 to 2009 period. The final column of each of Tables 27 to 29 and 31 to 33 showed the grounds on which the expenditures are justified as being conforming capital expenditures which can be taken into account in determining the projected capital base for the forthcoming access arrangement period.
281. WAGN summarised its submissions concerning actual conforming capital expenditure on page 54. WAGN concluded that all of its capital expenditure for the current access arrangement period is conforming, in accordance with the requirements of rule 79. In accordance with rule 77(2), WAGN submitted that it can be added to the capital base of the WAGN GDS for the purpose of determining the opening capital based for the forthcoming access arrangement period.
282. WAGN further provided a confidential special purpose financial report for the four year period ended 31 December 2008 prepared by Deloitte Touche Tohmatsu (**Deloitte**) detailing capital expenditure over the current access arrangement period. On 26 May 2010 WAGN provided a separate Deloitte report, dated 17 May 2010 for the year ended 31 December 2009.

#### *Synergy's submission*

283. Synergy, in its submission dated 12 April 2010 (page 3), submitted that the capital expenditure incurred during the 2005 to 2009 access arrangement period was some 8 per cent higher than forecast. Synergy submitted that prior to rolling this additional expenditure into the initial capital base for the 2010 to 2013/14 access arrangement period, the Authority will need to determine whether it meets the criteria in rule 79 of the NGR whereby new conforming capital expenditure is identified as capital expenditure which (a) would be incurred by a prudent service provider acting efficiently in accordance with accepted good industry practice and (b) is justifiable.

#### *Alinta's submission*

284. Alinta, in Attachment A to its submission dated 19 April 2010 (pages 6-7), submitted that WAGN's actual capital expenditure during the current access arrangement period of \$177.1 million was \$5 million, or 2.3 per cent, higher than the benchmark allowance of \$172.1 million. Alinta showed, in Table A.3 on page 6 of its submission, that if the CPI (All Groups, Eight Capital Cities) was instead used to adjust the allowed capital expenditure for the current access arrangement period, the benchmark allowance would actually be \$168.6 million. Alinta submitted that as a result, WAGN's actual capital expenditure during the current access arrangement period would actually be \$8.6 million, or 5 per cent, higher than that allowed by the Authority.



285. Alinta further submitted, at pages 7-8, that WAGN's claim that actual capital expenditure during the current access arrangement satisfies the requirements of rule 79(1) of the NGR appears to be entirely based on its assertion that this is the case, rather than any persuasive evidence to that affect.
286. Alinta submitted that WAGN's submission suppressed much of the information relating to the application of the tests in rule 79(2) of the NGR, which means that users and prospective users cannot reasonably be expected to be able to understand the basis for WAGN's claim that all capital expenditure is conforming capital expenditure.
287. Alinta submitted that given the significant increases in reference tariffs proposed by WAGN, a detailed investigation of WAGN's actual capital expenditure during the current access arrangement period and its forecast capital expenditure during the proposed access arrangement is necessary. Alinta supported this assertion by providing detailed reasoning at pages 8-18 of its submission, discussed below under conforming forecast capital expenditure.

### Consultants' reports

#### *EnergySafety report*

288. The EnergySafety division of the Department of Commerce (**EnergySafety**) provided the Authority with a technical report assessing WAGN's capital expenditure under rules 79(1)(a) and 79(2)(c) of the NGR. This requires that conforming capital expenditure be justified on the grounds of prudence, efficiency, safety, technical integrity and regulatory requirements or to meet demand for existing services.
289. EnergySafety detailed in its report each of WAGN's capital expenditure projects, under the current access arrangement as listed in Tables 27, 28 and 29 of WAGN's supporting confidential submissions.
290. EnergySafety concluded in relation to the requirements of rule 79(1)(a) that overall, the projects detailed and associated costs appear to be reasonable for a prudent service provider acting efficiently and in accordance with good industry practice.
291. In relation to rule 79(2)(c), EnergySafety has assessed the projects that fall under rule 79(2)(c)(i), (ii) and (iii) and determined that the capital expenditure on most of these projects is justifiable. In a few cases, EnergySafety has commented that further information is required in relation to the project.

#### *Frontier Economics report*

292. Frontier Economics Pty Ltd Australia (**Frontier**) provided the Authority with a report relating to the application of rule 79(2) of the NGR, including actual capital expenditure on the WAGN GDS over the current access arrangement period and forecast capital expenditure over the forthcoming access arrangement period.
293. Frontier evaluated conforming capital expenditure justification based on the criteria that the overall economic value of the expenditure is positive or that the expected incremental revenue resulting from the expenditure exceeds the capital expenditure in present value terms (rules 79(1)(b) and 79(2)(a), (b) and (d) of the NGR). Rules 79(3) and 79(4) set out the requirements for the assessments under rule 79(2) (a), (b) and (d). Rule 79(3) requires that in assessing the overall economic value of the capital expenditure consideration is only to be given to economic value directly

accruing to the service provider, gas producers, users and end users. Rule 79(4) sets out three requirements for determining the present value of the resulting expected incremental revenue from the capital expenditure. Firstly, that the prevailing reference tariffs be applied to the incremental services, or an estimate of the reference tariffs for comparable reference tariffs be applied; secondly that the incremental revenue be calculated as gross revenue from the incremental service minus incremental operating costs associated with the incremental service; and thirdly that the discount rate used to calculate present value be the rate of return on capital implicit in the relevant reference tariff.

294. Frontier, as noted on page 2 of its report, was not asked to assess capital expenditure justified on the basis that it is necessary for the purposes set out in rule 79(2)(c) regarding efficiency, safety, technical integrity and regulatory requirements or to meet demand for existing services.
295. Frontier noted in its report that it had sought substantiation of the net incremental revenue figures in WAGN's submission to support WAGN's claims that both actual and forecast demand and user-initiated capital expenditures satisfied the net incremental revenue test in rule 79(2)(b) of the NGR. The Frontier report notes that in response to this request WAGN provided additional information, including a report prepared by Marsden Jacob Associates and an excel spreadsheet applying rule 79(2)(b) of the NGR. The Marsden Jacob report sought to show that actual capital expenditure is justifiable with reference to the criterion in rule 79(2)(b).
296. Frontier concluded that WAGN's actual capital expenditure meets the requirements of the net incremental revenue test in the NGR assuming that the test applies to aggregate actual expenditure.
297. Frontier noted on page 5 of its report that Tables 27-29 and 31-33 of WAGN's submissions, all of which are not publicly available, do not demonstrate how each individual investment satisfies the relevant conforming capital expenditure criteria under rule 79(2) of the NGR and that no evidence of each project's satisfaction of the criteria is contained in the remainder of WAGN's submission. Frontier further stated that neither the Marsden Jacob report nor the rule 72(2)(b) spreadsheet provided by WAGN show how each project described in the relevant tables satisfies rule 79(2)(b) criterion. Frontier commented that the Authority may wish to consider whether WAGN should be required to demonstrate how individual projects are justifiable under rule 79(2)(b).

#### **Authority's assessment**

298. The Authority notes the confidential report prepared by Deloitte and provided by WAGN together with the proposed access arrangement. This report covers the period 1 January 2005 to 31 December 2008. A subsequent report dated 17 May 2010 by Deloitte covered the last year of the current access arrangement.
299. The Authority notes that this information was provided to the Authority on a confidential basis. The report reconciles the regulatory accounting information on which WAGN's proposed revisions have been prepared with WAGN's financial accounts. The report also independently verifies that the costs which have been claimed by WAGN have been duly incurred. The Authority is satisfied from the information contained in this report that the operating and capital expenditure of WAGN for the years ending 31 December 2005 to 2009 has been independently reviewed and duly incurred by WAGN.

300. The Authority also notes that the figures provided in Table 3 of the access arrangement information for 2009 are an estimate only. On 26 May 2010, WAGN provided the subsequent report dated 17 May 2010 by Deloitte. This provided updated actual capital expenditure for 2009 which is different from the values provided by WAGN in its access arrangement information.
301. The Authority notes that actual capital expenditure provided by WAGN and set out in Table 3 of the access arrangement information totals \$177.128 million (December 2009 dollars) for the current access arrangement, which is \$5.022 million more than the total approved forecast capital expenditure under the current access arrangement inflated using CPI (All Groups, Perth).
302. The Authority does not accept WAGN's proposal to adopt the use of CPI (All Groups, Perth) at the mid-point of the modelling period and instead requires WAGN to measure inflation using CPI (All Groups, Eight Capital Cities) at the end point of the modelling period. As a result of this decision, the Authority requires that actual capital expenditure for the 2005 to 2009 access arrangement period to be inflated using CPI (All Groups, Eight Capital Cities) at the end point of the modelling period. Table 3 below shows the capital expenditure with the Authority's CPI adjustment.

**Table 3 Capital expenditure by asset class 2005-2009 - Adjusted by the Authority**  
(\$ million, December 2009)

	2005	2006	2007	2008	2009 <sup>1</sup>
High pressure mains	0.520	1.547	1.485	3.285	10.356
Medium pressure mains	-	-	-	-	-
Medium/low pressure mains	7.890	8.932	13.290	11.640	9.752
Low pressure mains	-	-	-	-	-
Regulators	0.112	0.798	0.653	0.185	0.728
Secondary gate stations	-	-	-	0.013	1.634
Buildings	-	-	0.042	0.117	0.150
Meters and service pipes	18.589	21.890	19.392	17.669	17.876
Equipment and vehicles	-	-	-	-	-
Information technology	0.417	0.001	-	2.602	1.991
Full retail contestability	-	-	-	-	-
Land	-	-	-	-	-
<b>Total</b>	<b>27.528</b>	<b>33.168</b>	<b>34.861</b>	<b>35.511</b>	<b>42.487</b>

<sup>1</sup>. Estimate

303. Based on the adjusted figures in Table 3 above WAGN's actual capital expenditure for the current access arrangement period should total \$173.555 million, calculated in December 2009 dollars.
304. In order for the Authority to approve rule 77(2)(b) of the NGR, the Authority must also be satisfied that actual capital expenditure for the current access arrangement period is conforming capital expenditure in accordance with rule 79 of the NGR. The Authority notes that in order to be conforming capital expenditure, rule 79(1) of the NGR requires the expenditure to be incurred by a prudent service provider

acting efficiently and in accordance with accepted good industry practice and to be justifiable on one of the grounds set out in rule 79(2).

305. In order to assist the Authority to assess whether capital expenditure for the current access arrangement is conforming, the Authority engaged the use of two consultants, EnergySafety and Frontier. As summarised above, the consultants have provided their reports and conclusions regarding WAGN's capital expenditure to the Authority. The Authority notes that EnergySafety evaluated whether WAGN's actual capital expenditure is justified as conforming based on prudence, efficiency, safety, technical integrity and regulatory requirements or to meet demand for existing services under rules 79(1)(a) and 79(2)(c) of the NGR. Frontier evaluated whether WAGN's actual capital expenditure is justified as conforming based on economic criteria under rule 79(2)(a),(b) and (d), (and by implication rules 79(3) and 79(4)).
306. The Authority has considered EnergySafety's assessment of capital expenditure under rules 79(1)(a) and 79(2)(c) of the NGR for actual capital expenditure for the current access arrangement.
307. In relation to rule 79(1)(a), the Authority agrees with EnergySafety that actual capital expenditure is reasonable for a prudent service provider acting efficiently and in accordance with good industry practice.
308. In relation to rule 79(2)(c), the Authority also agrees with the assessment in the EnergySafety report that actual capital expenditure on most of the projects that fall under rule 79(2)(c)(i), (ii) and (iii) is justifiable. The Authority notes EnergySafety's comment that further detail is required on a small number of these projects.
309. The Authority has also considered Frontier's assessment of capital expenditure under rules 79(2)(a), (b) and (d) of the NGR for actual capital expenditure for the current access arrangement.
310. The Authority accepts Frontier's conclusion that WAGN's actual capital expenditure meets the requirements of the net incremental revenue test in rule 79(2)(b) of the NGR based on the aggregate actual expenditure.
311. Frontier raised the issue of whether WAGN should be required to demonstrate how individual projects are justifiable under rule 79(2)(b). The Authority's view is that as rule 79 does not provide for any particular level of disaggregation of capital expenditure and the Authority's discretion under this rule is limited, the Authority must apply the tests in rule 79 to WAGN's capital expenditure based on the manner in which WAGN has disaggregated this expenditure for the purpose of applying the rule 79 tests (provided this has been done on a logical and rational basis).
312. Based on the above, the Authority is satisfied that it is not necessary to require WAGN to disaggregate its actual capital expenditure beyond the level set out in its proposal.

### **Draft decision**

313. The Authority does not approve WAGN's actual capital expenditure figures for the current access arrangement period as submitted, to the extent that these figures are based on changes in CPI (All Groups, Perth) to the mid-point of the modelling period. The Authority considers that the values should be those in Table 3 of this

draft decision based on changes in CPI (All Groups, Eight Capital Cities) at the end of the modelling period.

314. On 26 May 2010, WAGN provided the subsequent report dated 17 May 2010 by Deloitte. This provided updated actual capital expenditure for 2009 which is different from the values provided by WAGN in its access arrangement information. The Authority has taken account of this recent information in this draft decision.
315. For the purpose of this draft decision, and in accordance with rule 41 and 59 of the NGR, the Authority is satisfied that WAGN's actual capital expenditure under the current access arrangement provided in Table 3 of the access arrangement information, as adjusted to reflect the values of Table 3 of this draft decision, is conforming in accordance with rule 79 of the NGR. However, the Authority requires WAGN to provide further information prior to the final decision on the projects listed in EnergySafety's report requiring clarification.
316. Subject to the provision of adequate information by WAGN, the Authority approves WAGN's actual capital expenditure under the current access arrangement as conforming capital expenditure for the purpose of rolling it into the capital base, based on the values in Table 3 of this draft decision. The Authority will review this component of the opening capital base in the final decision.
317. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

## ***Capital contributions by users***

### **Requirements of the NGL and the NGR**

318. Rule 81 of the NGR provides that a service provider may make, during an access arrangement period, capital expenditure that is, in whole or in part, non-conforming capital expenditure.
319. Rule 82 of the NGR provides that a user may make a capital contribution towards a service provider's capital expenditure. Any capital contributions by a user may, with the approval of the Authority, be rolled into the capital base for a pipeline on condition that the service provider does not benefit through increased revenue from the user's contribution to the capital base.
320. There are no specific access arrangement information requirements.

### **Access arrangement information**

321. WAGN set out user contributions to capital expenditures during the current access arrangement period in Table 8 (page 7) of the access arrangement information. WAGN stated that these contributions have been deducted from the appropriate conforming capital expenditures for the purpose of determining the opening capital base for the forthcoming access arrangement period.

### **Public submissions**

322. No public submissions were received in relation to capital contributions by users.



## Authority's assessment

323. The Authority notes that WAGN has elected to deduct any capital contributions made by users from capital expenditure for the purpose of determining the opening capital base for the forthcoming access arrangement period. WAGN, therefore, does not seek the Authority's approval to roll into the capital base user contributions, as permitted by rule 82 of the NGR.
324. The Authority notes that the special purpose financial report prepared by Deloitte has reviewed the appropriate financial and accounting information of WAGN with respect to 'customer contributions' for the years ending 31 December 2005 to 2008. The Authority notes that the figures in Deloitte's report are stated on a nominal basis, and therefore with the appropriate adjustment, accord with the figures provided by WAGN in Table 8 of the access arrangement information, which are stated in December 2009 dollars. The Authority is satisfied, having regard to the special purpose financial report, that WAGN's capital expenditure for the current access arrangement period does not include any capital contributions by users and therefore, that no such contributions are rolled into the opening capital based for the forthcoming access arrangement period. As WAGN does not seek approval to roll in any user contributions, it is not necessary for the Authority to consider the application of WAGN's proposal in respect of rule 81 and rule 82 of the NGR.
325. The Authority notes that the figures stated in Table 8 of the access arrangement information are inflated using CPI (All Groups, Perth) at the mid-point of the modelling period. The Authority requires WAGN to amend the figures in Table 8 to measure inflation using changes in CPI (All Groups, Eight Capital Cities) to the end point of the modelling period.

**Table 4      User capital contributions 2005-2009 - Adjusted by the Authority**  
**(\$ million, December 2009)**

	2005	2006	2007	2008*	2009
Allocated to specific projects	-	0.050	1.329	0.036	1.23
Not allocated to specific projects	0.242	2.713	1.348	1.281	0.00
<b>Total</b>	<b>0.242</b>	<b>2.762</b>	<b>2.677</b>	<b>1.317</b>	<b>1.23</b>

326. Table 4 above shows WAGN's user capital contributions for the current access arrangement period adjusted by the Authority using changes in CPI (All Groups, Eight Capital Cities) at the end of the modelling period.
327. The Authority further notes that the figure provided for user capital contributions in Table 8 of the access arrangement information for 2009 is an estimate only. The Authority notes that the 2009 figures have been updated to reflect the actual figures for 2009 as per special purpose financial report dated 17 May 2009.

## Draft decision

328. The Authority does not approve WAGN's use of CPI (All Groups, Perth) at the mid-point of the modelling period and requires the use of CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.

## ***Speculative capital expenditure account***

### **Requirements of the NGL and the NGR**

329. Pursuant to rule 77(2)(c) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, any amounts to be added to the capital base under rule 84 of the NGR.
330. Rule 84(1) of the NGR provides that a full access arrangement may provide that the amount of non-conforming capital expenditure, to the extent that it is not to be recovered through a surcharge on users or a capital contribution, is to be added to a notional speculative capital expenditure account.

### **Access arrangement proposal**

331. Clause 10 of the proposed access arrangement provides that the amount of any non-conforming capital expenditure is, to the extent that expenditure is not to be recovered through a surcharge on users or a capital contribution, to be added to a notional fund, the WAGN GDS speculative capital expenditure account, and it to be dealt with in accordance with rule 84(2) and rule 84(3).

### **Access arrangement information**

332. WAGN stated, at page 8 of the access arrangement information, that no amount has been withdrawn from a speculative capital expenditure account that should be added to the capital base in accordance with rule 84 of the NGR.

### **Public submissions**

333. No public submissions were received in relation to the rolling in of capital expenditure from a speculative capital expenditure account.

### **Authority's assessment**

334. The Authority notes that should the need arise during the forthcoming access arrangement period, WAGN has, in accordance with rule 84 of the NGR, made provision for any non-conforming capital expenditure to be added to the WAGN GDS speculative capital expenditure account.
335. The Authority is satisfied that WAGN's proposal is consistent with the NGR, including the national gas objective.

### **Draft decision**

336. The Authority approves clause 10 of the proposed access arrangement.

## ***Re-use of redundant assets***

### **Requirements of the NGL and the NGR**

337. Pursuant to rule 77(2)(c) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, any amounts to be added to the capital base under rule 86 of the NGR.

338. Rule 86 of the NGR provides that, subject to the new capital expenditure criteria, if, after the reduction of the capital base by the value of assets identified as redundant, the assets later contribute to the delivery of pipeline services, the assets may be treated as new capital expenditure of an amount calculated by taking their value as at the time of their removal from the capital base and increasing it annually at the rate of return implicit in the reference tariff.

#### **Access arrangement information**

339. There are no specific access arrangement information requirements. WAGN noted, on page 8 of the access arrangement information, that there has been no re-use of redundant assets requiring an amount to be added to the capital base in accordance with rule 86 of the NGR.

#### **Public submissions**

340. No public submissions were received in relation to the re-use of redundant assets.

#### **Authority's assessment**

341. The Authority notes that WAGN has not used, and does not intend to re-use, any redundant assets. The Authority is satisfied that WAGN's proposal is consistent with the NGR, including the national gas objective.

#### **Draft decision**

342. The Authority approves WAGN's proposed access arrangement in relation to the re-use of redundant assets.

### ***Depreciation over the current access arrangement period***

#### **Requirements of the NGL and the NGR**

343. Pursuant to rule 77(2)(d) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, depreciation over the earlier access arrangement period (to be calculated in accordance with any relevant provisions of the access arrangement governing the calculation of depreciation for the purpose of establishing the opening capital base).
344. There are no specific access arrangement information requirements. Accordingly, the relevant requirement is the general requirement that the service provider provides the Authority with all of the information necessary to understand the basis and derivation of the service provider's proposal in respect of depreciation (rule 42 of the NGR).

#### **Access arrangement information**

345. Table 9 (page 8) of the access arrangement information provides depreciation, expressed in constant prices at December 2009, over the current access arrangement period.



## Public submissions

### WAGN's submission

346. Neither WAGN nor any other interested party made any submissions in relation to depreciation over the current access arrangement period.

### Authority's assessment

347. The Authority notes that it has no discretion in relation to depreciation over the current access arrangement period.
348. The figures stated in Table 9 of the access arrangement information are inflated using changes in CPI (All Groups, Perth) at the mid-point of the modelling period. The Authority requires WAGN to measure inflation using changes in CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.
349. Table 5 below shows the Authority's draft decision values for depreciation over the current access arrangement period adjusted by changes in CPI using All Groups, Eight Capital Cities and modelled at the end of each modelling period. WAGN's values in comparison are shown in Table 9 of WAGN's access arrangement information.

**Table 5 Depreciation 2005-2009 - Adjusted by the Authority**  
(\$ million, December 2009)

	2005	2006	2007	2008	2009
High pressure mains	1.972	1.979	1.987	1.995	2.002
Medium pressure mains	5.432	5.540	5.640	5.725	5.820
Medium/low pressure mains	3.346	3.380	3.416	3.450	3.490
Low pressure mains	1.159	1.159	1.159	1.159	1.159
Regulators	0.512	0.514	0.517	0.519	0.521
Secondary gate stations	0.109	0.110	0.110	0.110	0.110
Buildings	0.105	0.105	0.106	0.106	0.106
Meters and service pipes	11.885	12.797	13.676	14.361	15.166
Equipment and vehicles	-	0.000	-	-	-
Information technology	1.376	2.139	2.799	3.353	4.153
Full retail contestability	2.763	2.763	2.763	2.763	2.763
Land	-	-	-	-	-
<b>Total</b>	<b>28.661</b>	<b>30.486</b>	<b>32.171</b>	<b>33.540</b>	<b>35.291</b>

### Draft decision

350. The Authority approves WAGN's proposed depreciation methodology for the current access arrangement period but does not approve WAGN's proposed depreciation values which have been based on the use of CPI (All Groups, Perth) at the midpoint of the modelling period. The Authority requires the use of CPI (All Groups, Eight Capital Cities) at the end of the modelling period.

351. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

### ***Previous redundant assets***

#### **Requirements of the NGL and the NGR**

352. Pursuant to rule 77(2)(e) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, redundant assets identified during the course of the earlier access arrangement period.

#### **Access arrangement information**

353. There are no specific access arrangement information requirements.
354. WAGN noted, on page 8 of the access arrangement information, that there has been no redundant assets identified during the current access arrangement.

#### **Public submissions**

355. No public submissions were received in relation to previous redundant assets.

#### **Authority's assessment**

356. The Authority notes that there has been no redundant assets identified during the current access arrangement and that no submissions were received in relation to previous redundant assets.
357. The Authority is satisfied that WAGN has complied with the requirements of rule 77(2)(e) of the NGR and that the opening capital base is not required to be calculated by reference to any redundant assets identified during the current access arrangement period.

#### **Draft decision**

358. The Authority approves WAGN's proposed access arrangement in relation to previous redundant assets.

### ***Asset disposals***

#### **Requirements of the NGL and the NGR**

359. Pursuant to rule 77(2)(f) of the NGR, the opening capital base is to be calculated by reference to, amongst other things, the value of pipeline assets disposed of during the earlier access arrangement period.
360. There are no specific access arrangement information requirements in relation to asset disposals. Accordingly, the relevant requirement is the general requirement that the service provider provides the Authority with all of the information necessary to understand the basis and derivation of the service provider's proposal (rule 42 of the NGR).

### Access arrangement information

361. WAGN noted, in Table 10 (page 9) of the access arrangement information that certain assets were disposed of during the current access arrangement period and have been removed from the capital base of the WAGN GDS, including:

- a) Land in Mount Claremont;
- b) Land and buildings in Ballajura; and
- c) Land and buildings in Bentley.

### Public submissions

#### *WAGN's submission*

362. WAGN noted the substantially the same details as provided in its access arrangement information on page 54 of its submission. WAGN also noted that there were no prior speculative capital expenditures or capital redundancies to be taken into account for the purposes of conforming capital expenditure.

#### *Other submissions*

363. No other public submissions were received in relation to asset disposal.

### Authority's assessment

364. The Authority notes that WAGN has removed from the opening capital base the value of three pipeline assets disposed of during the current access arrangement period.

365. The Authority notes that the figures stated in Table 10 of the access arrangement information are inflated using changes in CPI (All Groups, Perth) at the mid-point of the modelling period. The Authority requires WAGN to measure inflation using changes in CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.

366. Table 6 below shows the Authority's draft decision values in relation to asset disposals. WAGN's values in comparison, are shown in Table 10 of the access arrangement information.

**Table 6 Asset disposals - Adjusted by the Authority (\$million, December 2009)**

	2005	2006	2007	2008	2009
Buildings	-	-	-	-	1.028
Land	-	-	-	-	3.382
Total	-	-	-	-	4.410

### Draft decision

367. The Authority does not approve the values provided in Table 10 of the access arrangement information for asset disposals to the extent that the values in this table are based on changes in the CPI (All Groups, Perth) at the mid-point of the modelling period and not changes in the CPI (All Groups, Eight Capital Cities) as at the end point of the modelling period.

368. As a consequence of the above and other sections of this draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

## ***Calculation of opening capital base***

### **Access arrangement information**

369. Table 11 (page 10) of the access arrangement information sets out the opening capital base for the forthcoming access arrangement period.

### **Authority's assessment**

370. The Authority has no separate discretion in relation to the opening capital base and if it withholds its approval to any of the input components in rule 77(2)(f) of the NGR, then approval must be withheld for the opening capital base.
371. The Authority has analysed WAGN's proposal in respect of each input component of the opening capital base in accordance with rule 77(2)(f) of the NGR. As detailed above, the Authority's decision on each input component is as follows:
- a) The Authority does not approve WAGN's proposal in relation to the opening capital base as at the commencement of the current access arrangement period;
  - b) The Authority does not approve WAGN's proposal regarding past conforming capital;
  - c) The Authority approves WAGN's proposal concerning the amounts to be added to the capital base under rule 82, rule 84 or rule 86;
  - d) The Authority does not approve WAGN's proposal in relation to depreciation over the current access arrangement period;
  - e) The Authority approves WAGN's proposal regarding redundant assets for the current access arrangement period; and
  - f) The Authority does not approve WAGN's proposal concerning the value of pipeline assets disposed of during the current access arrangement period.
372. As a consequence of the Authority's decision concerning each of the input components required by rule 77(2)(f) above, the Authority does not approve the opening capital base in WAGN's proposed access arrangement.
373. Table 7 below shows the Authority's draft decision values in relation to the opening capital base for the current access arrangement period. WAGN's values in comparison, are shown in Table 11 of the access arrangement information.

**Table 7 Opening capital base for current access arrangement period – Adjusted by the Authority (\$ million, December 2009)**

	2005	2006	2007	2008	2009
Opening Asset Base	769.233	761.138	763.820	766.509	768.480
Conforming Capital Expenditure	27.528	33.168	34.861	35.511	42.487
Depreciation	-28.661	-30.486	-32.171	-33.540	-35.291
Asset Adjustment, Redundant Assets & Asset Disposal	-6.962	-	-	-	-4.410
Closing Asset Value	761.138	763.820	766.509	768.480	781.918

**Draft decision**

374. The Authority does not approve WAGN's value for the opening capital base for the forthcoming access arrangement period of \$788.188 million, expressed in December 2009 dollars.
375. The Authority considers that the opening value for the capital base for the forthcoming access arrangement period should be \$781.918 million, expressed in December 2009 dollars.
376. As a consequence of the above and other sections of this draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

**Forecast conforming capital expenditure****Requirements of the NGL and the NGR**

377. Rule 78(b) of the NGR states that the projected capital base for a particular period is the opening capital base plus the forecast conforming capital expenditure for the period minus forecast depreciation and minus forecast value of pipeline assets disposed of over the period.
378. Conforming capital expenditure is capital expenditure that conforms with the criteria set out in rule 79 of the NGR. As discussed previously for actual capital these criteria include reference to capital expenditure that would be incurred by a prudent service provider acting efficiently, and that the expenditure is justifiable on economic, safety or regulatory grounds.
379. Rule 79(3) of the NGR provides that when the Authority is deciding whether the overall economic value of capital expenditure is positive, consideration is to be given only to economic value directly accruing to the service provider, gas producers, users and end users.
380. Rule 79(4) of the NGR provides that when the Authority is determining the present value of expected incremental revenue:
- a tariff will be assumed for incremental services based on (or extrapolated from) prevailing reference tariffs or an estimate of the reference tariffs that

- would have been set for comparable services if those services had been reference services; and
- b) incremental revenue will be taken to be the gross revenue to be derived from the incremental services less incremental operating expenditure for the incremental services; and
  - c) a discount rate is to be used equal to the rate of return implicit in the reference tariff.
381. If capital expenditure made during an access arrangement period conforms, in part, with the criteria in rule 79 of the NGR, the capital expenditure is, to that extent, to be regarded as conforming capital expenditure.
382. The access arrangement information must also include all of the information necessary to understand the basis and derivation of the service provider's proposal in respect of forecast conforming capital expenditure (rule 42 of the NGR).
383. When assessing whether capital or operating expenditure is efficient and complies with other criteria, the Authority may, without embarking on a detailed investigation, infer compliance from the operation of an incentive mechanism or on any other basis the Authority considers appropriate (rule 71(1) of the NGR). However, the Authority must consider and give appropriate weight to submissions and comments received when the question whether a relevant access arrangement proposal should be approved is submitted for public consultation (rule 71(2) of the NGR).
384. The access arrangement information must provide forecast capital expenditure and the justification for that forecast (to be included in the projection of the capital base over the access arrangement period (rule 72(1)(c)(i) of the NGR).
385. The access arrangement information must also provide key performance indicators to be used by the service provider to justify expenditure over the access arrangement period (rule 72(1)(f) of the NGR).

#### **Access arrangement information**

386. Table 12 (page 12) of the access arrangement information sets out the forecast conforming capital expenditure for the proposed access arrangement period.
387. Table 8 below shows WAGN's actual capital expenditure by asset class for the current access arrangement period and WAGN's proposed forecast for the forthcoming access arrangement period. Actual capital expenditure is based on Table 3 of WAGN's access arrangement information and forecast conforming capital expenditure is based on Table 12 of the access arrangement information.

**Table 8 WAGN's Capital expenditure by asset class 2005-2009 and forecast 2010-2014 (\$ million, December 2009)**

	2005	2006	2007	2008	2009 <sup>1</sup>	2010 <sup>2</sup>	2010/11	2011/12	2012/13	2013/14
High pressure mains	0.5	1.6	1.5	3.3	9.5	9.6	4.2	7.0	10.7	10.3
Medium pressure mains	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium/low pressure mains	8.1	9.0	13.5	11.9	9.5	6.5	12.5	13.2	13.7	16.1
Low pressure mains	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Regulators	0.1	0.8	0.7	0.2	0.9	0.7	0.3	0.2	0.3	0.2
Secondary gate stations	0.0	0.0	0.0	0.0	1.6	2.0	0.4	0.0	0.0	0.0
Buildings	0.0	0.0	0.0	0.1	0.1	0.5	2.3	6.7	0.0	0.0
Meters and service pipes	19.1	22.2	19.6	17.5	18.9	7.4	16.3	18.9	20.4	22.6
Equipment and vehicles	0.0	0.0	0.0	0.0	0.0	0.0	4.5	0.0	0.0	0.6
Information technology	0.4	0.0	0.0	2.6	3.6	1.5	4.6	3.5	5.0	1.6
Full retail contestability	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>28.3</b>	<b>33.6</b>	<b>35.3</b>	<b>35.7</b>	<b>44.2</b>	<b>28.1</b>	<b>45.1</b>	<b>49.6</b>	<b>50.0</b>	<b>51.4</b>

1. Estimate,
2. Six months 1 January 2010 to 30 June 2010 only

388. The most significant increases in capital expenditure, both current and forecast, occur in the three asset classes of high pressure mains, medium/low pressure mains, and meters and service pipes.

389. The capital expenditure on high pressure mains increased significantly in the current access arrangement period from \$3.3 million (December 2009 dollars) in 2008 to an estimated \$9.5 million in 2009 and \$9.6 million in the six months from 1 January 2010 to 30 June 2010. WAGN forecasts that capital expenditure on this asset class will decrease to \$4.2 million in 2010/11 and then in each of the remaining years of the forthcoming access arrangement reach \$7.0 million, \$10.7 million and \$10.3 million in 2011/12, 2012/13 and 2013/14 respectively. The increase in capital expenditure on high pressure mains in the current access arrangement includes the construction of the Mandurah lateral high pressure main which was built to ease the capacity constraints on the existing high pressure main to Mandurah.

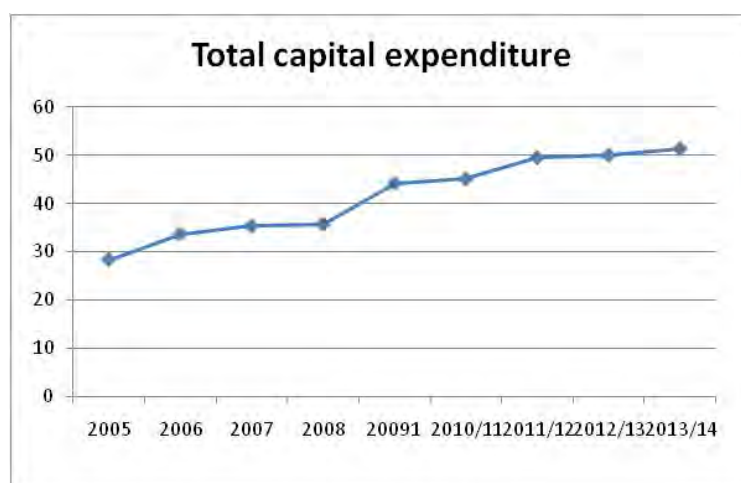
390. Capital expenditure on medium to low pressure mains decreased from a high of \$13.5 million in 2007 to \$11.9 million in 2008 and an estimated \$9.5 million in 2009. Forecast capital expenditure on this asset class is \$6.5 million in the six months from 1 January 2010 to 30 June 2010 and \$12.5 million in 2010/11. In the remaining years of the forthcoming access arrangement capital expenditure on medium to low pressure mains is forecast to increase to \$13.2 million, \$13.7 million



and \$16.1 million in 2011/12, 2012/13 and 2013/14 respectively, driven largely by forecast increases in the number of new connections.

391. Expenditure on meters and service pipes decreased from \$22.2 million in 2006 to \$19.6 million in 2007 and \$17.5 million in 2008 before increasing to an estimated \$18.9 million in 2009 and \$22.6 million in 2013/14 (forecast). These changes in capital expenditure largely follow the expenditure on medium/low pressure mains reflecting the changes in actual and forecast numbers of new connections.
392. The similarity in the pattern of changes of capital expenditure between medium/low pressure mains and meters and service pipes is to be expected as both asset classes are driven by the number of new connections and replacement of ageing pipes and meters.
393. Figure 1 below shows WAGN's actual and forecast total capital expenditure from 2005 to 2013/14 based on the information in Table 8 above.

**Figure 1. WAGN's total capital expenditure – Actual and forecast**



394. WAGN noted, on pages 11-12 of the access arrangement information, that expenditures on meters and service pipes are the largest component of forecast capital expenditure and that these expenditures are primarily to facilitate the connection of the forecast numbers of new customers. WAGN further noted that significant expenditures are forecast for reinforcement of parts of the WAGN GDS which will become capacity constrained during the forthcoming access arrangement period.
395. As expenditure on this asset class forms a significant proportion of the total level of capital expenditure (66 per cent in 2006) changes in actual and forecast expenditure on this asset class feed into significant changes in actual and forecast total capital expenditure.
396. WAGN submitted that as a prudent service provider, it constructs extensions and expansions as new areas are opened to urban and industrial/commercial development. Planning and pipeline construction when these new areas are 'greenfields' sites, facilitates efficient network expansion at the lowest sustainable cost. WAGN stated that the additional costs once roads, buildings and other infrastructure are in place are high. Nevertheless, WAGN submitted that the costs of this reinforcement work are relatively high because land development is expected

in areas which are not close to the existing high and medium pressure mains from which they will be supplied.

397. WAGN noted that trends in a number of key performance indicators have been used as benchmarks against which the forecasts of capital expenditure and operating expenditure used in determining total revenue and the revised reference tariffs have been assessed for reasonableness. WAGN outlined key performance indicators at pages 21-26 of the access arrangement information, including total capital expenditure per incremental customer connection.
398. WAGN noted that the indicators (past and forecast) are expressed in real, December 2009 dollars. The historical values are for calendar years 2000 to 2009 while the forecasts are for the financial years 2010/11 to 2013/14. WAGN noted that no forecast was provided for the six months from 1 January 2010 to 30 June 2010.
399. WAGN submitted that the network infrastructure was approaching full utilisation with the continual geographic expansion of the Perth Metropolitan area. This resulted in the WAGN GDS having to cater to the demand for gas connections in these expanding areas. WAGN submitted that there is now a requirement to implement reinforcement of the network infrastructure to support both existing demand and further growth at the extremities of the current WAGN GDS footprint.
400. Figure 1 on page 22 of the access arrangement information shows total capital expenditure per connection made during the year in which the capital expenditure is incurred. The forecast above-trend increase in total capital expenditure per (incremental) customer connection is the result of planned reinforcement of the high pressure parts of the network to allow extension of the WAGN GDS as the Perth metropolitan area continues to grow.
401. Figures 2 and 3 on pages 22-23 of the access arrangement information show the forecast of a continued increase in capital expenditure per (incremental) customer connection on medium and low pressure mains, and on meters and services pipes, but at rates at or below their long term trends.

## Public submissions

### *WAGN's submission – General*

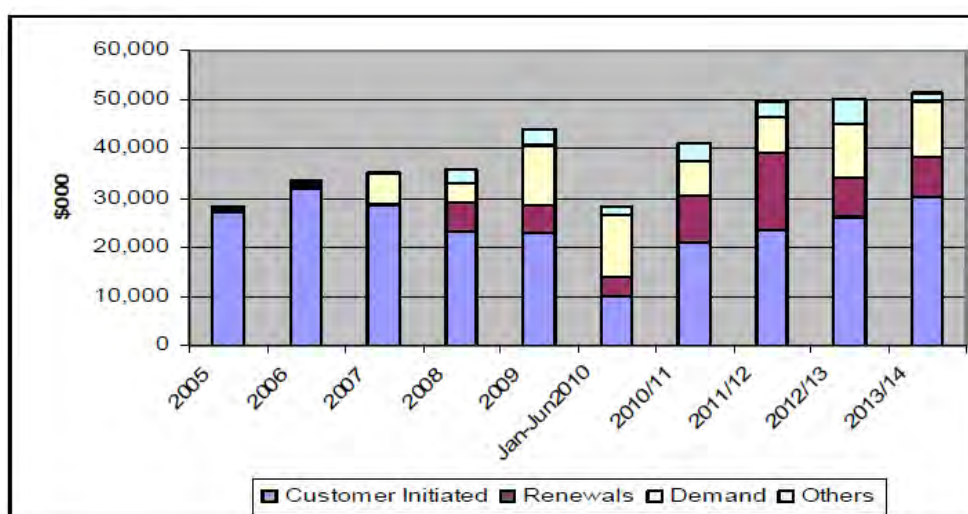
402. WAGN made submissions, on pages 13-15 of its submission, concerning the economic outlook and volume forecasts potentially impacting on the WAGN GDS over the forthcoming access arrangement period. WAGN noted the precarious global economy in recent times but commented that the global economy is stabilising and showing signs of recovery. WAGN submitted that the economic situation, both in Australia and internationally, makes the forecasting of the demand for gas haulage services, and of costs, particularly difficult.
403. WAGN stated at page 17 of its submission that the projected capital expenditure for the forthcoming access arrangement is conforming for the purpose of rule 78 and that it can be taken into account in determining total revenue and revised reference tariffs. WAGN further submitted on page 18 that it has developed a cash flow model for the purposes of assessing whether capital expenditure satisfies the incremental revenue test and that it has used this model to show that its forecast capital expenditures for 2010-2013/14 are conforming.

404. WAGN made submissions on pages 20-23 regarding the network development of the WAGN GDS together with the proposed design and construction work and operation and maintenance requirements that WAGN expects to undertake during the forthcoming access arrangement period.
405. Table 31 in WAGN's confidential submission listed all of the major projects which WAGN expects to undertake during the forthcoming access arrangement period. Table 32 summarises WAGN's variable volume capital expenditure forecast. WAGN noted on page 51 that variable volume capital expenditure is the capital expenditure on mains extensions, feeders and service pipes required to allow WAGN to make the numbers of new customer connections forecast for the forthcoming access arrangement period. Table 33 shows the forecast capital expenditure on information technology. WAGN submitted that the final column of each of Tables 31, 32 and 33 shows the grounds on which the forecast expenditures are justified as being forecast conforming capital expenditure which can be taken into account in determining the projected capital based for the forthcoming access arrangement period.
406. WAGN summarised forecast capital expenditure by type of expenditure for asset management and planning in Table 34 of its confidential submission. WAGN submitted that the incremental revenue test of rule 79(2)(b) is satisfied so that projected demand and customer initiated capital expenditure for 2010(1)-2013/14 is justifiable.
407. WAGN detailed, on page 53, The Vines distribution system and noted that it has now added the capital value of The Vines facilities to the opening capital base of WAGN GDS at the commencement of the forthcoming access arrangement period. WAGN submitted that it has, in effect, treated the value of The Vines distribution facilities as new capital expenditure incurred for the purposes of extending the WAGN GDS and has treated the extension as part of the covered pipeline.
408. WAGN summarised its submissions concerning forecast conforming capital expenditure on page 54. WAGN concluded that all of its projected capital expenditure for the forthcoming access arrangement period is conforming, in accordance with the requirements of rule 79 and can be taken into account, in accordance with rule 78, when determining the total revenue and revised reference tariffs for the WAGN GDS.
409. WAGN's submission at pages 70-71 contained substantially the same information as provided in the access arrangement information with respect to forecast conforming capital expenditure.
410. WAGN stated at page 38 of its submission that it has based its forecast capital expenditure for the forthcoming access arrangement period on a detailed network planning process to ensure that the network continues to perform in accordance with customer expectation, customer demand and legislative requirements. WAGN submitted that the specific factors that have been taken into account include:
- a) Expansion of the network for new customer connections;
  - b) Augmentation of the network to meet growth in demand;
  - c) Replacement of ageing assets to ensure that the network meets its service requirements;

- d) Improvement in public safety; and
- e) Compliance with safety, environmental and technical requirements.

411. Figure 3 on page 39 of WAGN's submission, reproduced below as Figure 2, provides a comparison of the forecast expenditure to the actual expenditure by categories. WAGN submitted that forecast capital expenditure has been calculated from the work volume multiplied by the unit costs and Table 11 (page 40) details the forecast capital expenditure for 2010-2013/14.

**Figure 2. WAGN's actual and forecast capital expenditure 2005–2013/14 (\$ million, December 2009)**



412. WAGN submitted information for each input used to develop its forecast capital expenditure with some confidential information in its submission.

#### *WAGN's submission - Overheads*

413. WAGN stated on page 40 of its submission that the costs shown in Table 11 include an overhead component. WAGN submitted that this overhead is essentially for WAGN to scope, design and project management each project. WAGN made confidential submissions in relation to the total capital overhead costs, including details concerning the forecast overheads.
414. WAGN submitted that the costs shown in Table 11 have been adjusted for the labour and material indices above CPI.
415. WAGN further noted that it has outsourced the majority of its capital works program and that WAGN has tested the market to ensure that the contractors on the panel have rates which are consistent with the lowest sustainable costs.

#### *WAGN's submission - User initiated capital expenditure*

416. WAGN submitted that user initiated capital expenditure is the investment made in extending gas mains so that the mains pass the customer premises, and the connection of service pipes from the mains into those premises. WAGN further

noted that in the case of services B2 and B3, the cost also includes cost of the installation of gas meters. Table 14 (page 41) of WAGN's submission details user initiated capital expenditure for the forthcoming access arrangement period.

417. User initiated capital expenditure is directly related to the number of new connections and WAGN submitted that Economic Consulting Services has forecast 15,630 new connections in 2009/10, levelling out in 2010/11 and a gradual increase to 20,039 by 2013/14. WAGN made confidential submissions in relation to the unit cost for user initiated capital expenditure for the forthcoming access arrangement period.
418. WAGN provided on page 42 of its submission the reasons why it considered user initiated capital expenditure to be consistent with prudence, efficiency, and good industry practice to achieve the lowest sustainable cost of providing services (rule 79(1)(a) of the NGR). The reasons being as follows:
- a) Prudent – customer initiated capital expenditure is required to connect new customers to the network.
  - b) Efficient – forecast costs have been derived from actual contractual costs, material costs, labour charges and overheads.
  - c) Consistent with good industry practice – WAGN's construction of mains, services and meters are with appropriate Australian standards.
  - d) To achieve the lowest sustainable cost of providing the services – the mains, services and meters used to connect customers are appropriately sized so that it is adequate to supply the customer demand.

*WAGN's submission - Renewals (replacement) capital expenditure*

419. WAGN submitted on pages 43-46 of its submission that the renewal of capital expenditure is for the replacement of ageing network assets to ensure that the network can continue to provide its services safely and reliably and WAGN is meeting its regulatory obligations. WAGN submitted that the main category that is being replaced is the cast iron pipes in Fremantle followed by meter replacement. WAGN's main operational centre is also outdated and requires a major refurbishment. WAGN also noted that other miscellaneous assets that are being replaced include telemetry, valves, pits and corrosion protection equipment. Table 16 (page 43) shows the capital expenditure for the renewal program for the forthcoming access arrangement period.
420. WAGN submitted on pages 43-44 the reasons why it considered its replacement capital expenditure to be consistent with prudence, efficiency, and good industry practice to achieve the lowest sustainable cost of providing services (rule 79(1)(a) of the NGR). The reasons being as follows:
- a) Prudent – renewal capital expenditure is required to ensure that the ageing assets are replaced in a timely manner to ensure the integrity of the network.
  - b) Efficient – forecast costs have been derived from actual contractors' costs, materials costs, labour charges and overheads.
  - c) Consistent with good industry practice – replacement of ageing assets ensure the integrity and safety of the network.



- d) To achieve the lowest sustainable cost of providing the services – replacement of these assets mitigate the risk of a catastrophic failure and safety concerns.

*WAGN's submission - Demand*

- 421. The main driver of forecast demand capital is growth in new connections from both 'greenfields' new residential and commercial developments and new connections within existing residential and commercial areas. Increased demand requires greater capacity requirements on all aspects of the distribution network including extension of high pressure mains, and medium to low pressure pipelines as well as reinforcement of existing pipelines. WAGN submitted on pages 46-47 that it has forecast demand capital to ensure that there is adequate capacity to meet the new customer demands and to ensure there is no loss of supply due to lack of capacity. WAGN stated that the projects have been divided into material projects over \$250,000 and miscellaneous projects less than \$250,000 as shown on Table 23 (page 46) of WAGN's submission.
- 422. WAGN's material projects for the forthcoming access arrangement period were detailed in its confidential version of its submission.
- 423. WAGN submitted on page 47 the reasons why it considered its demand capital expenditure to be consistent with prudence, efficiency, and good industry practice to achieve the lowest sustainable cost of providing services (rule 79(1)(a) of the NGR). The reasons being as follows:
  - a) Prudent – the demand capital expenditure is required to ensure that the network is able to meet the demand for service and to ensure that the integrity of the network is maintained.
  - b) Efficient – forecast costs have been derived from actual contractors' costs, materials costs, labour charges and overheads.
  - c) Consistent with good industry practice – the practice of ensuring that the network is able to meet the requirements of the gas demand through the network planning process is consistent with industry practice.
  - d) To achieve the lowest sustainable cost of providing the services – augmentation projects are required to ensure that WAGN can continue to meet the required gas demand and ensure that there is sufficient capacity for future growth. In the absence of these projects, WAGN could experience gas outages due to the inability to meet increased demand. This would result in substantial costs.

*WAGN's submission – 'Other (Performance and IT)'*

- 424. WAGN submitted on pages 47-49 that IT and performance projects enhance the functionality of the network. WAGN stated that there are 37 projects in the category 'Performance' and that most of the costs are small and fall between \$10,000 and \$90,000.
- 425. WAGN made confidential submissions concerning 'other' capital expenditure for the forthcoming access arrangement period, detailing specific IT projects in the WAGN Asset Management Plan. WAGN's Asset Management Plan was attached to WAGN's confidential submission to the Authority.

426. WAGN submitted on page 48 the reasons why it considered its other capital expenditure to be consistent with prudence, efficiency, and good industry practice to achieve the lowest sustainable cost of providing services (rule 79(1)(a) of the NGR). The reasons being as follows:
- a) Prudent – performance capital expenditure is required to ensure that the functionality of the network equipment is not compromised.
  - b) Efficient – forecast costs have been derived from actual contractors' costs, materials costs, labour charges and overheads.
  - c) Consistent with good industry practice – the practice of enhancing the network equipment to ensure their effectiveness is considered good industry practice.
  - d) To achieve the lowest sustainable cost of providing the services – these projects have been selected on the basis that they were required to maintain the network services. In the absence of these projects, WAGN is placed in a high risk of not being able to provide the services and the network assets will deteriorate at a higher rate.

*Synergy's submission*

427. Synergy, in its submission dated 12 April 2010 (pages 3-4), submitted that WAGN does not adequately explain why forecast conforming capital expenditure for the 2010 to 2013/14 access arrangement period is approximately 27 per cent more than that incurred during the current access arrangement period. Synergy submitted that the Authority should require WAGN to provide a more detailed publicly available explanation to enable proper public scrutiny. Synergy stated that the information provided by WAGN does not include sufficient detail about the key projects to be undertaken in the 2010 to 2013/14 period and their costs and the basis for assessing whether the expenditure is prudent.
428. Synergy provided the following example – the substantial increase in the total capital expenditure per incremental customer connection unit rate (as high as \$3,500 per new connection compared with the historical rate of \$1,000-\$2,750) is justified as “planned reinforcement of the high pressure parts of the network to allow extension of the WAGN GDS as the Perth metropolitan area continues to grow”, yet no specific details of this project are available. Synergy submitted that the Authority will need to have regard to the appropriateness of the capital expenditure for network augmentation in terms of forecast demand and for network replacement in terms of the general condition and age of the network.

*Alinta's submission – General*

429. As detailed above concerning past conforming capital expenditure, Alinta, in Attachment A to its submission dated 19 April 2010 (pages 7-8), submitted that WAGN's claim that forecast capital expenditure during the proposed access arrangement satisfies the requirements of rule 79(1) appears to be entirely based on its assertion that this is the case, rather than any persuasive evidence to that effect.
430. Alinta submitted that WAGN's submission suppresses much of the information relating to the application of the tests in rule 79(2) of the NGR, which means that users and prospective users cannot reasonably be expected to be able to



understand the basis for WAGN's claim that all capital expenditure is conforming capital expenditure.

431. Alinta submitted that given the significant increases in reference tariffs proposed by WAGN, a detailed investigation of WAGN's forecast capital expenditure during the proposed access arrangement is necessary. Alinta supported this assertion by providing detailed reasons at pages 8-12 of its submission:
- a) *A priori* evidence that not all actual and proposed capital expenditure is conforming. Alinta, at page 8 of its submission, outlined evidence from recent regulatory decisions in respect to proposed revised access arrangements in similar industries and other jurisdictions that support an *a priori* view that it is likely that not all of WAGN's proposed actual and forecast capital costs will be conforming.
  - b) Lack of independent review or benchmark of actual and proposed capital expenditure. Alinta, at pages 8-9, submitted that a detailed investigation of WAGN's actual expenditure during the current access arrangement and its forecast capital expenditure for the proposed access arrangement period is warranted given WAGN appears not to have provided any independent evidence to corroborate its claims that its actual and forecast capital expenditure meets the requirements of the NGR.
  - c) Changes in composition of actual expenditure. Alinta showed, at Table A.4 (page 10) of its submission, that there have been significant movements in capital expenditure between asset classes during the current access arrangement period. Alinta submitted that given the significant variation between the composition of capital expenditure allowed for the current access arrangement period, and that actually incurred, it is necessary that the Authority investigate in detail whether actual capital expenditure, especially for mains and regulators, satisfies the requirements of rule 79(1) and 79(2) of the NGR.
  - d) Apparent unconstrained nature of forecast capital expenditure. Alinta submitted on page 10, that there is no evidence that the requirements of rule 79(1) of the NGR informed WAGN's process in setting forecast capital expenditure. Alinta considers it unsafe to accept without detailed investigation that forecast capital costs for the proposed access arrangement meet the requirements of rule 79(1) of the NGR.
  - e) Application of rule 79(2) of the NGR to actual and forecast capital expenditure. Alinta commented on the lack of information available to users and prospective users to be able to understand the basis for WAGN's claim that all capital expenditure is conforming capital expenditure. In any event, Alinta submitted that there are a number of matters that the Authority should examine in detail in determining whether WAGN's claim that all capital expenditure satisfies the NGR, and is therefore conforming capital expenditure that can be added to the capital base:
    - i) First, that the increase in gas haulage volumes and the increase in customer connections would not have occurred but for the (actual or forecast) 'Demand' and 'User initiated' capital expenditure; and

- ii) Second, the level the tests in rule 79(2) of the NGR have been applied – at individual project level or at the capital asset class level.

432. Alinta, in Attachment A to its submission dated 19 April 2010 (pages 12-18), then went on to comment on the inputs used by WAGN to develop its forecast capital expenditure, and on the quantum of proposed forecast capital expenditure by asset class.

*Alinta's submission - Overheads*

433. Alinta submitted that WAGN's calculation of the overhead component of forecast capital expenditure for the proposed access arrangement period is inconsistent with the requirements of the NGR as forecast capital and forecast operating expenditure must be efficient. Alinta further submitted that it is unclear whether the quantum of overhead costs included in WAGN's forecast of capital costs for the proposed access arrangement period is the best forecast or estimate possible.

*Alinta's submission - User initiated capital expenditure*

434. Alinta submitted on page 14 of its submission that WAGN does not provide any information on expected unit costs, which means that users and prospective users cannot reasonably be expected to be able to understand the basis and derivation of WAGN's forecast user initiated capital expenditure. Alinta further submitted that it is unclear whether the quantum of forecast user initiated capital expenditure for the proposed access arrangement period is the best forecast or estimate possible.

*Alinta's submission - Renewals (replacement) capital expenditure*

435. Alinta submitted on page 14, that the forecast 'Renewals (Replacement)' capital expenditure during the proposed access arrangement period is \$45.4 million, which represents an increase of more than 265 per cent, or almost \$33 million, from actual expenditure of \$12.4 during the current access arrangement period. Alinta noted that WAGN indicated that the main category of assets that is being replaced is cast iron pipes in Fremantle, followed by meter replacement.

- a) Cast iron replacement and non-standard mains program - Alinta submitted at pages 14-15, that it is unclear what proportion of the forecast capital costs of \$45.5 million is simply a provision for the possible replacement of medium pressure steel mains, which still need to be inspected to determine whether they need to be replaced.
- b) Meter replacement - Alinta submitted at pages 15-16 that the precise cost of WAGN's proposed meter replacement program is not clear, and the relative cost of continuing to refurbish domestic gas meters for re-use versus a replacement program utilising new meters is also unclear.
- c) Buildings – Alinta noted at pages 18-19 of its submission that building capital expenditure for the proposed access arrangement period has increased by more than \$9.1 million (or 3000 per cent).
- d) Equipment and vehicles – Alinta noted at page 17 of its submission that WAGN expects to incur capital expenditure of \$5.1 million on 'Equipment and vehicles', in contrast to the current access arrangement period where WAGN did not incur any equipment or vehicle capital expenditure.

*Alinta's submission - Demand*

436. Alinta noted at page 17, that WAGN's submission indicates that capital expenditure included in this asset class ensures that there is adequate capacity to meet the new customer demand and to ensure there is no loss of supply due to lack of capacity. However, Alinta submitted that WAGN did not provide any information on the planned reinforcement of gas distribution systems, an asset management plan or expected unit costs.

*Alinta's submission - Other (Performance and IT)*

437. Alinta noted, at pages 17-18 of its submission, that capital expenditure on 'Other (Performance and IT) projects' is \$32.1 million in the forthcoming access arrangement period, an increase of 350 per cent. Alinta further noted that of the total forecast capital expenditure, \$14.2 million or 44 per cent is for unidentified IT projects and almost \$12.9 million or 40 per cent is being incurred for unidentified 'Performance' projects.

**Consultants' reports***EnergySafety report*

438. EnergySafety evaluated justification based on prudence, efficiency, safety, technical integrity or regulatory requirements and to meet the levels of existing demand under rules 79(1)(a) and 79(2)(c) of the NGR.
439. EnergySafety detailed in its report each of WAGN's capital expenditure projects, as forecast by WAGN in the forthcoming access arrangement and listed in Tables 31, 32 and 33 of its supporting confidential submissions.
440. EnergySafety concluded in relation to the requirements of rule 79(1)(a) that overall, the projects detailed and associated costs appear to be reasonable for a prudent service provider acting efficiently and in accordance with good industry practice.
441. In relation to rule 79(2)(c), EnergySafety has assessed the projects that fall under rule 79(2)(c)(i), (ii) and (iii) and determined that the capital expenditure on the majority of these projects is justifiable. In a number of cases, EnergySafety has commented that further information is required in relation to the project.

*Frontier Economics report*

442. Frontier provided the Authority with a draft report relating to the application of rule 79(2)(a), (b) and (d) of the NGR, including forecast capital expenditure over the forthcoming access arrangement period.
443. Frontier noted in its report that while there is an 11 year period for the net incremental revenues from actual expenditures over 2005-2009 to turn positive, the period for net incremental revenues from forecast expenditures to turn positive is 20 years, taking account of the life of the assets involved.
444. Frontier concluded that WAGN's forecast capital expenditure meets the requirements of the net incremental revenue test in the NGR assuming that:
- a) The test applies to aggregate actual expenditure; and

- b) The test can be satisfied over a 20 year time frame.

**Authority's assessment**

445. The Authority notes that WAGN has proposed forecast capital expenditure of \$224.252 million, expressed in December 2009 dollars. As discussed above, WAGN's actual capital expenditure as stated in the access arrangement information for the current access arrangement totals \$177.128 million. The Authority notes the proposed forecast capital expenditure for the forthcoming access arrangement is approximately 27 per cent higher than WAGN's capital expenditure during the current access arrangement period.
446. The largest component of WAGN's proposed forecast conforming capital expenditure is to accommodate increases in customer numbers both in existing areas requiring new meters and service pipes as well as reinforcement of existing mains. In addition the expansion in 'greenfields' sites requires both construction of new mains, and installation of new meters and service pipes.
447. The Authority notes, however, an inconsistency in Table 12 of the access arrangement information compared with the models provided and made public. Table 12 states that forecast conforming capital expenditure for 'equipment and vehicles' for 2010/11 is \$4.472 million, expressed in December 2009 dollars. The Authority notes that the models provided have the 'equipment and vehicles' for forecast conforming capital expenditure as \$0.649 million, expressed in December 2009 dollars. For the purpose of this draft decision, the Authority has assumed the figure contained in the WAGN model is the correct figure and has performed its own modelling accordingly.
448. On 26 May 2010, WAGN provided updated historical capital expenditure information based on the Deloitte special purpose financial report as discussed at above. The most significant difference for 2009 was due to the delayed start of certain information technology projects. Consequently, WAGN increased its 2010 forecast for information technology expenditure.
449. Table 9 below shows WAGN's forecast capital expenditure for the forthcoming access arrangement period calculated in December 2009 dollars.

**Table 9 Forecast capital expenditure – (\$ million, December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
High pressure mains	9.577	4.168	7.008	10.663	10.289
Medium pressure mains	-	-	-	-	-
Medium/low pressure mains	6.505	12.534	13.232	13.675	16.094
Low pressure mains	-	-	-	-	-
Regulators	0.668	0.261	0.229	0.267	0.203
Secondary gate stations	2.006	0.424	-	-	-
Buildings	0.454	2.057	6.691	-	-
Meters and service pipes	7.377	16.311	18.947	20.422	22.579
Equipment and vehicles	-	0.649	-	-	0.637
Information technology	3.087	4.599	3.474	5.021	1.635
Full retail contestability	-	-	-	-	-
Land	-	-	-	-	-
<b>Total</b>	<b>29.674</b>	<b>41.002</b>	<b>49.582</b>	<b>50.048</b>	<b>51.437</b>

<sup>1</sup>: 1 January 2010 to 30 June 2010 only

450. The Authority notes that in order to determine the projected capital base, rule 78(b) of the NGR requires calculation of forecast conforming capital expenditure. In order for the Authority to approve this component of rule 78 of the NGR, the Authority must be satisfied that forecast capital expenditure for the forthcoming access arrangement period is conforming capital expenditure in accordance with rule 79 of the NGR. The Authority notes the requirements in rule 79 to determine whether capital expenditure is conforming.
451. The Authority notes that it has limited discretion in relation to forecast conforming capital expenditure. In order to assist the Authority to assess whether capital expenditure for the forthcoming access arrangement is conforming, the Authority engaged the use of two consultants, EnergySafety and Frontier. As summarised above, the consultants have provided their reports to the Authority with EnergySafety evaluating justification with respect to the technical criteria of prudent service provider, safety, integrity and regulatory requirements (rules 79(1)(a) and 79(2)(c)) and Frontier evaluating justification under the economic criteria (rule 79(2)(a), (b) and (d) of the NGR).
452. The Authority has considered EnergySafety's assessment of capital expenditure under rules 79(1)(a) and 79(2)(c) of the NGR for forecast capital expenditure for the forthcoming access arrangement.
453. In relation to rule 79(1)(a), the Authority agrees with EnergySafety that WAGN's forecast capital expenditure is reasonable for a prudent service provider acting efficiently and in accordance with good industry practice.
454. In relation to rule 79(2)(c), the Authority also agrees with the assessment in the EnergySafety report that forecast capital expenditure on the majority of the projects that fall under rule 79(2)(c)(i), (ii) and (iii) is justifiable. The Authority has noted

EnergySafety's comment that further detail is required on a number of these projects.

455. The Authority accepts Frontier's conclusion that WAGN's forecast capital expenditure meets the requirements of the net incremental revenue test in rule 79 of the NGR based on the aggregate actual expenditure.
456. The Authority also notes Frontier's comments that there is a 20 year period for the net incremental revenues from forecast expenditures to turn positive. The Authority is satisfied that a 20 year time frame to meet the net incremental revenue test for forecast capital expenditure as proposed by WAGN is within the economic life of the main pipeline assets and is therefore appropriate.
457. Frontier raised the issue of whether WAGN should be required to demonstrate how individual projects are justifiable under rule 79(2)(b). The Authority's view, as noted previously, is that it must apply the tests in rule 79 to WAGN's capital expenditure based on the manner in which WAGN has disaggregated this expenditure for the purpose of applying the rule 79 tests (provided this has been done on a logical and rational basis). Therefore, the Authority is satisfied that it is not necessary to require WAGN to disaggregate its forecast capital expenditure beyond the level set out in its proposal.
458. The Authority notes rule 74 of the NGR and the requirements when providing forecasts and estimates. Rule 74(2) of the NGR provides that a forecast or estimate must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances. The Authority is satisfied that WAGN's forecasts have been arrived at in accordance with rule 74(2) of the NGR.
459. Finally, the Authority notes that when calculating the capital base for the next access arrangement, if the forecast for capital expenditure does not accord with actual capital expenditure for the forthcoming access arrangement period, the NGR enables an adjustment of the opening capital base to correct any discrepancies.

#### **Draft decision**

460. For the purpose of this draft decision, and in accordance with rule 41 and 59 of the NGR, the Authority is satisfied that WAGN's forecast capital expenditure under the forthcoming access arrangement provided in Table 12 of the access arrangement information, as adjusted to reflect the values in Table 9 of this draft decision, is conforming in accordance with rule 79 of the NGR. However, the Authority requires WAGN to provide further information prior to the final decision on the projects listed in EnergySafety's report requiring clarification.
461. Subject to the provision of adequate information by WAGN, the Authority approves WAGN's forecast capital expenditure under the forthcoming access arrangement as conforming capital expenditure for the purpose of rolling it into the capital base, based on the values in Table 9 of this draft decision. The Authority will review this component of the forecast capital base in the final decision.
462. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.



## Forecast depreciation

### Requirements of the NGL and the NGR

463. Rule 88 of the NGR provides that the forecast depreciation of the capital base for the purpose of determining a reference tariff is to be calculated for each year of the access arrangement period on the basis set out in the depreciation schedule(s). The depreciation schedule may consist of a number of separate schedules, each relating to a particular asset or class of assets.
464. Rule 76(b) of the NGR provides that forecast depreciation is a building block for determining total revenue for each year.
465. Forecast depreciation is to be deducted from the capital base in arriving at the projected capital base for each year (rule 78(c) of the NGR).
466. The requirements in relation to forecast depreciation are set out in rule 89 of the NGR.
467. Rule 89(1) of the NGR sets out how the depreciation schedule should be designed and provides that it should be designed;
  - a) so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services;
  - b) so that each asset or group of assets is depreciated over the economic life of that asset or group of assets;
  - c) so as to allow, as far as reasonably practicable, for adjustment reflecting changes in the expected economic life of a particular asset, or a particular group of assets;
  - d) so that (subject to the rules about capital redundancy), an asset is depreciated only once; and
  - e) so as to allow for the service provider's reasonable needs for cash flow to meet financing, non-capital and other costs.
468. Rule 89(2) of the NGR provides that compliance with the abovementioned requirements may involve deferral of a substantial proportion of the depreciation, particularly where:
  - a) the present market for pipeline services is relatively immature;
  - b) the reference tariffs have been calculated on the assumption of significant market growth; and
  - c) the pipeline has been designed and constructed so as to accommodate future growth in demand.
469. The access arrangement information must specify a forecast of depreciation or the period including a demonstration of how the forecast is derived on the basis of the proposed depreciation method (rule 72(1)(c)(ii) of the NGR).



470. The access arrangement information must also include all of the information necessary to understand the basis and derivation of the service provider's proposal in respect of forecast depreciation (rule 42 of the NGR).

### **Access arrangement information**

471. WAGN provided at page 13 of the access arrangement information, that forecast depreciation for the forthcoming access arrangement period has been calculated using the straight line method. WAGN further submitted that the straight line method has been applied using the economic lives and, for the assets of the initial capital base, the remaining economic lives. The asset lives have been set out in Table 13 (page 13) with the forecast depreciation outlined in Table 14 on page 14 of the access arrangement information.
472. Table 15 (page 15) of the access arrangement information provides a demonstration of how the forecast was derived and shows the calculation of forecast depreciation for a single class of assets – high pressure mains.

### **Public submissions**

#### *WAGN's submission*

473. WAGN's submissions at pages 74-75 contain substantially the same information as provided in the access arrangement information.

#### *Other submissions*

474. No other public submissions were received in relation to forecast depreciation.

### **Authority's assessment**

475. Under WAGN's proposed revisions, depreciation is forecast to decrease significantly over the 6 month period 1 January 2010 to 30 June 2010 (from a level of around \$25-\$39 million per annum to \$0.33 million over this six month period).
476. There are two main reasons for this. First, meters and service pipes have now been fully depreciated with the depreciation charge for these items under the current access arrangement around \$8.4 million per annum.
477. Secondly, depreciation has also decreased substantially because WAGN has proposed negative values for the depreciation of equipment, vehicles and information technology as a result of over-depreciating these items under the current access arrangement (that is, depreciating them by more than the written down value of the asset, resulting in a negative asset value and negative depreciation). WAGN's tariff model, included as part of its supporting information in both a confidential and public version, contains details of this over-depreciation.
478. The over-depreciation of assets has arisen because depreciation over the current access arrangement period is to be determined using forecast capital expenditure (without adjustment for actual capital expenditure if that is greater or less than forecast) whereas actual capital expenditure in some instances was substantially less than forecast. Given the existence of negative asset values in the regulatory capital base it is necessary for the purpose of the forthcoming access arrangement period it is necessary to make a correction for the negative asset values.

479. In WAGN's model the issue is addressed by negative asset values being carried forward into 2010 and depreciation that would otherwise occur in that year being adjusted. This may be seen in Table 14 of WAGN's access arrangement information where depreciation has a negative value for 3 asset classes which corrects the values as at 30 June 2010, with the result that for the 6 months to 30 June 2010 there is total depreciation of approximately \$328,000 for a total asset base of \$778 million.
480. The Authority is not satisfied that WAGN's approach represents an appropriate method to adjust for negative asset values within the regulatory capital base. The Authority considers that in order to ensure that the projected capital base and depreciation for the forthcoming access arrangement period provide a proper basis, consistent with the national gas objective, for determination of reference tariffs, it is necessary for the capital base to be adjusted to remove negative asset values before the commencement of the forthcoming access arrangement period.
481. The Authority, therefore, requires reference tariffs to be modelled on the basis that the negative asset values are adjusted as at 31 December 2009 with the consequence that negative asset values are not carried over into the forthcoming access arrangement period. This requires an offsetting adjustment in the cost of service as reflected in the total revenue within the reference tariff model in 2010.
482. The Authority considers this to be the most appropriate method to adopt to address this issue, which is a consequence of the application of the depreciation rules applicable to the regulatory capital base. The adjustment method proposed by the Authority ensures that there is no delay in return to users by reducing the asset base over the remaining life of the asset class. It also avoids issues arising if the capital base or capital expenditure roll forward becomes a negative value.
483. WAGN has proposed to forecast financial data escalating at the mid-point of the modelling period. The Authority requires the WAGN GDS to be consistent with the Authority's long-standing regulatory practice for all access arrangements for regulated gas pipelines in Western Australia and model forecasts at the end point of the modelling period.
484. As a consequence of the above adjustments, the Authority does not accept the values set out in Table 14 of the access arrangement information for forecast depreciation.
485. Table 10 below shows the Authority's draft decision values in relation to forecast depreciation. WAGN's values in comparison, are shown in Table 14 of the access arrangement information.

**Table 10 Forecast depreciation – Adjusted by the Authority - (\$ million, December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
High pressure mains	1.056	2.192	2.227	2.285	2.374
Medium pressure mains	2.708	5.416	5.416	5.416	5.416
Medium/low pressure mains	2.120	4.348	4.557	4.777	5.005
Low pressure mains	0.580	1.159	1.159	1.159	1.159
Regulators	0.285	0.587	0.593	0.599	0.606
Secondary gate stations	0.075	0.201	0.211	0.211	0.211
Buildings	0.017	0.052	0.103	0.270	0.270
Meters and service pipes	3.680	7.656	8.309	9.067	9.884
Equipment and vehicles	-	0.585	0.650	0.650	0.650
Information technology	0.424	1.477	2.396	3.091	3.870
Full retail contestability	0.000	-	-	-	-
Land	-	-	-	-	-
<b>Total</b>	<b>10.945</b>	<b>23.672</b>	<b>25.621</b>	<b>27.526</b>	<b>29.445</b>

<sup>1</sup> 1 January 2010 to 30 June 2010 only

### Draft decision

486. The Authority does not approve WAGN's proposed values for forecast depreciation as stated in Table 14 of WAGN's access arrangement information.
487. The Authority concludes that the appropriate values for forecast depreciation should be as stated in Table 10 of this draft decision.
488. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

### Forecast asset disposals

#### Requirements of the NGL and the NGR

489. The projected capital base is to be calculated in accordance with the formula set out in rule 78 of the NGR.
490. Rule 78(d) of the NGR provides that the projected capital base for a particular period is to be calculated by reference to the opening capital base and, amongst other things, the forecast value of pipeline assets to be disposed of in the course of the period.
491. There are no specific access arrangement information requirements.

**Access arrangement information**

492. WAGN stated, at page 11 of the access arrangement information, that no pipeline assets of material value are expected to be disposed of during the forthcoming access arrangement period.

**Public submissions**

493. No public submissions were received in relation to forecast asset disposals.

**Authority's assessment**

494. WAGN disposed of certain assets during the current access arrangement period, which was taken into account for the purpose of determining the opening capital base for the current access arrangement.
495. The Authority notes that WAGN does not intend to dispose of any assets of material value during the forthcoming access arrangement period. The Authority accepts WAGN's submission. The Authority notes the inherent unpredictability associated with forecasting such activities and that in the event any assets are unexpectedly disposed of during the forthcoming access arrangement period, the NGR enables an adjustment of the opening capital base for the next access arrangement for the net value of any assets disposed during the forthcoming access arrangement period.

**Draft decision**

496. The Authority accepts WAGN's proposal that no value for disposals should be included in the projected capital base.

***Calculation of projected capital base*****Access arrangement information**

497. WAGN's projected capital base information is set out on pages 11-16 of the access arrangement information. Table 16 (page 16) of the access arrangement information provides the determination of the projected capital base for the forthcoming access arrangement period.

**Authority's assessment**

498. The Authority notes that it has no separate discretion in relation to the projected capital base for the forthcoming access arrangement period and that if it has withheld its approval to any of the input components in rule 78 of the NGR, then approval is to be withheld for the projected capital base.
499. The Authority has considered WAGN's proposal in respect of each input component of projected capital base in accordance with rule 78 of the NGR. As detailed above, the Authority's decision on each input component is as follows:
- a) The Authority does not approve WAGN's proposed opening capital base;
  - b) The Authority does not approve WAGN's proposal regarding forecast conforming capital expenditure;

- c) The Authority does not approve WAGN's proposal in relation to forecast depreciation for the forthcoming access arrangement period; and
  - d) The Authority approves WAGN's proposal concerning the forecast value of pipeline assets to be disposed of in the forthcoming access arrangement period.
500. As a consequence of the Authority's decision concerning each of the input components required by rule 78 above, the Authority does not approve the projected capital base proposed in WAGN's proposed access arrangement.
501. Table 11 below shows the Authority's draft decision values in relation to the projected capital base for the forthcoming access arrangement period. WAGN's values in comparison are shown in Table 16 of the access arrangement information.

**Table 11 Modelled capital base for the forthcoming access arrangement period – Adjusted by the Authority (\$ million, December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
Opening Asset Base	781.918	804.759	822.089	846.050	868.571
Conforming Capital Expenditure	29.674	41.002	49.582	50.048	51.437
Depreciation	10.945	23.672	25.621	27.526	29.445
Asset Adjustment, Redundant Assets & Asset Disposal	-	-	-	-	-
Closing Asset Value	804.759	822.089	846.050	868.571	890.563

<sup>1</sup> 1 January 2010 to 30 June 2010 only

### Draft decision

502. The Authority does not approve WAGN's proposed projected capital base figures for the forthcoming access arrangement. The Authority concludes that the values should be those in Table 11 of this draft decision.
503. As a consequence of the above and other sections of this draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

## Return on capital

### Requirements of the NGL and the NGR

504. Rule 87(1) of the NGR provides that the rate of return on capital is to be commensurate with prevailing conditions in the market for funds and the risks involved in providing reference services.
505. Rule 87(2) of the NGR provides that in determining a rate of return on capital:
- a) it will be assumed that the service provider:
    - i) meets benchmark levels of efficiency; and

- ii) uses a financing structure that meets benchmark standards as to gearing and other financial parameters for a going concern and reflects in other respects best practice; and
- b) a well accepted approach that incorporates the cost of equity and debt, such as the Weighted Average Cost of Capital (**WACC**), is to be used; and a well accepted financial model, such as the Capital Asset Pricing Model (**CAPM**), is to be used.

### Access arrangement information

506. The access arrangement information must specify the proposed rate of return, the assumptions on which the rate of return is calculated and a demonstration of how the rate of return is calculated (rule 72(1)(g) of the NGR).

### Access arrangement proposal

507. WAGN proposes that the rate of return used in determining the total revenue and reference tariffs for the revisions to the access arrangement be determined as a real pre-tax weighted average of the returns applicable to debt and equity.<sup>2</sup>
508. The Sharpe-Lintner CAPM is widely used by regulators across Australia to estimate the cost of equity. WAGN departs from this current practice of estimating the cost of equity. WAGN proposes to use some other forms of the CAPM, such as the Black CAPM, Fama French CAPM, and zero-beta Fama French CAPM, together with Sharpe-Lintner CAPM, to estimate the cost of equity.
509. WAGN proposes that the real pre-tax rate of return for the GDS be 11.1 per cent which is the lower limit of the upper quartile of a range of pre-tax real WACC's estimated using the four different versions of CAPM proposed by WAGN to estimate the cost of equity.
510. It is the current practice of regulators in Australia to use historical data on equity premium to derive the market risk premium (MRP). However, on the assessment of the forward view of volatility implicit in the pricing of options on the ASX 200 Index, WAGN proposes that a forward looking MRP of 8 per cent will reflect "average" current market expectations over the regulatory period.
511. WAGN proposes to include a component of pre-financing cost of 16.3 basis points in the cost of debt, with and an additional cost of debt issuance of 12.5 basis points.
512. The Capital Asset Pricing Model (CAPM) parameter values that WAGN has applied in determining the Rate of Return are presented in Table 67 of WAGN's submission (page 108). Table 67 of the 'WAGN's submission is reproduced in Table 12 of this Draft Decision below.

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<sup>2</sup> Section 7.2 of WAGN's Proposed Revisions, page 133

**Table 12 WAGN's proposed parameter values for determination of rate of return**

Parameter	WAGN
Gearing (ratio of debt to total financing)	60%
Tax rate	30%
Nominal risk free rate of return	5.59%
Market risk premium	8.0%
Gamma (value of imputation credits)	20%
Debt risk premium	4.50%
Allowance for debt raising costs (0.1630 + 0.1250)	0.288%
Expected inflation	2.47%

### Public submissions

513. In its submission, the Office of Energy notes that the WACC, together with the return on capital component of the building blocks, is a significant driver in the increased costs faced by gas distribution consumers.<sup>3</sup>
514. Synergy requests the Authority to consider whether the proposed real pre-tax rate of return of 11.1 percent is reasonable.<sup>4</sup>
515. Alinta expresses its concerns regarding the estimates of some WACC parameters and methodologies proposed by WAGN in its submission. Each of these concerns will be addressed separately in the discussion of the WACC parameters below.

### Authority's assessment

#### *The WACC formulae*

516. While all regulators of utility industries in Australia use the WACC to estimate the cost of capital, there is no clear precedent on the form of the WACC to be used (i.e. pre-tax or post-tax, real or nominal):
- A pre-tax real WACC has been generally preferred by the Independent Pricing and Regulatory Tribunal of New South Wales (**IPART**) and the Independent Competition and Regulatory Commission (**ICRC**) of the Australian Capital Territory.
  - The Australian Competition and Consumer Commission (**ACCC**) and the Australian Energy Regulator (**AER**) have used a post-tax nominal form of WACC in recent decisions.

<sup>3</sup> The Office of Energy's Submission to the Economic Regulation Authority: WA Gas Networks Pty Ltd Proposed Revisions to the Access Arrangements for the Mid-West and South-West Gas Distribution Systems, page. 3.

<sup>4</sup> Synergy's Submission to the Economic Regulation Authority regarding Proposed Revisions to the Access Arrangements for the Mid-West and South-West Gas Distribution Systems, page. 11.



- c) The Essential Services Commission of Victoria (**ESC**) has used a post-tax real form of WACC in recent decisions.

**The nominal post-tax WACC formula:**

517. This is an estimate of the post-tax return on assets, which can be expressed as:

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

where:

- a)  $R_e$  is the nominal post-tax expected rate of return on equity - the cost of equity;
- b)  $R_d$  is the nominal pre-tax expected rate of return on debt - the cost of debt;
- c)  $\frac{E}{V}$  is the proportion of equity in the total financing (which comprises equity and debt);
- d)  $\frac{D}{V}$  is the proportion of debt in the total financing; and
- e)  $T_c$  is the corporate tax rate; and
- f)  $\gamma$  (Gamma) is the value of franking credits created (as a proportion of their face value).

**The nominal pre-tax WACC formula:**

518. This is an estimate of the pre-tax return on assets which can be obtained by dividing the right hand side of the formula for the above nominal post-tax by the component  $(1 - T_c)$ , which can be expressed as:

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

**The real pre-tax WACC formula**

519. A real pre-tax WACC is obtained by removing expected inflation  $\pi_e$  from the nominal pre-tax WACC:

$$WACC_{\text{real pre-tax}} = \frac{(1 + WACC_{\text{nominal pre-tax}})}{1 + \pi_e} - 1$$

520. The Authority adopts a pre-tax real WACC approach as this method:

- a) simplifies financial modelling;

- b) is consistent with the regulatory practice adopted by other Australian regulators<sup>5</sup> that quarantines regulated businesses from inflation risk in regulated prices;
- c) is consistent with the preferences of major utilities in Western Australia (e.g. Western Power); and
- d) allows consistency across regulated utilities in Western Australia.

### *Calculation method of rate of return*

521. The Authority notes that WAGN's proposed method of ascertaining a rate of return using a real pre-tax WACC is appropriate and this proposal is also consistent with the Authority's preferences. The Authority is therefore satisfied that the proposed method of calculating the rate of return using a real pre-tax WACC formula meets the requirements of the NGR.
522. WAGN's proposed methodologies and estimates for each of the CAPM parameters are considered below.

### *Financial structure (Gearing)*

#### **Access arrangement proposal**

523. WAGN proposes a ratio of debt to assets of 60 per cent.<sup>6</sup> WAGN notes that this assumed ratio of 60 per cent is consistent with the Authority's previous determinations for the GDS, as well as with the AER's decisions on the gearing of a benchmark efficient service provider in electricity or gas. The debt to assets ratio under the current Access Arrangement is also 60 per cent.

#### **Public submissions**

524. The Authority has not received any public submissions in relation to WAGN's proposed debt to assets ratio.

#### **Authority's assessment**

525. Gearing refers to the proportions of the value of the regulated business assumed to be financed by debt and equity. Financial gearing refers to the ratio of debt to total asset value. The relative proportions of debt and equity that a firm has outstanding constitute its capital structure. The capital structure choices differ across industries as well as for different companies within the same industry.
526. The Authority assumes that the regulated business tends towards the capital structure of a benchmark efficient utility business in the long run. As the optimal level of gearing is not directly observable, the 60/40 gearing level is derived from the average of actual gearing levels from a group of comparable firms.<sup>7</sup> The actual

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<sup>5</sup> For example, both IPART and ICRC use a real pre-tax WACC.

<sup>6</sup> WAGN's submission, page 83.

<sup>7</sup> Australian Energy Regulator, May 2009, *Final Decision, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*

proportion of debt and equity for each business is dynamic and depends on a number of business specific factors.

527. The Authority agrees that WAGN's proposed debt to assets ratio of 60 per cent is consistent with the approach taken in relation to the current Access Arrangement and the approach taken in the AER electricity WACC Review, as well as being otherwise consistent with regulatory precedent.

### **Draft decision**

528. The Authority approves WAGN's proposal that the appropriate debt to total assets ratio is 60 per cent and the equity to total assets ratio is 40 per cent.

## **Corporate tax rate**

### **Access arrangement proposal**

529. WAGN adopts a statutory corporate tax rate of 30 per cent<sup>8</sup> in relation to the estimate of company taxation liabilities associated with regulated activities. The corporate tax rate under the current Access Arrangement is also 30 per cent.

### **Public submissions**

530. The Authority did not receive any public submissions regarding the proposed corporate tax rate.

### **Authority's assessment**

531. There has been some debate amongst regulators as to whether WACC determinations should use the statutory corporate tax rate (30 per cent), or effective tax rates.<sup>9</sup> Many companies have effective tax rates that are well below the statutory rate and there is a risk that using the statutory tax rate will overestimate the returns required by companies to meet tax obligations. However, verifying an individual company's effective tax rate would require modelling of taxation cash flows. The benefit of using the statutory rate as a benchmark assumption is that it is simple to apply.
532. The Authority has in previous WACC determinations assumed the effective taxation rate of the utility businesses to be equal to the statutory rate of corporate income tax.
533. The Authority accepts WAGN's proposal with respect to the corporate tax rate of 30 per cent.

### **Draft Decision**

534. The Authority approves WAGN's proposal for a corporate tax rate of 30 per cent.

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<sup>8</sup> Access Arrangement Information, page 29

<sup>9</sup> IPART, 2002, *The weighted average cost of capital (WACC): Discussion paper*

## *Nominal risk free rate of return*

### **Access arrangement proposal**

535. WAGN has approximated the risk free rate of return using the proxy of daily yield data for Commonwealth Government securities with terms to maturity of 10 years, reported by the Reserve Bank of Australia.
536. WAGN proposes a nominal risk free rate of return of 5.59 per cent.<sup>10</sup> This is the average of 10-year Commonwealth Government Securities for the 20 trading days to 13 November 2009 as reported by the Reserve Bank of Australia. This was the most recent data available at the time that WAGN submitted its proposed revised access arrangement.

### **Public submissions**

537. In its submission, Alinta notes that the value of the nominal risk free rate adopted by WAGN appears to be largely consistent with the value adopted by the Authority in its Final Decision in December 2009 on Western Power's proposed revisions to the Access Arrangement for the South West Interconnected Network.<sup>11</sup>

### **Authority's assessment**

538. The risk free rate is the rate of return an investor receives from holding an asset with guaranteed payments (i.e. no risk of default). The Commonwealth government bond rate is widely used as a proxy for the risk free rate in Australia.<sup>12</sup> CAPM theory does not provide guidance on the appropriate proxy for the risk free rate. In Australia, regulators' current practice is to average the yield on the indexed 10-year Commonwealth government bonds for a period of 20 trading days as close as feasible before the day the decision is made.
539. The Authority's approach is to use a 20-day moving average<sup>13</sup> of observed rates of return on 10-year Commonwealth government bonds as an estimate of the risk free rate.
540. The Authority agrees that WAGN's proposed methodology for determining the nominal risk free rate of return is appropriate. It is a method which has been adopted by most Australian economic regulators (e.g. the AER, ESC and IPART). Unless there is a demonstrated reason for change, maintaining the conventional practice in determining the risk free rate provides some certainty for regulated

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<sup>10</sup> Access Arrangement Information, pages 138-9

<sup>11</sup> Alinta: Submission to WA Gas Networks – Proposed Revised Access Arrangement for the Mid-West and South-West Gas Distribution Systems, page 30

<sup>12</sup> Although Blanco *et al* consider swap rates as superior to Government bonds as a proxy for the risk free rate and state that "it is well known that government bonds are no longer an ideal proxy for the unobservable risk free rate". See Blanco, Brennan, and Marsh, "An Empirical Analysis of the Dynamic Relation between Investment-Grade Bonds and Credit Default Swaps", *The Journal Of Finance*, Vol. LX, no. 5 October 2005, p2261, for details.

<sup>13</sup> There are three different types of moving averages: (i) Simple Moving Average; (ii) Exponential Moving Average; and (iii) Weighted Moving Average, and they are all calculated slightly differently. However, all have a similar smoothing effect on the data, so that any unexpected changes on rates are removed, and, as a result, the overall direction is shown more clearly. For simplicity, the Authority adopts the simple moving average in its calculations.

businesses in the manner in which the rate of return is to be determined, and is thereby consistent with maintaining incentives for investment and with the National Gas objective.

541. The data adopted by WAGN for the calculation of the nominal risk free rate, was current as at 13 November 2009.
542. The most recent data available at the time of this draft decision is updated to 30 July 2010.
543. For the purpose of this draft decision, the Authority adopts the updated values, as at 30 July 2010. Adopting these updated values and the calculation methodology proposed by WAGN, the Authority calculates a nominal risk free rate of 5.16 per cent.
544. The Authority notes that these values will need to be updated at the time of the Final Decision, so as to be commensurate with prevailing market conditions at the time.

### **Draft decision**

545. The Authority approves WAGN's proposal in relation to the methodology for calculation of the nominal risk free rate of return.
546. The Authority considers the estimated nominal risk free rate of return should be 5.16 per cent, as at 30 July 2010.

### *Market risk premium*

#### **Access arrangement proposal**

547. WAGN's view that the recent global financial crisis has driven required risk premiums higher, and that the return of the Market Risk Premium (**MRP**) to values consistent with the long term average of 6 per cent is unlikely to be rapid. WAGN argues that a severe financial crisis affects asset markets for three to five years after the events which precipitate the crisis.<sup>14</sup>
548. In addition, WAGN's view is that the long term average of historical excess returns is not a reasonable basis of estimation for the MRP and that this approach will not provide the best estimate in the circumstances.<sup>15</sup>
549. WAGN has sought the assistance of Value Advisor Associates (**VAA**) in estimating the MRP for the proposed access arrangement. VAA's view is also that the MRP is an essential input to estimating a cost of equity under the CAPM and because the model is forward looking the CAPM requires inputs that are forward looking.
550. VAA, on behalf of WAGN, argues that the use of an historical average as an input to the risk premium on equity contrasts with the widespread use of spot rates on debt to estimate the cost of debt. VAA then argues that, in the current market conditions, because of large increases in debt premiums, there is a substantive disconnect

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<sup>14</sup> Submission, page 85

<sup>15</sup> Access Submission, page 86

between the risk spread on debt and equity when the historical average MRP is used to estimate the cost of equity. VAA considers that this approach substantially underestimates the required return on equity.<sup>16</sup>

*Implied volatility approach*

551. WAGN proposes a departure from using a long term average approach to estimate MRP with a forward looking MRP estimated using the Implied Volatility Approach. Using this approach WAGN proposes a market risk premium of 8 per cent be used in determining the total revenue and revised reference tariffs for the forthcoming access arrangement. In comparison, the MRP used for the current access arrangement is within the range of 5 per cent to 6 per cent.
552. VAA argues that there are good reasons for changing from a long term average MRP to a forward looking MRP as estimated using the Implied Volatility Approach. VAA presents four factors which when combined support the change in approach. These factors are as follows:<sup>17</sup>
- a) A period of unusual economic circumstances in the form of the global financial crisis.
  - b) The substantive increase in risk spreads on debt arising from a current period of unusual economic circumstances.
  - c) The availability of a forward view of market risk through the implied volatility of options on the stock market index.
  - d) Promising research supporting departure from the long term average approach.
553. While VAA admits that using Implied Volatility Approach to estimate a forward looking MRP is still an evolving area for research, it nevertheless is of the view that the significant effect of the global financial crisis on risk and risk premium (spreads) in financial markets warrants a departure from the use of the long term average MRP over the regulatory period for WAGN from 1 January 2010 to 30 June 2014.
554. VAA argues that a current view of market risk or volatility, which it uses to justify the use of the Implied Volatility Approach, can be derived from trades in options on the ASX 200 Index. This is because a key determinant of the price of these options is a view of the volatility of the market. Given observations of the price of an option, the implied volatility can be derived as the only unknown variable in the Black and Scholes call option pricing relationship. By construction, it is therefore a forward looking estimate of the risk of the market.<sup>18</sup>
555. From its analysis, VAA concludes that there has been a strong relationship between forward looking measures of risk (being the implied volatility derived from the option price of a three month option on the index) and backward looking measures of risk (being the annualised 30-day moving average of the standard deviation of the ASX

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<sup>16</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 2

<sup>17</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 2

<sup>18</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 12



200 Index). In addition, a strong historical relationship between market return and risk can also be found. As a result, VAA proposes that a forward MRP can be derived from the historical volatility measures of the market.<sup>19</sup>

556. In deriving a forward MRP from implied volatility, VAA then assumes a constant required rate of return per unit of risk, and applies this to the forward view of risk assessed from the implied volatility.
557. VAA's estimates reveal that the unit price of risk implicit in empirical estimates of the parameters of CAPM is about 50 basis points<sup>20</sup> (i.e. a 7 per cent MRP with an annual average standard deviation of 14 per cent implies 50 basis points per unit of risk). This estimate of the unit price of risk of 50 basis points is then applied to the current implied volatility. The implied MRP from such observations is 12.2 per cent (being equal to 24.4 per cent multiplied by 50 bps) where the implied volatility of the longest call option (for 12 months) is 24.4 per cent over a period of 21 days to 30 November 2009.<sup>21</sup>
558. In conclusion, on the assessment of the forward view of volatility implicit in the pricing of options on the ASX 200 Index, VAA estimate that a forward looking MRP of 8 per cent will reflect "average" current market expectations over the regulatory period. VAA states that, in its estimates, MRP is derived as a compound average of its estimate of the spot MRP (November 2009) of 12 per cent and a transition to the long term average of 7 per cent over the period of interest, from 2011 to 2015.<sup>22</sup>

### Public submissions

559. In its submission, Alinta notes that WAGN's adoption of a value for the MRP of 8 per cent is unlikely to comply with the National Gas Rules in the absence of information providing support for WAGN's proposed MRP. Alinta also notes that WAGN's decision to suppress information on the basis for its proposed MRP is "at odds" with standard regulatory practice, particularly where businesses and/or regulators propose a departure from well accepted values, as in the case of WAGN's proposed MRP value.<sup>23</sup>

### Authority's assessment

#### *Disconnection between the risk spread in debt and equity*

560. The Authority does not accept the argument from Value Advisor Associates, on behalf of WAGN, that there is an inconsistency in the use of spot rates on debt to estimate the cost of debt and the use of historical data to estimate the risk premium on equity.
561. The Authority considers that it is appropriate that the debt premium is provided on a 20 day spot basis as it affords the service provider the opportunity to fix its debt premium at current market rates. The return on equity, reflected through the market

<sup>19</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 14-6.

<sup>20</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 16.

<sup>21</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 6.

<sup>22</sup> WAGN's Access Arrangement: Supporting document from Value Advisor Associates (VAA), page 2.

<sup>23</sup> Alinta: Submission to WA Gas Networks – Proposed Revised Access Arrangement for the Mid-West and South-West Gas Distribution Systems, page 32.



risk premium, is a longer term concept and is appropriately measured on an historical basis.

#### Consideration of the Dividend Growth Model

562. The Dividend Growth Model (**DGM**) is a model expressing the value of a share as the sum of the present value of future dividends where the dividends are assumed to grow at a constant rate. The DGM relates current price of a share ( $P_0$ ) to the next period's dividend ( $D_1$ ), the required rate of return ( $r$ ) and the expected dividend growth in perpetuity ( $g$ ) as follows:

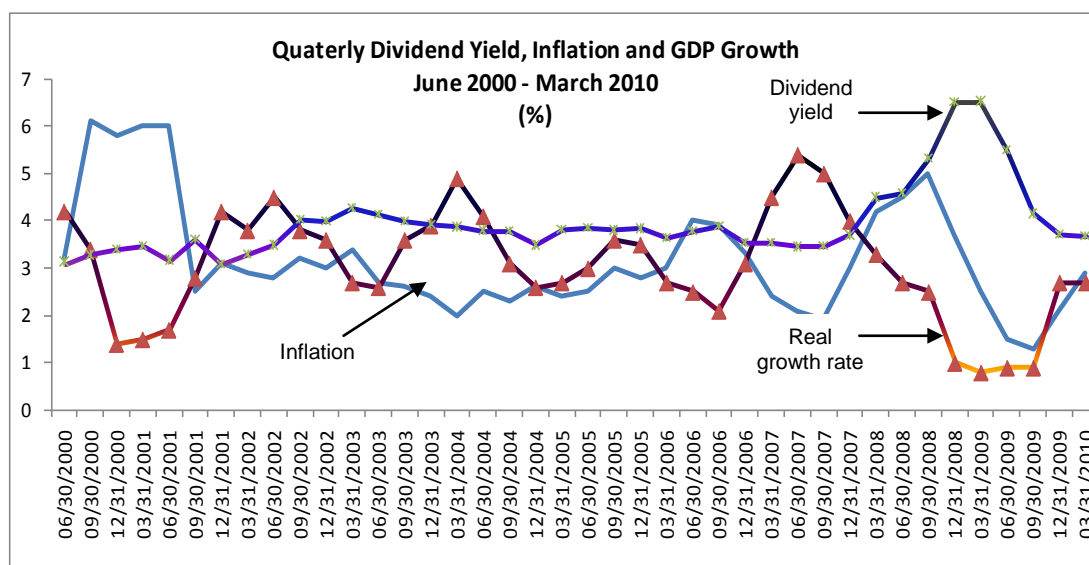
$$P_0 = \frac{D_1}{r - g};$$

which can be rearranged as:  $r = \frac{D_1}{P_0} + g = \frac{D_1}{P_0} + g_y + g_p.$

where  $\frac{D_1}{P_0}$  is the prospective annual dividend yield and  $g$  is assumed to be the economic growth rate (the growth rate of GDP). In addition, the growth rate  $g$  is divided into two components: (i) the expected real rate of growth  $g_y$ ; and (ii) expected inflation  $g_p$ .

563. The estimated MRP using the DGM is the sum of three components: (i) annual dividend yield; (ii) expected real rate of growth; and (iii) expected inflation. Each of these components is itself an estimate and as a result is subject to a degree of uncertainty. The degree of uncertainty tends to be higher in an economic downturn.
564. The Authority considers recent time series of inputs for the DGM for the period from June 2000 to March 2010 (data from Bloomberg).

**Figure 3. Quarterly dividend yield, inflation and GDP growth**



565. Figure 3 shows that all three series used as inputs for the DGM exhibit a relatively high degree of volatility. The Authority's view is that, for any estimate, there is a degree of uncertainty involved that can be summarised in terms of a standard deviation where the higher the volatility, the higher the standard deviation. For the period 30 June 2000 to 31 March 2010 the standard deviations for dividend yield, inflation and GDP growth are 0.77, 1.75, and 1.59 respectively. A straight projection of these series is likely to be subject to large error and therefore, some form of forecast is required.
566. Evidence exists that the record of economic forecasting is not always reliable<sup>24</sup> and furthermore the estimate of MRP using a DGM involves at least three forecasts (dividend yield, inflation and GDP growth), so any error in these individual estimates compounds for the overall estimate of MRP.
567. Given a poor record of economic forecasting on which DGM is based, the Authority is of the view that it is inappropriate to use the DGM, or any other methods based on economic forecasting that depart from using historical data on equity premium, to derive an estimated MRP, particularly for a period with a high level of uncertainty.
568. The Authority has considered the estimates of MRP using the DGM in the AER's recent decisions, together with the AER's WACC review in May 2009 for electricity transmission and distribution networks.
569. The Authority is aware that the AER notes, as stated in the WACC review, that cash flow based measures of the MRP (such as the DGM) are subject to a number of limitations:
- a) They provide highly variable forward looking estimates of the MRP.
  - b) They are sensitive to small changes in assumptions.
  - c) There is a relative lack of data sources of these estimates.
570. In its most recent final decision for the ActewAGL Gas Distribution (ACT Queanbeyan and Palerang) Network,<sup>25</sup> the AER notes that there are inherent problems in any DGM including:
- a) reliance on contentious assumptions, such as:
    - i) markets are perfectly priced at all times; and
    - ii) forecast dividend distributions accurately reflect market expectations;
  - b) forecasts are highly variable:
    - i) small, plausible changes to inputs and assumptions produce large changes in MRP estimates; and

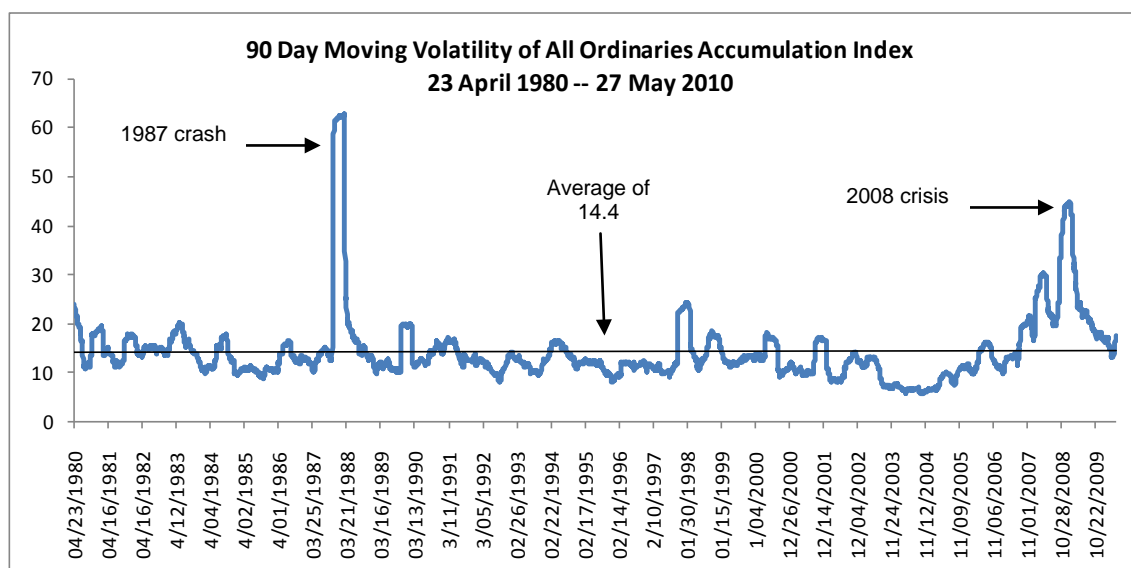
<sup>24</sup> For example, see Fildes, R. and Makridakis, S. (1995). The impact of empirical accuracy studies on time series analysis and forecasting, *International Statistical Review*, 63, 3, 289-308; and Hendry, D. and Clements, M. (2003). Economic forecasting: some lessons from recent research, *Economic Modelling*, 20, 301-329.

<sup>25</sup> The Australian Energy Regulator (March 2010), Final Decision, Access Arrangement Proposal on ACT, Queanbeyan and Palerang Gas Distribution Network, page 61

- ii) even if consistent inputs are used, implausibly large changes in MRP are estimated across short periods of time.

571. The Authority considers that the most significant issues leading VAA to propose a departure from the previously adopted method of using historical data on equity premium to derive a forward looking MRP are (i) the unusual economic circumstances, namely the global financial crisis; and (ii) the substantive increase in risk spreads on debt for the regulatory period from 2010 to 2014. VAA then uses historical data from Bloomberg on annualised 90-day moving volatility of the All Ordinaries Accumulation Index and the implied volatility of call options of different maturities (1 month, 3 months, and 12 months) to illustrate what VAA calls unusual economic circumstances which have occurred at times over the period from 1980 to 30 November 2009.
572. The Authority has used the same approach with a Bloomberg data set updated to 27 May 2010<sup>26</sup>. Figure 4 shows a 90-day moving average of the volatility of the All Ordinaries Accumulation Index for the period from 23 April 1980 to 27 May 2010. Figure 4 shows that recently risk in the equity market has been significantly lower than that in the late-2008 to early-2009 financial crisis and has almost returned to the pre-crisis level.

**Figure 4. Moving volatility of the All Ordinaries Accumulation Index 23 April 1980 – 27 May 2010**

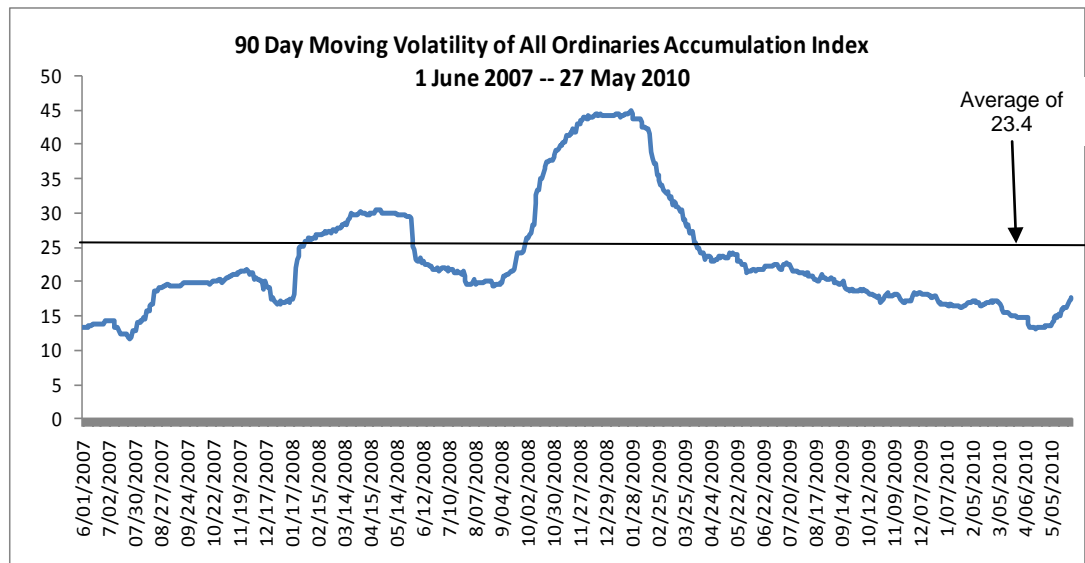


Source: Bloomberg

573. The Authority's view is that VAA's argument that the equity market is experiencing a period of unusually high risk is not justified. Figure 5 illustrates the 90-day moving volatility of the All Ordinaries Accumulation Index for the period before and after the crisis (1 June 2007 to 27 May 2010). The level of risk has been significantly lower and has returned to the pre-crisis level as shown in Figure 5.

<sup>26</sup> This was the most recent Bloomberg data set available when the Authority undertook this analysis.

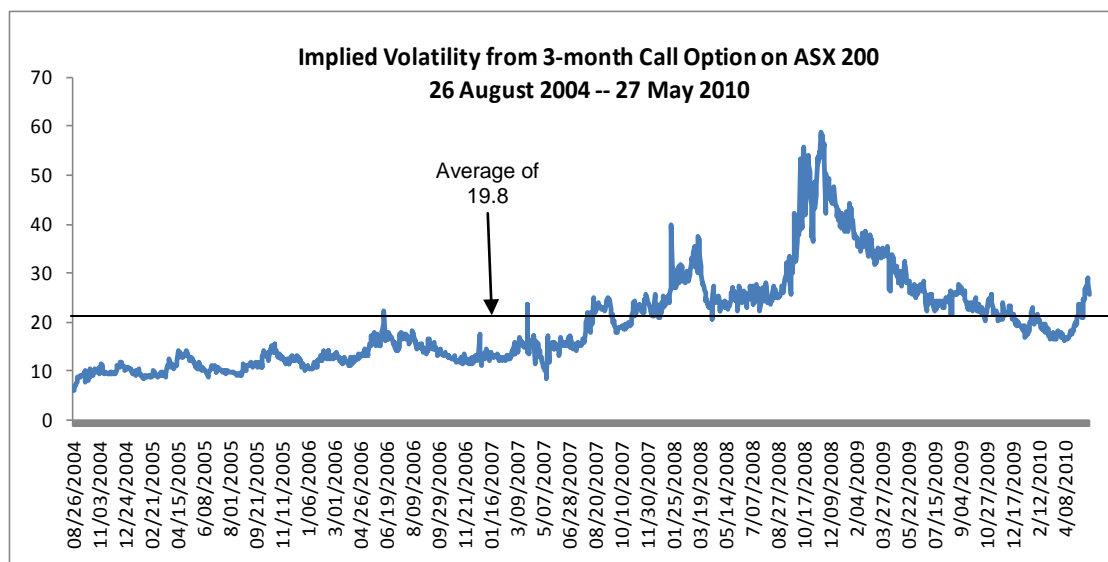
**Figure 5. 90 Day moving volatility of the All Ordinaries Accumulation Index  
1 June 2007 – 27 May 2010**



Source: Bloomberg

574. The Authority accepts VAA's observation that current market risk (or volatility) can be derived from trades in options on the ASX 200 Index, even though it is only partial. However, analysing the data set from Bloomberg for the longer period (from 26 August 2004 to 27 May 2010<sup>27</sup>) rather than the data set used by VAA, the Authority concludes that the level of risk has returned to around average level. Figure 6 supports the Authority's view on this issue.

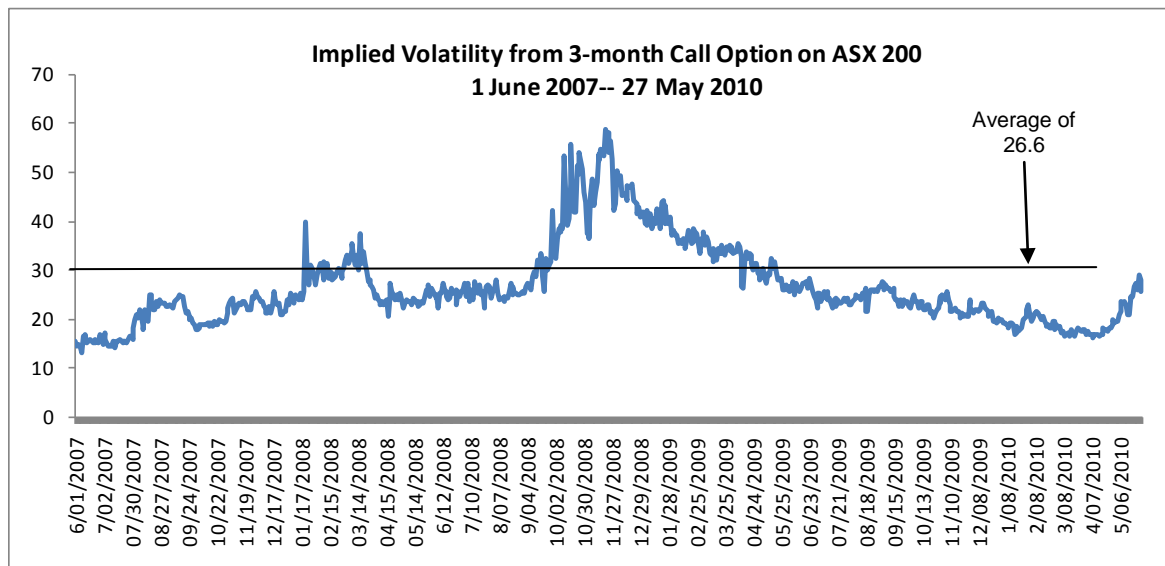
**Figure 6. Implied volatility from 3-month Call Option on ASX 200 26 August 2004 – 27 May 2010**



Source: Bloomberg

<sup>27</sup> The longest data set available from Bloomberg at the time of the Authority's analysis.

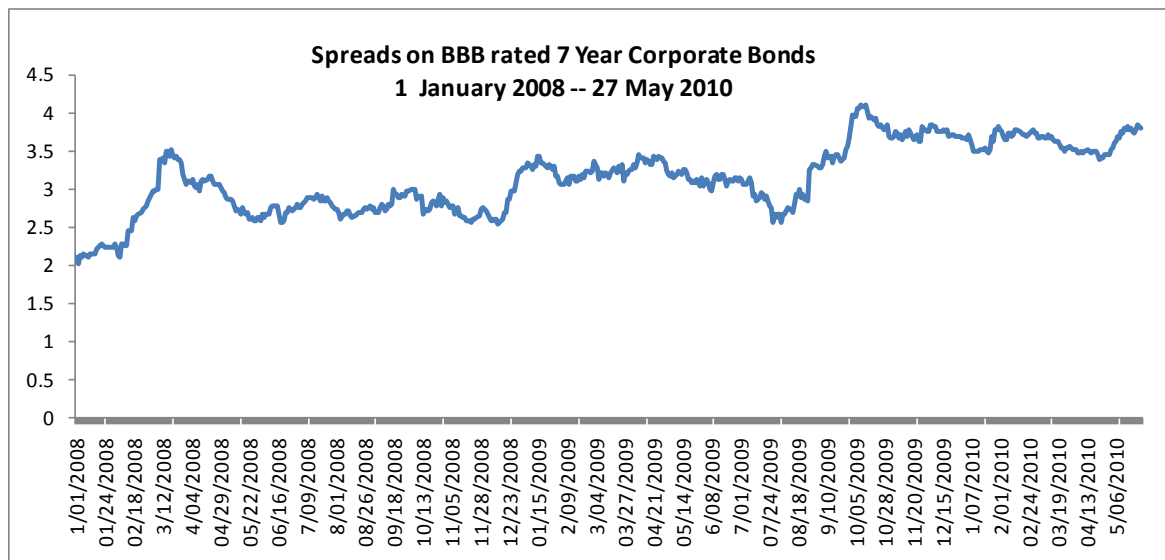
**Figure 7. Implied volatility from 3-month Call Option on ASX 200 1 June 2007 – 27 May 2010**



Source: Bloomberg

575. In addition, VAA uses the risk premium on BBB-rated corporate bonds from Bloomberg to illustrate its view that the debt market is experiencing a period of unusually high risk. Using a data set from Bloomberg for the period before and after the crisis, from 1 January 2008 until 15 April 2010, the premium on 7-year BBB rated Australian corporate bonds over the yield on 10-year Commonwealth Government Securities is as shown in Figure 8 below.

**Figure 8. Spread on BBB-rated 7-Year Corporate Bonds 1 January 2008 – 27 May 2010**



Source: Bloomberg

576. The Authority notes that:

- a) Debt spreads on BBB rated 7-year corporate bonds have been somewhat lower in 2010 compared with in 2009, even though they have not returned to the pre-crisis level (September/October 2008);

- b) However, the Authority is of the view that debt spreads on BBB rated 7-year corporate bonds are not a good proxy for the level of market risk. This is because the market for 7-year BBB rated corporate bonds has been very thin in Australia since the financial crisis, and as such, illiquid. In addition, in deriving the yields for 7-year BBB rated Australian corporate bonds, Bloomberg bases its estimates on a basket that includes a very small number of bonds whose maturity is significantly less than 7 years.
- c) The Authority requested from WAGN, the detailed calculations used by VAA to justify the MRP value of 8 per cent. WAGN provided a confidential response to this request on 15 April 2010 which set out reasons as to why it could not provide this information.

577. The Authority is not aware of any empirical studies published in academic journals regarding the estimate of MRP using the Implied Volatility Approach for Australia. Given the above-mentioned weaknesses, the Authority is of the view that the Implied Volatility Approach cannot yet be considered a reliable model to derive a MRP for WAGN at this time. As a result, the Authority considers there is no persuasive evidence to depart from the previously adopted method of estimating a MRP using historical data on the risk premium for the purpose of this Access Arrangement.

*Consideration of the method of using historical data*

- 578. The market risk premium is the required return, over and above the risk free rate, on a fully diversified portfolio of assets.
- 579. It is the current practice from regulators across Australia to estimate the MRP using the historical data on equity premium.
- 580. Australian regulators have consistently applied a MRP of 6.0 per cent in their decisions, except for the AER's decisions after its review of WACC parameters released in May 2009. It is noted that a MRP of 6.0 per cent was first adopted in Australia by the ACCC<sup>28</sup> and the Victorian Office of the Regulator General. A MRP range of 4.5-7.5 per cent was derived on the basis of consultant work prepared by Professor Davies at the University of Melbourne, where the upper- bound of this range was based on historical estimates and the lower bound was based on cash flow measures<sup>29</sup>. As such, the mid-point of that range (six per cent) was adopted. Subsequently, Australian regulators have consistently applied a MRP of 6.0 per cent which is estimated using historical data on equity premium.
- 581. In its review of WACC parameters for electricity distribution and transmission networks in May 2009, the AER commissioned Associate Professor Handley at the University of Melbourne to update historical excess returns using full year data for 2008. The estimates for this study covered the periods of 1883-2008, 1937-2008,

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<sup>28</sup> ACCC, Access arrangement by Transmission Pipelines Australia Pty Ltd and Transmission Pipelines Australia (Assets) Pty Ltd for the Principal Transmission System – Access arrangement by Transmission Pipelines Australia Pty Ltd and Transmission Pipelines Australia (Assets) Pty Ltd for the Western Transmission System – Access arrangement by Victorian Energy Networks Corporation for the Principal Transmission System, Final decision, 6 October 1998.

<sup>29</sup> ORG, Access arrangements – Multinet Energy Pty Ltd and Multinet (Assets) Pty Ltd – Westar (Gas) Pty Ltd and Westar (Assets) Pty Ltd – Stratus (Gas) Pty Ltd and Stratus Networks (Assets) Pty Ltd , Final decision, October 1998.

1958-2008, 1980-2008 and 1988-2008, were relative to 10-year Commonwealth Government Securities, were grossed-up for a theta<sup>30</sup> of 0, 0.28, 0.5, 0.65 and 1.0 and included standard errors and 95 per cent confidence intervals. The results are presented in Table 13 below.

**Table 13 Historical excess returns - (arithmetic average, relative to 10-year bonds, 'grossed-up' for value of imputation credits distributed, in terms of percentage)**

Utilisation rate	0.00	0.28	0.5	0.65	1.00
1883-2008	5.9*	6.0*	6.1*	6.1*	6.2*
1937-2008	5.4*	5.5*	5.6*	5.7*	5.9*
1958-2008	5.7	5.9	6.1	6.2*	6.4*
1980-2008	5.0	5.3	5.6	5.8	6.3
1988-2008	3.8	4.3	4.7	5.0	5.6

\*Indicates estimates are statistically significant at the five per cent level based on a two-tailed t-test. Source: Handley (2009).<sup>31</sup>

Source: Handley (2009).<sup>32</sup>

582. The above estimates reveal that the most recent long term historical average excess returns estimated over a range of long term estimation periods (1883-2008, 1937-2008, 1958-2008), once 'grossed-up' for a utilisation rate of 0.65 and estimated relative to the yield on 10-year Commonwealth Government Securities, is close to 6 per cent (between 5.7 and 6.2 per cent).

583. An estimate of MRP of 6 per cent, from the AER's view, was the best estimate of a forward looking long term value for MRP prior to the onset of the global financial crisis under relatively stable market conditions with the assumption that there is no structural break which has occurred in the market. However, given the state of the international financial market at that time (May 2009), when relatively stable market conditions did not exist, and taking into account the uncertainty surrounding the global economic crisis, the AER considered that a MRP of 6.5 per cent was reasonable.

"The AER considers that prior to the onset of the global financial crisis, **an estimate of 6 per cent was the best estimate** of a forward looking long term MRP, and accordingly, under relatively stable market conditions—assuming no structural break has occurred in the market—this would remain the AER's view as to **the best estimate of the forward looking long term MRP.**" [emphasis added]<sup>33</sup>

<sup>30</sup> Theta is the value of a franking credit to investors at the time they receive it.

<sup>31</sup> J. C. Handley, *Further comments on the historical market risk premium*, Report prepared for the AER, 14 April 2009, pp.6-9.

<sup>32</sup> J. C. Handley, *Further comments on the historical market risk premium*, Report prepared for the AER, 14 April 2009, pp.6-9.

<sup>33</sup> Australian Energy Regulator, May 2009, *Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, page 175.



584. The current state of the Australian financial market has significantly improved as evidenced by six consecutive increases in the cash rate by the Reserve Bank of Australia since 7 October 2009. In its recent Statement on Monetary Policy Decision on 4<sup>th</sup> May 2010,<sup>34</sup> the Reserve Bank stated that:

“Global financial markets are functioning much better than they were a year ago, but sovereign risk concerns have escalated significantly in Europe over recent weeks. This has prompted additional efforts by policymakers to put fiscal policies onto a sounder footing and to provide support for Greece in the near term. To date, there has been very little contagion outside Europe.”  
[and]

“Australia’s terms of trade are rising by more than earlier expected, and this year will probably regain the peak seen in 2008. This will add to incomes and foster a build-up in investment in the resources sector. Under these conditions, output growth over the year ahead is likely to exceed that seen last year, even though the effects of earlier expansionary policy measures will be diminishing. The process of business sector deleveraging is moderating, with business credit stabilising and indications that lenders are starting to become more willing to lend to some borrowers, though credit conditions for some sectors remain difficult.”

585. The Authority also observes that, prior to the global financial crisis in 2008, 6 per cent was the market risk premium value most commonly used by market practitioners. Surveys of market risk practice show that 47 per cent of market practitioners apply a MRP of 6 per cent, while 69 per cent apply a value of 6 per cent or less. The remainder of market practitioners apply values of MRP more than 6 per cent.<sup>35</sup>
586. IPART has used a market risk premium range of 5.5 per cent to 6.5 per cent in its recent determinations, such as for metropolitan and outer metropolitan bus services in December 2009, the CityRail determination, and recent determinations on prices charged by Sydney Catchment Authority and Hunter Water. IPART argues that deriving MRP from a long-term historical time series remains appropriate. IPART also considers that relying on a long-term historical time series adequately takes into account any impact on excess returns of recent market events such as the global financial crisis.
587. The Queensland Competition Authority has also used 6 per cent for MRP in the Draft determination for Queensland Rail in December 2009. QCA argued that it did not lower the MRP when the market conditions at the time led some stakeholders to seek a reduction therefore, increasing the MRP now would be inconsistent with the past practice of setting the MRP at a level to encourage investment over the medium term and not in response to short term market fluctuations.
588. The Authority has considered the data on market returns for the periods detailed in Table 14. The Authority has had regard to the analysis by the AER in its WACC determination. However, the Authority does not have access to the data set to the

<sup>34</sup> The Reserve Bank of Australia (4 May 2010), Statement by Governor Glenn Stevens on Monetary Policy Decision, accessed at <http://www.rba.gov.au/media-releases/2010/mr-10-07.html>

<sup>35</sup> G. Truong, G. Partington and M. Peat, ‘Cost of capital estimation and capital budgeting practices in Australia’, *Australian Journal of Management*, Vol. 33, No. 1, June 2008, p.155.

end of 2008 prepared by Associate Professor Handley, the AER's consultant on the market risk premium, on which the AER has derived its conclusions on the issue. The Authority has also had regard to its own data set with an update to the end of 2009.

**Table 14 Estimates of the market risk premium over a range of different periods<sup>36</sup>**

Value of Imputation Credits	1958 - 2009	1980 - 2009	1988 - 2009
0%	6.2	5.7	4.6
60%	6.7	6.4	5.7

*Source: Economic Regulation Authority*

589. Table 14 shows that the range of estimates of the market risk premium over the various periods, using the Authority's data set and including an adjustment for the value of imputation credits (60 per cent), is 5.7 per cent to 6.7 per cent. This range of estimates does not provide any convincing evidence for the Authority to depart from the value of 6 per cent for MRP widely accepted by many Australian regulators.
590. In the Authority's recent Final Decision on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline, a range for the MRP of 5 per cent and 7 per cent, with the mid-point value of 6 per cent, was adopted.
591. In addition, in the Authority's recent Final Decision on Proposed Revisions to the Access Arrangement for the South West Interconnected Network, a mid-point value of the MRP of 6 per cent was also adopted.
592. The Authority adopts the same approach it took in its Final Decisions on the Proposed Revisions to the Access Arrangement for the South West Interconnected Network, and on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline, for the same reasons as applied in those decisions. This approach is consistent with historical regulatory practice that a MRP of 6 per cent is within the reasonable range of values.

### **Draft decision**

593. The Authority does not approve WAGN's proposal in regard to the MRP.
594. The Authority considers that a reasonable point estimate for the MRP is 6 per cent.

### *Value of imputation credits*

### **Access arrangement proposal**

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<sup>36</sup> The adjustments for the value of imputation credits of 60 per cent have been interpolated using the values of imputation credits at 50 per cent and 65 per cent made by the AER in its WACC review, p.209. It is immaterial to make the adjustment for the value of imputation credits for one more year (from the ending year of 2008 in the AER's analysis to the ending year of 2009 as calculated using the Authority's data set).

595. The value of imputation credits, known as “gamma” ( $\gamma$ ),<sup>37</sup> is the product of two components:
- a) the payout ratio (F): the rate at which franking credits that are created by the firm are distributed to shareholders, attached to dividends; and
  - b) the utilisation rate (theta): the value to investors of a franking credit at the time they receive it.
596. National Economic Research Associates (**NERA**), on behalf of WAGN, prepared a submission on the issue of the estimate of imputation credits (gamma). NERA’s arguments can be grouped into three distinct themes:
- a) the estimate of the payout ratio (F);
  - b) the estimate of utilisation rate (theta); and
  - c) the method used to estimate the utilisation rate (theta).

Each of these themes is discussed in turn below.

#### *Payout ratio (F)*

597. NERA concludes that the appropriate assumption as to the distribution rate of imputation credits (i.e. the payout ratio) for a regulated gas distribution business is 68 per cent. This reflects:
- a) the average market payout ratio over the period from 1997 to 2007; and
  - b) the assumption that retained imputation credits have no value.

Each of these is discussed in turn below.

#### *The average market payout ratio*

598. The AER has adopted a distribution rate (F) of 1.0, reflecting advice by Associate Professor Handley that this assumption is consistent with a standard assumption of valuation practice that all free cash flows are paid out to investors.<sup>38</sup>
599. NERA examined the Australian Tax Office (**ATO**) statistics on the creation and distribution of credits for the tax years from 1996/97 and 2006/07. NERA’s analysis reveals that:
- a) the actual proportion of credits created that were distributed in the same year (not in other years) on average from 1997 through to 2007 was 68 percent;

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<sup>37</sup> Monkhouse, P. ‘Adapting the APV Valuation Methodology and the Beta Gearing Formula to the Dividend Imputation Tax System’, *Accounting and Finance*, 37, vol. 1, 1997, pp. 69-88.

<sup>38</sup> Australian Energy Regulator, December 2008, *Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, p. 302.

- b) if firms had followed the AER one-year strategy (i.e. distributing 71 per cent of this year's credits as well as all the retained credits from the prior year), 97 per cent of all credits created would have been distributed; and
- c) if firms had followed the AER five-year strategy (i.e. distributing 71 per cent of this year's credits (year t), as well as the credits retained from the year five years previous to this year (year t-5)), then the average market payout of 89 per cent of all credits created in the year t-5 would have been distributed.<sup>39</sup>

600. Based on this analysis, NERA concluded that the appropriate payout ratio for a regulated gas distribution business is 68 per cent – the actual proportion of imputation credits created that were distributed in the same year from NERA's calculations.

*Retained imputation credits have no value*

- 601. NERA is of the view that, under a classical tax regime<sup>40</sup>, the value of the firm will be independent of whether free cash flows are fully distributed or retained, since the value is eventually returned to shareholders as higher dividends.
- 602. However, NERA argues that, under an imputation tax system<sup>41</sup>, the payout policy of a firm can affect its value, since retained imputation credits<sup>42</sup> cannot be reinvested by the firm. In other words, unlike retained earnings that can be reinvested by a business to increase future equity returns, imputation credits only have value when distributed to shareholders. It follows that imputation credits have no value when they are not distributed to shareholders.
- 603. NERA is of the view that, on the basis of data from the ATO, Australian companies have not distributed retained imputation credits quickly and they are holding \$148 billion in their franking accounts, and this suggests that the market value of retained imputation credits is low or even zero.

*Utilisation rate (theta)*

- 604. In its 2009 WACC Review, the AER adopted a point estimate for theta of 65 per cent which is a mid-point value of the range estimates as below:
  - a) a lower bound of 0.57, being the estimate from a dividend drop-off study<sup>43</sup>; and

<sup>39</sup> WAGN's Access Arrangement: Supporting document from NERA, pages 10-11.

<sup>40</sup> A classical tax system (double taxation) taxes both company profits, and any dividend income. This double taxation of dividends thus provides an incentive to retain profits.

<sup>41</sup> A tax system in which a franking credit is received by resident shareholders, when determining their personal income taxation liabilities, for corporate taxation paid at the company level.

<sup>42</sup> Retained imputation credit is a notional concept that reflects the "value" for imputation credits which are created but not distributed to the shareholders.

<sup>43</sup> Dividend drop-off studies analyse the movement in stock prices on the ex-dividend data and can be used to estimate the market value of dividend imputation credits in one of two ways:

- the value of theta is estimated by considering the net movement in prices – where the net movement is the sum of the cash dividend and the change in price; and
- the value of theta and the value the market places on dividends are jointly estimated by considering the gross movement in prices – this explicitly allows the market to value cash dividends at less than 100 per cent of their face value.

- b) an upper bound of 0.74, being the estimate using redemption rates from tax statistics.
605. WAGN, on the grounds of NERA's advice, argues that the estimate of theta using imputation credit redemption rates from the ATO is problematic. It believes that the redemption rates could not be used to provide a reasonable upper bound on theta. WAGN is of the view that the redemption rates overestimate the value of theta because of two reasons:
- a) the value investors place on imputation credits cannot be measured as a holdings-weighted average of redemption rates. Instead, it is more likely that a wealth-weighted average should be used. These two averages are defined below. NERA's analysis also reveals that a holdings-weighted average is likely to be higher than a wealth-weighted average; and
- b) redemption rates from the ATO do not take into account the costs investors incur in accruing imputation credits and these affect their value to investors.<sup>44</sup>

These two arguments are discussed separately below.<sup>45</sup>

*A wealth-weighted average of utilisation rates versus a holdings-weighted average:*

606. A wealth-weighted average is a ratio between invested amounts of money by domestic investors and the total invested amounts of money, which includes invested amounts by both resident and non-resident investors.
607. A holdings-weighted average is the ratio between the value of imputation credits received by resident investors and the total value of imputation credits received by both resident and non-resident investors. This average will ignore any investments from the companies that fail to pay dividends to shareholders in the year.
608. NERA is of the view that a holdings-weighted average is likely to be higher than a wealth-weighted average of utilisation rates.
609. NERA argues that the rate at which imputation credits are "redeemed" at the ATO is the proportion of the distributed imputation credits used by investors in their tax returns. Redemption rates therefore represent a holding-weighted average of the rates at which investors redeem.
610. As a result, NERA is of the view that the use of redemption rates by the AER to estimate theta will overstate the value of theta.

*Costs of accruing imputation credits*

611. The AER considers that the costs associated with accessing imputation credits are irrelevant if a domestic version of the CAPM is assumed to be true.<sup>46</sup>
612. NERA considers two theoretical scenarios:

<sup>44</sup> WAGN's Access Arrangement, page 142

<sup>45</sup> WAGN's Access Arrangement: Supporting document from NERA, pages 17-18.

<sup>46</sup> The AER considers that, for domestic CAPM, non-market assets including assets held by the investors in other markets are outside the model and therefore play no role in the pricing of domestic assets.

- a) first, NERA argues that if the estimate of theta is high, this indicates that there are significant barriers for international investment into the Australian financial market and that the Australian equity prices will not be influenced by the offshore wealth held by foreign investors; and
  - b) second, if the value of theta is low, this indicates that foreign investors are able to shift their wealth between domestic and foreign assets. As such, there will be a significant impact on the price of domestic equities.
613. NERA is of the view that the second scenario is highly likely because the Australian equity market is integrated with the world equity market to a large extent. This conclusion is based on two pieces of evidence:
- a) first, using the Australian Bureau of Statistics (**ABS**) data, NERA presents that non- residents held 29 per cent of the total value of equity on issue by Australian business groups as of 30 June 2007. As such, NERA concludes that foreign investors hold a very large share of the Australian equity market; and
  - b) second, Australia has run a current account deficit over the last 30 years and so has been borrowing throughout this period. This indicates that part of the substantial amount that Australia has borrowed will be in the form of equity.
614. NERA considers that, when domestic investors are holding a portfolio heavily weighted with domestic equities, they must bear more risk than would otherwise be the case if they were to diversify internationally. This higher level of risk must be considered as a cost for domestic investors. NERA concludes that a portfolio heavily weighted with domestic equities may have a higher return for a domestic investor who is able to use the imputation tax credits; however, such a portfolio will be riskier than one that is internationally diversified.
615. NERA argues that there is evidence the Australian equity market is not segmented from international equity markets. As such, the existence of non-residents and foreign assets in the Australian equity market is obvious. NERA is of the view that this existence will affect the value of imputation credits observed from actual market data.
616. Redemption rates from the ATO have ignored the cost (risk) of accruing imputation credits. As such, theta will be over-estimated when the redemption rates are used.
617. WAGN is of the view that, based on the advice by NERA, the tax statistics approach used by the AER should not be used to estimate the values of theta. WAGN argues that the value of imputation credits (theta) is most appropriately estimated from dividend drop-off studies.

*Dividend Drop-Off studies*

618. NERA contends that there are a number of material errors in the AER's conclusion on the market value of distributed imputation credits (theta) of 0.57 (lower bound –



an estimate from Beggs and Skeel's study in 2006) and 0.74 (upper bound – a midpoint value of the estimates from tax statistics).<sup>47</sup> NERA argues that:

- a) the AER overlooks a number of studies that indicate that the market value of theta is low;
- b) the AER relies on tax statistics that overstate the value of theta; and
- c) the AER relies on a single dividend drop-off study when other studies are available.

619. NERA is of the view that the tax statistics method should not be used to estimate the values of theta and that dividend drop-off studies represent the most robust use of market data for estimating the value of theta.

620. Regarding dividend drop-off studies, NERA argues that if one allows dividends to be valued at less than their face value, the estimated value of theta falls to between 0.37 (Strategic Finance Group Consulting (**SFG**)) and 0.57 (Beggs and Skeels). In NERA's opinion, the value of theta is likely to be closer to that estimated by the SFG as its study considers a substantially greater, and more recent, sample of market data.<sup>48</sup>

621. NERA concludes that the distribution rate is around 70 per cent and the market value of theta ranges between zero and 0.57. As a result, a reasonable range for gamma is between zero and 0.4.

622. On acceptance of NERA's recommendations, WAGN has adopted a value of 0.70 for the pay-out ratio and a value of theta in the range 0 to 0.57. As such, a value of imputation credit, gamma, lies in the range 0 to 0.4. The point estimate of 0.2 has been used in setting the rate of return for the WAGN.<sup>49</sup> The value of imputation credit under the current Access Arrangement is within the range of 0.3 and 0.6.

### Public submissions

623. In its submission, Alinta expresses its concern on WAGN's proposal of the value of gamma of 0.2, which is significantly different from the range of 0.57 and 0.81 adopted by the Authority in the 2009 Final Decision on Proposed Revisions to the Access Arrangement for the South West Interconnected Network.

### Authority's assessment

624. A full imputation tax system for companies has been adopted in Australia since 1 July, 1987. While Australia and New Zealand have full imputation tax systems (which are discussed below), many other countries have a partial imputation system, where only partial credit is given for the company tax.

625. Under the tax system of dividend imputation, a franking credit is received by Australian resident shareholders, when determining their personal income taxation liabilities, for corporate taxation paid at the company level. In a dividend imputation

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<sup>47</sup> WAGN's Access Arrangement: Supporting document from NERA, page 24

<sup>48</sup> WAGN's Access Arrangement: Supporting document from NERA, page 24

<sup>49</sup> WAGN's Submission: page 87



tax system, the proportion of company tax that can be fully rebated (credited) against personal tax liabilities is best viewed as personal income tax collected at the company level. With the full imputation tax system in Australia, the company tax (corporate income tax) is effectively eliminated if all the franking values are used as credits against personal income tax liabilities.

626. It is widely accepted that the approach adopted by regulators across Australia to define the value of imputation credits, known as “gamma”  $\gamma$ , is in accordance with the Monkhouse definition.<sup>50</sup> There are two components of gamma:
- a) the payout ratio (F); and
  - b) theta ( $\theta$ ).
627. As a result, the actual value of franking credits, represented in the WACC by the parameter ‘gamma’, depends on the proportion of the franking credits that are created by the firm and that are distributed (the payout ratio, F), and the value that the investor attaches to the credit (theta), which depends on the investor’s tax circumstances (that is, their marginal tax rate). As these will differ across investors, the value of franking credits may be between nil and full value (i.e. a gamma value between zero and one). A low value of gamma implies that shareholders do not obtain much relief from corporate taxation through imputation and therefore require a higher pre-tax income in order to justify investment.
628. In considering the value of imputation credits, the Authority has had regard to the detailed consideration given by the AER to this element of the WACC calculation.<sup>51</sup>

#### *Payout ratio (F)*

629. The AER has adopted a distribution rate (F) of 1.0, reflecting advice that this assumption is consistent with a standard assumption of valuation practice that all free cash flows are paid out to investors.<sup>52</sup> On this basis, the AER has rejected the use of empirically observed market average distribution ratios. Advice to the AER also indicates that an assumed distribution rate of 1.0 is consistent with the Officer WACC.<sup>53</sup>
630. In addition, the AER noted that the Officer WACC framework is a perpetuity framework, which includes a simplifying assumption that cash flows occur in perpetuity and are therefore fully distributed at the end of each period. The AER accepted the advice of its consultant, Associate Professor Handley, and noted that it would be inconsistent to assume that there is a full distribution of a service

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<sup>50</sup> Monkhouse, P. ‘Adapting the APV Valuation Methodology and the Beta Gearing Formula to the Dividend Imputation Tax System’, *Accounting and Finance*, 37, vol. 1, 1997, pp. 69-88.

<sup>51</sup> Australian Energy Regulator, December 2008, *Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, pp. 287 – 340. Australian Energy Regulator, May 2009, *Final decision, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, pp. 393 – 469.

<sup>52</sup> Australian Energy Regulator, December 2008, *Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, p. 302.

<sup>53</sup> Australian Energy Regulator, December 2008, *Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, Attachment G: John C Handley, 12 November 2008, A note on the valuation of imputation credits.

provider's free cash flow but not a full distribution of the imputation credits associated with that free cash flow.

631. The AER considers that the assumption of a zero value for retained imputation credits is inconsistent with the Officer WACC framework.
632. The AER is also of the view that the actual payout ratio is unlikely to be significantly less than 100 per cent, based on an observed payout ratio from tax statistics of 71 per cent and the assumption that retained imputation credits have a positive value.<sup>54</sup>
633. On the ground of the above analyses, the Authority considers that the payout ratio of 1.0 is appropriate.

#### *Estimates of theta ( $\theta$ )*

634. The AER has considered two sources of information on the utilisation rate.
635. First, the AER has placed significant weight on an estimate of the utilisation rate ( $\theta$ ) of 0.57, derived in a dividend drop-off study over the period 2001 to 2004,<sup>55</sup> taking into account that this study:
  - a) is directly relevant to the current imputation tax regime, assessing the value of imputation credits over the post-2000 period after changes in tax law that allowed Australian taxpayers to claim a full cash rebate for unused imputation credits;
  - b) is able to be verified on the basis of statistical tests presented in the paper; and
  - c) is an independent and credible published study that has been through the academic peer review process.
636. Second, the AER has had regard to estimates of the utilisation rate from taxation statistics, indicating a range of values of the utilisation rate,  $\theta$ , from 0.67 (pre-2000) to 0.81 (post-2000) and a point estimate of 0.74.<sup>56</sup>
637. The Authority does not agree with NERA's argument that the method using tax statistics should not be used to estimate the value of theta. This argument from

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<sup>54</sup> The Australian Energy Regulator, May 2010, Final Decision, South Australia Distribution Determination, 2010-11 to 2014-15, page 150

<sup>55</sup> Australian Energy Regulator, December 2008, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters, p 327, citing Beggs, D. and Skeels C.L., 2006, Market arbitrage of cash dividends and franking credits, *The Economic Record* vol 82 no.258, p. 247. AER, May 2009, Final decision, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters, pp. xix, 466.

<sup>56</sup> Australian Energy Regulator, December 2008, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters, p 333, citing Handley, J. C. and Maheswaran, K., A measure of the efficacy of the Australian Imputation Tax System, *The Economic Record* vol. 84 no. 264 p.91. Australian Energy Regulator, May 2009, Final decision, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters, pp. xix, xx, 466, 467.

NERA was rejected by the AER in its WACC Review in May 2009 which can be summarised as below.<sup>57</sup>

638. First, the AER's consultant on the issue, Associate Professor Handley, argues that the utilisation rates estimated by Handley and Maheswaran (2008) are relevant to the analysis of gamma. Handley confirms that an average utilisation rate across all investors of around 70-80 per cent is reported in the 2008 Handley and Maheswaran study. This represents a simple average of utilisation rates across investors, which assumes the set of investors is indicative of the set of investors in the domestic market portfolio. As a result, Handley believes that this estimate of theta may be interpreted as a reasonable upper bound on the value of gamma.
639. Second, the redemption rate used in the 2008 Handley and Maheswaran study weights domestic and foreign investors according to their presence in the Australian financial market. The Authority has adopted a domestic CAPM framework in which foreign investors in the Australian financial market are recognised to the extent that they invest in the domestic financial market. As such, a tax statistics approach can produce an indication of the upper bound estimate of the utilisation rate.
640. In addition, in its most recent Final Decision on the South Australia Distribution Determination, the AER considers that an utilisation rate of 0.65, based on an estimate from tax statistics as well as an estimate from market prices, is better than a market based estimate alone.<sup>58</sup>
641. The mid-point estimate of theta  $\theta$  is 0.65, together with the payout ratio  $F$  of 1.0. This provides an estimate of 0.65 for gamma in all determinations after the 2009 WACC review by the AER.
642. The Authority has recently determined a value of gamma in its Final Decision on the Proposed Revision to the Access Arrangement for the South West Interconnected Network and on the Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline.
643. However, a more recent study by SFG Consulting in 2009, compared with the 2006 Beggs and Skeels study produced an estimated lower utilisation rate of 0.3759. This study used the same data as Beggs and Skeels in 2006 (which analysed data up to 10 May 2004) but analysed a further period of 28 months of data (up to 30 September 2006). This estimate was verified by one of the authors, C. Skeels, in the 2006 study by Beggs and Skeels. Skeels concluded that:

"the only reasonable conclusion to be drawn is that the extended data set should yield more accurate parameter estimates for the 1 July 2000 onwards sub-sample than does the shorter data set."<sup>60</sup>

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<sup>57</sup> Australian Energy Regulator, December 2008, Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters, pages 452-4.

<sup>58</sup> The Australian Energy Regulator, May 2010, Final Decision, South Australia Distribution Determination, 2010-11 to 2014-15, p.xxiv.

<sup>59</sup> SFG Consulting, 2009, The value of imputation credits as implied by the methodology of Beggs and Skeels (2006), page 3.

<sup>60</sup> Skeels, C. 2009, A Review of the SFG Dividend Drop-Off Study. A report prepared for Gilbert and Tobin, p.11.

644. The Authority notes that the AER's view is that the 2009 SFG study is subject to methodological concerns. In its most recent Final Decision for South Australia Distribution Determination in May 2010, after taking account of the advice of its consultants, Professor Michael McKenzie, Associate Professor Graham Partington (University of Sydney) and Associate Professor John Handley (University of Melbourne), the AER considers that market based estimates of theta in the form of dividend drop-off studies are subject to significant concerns due to noise in the data and the likely effects of multi-collinearity on the regression results. Nevertheless, the Authority notes that the AER does make use of information from previous dividend drop-off studies in coming to its position on a reasonable value for the utilisation rate.
645. Given the uncertainty about the estimates of the utilisation rate using dividend drop-off studies and tax studies, the Authority's position is to take a wide range of estimates of the utilisation rate. Overall, the Authority considers that a reasonable range for the value of gamma is 0.37 to 0.81. This will provide a reasonable mid-point value of theta of 0.60.
646. Based on a distribution rate of 1.0 and a theta of 0.60, the Authority concludes that a reasonable value of gamma for this determination is 0.60.

#### **Draft decision**

647. The Authority does not approve WAGN's proposal in relation to gamma. The Authority considers that a reasonable point estimate for gamma is 0.60.

### *Credit rating and debt risk premium*

#### **Access arrangement proposal**

648. WAGN has estimated a nominal pre-tax return on debt as the sum of three components:<sup>61</sup>
- a) The nominal risk free rate;
  - b) A debt risk premium; and
  - c) An allowance for debt raising costs.

#### *Notional credit rating*

649. WAGN, on the basis of the advice by its consultant Second Opinion Financial Advisory (**SOFA**), has proposed to adopt a notional credit rating of BBB/BBB+.<sup>62</sup>
650. SOFA indicates that gas utilities in Australia should be given a lower credit rating than electricity utilities. In current credit conditions, SOFA's review indicates that BBB/BBB+ would be the highest credit rating to gas utilities unless they are well diversified, very large and have high interest coverage level.

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<sup>61</sup> Access Arrangement, page 142

<sup>62</sup> WAGN's Access Arrangement: Supporting document from Second Opinion Financial Advisor (SOFA), page 18.

*Data Sources: Bloomberg versus CBASpectrum*

651. SOFA is of the view that curve extrapolation is a major contemporary issue in determination of the debt margin because of insufficient 10-year Australian corporate bonds in the market.<sup>63</sup>
652. SOFA concluded that extrapolation is an issue for the CBASpectrum dataset relied on by regulators because the longest maturing underlying bonds are well short of this 10-year maturity, even though CBASpectrum publish a series of curves out to 10 years.
653. Since the methodology to construct the fair yield curves is not available, SOFA predicts that CBASpectrum seems to apply a standardised function in its fair yield curves that imposes a declining rate of increase in the debt margin, and a margin between each of the curves through the term structure. This approach will produce curve shapes across the credit rating spectrum that all look the same and are spaced conveniently apart without cross-over.
654. SOFA then argues that data and academic research indicate that there is no specific shape for the term structure of credit spreads. As such, the CBASpectrum approach is not suitable for setting a debt margin for an access arrangement. As a result, the CBASpectrum BBB+ fair yield curve is not recommended for determining the debt margin.
655. For the Bloomberg dataset, because fair yield curves for 10-year Australian corporate bonds with BBB credit rating are not published, the debt margin for 10-year BBB corporate bonds is necessarily derived by the user from shorter term corporate bonds (say 8 years) with the same credit rating BBB, and equal term corporate bonds of 10 years with different credit rating (say A). This is particularly so since August 2009, when Bloomberg reduced its Australian A and BBB curves to 7 years. As a result, extrapolation is also an issue when using fair yield curves from Bloomberg.
656. Analyses from SOFA indicate that the Bloomberg BBB curve, with linear extrapolation of the debt margin at its longest maturity point using the debt margin in the two years prior, provided the most robust 10-year BBB/BBB+ debt margin.
657. SOFA is of the view that the BBB/BBB+ debt margin for WAGN is derived from the Bloomberg BBB 7-year fair value, linearly extrapolated to a 10-year maturity by the per annum differential in debt margins derived from the 7/5-year Bloomberg BBB fair yield spread.<sup>64</sup>

*Debt risk premium*

658. SOFA proposes to adopt the following method to derive the 10-year BBB/BBB+ debt margin for the allocation to the GDS:

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<sup>63</sup> WAGN's Access Arrangement: Supporting document from Second Opinion Financial Advisor (SOFA), page 18.

<sup>64</sup> WAGN's Access Arrangement: Supporting document from Second Opinion Financial Advisor (SOFA), page 12.

- a) Verify the longest maturity represented by bonds in the Bloomberg BBB fair yield curve, being the 7-year maturity;
  - b) Determine the 7-year debt margin, as the difference between the fair yield and the interpolated Commonwealth Government Securities in the indicative averaging period; and
  - c) Linearly extrapolate the 7-year debt margin to a 10-year debt margin by adding on the per annum debt margin differential between the 5-year and 7-year Bloomberg BBB fair yield curve.
659. SOFA proposes a debt margin for 10-year BBB/BBB+ Australian corporate bonds of 4.33 per cent (semi-annual) or 4.50 per cent annualised.<sup>65</sup>

### Public submissions

660. Alinta raises a concern regarding two methodological issues from WAGN's consultant in the absence of the report: (i) the number of trading days; and (ii) data limitations in the Bloomberg data.<sup>66</sup>

### Authority's assessment

661. The Authority does not approve WAGN's proposal in relation to the credit rating for the GDS of BBB/BBB+. The Authority considers that the credit rating of BBB+ approved under the current access arrangement for the GDS remains appropriate.
662. The debt risk premium is a margin above the risk free rate reflecting the risk in provision of debt finance.
663. The Authority's preferred method for estimating a debt risk premium is the use of market evidence of debt costs for businesses with a credit risk profile consistent with a BBB+ credit rating, at the end of April 2010, with relevant sources of market evidence including CBASpectrum and Bloomberg. An allowance for debt issuance costs of 12.5 basis points is added to the debt risk premium to give the debt margin.
664. The Authority has considered estimates of debt risk premiums derived from information on debt costs from the CBASpectrum and Bloomberg data sources for Australian corporate bonds.
665. CBASpectrum publishes fair value yield estimates for 10-year BBB+ rated corporate bonds, and debt risk premiums can be determined directly from these estimates.
666. Bloomberg currently publishes fair value yield estimates for BBB rated bonds of up to seven years tenor, although the data used to produce these estimates are from both BBB and BBB+ rated bonds. Derivation of estimates of debt costs for 10-year BBB+ rated bonds from Bloomberg data must necessarily be by processes of extrapolation and interpolation from estimates for shorter duration bonds or bonds of different credit ratings.

<sup>65</sup> WAGN's Access Arrangement: Supporting document from Second Opinion Financial Advisor (SOFA), page 76.

<sup>66</sup> Alinta: Submission to WA Gas Networks – Proposed Revised Access Arrangement for the Mid-West and South-West Gas Distribution Systems, page 34.



667. The available methods for calculating the debt risk premium using Bloomberg data have become more limited due to a lack of liquidity in the Australian corporate bond market.
668. The Authority considers that the approach taken in the Authority's recent determinations on the access arrangement for the South West Interconnected Network (SWIN) in December 2009 and on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline in May 2010 is appropriate to be considered as the approach to estimate the debt risk premium for this decision.
669. Given the limitations of the Bloomberg information, combined with the need to be consistent with the Authority's recent determinations on the Access Arrangement for the South West Interconnected Network (**SWIN**) in December 2009 and on the Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline in May 2010, the Authority has considered using the same methods to estimate debt risk premiums by three methods:
- a) estimates directly from CBASpectrum for 10-year BBB+ rated bonds (Method 1);
  - b) using Bloomberg information only, taking the estimate for 7-year BBB/BBB+ rated bonds and adding a margin calculated as the spread between 7-year and 10-year AAA rated bonds as a proxy for the spread between the (unavailable) 7-year and 10-year BBB/BBB+ rated bonds (Method 2);<sup>67</sup> and
  - c) using Bloomberg information only, the estimate obtained using Method 2 is adjusted by multiplying that estimate by the ratio of the spread between: 10-year and 7-year A rated bonds; and the spread between 10-year and 7-year AAA rated bonds for the period 1 August 2007 to 18 August 2009 – the last date that data on fair yield for 10-year A rated corporate bonds is available (Method 3).
670. However, the Authority notes that since July 2010 Bloomberg ceased to publishing fair yields on 10-year and 7-year AAA corporate bonds. As such, proposed methods 2 and 3 can no longer be used. The Authority is investigating alternative approaches for inclusion in the final decision.
671. The Authority used estimates of debt risk premium from CBASpectrum in its recent Final Determination on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline. This decision took into account the findings from the AER that, on the basis of the Weighted Sum of Squared Errors Test, CBASpectrum has recently been a better predictor of the fair yields for 10-year Australian corporate bonds.
672. The Weighted Sum of Squared Errors (**WSSE**) Test has been carried out by the AER in three steps:
- a) define a population of fixed interest corporate bonds to observe;

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<sup>67</sup> AAA rated bonds yields are used because yields on 10-year AA rated bonds are not available from Bloomberg.



- b) observe the yields for the sample of bonds from Bloomberg and CBASpectrum; and
- c) compare the estimates from Bloomberg and CBASpectrum, and an average of the two estimates by CBASpectrum and Bloomberg, to the observed yields to determine which fair yield estimate more closely aligns with the observed yields from the sample of the bonds selected.

$$WSSE = \frac{1}{n} \sum_{i=1}^n \left\{ \left[ \sum_{j=1}^n (Observed_{i,j} - Fair_{i,j})^2 \right] \frac{1}{t_i} \right\}$$

Where:

- i) n is the number of bonds in the sample;
  - ii)  $t_i$  is the number of observations for the  $i^{th}$  bond;
  - iii)  $Observed_{i,j}$  is the  $j^{th}$  observed yield for the  $i^{th}$  bond, taken from either Bloomberg or CBASpectrum; and
  - iv)  $Fair_{i,j}$  is the  $j^{th}$  fair yield for the  $i^{th}$  bond, taken from either Bloomberg or CBASpectrum.
673. In its recent determinations<sup>68</sup> in 2010, the AER noted that CBASpectrum provided the best predictor of the fair yields for 10-year Australian corporate bonds. The Authority agrees with this view.
674. In addition, the Authority is of the view that observed debt risk premiums for Australian business bonds with a maturity of two years and longer are appropriate to be considered as a cross check for the method used to estimate debt risk premiums.
675. The Authority's position is that any security included in the set of securities to derive the debt risk premium should ideally satisfy the following three criteria. The security must:
- a) have the same credit rating as the regulated businesses (BBB/BBB+ in this case because credit rating of BBB+ is applied for WAGN);
  - b) be in the same industry (the utility sector in this draft decision); and
  - c) have a maturity of two years and longer (this benchmark is set out in the AER and IPART's analyses).
676. Given that the current market for bonds in Australia is very thin, the Authority has made the following observations:

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<sup>68</sup> Australian Energy Regulator, May 2010, Final Decision, South Australia: Distribution Determination 2010-11 to 2014-15.

- a) When the credit rating of BBB/BBB+ is targeted, four bonds satisfy Criterion 1 (the same credit rating) and Criterion 3 (maturity of two years and longer), but not Criterion 2 (the same industry with the regulated business).
- b) When the industry-based criteria are targeted, together with Criterion 3, only one bond is found.
677. On the grounds of the above analyses, the Authority considers that it is appropriate to include three bonds which satisfy Criterion 1 and Criterion 3 in the set of securities.
678. The Authority notes that bonds issued by individual companies mature together with the credit rating of the company and change over time. As a result, the set of securities will be frequently updated as soon as the new bond is issued and satisfies the criteria set out above.
679. In conclusion, the set of securities, together with their spreads to the 10-year Commonwealth Government Security for the 20-trading period to 30 July 2010 is summarised in Table 15 below.

**Table 15 Estimates at 30 July 2010 of debt risk premiums for the set of securities<sup>69</sup>**

Name of business	Credit rating	Maturity	Debt risk premium for 10-year CGS (average of 20 trading days to 30 July 2010)
Santos	BBB+	23 Sep 2015	3.77%
Snowy Hydro	BBB+	25 Feb 2013	3.21%
General property Trust	BBB	22 Aug 2013	1.82%
The average of the set of securities			2.93%

Source: Economic Regulation Authority's analysis

680. Table 15, which is based on Bloomberg data, shows an average debt risk premium for the three companies of 2.93 per cent.
681. For the purpose of this draft decision, the Authority has used an estimated value derived from CBASpectrum data of 3.293 per cent as the debt risk premium for BBB+ for the 20-trading day period to 30 July 2010. The Authority considers that this value, which is higher than the average debt risk premium in Table 15 above, reasonably reflects the prevailing market conditions in Australia.

<sup>69</sup> Coles was excluded from the set of securities because it is operating in a significantly different industry (IPART, 2010, p.9). The estimate of margin to 10-year CGS for Coles for the same period is 0.89 per cent, which is significantly lower than the estimates of debt margin for other securities in the set.

682. The Authority acknowledges that the debt risk premium will have to be updated for the purpose of the final decision to reflect the most up to date estimates available.

### Draft decision

683. The Authority does not approve WAGN's proposal in relation to the credit rating for the GDS of BBB/BBB+. The Authority considers that an appropriate credit rating for the GDS is BBB+.
684. The Authority does not approve WAGN's proposal in relation to the debt risk premium. The Authority considers that a reasonable value as of 30 July 2010 for the debt risk premium for the GDS is 3.293 per cent.

### Debt raising costs

#### Access arrangement proposal

685. WAGN proposes an allowance for debt raising costs of 12.5 basis points to be included in its estimate of the cost of debt.<sup>70</sup>
686. WAGN, based on advice from its consultant Second Opinion Financial Advisory (SOFA), proposes to adopt an additional annualised allowance of 16.3 basis points for the recovery of pre-financing costs to be included in the debt raising costs in the estimate of the cost of debt.<sup>71</sup>
687. Based on the assumed nominal risk free rate of 5.59 per cent, a debt risk premium for credit rating BBB/BBB+ of 4.50 per cent, a cost of debt issuance of 0.125 per cent and an additional allowance for pre-financing costs of 0.163 per cent for the pricing period considered, WAGN proposes a debt margin (total cost of debt) of 10.38 per cent.<sup>72</sup>

$$r_d = 5.59\% + 4.50\% + 0.125\% + 0.163\% = 10.38\%.$$

#### Public submissions

688. In its submission, Alinta raises a concern on the component of pre-financing costs to be included in the cost of debt proposed by WAGN. Alinta argues that, given the absence of WAGN's consultant report, there is a risk that there may be some double counting of WAGN's financing and re-financing costs.

#### Authority's assessment

689. The Authority notes that debt raising costs may include underwriting fees, legal fees, company credit rating fees and any other costs incurred in raising debt finance. In practice, regulators across Australia have typically included an allowance of 12.5 basis points for these costs in the debt margin as an addition to the debt risk premium.

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<sup>70</sup> WAGN's submission: page 88

<sup>71</sup> WAGN's submission: page page 88

690. The current allowance for debt raising costs of 12.5 basis points is based on a benchmark analysis conducted by the Allen Consulting Group (**ACG**) in 2004.<sup>73</sup> The ACG undertook a study for the ACCC in 2004 on appropriate debt and equity raising costs to be included in costs recognised for the purposes of determining regulated revenues and prices. This study determined debt raising costs based on long-term bond issues, consistent with the assumptions applied in determining the costs of debt for a benchmark regulated entity. Debt raising costs were based on costs associated with Australian international bond issues and for Australian medium term notes sold jointly in Australia and overseas. Estimates of these costs were equivalent to 8.0 to 10.4 basis points per annum when expressed as an increment to the debt risk premium.<sup>74</sup>
691. In its Final Decision on South Australia: Distribution Determination in May 2010, the AER is of the view that the ACG methodology used for assessing debt raising costs takes into account the management of refinancing risk. The AER also notes that the review conducted by the ACG in 2004 included detailed interviews with relevant entities, and that this specifically included an interview with Standard and Poor's. The AER considers that it is reasonable to conclude that the ACG took into account the need for a refinancing plan to mitigate refinancing risk to an appropriate level when estimating the appropriate benchmark for debt raising costs.<sup>75</sup>
692. The Authority considers that there is a trade-off between the credit rating of a firm and its debt raising costs. The current practice adopted by the Authority is that only the efficient cost is allowed for the benchmark firm to take the minimum actions required to maintain the current benchmark credit rating.
693. The Authority's view is that inclusion of 12.5 basis points as an addition to the debt risk premium is generally acknowledged as a conservative allowance for all related cost of debt issuance.
694. The Authority is of the view that it is not appropriate to include the pre-financing cost to the cost of debt. To do so would be inconsistent with recognised regulatory practice and the Authority's usual approach. The Authority is not satisfied that SOFA, on behalf of WAGN, has established any convincing reason for departing from the approach adopted by most Australian regulators.
695. The Authority accepts Alinta's view that there may be some double counting of WAGN's pre-financing cost if it is included in the cost of debt.
696. The Authority is not aware of any decisions by Australian regulators in which pre-financing cost are included in the cost of debt.

#### **Draft decision**

697. The Authority does not approve WAGN's proposal in relation to pre-financing cost. The Authority considers that an allowance for debt raising costs of 0.125 per cent is appropriate.

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<sup>73</sup> Allen Consulting Group, December 2004, Debt and Equity raising transaction costs: Final report to ACCC.

<sup>74</sup> Allen Consulting Group, December 2004, Debt and Equity raising transaction costs: Final report to ACCC.

<sup>75</sup> Australian Energy Regulator, May 2010, Final Decision, South Australia: Distribution Determination 2010-11 to 2014-15, pages 382-3.

698. Based on the above the Authority considers that the total debt margin for the GDS, should comprise the debt risk premium plus an allowance for debt raising costs. Therefore, the debt margin considered appropriate for this draft decision is 3.418 per cent being the sum of the debt risk premium (3.293 per cent) and the debt issuance costs (0.125 per cent).

### *Expected inflation*

699. In its access arrangement proposal WAGN has used a widely accepted method to estimate the inflation rate which has been calculated as the geometric mean of the Reserve Bank of Australia's (**RBA**) inflation forecasts for the next ten years. WAGN proposes an expected inflation rate of 2.47 per cent.<sup>76</sup> The inflation rate adopted for the purpose of the current Access Arrangement is 2.51 per cent.

### **Public submissions**

700. Alinta appears to agree with the method of estimating expected inflation adopted by WAGN.<sup>77</sup>

### **Authority's assessment**

701. The Authority agrees with the general approach to determine the expected inflation rate adopted by WAGN.
702. In the Authority's recent Final Decisions on the proposed access arrangement for the Goldfields Gas Pipeline in May 2010 and on its Proposed Revisions to the Access Arrangement for the South West Interconnected Network in December 2009, the same general approach was adopted.
703. The Authority adopts the same approach for this draft decision. The forecasts on which the Authority relies for its calculations are all from the RBA's May 2010 *Statement on Monetary Policy*.<sup>78</sup>
- a) 3.00 per cent for the year to June 2011;
  - b) 3.00 per cent for the year to June 2012; and
  - c) 2.50 per cent (being a mid-point estimate of the RBA's long term inflation forecasts) for each year from July 2013.
704. Using the above forecasts, the Authority has calculated the forecast inflation rate for this draft decision of 2.60 per cent.
705. The Authority produces the forecast inflation rate of 2.60 per cent whereas WAGN has produced 2.47 per cent in its submission (Access Arrangement Information, page 161). The reason for this difference is that while the Authority is using the RBA's forecasts from its May 2010 *Statement on Monetary Policy*, WAGN adopted

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<sup>76</sup> Access Arrangement Information, page 161

<sup>77</sup> Alinta: Submission to WA Gas Networks – Proposed Revised Access Arrangement for the Mid-West and South-West Gas Distribution Systems, page 30.

<sup>78</sup> Reserve Bank of Australia, May 2010, *Statement on Monetary Policy*, available at <http://www.rba.gov.au/publications/smp/2010/may/pdf/0510.pdf> page 56

the forecasts from the RBA's November 2009 *Statement on Monetary Policy* because of the date on which WAGN's Information Submission was lodged with the Authority.

### **Draft decision**

706. The Authority accepts WAGN's proposed methodology to calculate the forecast rate of inflation.
707. Based on the above, the Authority's calculation of expected inflation for the draft decision is 2.60 per cent.
708. Based on an estimated nominal risk free rate of return of 5.16 per cent and an inflation rate of 2.60 per cent, the Authority estimates a real risk free rate of 2.50 per cent.

### *Models to estimate the cost of equity*

#### **Access Arrangement Proposal**

709. WAGN is of the view that no single asset pricing model can, on its own, provide an estimate of expected rate of return on equity which is commensurate with prevailing conditions in the market for funds. One reason is because each model takes into account only certain aspects of the economic processes through which returns on financial assets are determined. WAGN also argues that pricing models derived by assuming a simple exchange economy cannot provide a complete explanation of the determinants of asset prices, since these models do not take into account the technological, market and regulatory risks to which the owners of physical assets are exposed.<sup>79</sup>
710. WAGN then proposes that the determination of a rate of return for the GDS should recognise that:<sup>80</sup>
- a) there are multiple models which might be used in calculating an expected rate of return on equity;
  - b) these pricing models are all particular cases of the inter-temporal capital asset pricing model, which is a well-accepted pricing model;
  - c) each of these models provides an insight into the way in which asset prices are determined, but each also has specific limitations; and
  - d) all pricing models do not – and cannot – provide an estimate of the expected rate of return on equity which is commensurate with prevailing conditions in the market for funds and with the risks involved in delivering the reference services, because they are derived from a view of economic processes generating expected returns which are incomplete.

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<sup>79</sup> Access Arrangement Information, page 163

<sup>80</sup> Access Arrangement Information, page 164-5

711. As a result, WAGN concluded that, under these circumstances, the best approach for determining the rate of return for WAGN GDS was to use multiple pricing models, as all these models estimate the rate of return on equity by using current financial market data, and taking account of more of the available information on economic processes.<sup>81</sup> The asset pricing models that WAGN proposed to use in determining the rate of return on equity for WAGN include:

- a) Sharp-Lintner CAPM;
- b) Black's CAPM;
- c) Fama and French; and
- d) Zero-beta Fama-French Model

Each of these pricing models is briefly discussed in turn below.

#### *Sharp-Lintner CAPM*

712. Sharp-Lintner CAPM explains the expected return,  $E(r_i)$ , on any financial asset  $i$  in terms of the rate of return on a risk-free asset,  $r_f$ , and a premium for risk,  $(E(r_M) - r_f) \times \beta_i$ , where  $E(r_M)$  is the expected rate of return on a market portfolio of assets, the term  $(E(r_M) - r_f)$  represents the market risk premium (MRP) and  $\beta_i$  is the equity beta of asset  $i$  and is defined as  $\beta_i = \text{cov}(r_i, r_M) / \text{var}(r_M)$ :  

$$r_e = r_f + (E(r_M) - r_f) \times \beta_i$$

#### *Black CAPM*

713. Black CAPM was developed from the Sharp-Lintner CAPM, but without assuming the existence of a risk free rate asset and without assuming unrestricted borrowing and lending. In Black's derivation of CAPM, the return on a portfolio, known as zero-beta portfolio ( $E(r_z)$ ), for which the return is uncorrelated with the return on the market portfolio, acts as the equivalent of the risk free return.

$$r_e = E(r_z) + (E(r_M) - E(r_z)) \times \beta_i$$

714. The main findings from the Black CAPM are that: (i) when  $\beta$  is low, the expected return predicted by the Sharp-Lintner CAPM is less than the expected return predicted by the Black CAPM; and (ii) when  $\beta$  is high, the expected return predicted by the Sharp-Lintner CAPM is greater than the expected return predicted by the Black CAPM. The Black CAPM is more reflective of actual returns.

715. WAGN considers that three anomalies remain after analysing predictions from the Sharp-Lintner CAPM and Black CAPM (WAGN's Access Arrangement, pages 152):

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<sup>81</sup> Access Arrangement Information, page 167



- a) a size effect: low market value shares have higher returns than can be explained by the Sharp-Lintner CAPM;
- b) a value effect: returns are predicted by ratios of market value accounting measures such as earnings and book value of equity; and
- c) a momentum effect: shares with high returns during the past three to 12 months tend to have higher returns in the immediate future.

#### *Fama-French Model*

716. Fama-French Model (**FFM**) was developed from the inter-temporal CAPM.<sup>82</sup> The FFM identifies three sources of undiversifiable risk which capture all three above-mentioned anomalies:

- a) The excess return to the market portfolio (the market risk premium, MRP);
- b) The value or growth risk premium, high minus low (**HML**) – the premium earned by high minus low book value shares. In this asset pricing model, high-value firms have a high ratio between book value of equity and market value of equity whereas the opposite is true for low-value firms (also known as growth shares); and
- c) The size risk premium, small minus big (**SMB**) – the premium earned by small minus big shares. Small (big) firms have small (big) total capitalisation (i.e. equity at market value).

$$r_e = r_f + (E(r_M) - r_f) \times \beta_m + HML \times h + SMB \times s$$

717. The FFM states that small firms and firms with high book-to-market ratios require additional returns to compensate investors for these additional risks. Accordingly, large firms and firms with a low book-to-market ratio have less risk and therefore investors require a lower rate of returns.

718. From the above analyses, WAGN concluded that inter-temporal capital asset pricing is a well accepted financial model, and that the Sharp-Lintner CAPM, the Black CAPM and the FFM are three specific forms of the multiple linear factor model derived from inter-temporal capital asset pricing (WAGN's proposed access arrangement, pages 156).

719. As a result, WAGN commissioned economics consultants NERA to estimate the parameters of the above three models, together with a fourth variant of the multiple linear factor model derived from inter-temporal capital asset pricing – a zero-beta version of the FFM. NERA claims that the zero-beta version of the FFM, like the Black CAPM, gives recognition to the fact that investors are not able to borrow and lend freely at the risk free rate of return.

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<sup>82</sup> The Authority does not examine a full inter-temporal CAPM in this Decision because it is not directly linked to the arguments raised by WAGN and its consultant on the issue to estimate the cost of equity.

720. Table 66 presents estimated rates of return on equity for the above-mentioned four different methods. The estimate made using the Sharp-Lintner CAPM uses the AER's estimate of 0.80 for equity beta (WAGN's proposed access arrangement, page 159-160). Table 66 of the proposed access arrangement is reproduced in Table 16 of this draft decision below.

**Table 16 WAGN's estimated nominal rates of return on equity**

Method of Determining Cost of Equity	Value
Sharp-Lintner CAPM	11.99%
Black (zero beta) CAPM	13.59%

721. The real, pre-tax costs of capital associated with each CAPM approach are presented in Table 17 below.

**Table 17 WAGN's proposed real, pre-tax Weighted Average Costs of Capital**

Method of Determining Cost of Equity	Real WACC
Sharp-Lintner CAPM	8.67%
Black (zero beta) CAPM	10.64%
Fama-French three factor CAPM	10.49%
Fama-French (zero beta) three factor CAPM	11.93%

722. WAGN determined the real, pre-tax rate of return for the WAGN to be 11.1 per cent, which is the lower limit of the upper quartile of the range of pre-tax real WACC shown in Table 17, calculated as:

$$\begin{aligned}
 &= 8.67\% + 0.75 \times (11.93\% - 8.67\%) \\
 &= 11.1\%.
 \end{aligned}$$

723. WAGN provides no evidence as to why this point in its range of estimates is chosen, as opposed to (say) the mid-point of the range.

### Public submissions

724. In its submission, Alinta expresses its major concerns on WAGN's proposal to use four different versions of CAPM to estimate the cost of equity. Key questions from Alinta are summarised as follows:

- Is WAGN relying on more than one financial model to derive the cost of equity?
- If that is the case, then is that approach consistent with the requirements of the National Gas Rules?
- Are all models used by WAGN well accepted?

725. In response to the first question, Alinta argues that WAGN is relying on more than one financial model. This argument is based on the statement by WAGN in its proposed access arrangement that:

“... there is, at present, no single model which explains the economic processes that generate asset prices”<sup>83</sup>

726. In response to the second question, Alinta argues that the National Gas Rules allow only a well accepted financial model such as the Capital Asset pricing Model (National Gas Rule 87(2)(b)). As such, the approach adopted by WAGN to estimate the cost of equity is not consistent with the requirements of the National Gas Rules.
727. In response to the third question, Alinta argues that the inter-temporal capital asset pricing model is not a well accepted model. This argument is based on the study by Lawriwsky for the Essential Services Commission in 2008.<sup>84</sup>

### **Authority's assessment**

728. In considering an appropriate cost of equity for WAGN, the Authority has assessed the advice provided by NERA Economic Consulting (**NERA**), which has been used by WAGN to formulate its proposal. The Authority's assessments of the three alternatives to the Sharpe-Lintner CAPM, namely Black CAPM; Fama-French CAPM; and Zero-beta Fama-French CAPM, are discussed below.

#### *Black CAPM*

729. To estimate the cost of equity, the Black CAPM requires a risk free rate, an estimate of the zero-beta premium, an equity beta and a market risk premium.
730. Except for the zero-beta premium, all other parameters are the same with those used in the Sharpe-Lintner CAPM.
731. NERA proposes the zero-beta premium of 6 per cent. This proposal is based on the work of Lajbcygier and Wheatley (2009), in which the authors concluded that estimate for the zero-beta premium is well in excess of the market risk premium.<sup>85</sup> As a result, NERA notes that it is conservative to use a zero-beta premium of 6 per cent.<sup>86</sup>
732. The Authority has not identified any evidence that the Black CAPM has been broadly applied by financial analysts and business practitioners in valuation or capital budgeting in Australia.

#### *Fama-French Model (FFM)*

733. To estimate the cost of equity, FFM requires a risk free rate, estimates of the exposures of the equity to the market, HML (high minus low) and SMB (small minus big), a market risk premium, and HML and SMB premiums.

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<sup>83</sup> Access Arrangement Information, page 102

<sup>84</sup> Lawriwsky, M., 2008, The origins of the CAPM and its application in commercial practice and economic regulation. A report to the Essential Services Commission of Victoria

<sup>85</sup> Lajbcygier, P. and Wheatley, S. (2009), Dividend Yield, Imputation Credits and Returns, Working Paper, Monash University.

<sup>86</sup> WAGN's Access Arrangement: Supporting document from NERA Economic Consulting (NERA), page 13.

734. NERA's estimates of the exposures of an Australian utility to the market ( $\beta_m$ ) HML ( $h$ ) and SMB ( $s$ ) are 0.65, 0.38 and 0.44 with the standard errors of 0.05, 0.06, and 0.07 respectively. These estimates were derived using the weekly data from 4 January 2002 to 6 March 2009 on the nine Australian utilities that the AER uses in its analyses on the WACC Review.<sup>87</sup>
735. Regarding the estimates for the HML and SMB premiums, NERA apply the procedure used by Anderson (1957)<sup>88</sup> to a combination of monthly Australian data from 1975 to 2008 and US data from 1926 to 2008. Based on this approach, NERA proposes the HML and SMB premiums of 3.61 per cent and 2.58 per cent per year respectively.<sup>89</sup>
736. The Authority requested from WAGN the detailed calculations used by NERA to justify its estimates. WAGN provided a confidential response to this request on 15 April 2010 which set out reasons as to why it could not provide this information. As a consequence, the Authority does not have access to the estimates prepared by NERA, WAGN's consultant on the issue. This has made the Authority's assessment more difficult. The Authority does not approve these estimates for the following reasons.
737. First, the standard errors for the above estimates of HML and SMB premiums are 2.89 and 2.77. The values of standard errors reveal that the estimates are not precise and are not statistically significant.<sup>90</sup>
738. Second, deriving estimates by combining Australian and US data may not be appropriate because it may not reveal prevailing market conditions in Australia.
739. Regardless of the method of calculation in this specific case, the Authority does not accept that the FFM model is a well-accepted financial model. Concerns include both appropriateness of the model and its limited use in Australian financial markets.
740. FFM has not been widely used by financial analysts and business practitioners in Australia in valuation and capital budgeting. A practical reason for this is that values of the 'theta factor' (i.e. the input factors) are not commercially available in Australia. The FFM has been applied in portfolio asset allocation in the funds management industry. There is no evidence of widespread application of the model by financial analysts and business practitioners at the individual firm level, although one example of a partial application that has been identified is the hybrid CAPM recommended by KPMG in 1993.<sup>91</sup>

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<sup>87</sup> WAGN's Access Arrangement: Supporting document from NERA Economic Consulting (NERA), page 16.

<sup>88</sup> In a strict statistical sense for a t-test, with 95 per cent level of confidence, a null hypothesis that HML and SMB premiums are equal to zero cannot be rejected. As such, this reveals that the estimates of HML and SMB premiums in this study by NERA are not statistically different from zero.

<sup>89</sup> WAGN's Access Arrangement: Supporting document from NERA Economic Consulting (NERA), page 16.

<sup>90</sup> Anderson, T.W. (1957), *Maximum likelihood estimates for a multivariate normal distribution when some observations are missing*, Journal of the American Statistical Association, Vo. 52, pp. 200-203.

<sup>91</sup> Lawriwsky, M., 2008, The origins of the CAPM and its application in commercial practice and economic regulation. A report to the Essential Services Commission of Victoria

741. The Authority contends that while the FFM continues to be considered in finance textbooks, it is used as an illustration of the potential limitations of the Sharpe-Lintner CAPM, and not because it is widely applied in business.
742. While the FFM has achieved a degree of support in academic circles, there has also been scepticism due to concerns about 'data mining',<sup>92</sup> that is, the reporting of results of strong correlations between variables, without the benefit of a *priori* theory justifying the inclusion of those variables.

#### *Zero-Beta FFM*

743. To estimate the cost of equity, zero-beta FFM requires all parameters required by the FFM, together with the estimate of zero-beta premium.
744. Using the same estimate of the zero-beta premium from the Black CAPM, NERA proposes to use the estimate of 6 per cent. However, NERA does not provide a single academic paper or practical example of the use of the zero-beta FFM in Australia.

#### *Conclusion*

745. The Authority is of the view that the Sharp-Lintner CAPM is the most widely used CAPM model to estimate the cost of equity. The Authority is not aware of any regulators in Australia who use different versions of the CAPM to estimate the cost of equity for their decisions.
746. In the CAPM, the equity beta value is a scaling factor applied to the market risk premium to reflect the relative risk to equity funds in the particular firm or activity in question.
747. The Authority considers that in ascribing a value to the equity beta, primary reliance should be placed on capital market evidence and statistical estimates of beta values, where these are available for comparable businesses.
748. In its 2009 WACC review for electricity transmission and distribution network service providers, with the assistance of Associate Professor Henry of the University of Melbourne, the AER established a sample of Australian businesses, comprising gas-only network businesses, one electricity-only network business, network businesses active in both electricity and gas, and general utility businesses. Given the limitations of available Australian data, the AER considered that gas network businesses could be considered as reasonable but not perfect comparators to electricity network businesses, given that both industries involve the transportation of energy.<sup>93</sup>

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<sup>92</sup> Data mining can lead to spurious correlation between variables. Data mining is the process in which the researcher will simply keep going until he finds a relationship that is statistically significant. He may either try out new variables or playing around with the form of the relationship assumed until he "discovers" something that is statistically significant. This process is likely to generate many spurious relationship between variables because one is bound – sooner or later, to find a variable that is associated with another maybe for no other reason than accident (Melberg, H, 2000, "From spurious correlation to misleading association", the University of Oslo).

<sup>93</sup> The main sample consisted of: AGL (2002 to 2005); Alinta (2002 and 2007); Alinta Network Holdings Pty Ltd (2003 to 2006); Country Energy (2002 to 2006); Diversified Utility and Energy Trusts (2003 to 2008);

749. The AER considers that the reasonable range of the equity beta for a gas or electricity distribution network of between 0.4 and 0.7 is justified on the grounds of empirical information. The AER has also considered the need for regulatory certainty and adopting a conservative approach in estimating the equity beta, commensurate with prevailing market conditions and the risks involved in providing reference services. On this basis, the AER considers that a value of 0.8 provides best estimate of the equity beta arrived at on a reasonable basis for gas and electricity transmission and distribution networks.<sup>94</sup>
750. There are a substantial number of regulatory determinations for electricity and gas networks in Australia that have applied equity beta values of 1.0 and less than 1.0.<sup>95</sup> Empirical studies of beta values have been subject to scrutiny and debate as part of regulatory processes. Over the past five years, there has been a downward trend in the beta values being applied in regulatory decisions for gas and electricity businesses.
751. The summary of previously adopted values of equity beta by regulators in Australia is shown in Table 18.

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ElectraNet Pty Ltd (2002 to 2008); Energy Australia (2002 to 2006); Envestra Ltd (2002 to 2008); Ergon Energy Corporation (2002 to 2008); ETSA Utilities (2002 to 2008); GasNet Australia (Operations) Pty Ltd (2002 to 2007); Integral Energy (2002 to 2006); SP AusNet Group (2006 to 2008), and SPI PowerNet Pty Ltd (2002 to 2005).

<sup>94</sup> See for example: Australian Energy Regulator 2009-10, Final decision: WACC review, May 2009; Jemena: Access arrangement proposal for the NSW gas networks 1 July 2010 – 30 June 2015 (Draft Decision February 2010).

<sup>95</sup> Australian Energy Regulator, December 2008. Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters, p. 183.



**Table 18 Equity beta in gas transmission and distribution determinations**

Regulator (Year)	Sector	Equity Beta (Final Decision)
ERA (2005, Final) <sup>96</sup>	Gas transmission	0.8-1.33
QCA (2006, Final) <sup>97</sup>	Gas transmission	1.0
ACCC (2006, Final) <sup>98</sup>	Gas transmission	1.0
ESC (2008, Final) <sup>99</sup>	Gas distribution	0.8 <sup>100</sup>
AER (2009, Draft) <sup>101</sup>	Gas distribution	0.8
ERA (2010, Final) <sup>102</sup>	Gas transmission	0.8-1.0
AER (2010, Final) <sup>103</sup>	Gas distribution	0.8

752. Historically, equity betas have been set higher for regulated gas and electricity transmission businesses, compared to distribution businesses. This reflects the historical risk profiles of transmission versus distribution networks (diversified customer base, more stable demand).

753. In the 2009 review of WACC parameters, the AER concluded that a beta value of 0.8 is appropriate for both transmission and distribution businesses in the National Electricity Market.<sup>104</sup> In the most recent determinations for gas networks, the AER has consistently applied an equity beta value of 0.8.<sup>105</sup> The AER noted that:

<sup>96</sup> Economic Regulation Authority, May 2005. Final Decision on the Proposed Access Arrangement for the Goldfields Gas Pipeline

<sup>97</sup> ACCC, December 2006. Final Decision: Revised access arrangement by APT Petroleum Pipelines Ltd for the Roma to Brisbane Pipeline.

<sup>98</sup> ACCC, December 2003. East Australian Pipeline Limited: Access Arrangement for the Moomba to Sydney Pipeline System.

<sup>99</sup> ICRC, October 2004. Review of access arrangement for ActewAGL natural gas system in ACT, Queenbeyan and Yarrowlumla, Final decision, p.174-177.

<sup>100</sup> The ESC selected a equity beta value of 0.7, then effectively adjusted the beta to 0.8 by making a transitional allowance. Essential Services Commission Appeal Panel, Decision on the Envestra Albury Appeal: E2/2008.

<sup>101</sup> ICRC, October 2004. Review of access arrangement for ActewAGL natural gas system in ACT, Queenbeyan and Yarrowlumla, Final decision, p.174-177.

<sup>102</sup> Economic Regulation Authority, April 2010. Final Decision on the Proposed Access Arrangement for the Goldfields Gas Pipeline

<sup>103</sup> Australian Energy Regulator, 2010, Final Decision, Country Energy Wagga Wagga Natural Gas Distribution Network, Access arrangement, July 2010-June 2015, p. 45; and Access Arrangement proposal: ACT, Queenbeyan and Palarang gas distribution network, p.68.

<sup>104</sup> Australian Energy Regulator, May 2009. Electricity transmission and distribution network service providers, Statement of the revised WACC parameters (transmission), Statement of the revised WACC parameters (transmission), Statement of regulatory intent on the revised WACC parameters (distribution), p. 6.

<sup>105</sup> Australian Energy Regulator 2009-10. Jemena: Access arrangement proposal for the NSW gas networks 1 July 2010 – 30 June 2015, (Draft Decision February 2010). ActewAGL: Access Arrangement for the ACT Gas distribution network, (Draft Decision November 2009); and Country Energy Wagga Wagga Natural Gas Distribution Network, Access arrangement, July 2010-June 2015,(Draft Decision November 2009)



Although reliance on market data suggests a value of between 0.4 and 0.7, the AER concludes that a conservative approach has merit, ensuring that the efficient network service provider has opportunity to at least recover efficient costs.<sup>106</sup>

754. In general, volume risk arises for gas networks because gas is used for specific purposes (e.g. electricity generation, heating) and therefore demand volumes will be impacted by weather trends that may deviate substantially from average expectations. Contractual arrangements such as long term take-or-pay contracts mitigate this risk. The AER recently noted that while it accepts that gas businesses may have greater volume risk (compared to an electricity business), the degree to which volume risk represents business specific risk or systematic (market wide) risk has not yet been settled.<sup>107</sup>

755. The AER has published two final decisions and one draft decision on access arrangement proposals for gas networks: the NSW gas networks, ActewAGL and Country Energy.<sup>108</sup> The equity beta value determined in all three decisions was 0.8. In the AER decision on the NSW gas networks, the AER noted that:

The nature of the gas industry (including the regulatory regime) means that the equity beta of a benchmark efficient service provider is likely to be significantly less than the beta of the market portfolio. This is because demand for energy is relatively inelastic, and the nature of regulated price and revenue caps further reduces fluctuation in income (page 175).

756. The Authority adopted the range of equity beta of 0.8 and 1.0 in its most recent final decision on the proposed access arrangement for Goldfields Gas Pipeline in May 2010.

757. Therefore, the Authority considers that a reasonable point estimate for equity beta is 0.8, at a gearing level of 60 per cent debt to total assets.

### **Draft decision**

758. The Authority does not agree with WAGN that other versions of CAPM, namely Black CAPM, Fama-French CAPM, and Zero-beta Fama French CAPM, are well accepted models.

759. The Authority does not approve WAGN's proposal in relation to the equity beta. The Authority considers that a reasonable point estimate for equity beta is 0.8, using the Sharpe-Lintner CAPM, at a gearing ratio of 60 per cent debt to total assets.

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<sup>106</sup> Australian Energy Regulator, 2010, Final Decision, Access Arrangement proposal: ACT, Queanbeyan and Palerang gas distribution network, p.68.

<sup>107</sup> Australian Energy Regulator, February 2010. Jemena: Access arrangement proposal for the NSW gas networks 1 July 2010 – 30 June 2015; p.129 (Draft Decision February 2010).

<sup>108</sup> Australian Energy Regulator, 2009-10. Jemena: Access arrangement proposal for the NSW gas networks 1 July 2010 – 30 June 2015, (Draft Decision February 2010). ActewAGL: Access Arrangement for the ACT Gas distribution network, (Draft Decision November 2009). Country Energy Wagga Wagga Natural Gas Distribution Network, Access arrangement, July 2010-June 2015, (Draft Decision November 2009).

*Authority's assessment of rate of return*

760. Based on the above assessment of each of the CAPM parameters, the point estimates that the Authority considers may reasonably be applied to parameters of the CAPM in estimating the rate of return for the WAGN are as follows:

**Table 19 Authority's required amendments to WAGN's proposed parameter values for determination of a rate of return (at 31 July 2010)**

Parameter	Value
Nominal Risk Free Rate ( $R_f$ )	5.16 %
Real Risk Free Rate ( $R_f^r$ )	2.50 %
Inflation Rate $\pi_e$	2.60%
Debt Proportion ( $D$ )	60%
Equity Proportion ( $E$ )	40%
Cost of Debt: Debt Risk Premium (DRP) (BBB+)	3.293 %
Cost of Debt: Debt Issuing Cost (DIC)	0.125%
Cost of Debt: Debt Margin (RM)	3.418%
Australian Market Risk Premium (MRP)	6%
Equity Beta ( $\beta_e$ )	0.8
Corporate Tax Rate ( $T_c$ )	30%
Franking Credit ( $\gamma$ )	60%
Nominal Cost of Debt ( $R_d^n$ )	8.58%
Nominal Pre Tax Cost of Equity ( $R_e^{n,\text{pre-tax}}$ )	11.32%
Real Pre Tax Cost of Equity ( $R_e^{r,\text{pre-tax}}$ )	8.50%
Nominal After Tax Cost of Equity ( $R_e^{n,\text{post-tax}}$ )	9.96%
Real After Tax Cost of Equity ( $R_e^{r,\text{post-tax}}$ )	7.17%

**Table 20 Estimates of WACC**

WACC	Value
Nominal Pre Tax WACC ( $WACC_n^{\text{pre-tax}}$ )	9.67%
Real Pre Tax WACC ( $WACC_r^{\text{pre-tax}}$ )	6.89%
Nominal After Tax WACC ( $WACC_n^{\text{post-tax}}$ )	9.13%
Real After Tax WACC ( $WACC_r^{\text{post-tax}}$ )	6.37%

**Draft decision**

761. The Authority does not approve WAGN's proposal in relation to the Rate of Return. Section 9 of WAGN's access arrangement information, headed "Rate of Return" should be consistent with the values in Table 19 and Table 20 of this draft decision.
762. For the purposes of this draft decision, the Authority adopts the point value, being a real pre-tax Rate of Return of 6.89 per cent.
763. As a consequence of the above, the Authority requires an amendment to Annexure B of WAGN's proposed revised access arrangement to change WAGN's proposed rate of return from 11.1 per cent (pre-tax real) to 6.89 per cent (pre-tax real). This requirement is set out in Amendment 8 of this draft decision.

**Return on working capital****Requirements of the NGL and the NGR**

764. The NGL and the NGR do not make specific reference to the cost of working capital used by a service provider.
765. Rule 76 of the NGR provides that total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach. The cost of working capital is not specifically included as a building block.

**Access arrangement proposal**

766. WAGN proposes including a return on working capital as part of total revenue as shown in Table 28 of WAGN's access arrangement information.

**Public submissions***WAGN's submission*

767. WAGN's supporting submission states that section 24(2) of the NGL requires that a service provider be provided with a reasonable opportunity to recover at least the efficient costs which it incurs in providing reference services. WAGN argues that efficient costs which a service provider can be expected to incur will include the efficiently incurred costs of financing provision of the reference services. WAGN submits that these costs should include the costs of financing the physical assets used to provide those services.

768. WAGN submits that under rule 76 the total revenue for each year of the access arrangement period should include efficiently incurred costs of financing working capital.

*Other submission*

769. No other submissions were received on working capital.

**Authority's assessment**

770. The Authority is aware that the AER has questioned whether an allowance for costs of working capital can reasonably be included in the determination of regulated revenues for utility businesses. In its final decision on the SWIN the Authority foreshadowed that it was giving further consideration to this matter.
771. The Authority has now formed the view that the appropriate approach for dealing with the costs of working capital should be consistent with that adopted by the AER.
772. The AER does not allow service providers an allowance for working capital on the basis of its annual modelling approach under which cash flows are assumed to occur on the same (final) day of each year. Since cash flows are assumed to occur simultaneously there is no need under this modelling approach for an allowance to be provided for working capital.
773. The Authority, which uses an end of year modelling approach, agrees with the AER's view in relation to providing an allowance for working capital.

**Draft decision**

774. The Authority does not approve WAGN's proposal for the inclusion of costs in relation to working capital.
775. The Authority does not consider the provision of an allowance for the cost of working capital to be appropriate for the GDS.

## Depreciation for rolling forward capital base

**Requirements of the NGL and the NGR**

776. Rule 90 of the NGR provides that a full access arrangement must contain provisions governing the calculation of depreciation for establishing the opening capital base for the next access arrangement period after the one to which the proposed access arrangement currently relates. The provisions must resolve whether depreciation of the capital base is to be based on forecast or actual capital expenditure.
777. There are no specific access arrangement information requirements.

**Access arrangement proposal**

778. Clause 9.1(a) of the proposed access arrangement provides that for the calculation of the opening capital base for the WAGN GDS for the next access arrangement period, depreciation over the forthcoming access arrangement period is to be calculated in accordance with a straight line method and is to be the sum of:

- a) depreciation on the opening capital base over the forthcoming access arrangement period; and
- b) depreciation of the forecast capital expenditure for the forthcoming access arrangement period (being the amount of forecast capital expenditure used for the purpose of determining haulage tariffs for the forthcoming access arrangement period).

779. Clause 9.1(b) of the proposed access arrangement provides that for the calculation of the opening capital base for the WAGN GDS for the next access arrangement period, each of:

- a) the opening capital base for the forthcoming access arrangement period (adjusted for any difference between estimated and actual capital expenditure included in that opening capital base);
- b) conforming capital expenditure made, or to be made, during the forthcoming access arrangement period;
- c) any amounts added to the capital base under rule 82, rule 84 and rule 86 of the NGR;
- d) depreciation over the forthcoming access arrangement period;
- e) redundant assets identified during the course of the forthcoming access arrangement period; and
- f) the value of pipeline assets disposed of during the current access arrangement period,

is to be escalated, at the rate of inflation as measured by the increases in CPI All Groups, Perth, and expressed in the prices prevailing on a date nominated by WAGN (provided the date is a date on or prior to the end of the forthcoming access arrangement period).

### **Access arrangement information**

780. WAGN provided no access arrangement information in relation to depreciation for the next access arrangement period.

### **Public submissions**

#### *WAGN's submission*

781. WAGN made no specific submissions in relation to depreciation for the next access arrangement period.

#### *Other submissions*

782. No public submissions were received specifically in relation to depreciation for the next access arrangement period.

### Authority's assessment

783. The Authority notes that, in accordance with rule 90 of the NGR, WAGN have proposed to depreciate the capital base for the next access arrangement period based on the forecast capital expenditure for the forthcoming access arrangement period. The Authority accepts that WAGN's proposal complies with the requirements of rule 90 of the NGR.
784. The Authority does note however, that clause 9.1(b) of the proposed access arrangement uses changes in CPI (All Groups, Perth), to determine the opening capital base for the WAGN GDS for the next access arrangement period. The Authority requires WAGN to measure the rate of inflation using changes in CPI (All Groups, Eight Capital Cities).

### Draft decision

785. The Authority approves clause 9.1(a) of the proposed access arrangement.
786. The Authority does not approve clause 9.1(b) of the proposed access arrangement. The Authority requires clause 9.1(b) to measure the rate of inflation using CPI (All Groups, Eight Capital Cities).

#### Required Amendment 6

The Authority requires clause 9.1(b) of the proposed access arrangement to read:

(b) For the calculation of the Opening Capital Base for the WAGN GDS for the Next Access Arrangement Period, each of:

- (i) the Opening Capital Base for the Current Access Arrangement Period (adjusted for any difference between estimated and actual capital Expenditure included in that Opening Capital Base);
- (ii) Conforming Capital Expenditure made, or to be made, during the Current Access Arrangement Period;
- (iii) any amounts added to the Capital Base under rule 82, rule 84 and rule 86 of the National Gas Rules;
- (iv) depreciation over the Current Access Arrangement Period (calculated in accordance with paragraph 9.1(a));
- (v) redundant assets identified during the course of the Current Access Arrangement Period; and
- (vi) the value of Pipeline Assets disposed of during the Current Access Arrangement Period;

is to be escalated, at the rate of inflation as measured by the CPI All Groups, Eight Capital Cities, and expressed in the prices prevailing on a date nominated by WAGN (provided that date is a date on or prior to the end of the Current Access Arrangement Period).

## Cost of corporate taxation

### Requirements of the NGL and the NGR

787. Rule 76(c) of the NGR provides that total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach in which one of the building blocks is, if applicable, the estimated cost of corporate income tax for the year.
788. The access arrangement information must specify the proposed method for dealing with taxation, and a demonstration of how the allowance for taxation is calculated (rule 72(1)(h) of the NGR).

### Access arrangement information

789. WAGN stated at page 29 of the access arrangement information that it used a tax rate of 30 per cent in determining the rate of return for the WAGN GDS. WAGN submitted that this is consistent with the Authority's prior practice of using the corporate tax rate as the rate appropriate for the setting of access prices for benchmark efficient service providers.
790. WAGN further noted, at page 35 of the access arrangement information, that through the use of a pre-tax WACC in the calculation of the return component of the total revenue, allowance is implicitly made for the cost of corporate income tax.
791. WAGN further provided that under Australian taxation law, at least some of the shareholders of a corporation which distributes dividends receive credits for tax already paid at the corporate level.

### Public submissions

#### *WAGN's submission*

792. WAGN reiterated at pages 83 and 116 of its submissions, substantially the same statements made in the access arrangement information.

#### *Other submissions*

793. No other public submissions were received in relation to the cost of corporate taxation.

### Authority's assessment

794. The Authority notes that WAGN has adopted the use of a real pre-tax WACC in the calculation of the return component of total revenue and as a result, allowance is implicitly made for the cost of corporate taxation. The Authority has approved the use of a real pre-tax WACC.
795. The Authority further notes that under the current access arrangement, a corporate tax rate of 30 per cent has been used. WAGN has again proposed to adopt a statutory corporate tax rate of 30 per cent in the forthcoming access arrangement. The Authority accepts and approves WAGN's proposal to adopt a corporate tax rate of 30 per cent.



## **Draft decision**

796. The Authority approves WAGN's proposal in relation to the cost of corporate taxation in the calculation of the return component of total revenue.

## **Incentive mechanism carryover**

### **Requirements of the NGL and the NGR**

797. Rule 76(d) of the NGR provides that total revenue is to be determined for each regulatory years of the access arrangement period using the building block approach in which one of the building blocks is increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency.
798. The access arrangement information must provide proposed carry-over of increments or decrements for efficiency gains or losses, demonstrate how allowance is to be made for such increments or decrements (rule 72(1)(i) of the NGR).
799. The access arrangement information must also contain the information necessary to understand the basis and derivation of the service provider's proposal in respect of the incentive mechanism (rule 42 of the NGR).

### **Access arrangement information**

800. WAGN specified on pages 4-5 of the access arrangement information details regarding expenditure and pipeline usage over the current access arrangement period. Capital expenditure, by asset class, during the current access arrangement period is set out in Table 3 (page 4) of the access arrangement information while operating expenditure, by category, during the current access arrangement is set out in Table 4 (page 5).
801. Pipeline usage over the current access arrangement period is shown in Table 5 and Table 6 on page 5 of the access arrangement information. Table 5 provides the minimum, maximum and average demand, while Table 6 shows WAGN GDS customer numbers by tariff class.
802. Under the current access arrangement WAGN proposed incentive mechanisms in respect of user initiated capital expenditure and non capital costs, pages 36-37 of the access arrangement information. Table 22 (page 37) of the access arrangement information details the efficiency gains achieved by WAGN over the current access arrangement period.
803. WAGN noted that expenditure benchmarks have been adjusted to take into account:
- a) changes in the scope of the activities which form the basis of the determination of the original benchmarks; and
  - b) the difference between forecast and actual growth by adjusting the original benchmarks on the basis of the difference between the actual number of connections in any year and the assumed number of connections for that year.

804. The carry-over of increments into total revenue for the forthcoming access arrangement period is provided for in Table 28 (page 54) of the access arrangement information.

### **Public submissions**

#### *WAGN's submission*

805. WAGN summarised the efficiency gains of user initiated capital expenditure achieved during the current access arrangement period in Table 75 (page 123) of WAGN's submission. WAGN submitted that the actual cost of connections has been higher than the regulatory benchmark in the years 2005 to 2007, while in 2008 the costs of connection were lower than the benchmark. WAGN noted that during this period, WA experienced a significant increase in labour and materials costs.
806. Table 76 (pages 123) of WAGN's submissions demonstrates how the user initiated capital expenditure financing gain is carried across to the forthcoming access arrangement period.
807. In relation to non-capital costs, Table 77 (page 124) of WAGN's submissions shows the efficiency gains achieved. WAGN submitted that an adjustment of non capital costs has been made to take into account the impact of customer connections in excess of the regulatory benchmark. Table 78 (page 125) demonstrates how the non-capital cost efficiency gains are carried across to the forthcoming access arrangement period.
808. Table 79 (page 125) of WAGN's submissions summarises the impacts on the gains (and losses) made in respect of both the user initiated capital expenditure incentive mechanism and the non-capital cost incentive mechanism. WAGN submitted that these amounts result in a net efficiency gain which has been added to the total revenue for the forthcoming access arrangement period.

#### *Other submissions*

809. No other public submissions were received in relation to the incentive mechanism carryover.

### **Authority's assessment**

810. The Authority notes that WAGN has not proposed an incentive mechanism for the forthcoming access arrangement period.
811. The current access arrangement includes an incentive mechanism in respect of user initiated capital expenditure and non capital costs. WAGN claims that it has achieved efficiency gains during the current access arrangement period which it is entitled to carry over into the forthcoming access arrangement period and to include in total revenue for the purpose of determining reference tariffs.
812. The Authority notes the confidential report prepared by Deloitte and provided by WAGN together with the proposed access arrangement. This report covers the period 1 January 2005 to 31 December 2009.
813. The Deloitte report was provided to the Authority on a confidential basis. The report reconciles the regulatory accounting information on which WAGN's proposed revisions have been prepared with WAGN's financial accounts. The report also

independently verifies that both the operating and capital expenditure which have been claimed by WAGN have been duly incurred, including expenditure relevant to the calculation of efficiency carryovers. The Authority is satisfied from the information contained in this report that the efficiency carryovers for both operating and capital expenditure for the period from 31 December 2005 to 2009 have been calculated by WAGN based on independently reviewed and validated figures.

814. The Authority notes that the capital and operating expenditure for the final year of the current access arrangement is not taken into account in determining the efficiency carryovers.
815. As discussed above, the Authority notes that the figures stated in Table 22 of the access arrangement information are inflated using CPI (All Groups, Perth) at the mid-point of the modelling period. The Authority requires inflation to be measured using CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.
816. Table 21 below shows the Authority's draft decision in relation to efficiency gains. WAGN's values in comparison, are shown in Table 22 of the access arrangement information.

**Table 21 Efficiency gains – Adjusted by the Authority**

	2005	2006	2007	2008	2009 <sup>1</sup>
<b>Non capital costs incentive</b>					
Adjusted benchmark OPEX	43.867	43.394	42.615	41.806	41.483
Actual OPEX	39.370	40.864	40.783	37.672	43.220
Underspending	4.497	2.530	1.833	4.134	-1.737
Efficiency gain/loss (-ve)	4.497	-1.967	-0.697	2.301	-
<b>User initiated Capital Expenditure incentive</b>					
Adjusted user initiated CAPEX benchmark	25.207	27.824	25.399	22.824	20.953
Adjusted user initiated CAPEX	27.136	31.833	28.664	23.131	22.740
Incremental gain	-1.930	-4.008	-3.265	-0.307	-1.786
Financing gain/loss(-ve)	-0.131	-0.272	-0.221	-0.021	-

<sup>1</sup> Note 2009 is excluded from the calculation of carry forward, it is included for illustrative purposes

### Draft decision

817. The Authority does not approve the values for the carry-over of increments for efficiency gains as proposed by WAGN to the extent that the values are based on the CPI (All Groups, Perth) modelled at the mid-point of the year and not the CPI (All Groups, Eight Capital Cities) modelled at the end point of the year.
818. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

## Forecast operating expenditure

### Requirements of the NGL and the NGR

819. Rule 76(e) of the NGR provides that total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach, in which one of the building blocks is a forecast of operating expenditure for the year.
820. The forecast operating expenditure must conform to the criteria in rule 91 of the NGR. Rule 91 provides that operating expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.
821. Given that this is a forecast, WAGN's forecast operating expenditure must also comply with the requirements of rule 74 of the NGR.
822. The access arrangement information in relation to the forecast of operating expenditure must:
- a) provide forecast operating expenditure over the access arrangement period and provide a justification for the forecast (rule 72(1)(e) of the NGR);
  - b) provide key performance indicators to be used by the service provider to justify expenditure over the access arrangement period (rule 72(1)(f) of the NGR); and
  - c) contain the information necessary to understand the basis and derivation of the service provider's proposal in respect of forecasting operating expenditure (rule 42 of the NGR).

### Access arrangement information

823. WAGN's forecast of operating expenditure over the forthcoming access arrangement period is shown in Table 19 (page 20) of the access arrangement information.
824. WAGN advised in the access arrangement information that it had forecast operating expenditure from a zero base.
825. WAGN also stated that the forecast operating expenditure represents the lowest sustainable cost of providing the reference services.
826. The categories of operating expenditure costs identified by WAGN in the access arrangement information are network, marketing, corporate, information technology, regulatory and unaccounted for gas costs. WAGN advised that:
- a) Network costs - network cost inputs were derived from the historical costs of undertaking maintenance and operating activities required to meet existing regulatory and legislative requirements (page 20);
  - b) Corporate costs - the forecast of these costs reflects the costs of corporate services sourced from an external provider and an allocation of costs incurred

- by WAGN in managing debt and equity portfolios, and in meeting corporate governance requirements (page 20);
- c) Information technology costs – the forecast of these costs is based on the current costs of service, which are currently sourced from an external service provider. This forecast also takes into account the licence costs associated with current software applications and new applications forecast to be developed during the forthcoming access arrangement period (page 20);
  - d) Regulatory costs - the forecast of these costs reflects forecasts of levies and charges payable to external regulators based on forecasts provided by the external regulators and historical levels of expenditure (page 20).
  - e) Unaccounted for gas - the forecast cost of unaccounted for gas is based on gas prices received as a result of a tender process (page 20).
827. WAGN advised that certain key performance indicators were used as benchmarks against which the forecasts of operating expenditure have been assessed for reasonableness (see rule 72(1)(f) of the NGR) Those key performance indicators are as follows (pages 21-26):
- a) Operating expenditure per kilometre of main;
  - b) Operating expenditure per GJ delivered; and
  - c) Operating expenditure per customer connection.
828. Figures 4, 5 and 6 on pages 23-24 of the access arrangement information show operating expenditure per kilometre of main, per GJ of gas delivered and per customer connection, respectively. In these figures historical values are given for the period from 2000 to 2009 and forecasts are given for the years 2010 to 2013, the forthcoming access arrangement period.
829. WAGN noted that operating expenditure during the forthcoming access arrangement period is forecast to be above the declining long term trend. Three reasons are given for this, as follows (pages 24-25):
- a) A significantly higher cost of gas required to replace unaccounted for gas as a result of significantly higher prices in a new gas purchase contract;
  - b) Significantly higher regulatory costs; and
  - c) Higher corporate costs allocated to WAGN as the group of companies to which WAGN belongs has been restructured. Corporate costs comprise largely of labour costs, which have continued to increase.
830. Figures 7, 8 and 9 on pages 25-26, show the operating expenditure per kilometre of main, per GJ of gas delivered and per customer connection (historical for 2005 to 2009 and forecast for 2010 to 2013) with the effects of these three contributors removed.

## Public submissions

### *WAGN's submission - General*

831. WAGN's actual operating expenditure for the current access arrangement period is set out on page 57 of its public submission (Figure 5 and Table 38).
832. WAGN advised that it used an estimate of the 2009 expenditure as the base for the forecast period. WAGN adjusted the estimated 2009 expenditure by a number of factors to forecast the operating expenditure for the 2010-2014 period (page 58). These factors included:
- a) Increased volume in work due to deteriorating assets, increased customer numbers and expansion of the network;
  - b) Adjustment of forecast expenditure related to labour and material price escalation above the expected inflation;
  - c) Changes due to increased regulatory, legislative, health and safety obligations;
  - d) Expenditure that has been attributed to capital expenditure activities deducted from the operating expenditure; and
  - e) Costs associated with non-regulated assets deducted from the operating costs.
833. WAGN outlined, in Table 41 (page 59) of its public submission, the forecast operating expenditure for the forthcoming access arrangement period, broken into six categories of costs. These categories are operations (referred to in the access arrangement information as network), marketing, unaccounted for gas, information technology, corporate and regulatory. In its public submission WAGN has explained each of these categories of costs and, where relevant, listed and explained any sub-categories of costs that it has included within each of these six broader categories (pages 59-70).
834. In its confidential submission, WAGN gave its forecast in relation to each of these sub-categories of costs and provides some further information in respect of certain of those sub-categories.
835. WAGN submitted (pages 70-71) that its forecast of operating expenditure for the period 2010 to 2014 complies with rule 91(1) of the NGR for the following reasons:
- a) Prudent – the forecast is prudent because it has been based on the requirements of a distribution services business; including maintaining the network in accordance with the relevant Australian standards and to manufacturers' recommendations, managing gas emergencies in accordance with WAGN's safety case, providing metering and billing services and other related services to full retail contestability, managing the ICT functions to support the distribution service and providing the corporate functions of a distribution business;
  - b) Efficient – the forecast costs are efficient because they are based on contractors' rates, labour rates and suppliers' material costs;



- c) Good industry practice - the costs included in the forecast will be incurred as a result of WAGN complying with relevant legislative requirements, Australian standards, manufacturers' recommendations, WAGN's gas safety case, ICT industry practices and are otherwise necessary to sustain the distribution business; and
- d) To achieve the lowest sustainable costs of delivery pipeline services – WAGN has forecast its costs based on a ground up approach to maintain the distribution services.

836. In its confidential submission WAGN provided the Authority with further information in support of its submission that its forecast of operating expenditure complies with the requirements of rule 91(1) of the NGR.

*WAGN's submission - Unaccounted for gas*

837. WAGN noted that it has based the starting price in the forecast costs of unaccounted for gas, and subsequent escalation, on a closed tender to obtain an independent market rate for gas to replace unaccounted for gas. Further details in relation to this process and in relation to the price on which the cost forecast is based are contained in WAGN's confidential submission.

838. Also contained in WAGN's confidential submission is information regarding the estimated percentage of unaccounted for gas (as a percentage of total gas throughput) used by WAGN to derive its forecast of costs for this category. WAGN has forecast an increase in the percentage of unaccounted for gas over the forthcoming access arrangement period, said to be based on actual unaccounted for gas volumes for the WAGN GDS during the current access arrangement and on an increasing trend demonstrated by that data. WAGN submitted that, at least, 2 external events (which are explained in the confidential submission) have influenced the increasing trends in unaccounted for gas.

*WAGN's submission – Network costs*

839. WAGN's confidential submission detailed various sub-categories of operations costs included in WAGN's forecast. One-off costs have been included as a sub-category of operations costs on the basis that these costs were incurred as a result of the delayed implementation of the NGL and the NGR in Western Australia and the consequential delay in the change in the level of reference tariffs. WAGN explained in more detail the nature and extent of these costs in its confidential submission.

*Synergy's submission*

840. In its submission dated 12 April 2010 (pages 4-5 and Table 3.1) Synergy noted that the total forecast operating expenditure for the 2010 to 2013/14 access arrangement period is some 25 percent higher than the incurred operating expenditure for the 2005 to 2009 access arrangement period, with noticeable increases in almost all operational areas. Synergy noted that it did not have access to sufficient information to determine whether these increases comply with the requirements of the NGR.

841. Synergy has urged the Authority to carefully scrutinise these increases in expenditure, in particular whether:

- a) The proposed expenditure on external consultants is prudent;



- b) The proposed increased spend on information technology pertains only to systems essential for servicing WA gas customers and not to non-essential 'bells and whistles' systems or those pertaining to customers in other jurisdictions; and
- c) The proposed increased regulatory spend is prudent.

#### *Alinta's submission*

842. In Attachment A to its submission dated 19 April 2010 (pages 18-28) Alinta noted that WAGN's forecast operating expenditure is \$58.14 million, or more than 26 per cent, higher than actual expenditure in the current access arrangement period. Alinta also noted that the forthcoming access arrangement period is only 4.5 years whereas the current access arrangement was 5 years long. Alinta stated that if you take this into account the average annual forecast operating expenditure for the proposed access arrangement is approximately 40 per cent higher.
843. Alinta submitted that a detailed investigation of WAGN's actual expenditure during the current access arrangement period and forecast operating expenditure during the forthcoming access arrangement is necessary (pages 19-21). In particular because:
- a) There is *a priori* evidence from recent access arrangement decisions in similarly regulated industries and other jurisdictions to conclude it likely that not all of WAGN's forecast operating costs will meet the requirements of rule 91(1) of the NGR (page 20);
  - b) WAGN has not provided any independent evidence to corroborate its claim that its forecast operating expenditure meets the requirements of the NGR (page 20). This is in circumstances where WAGN's process for establishing costs for 2009 (from which its forecast was generated) was not constrained by the requirements of rule 91(1) of the NGR. It would therefore be unsafe to accept, without a detailed investigation, that WAGN's forecast operating costs for the forthcoming access arrangement period meets the requirements of rule 91(1).
844. Alinta made further comments on certain cost drivers at pages 22-28 of its submission.

#### **Authority's assessment**

845. As noted above WAGN outlined in its public submission six categories of operating expenditure for the forthcoming access arrangement. These categories are, operations (referred to in the access arrangement information as network costs), marketing, unaccounted for gas, information technology, corporate and regulatory. In its public submission WAGN has explained each of these categories of costs.
846. In relation to the categories of marketing, corporate, information technology, and network costs (other than costs associated with delaying lodgement of the proposed access arrangement) the Authority has assessed these forecast costs against WAGN's audited historical expenditure. The Authority agrees with WAGN that labour and resource costs in this industry are currently increasing above CPI. The Authority considers that WAGN's proposal for the above costs provides a reasonable basis for the forecast costs over the forthcoming access arrangement period.

847. The Authority is satisfied that the above categories of WAGN's forecast operating expenditure comply with the applicable requirements of the NGL and the NGR (in particular rule 91(1)) and are consistent with applicable criteria prescribed by the NGL and the NGR, in particular rule 74(2) of the NGR.

*Unaccounted for gas costs*

848. WAGN notes that it has based the starting price in the forecast costs of unaccounted for gas, and subsequent escalation, on a tender to obtain an independent market rate for gas to replace unaccounted for gas. Further details in relation to this process and in relation to the price on which the cost forecast is based are contained in WAGN's confidential submission.
849. Also contained in WAGN's confidential submission is information regarding the estimated percentage of unaccounted for gas (as a percentage of total gas throughput) used by WAGN to derive its forecast of costs for this category. WAGN has forecast an increase in the percentage of unaccounted for gas over the forthcoming access arrangement period, said to be based on actual unaccounted for gas volumes for the WAGN GDS during the current access arrangement and on an increasing trend demonstrated by that data. WAGN submitted that, at least, two external events (which are explained in the confidential submission) have influenced the increasing trends in unaccounted for gas.
850. The first issue considered by the Authority is the issue of the costs of unaccounted for gas. In Table 19 of the access arrangement information WAGN forecast it's unaccounted for gas costs for the forthcoming access arrangement period. WAGN has estimated those costs at an average of \$10.5 million per annum, with an increasing trend. This amounts to approximately 5-7 per cent of WAGN's cost of service over the next 4.5 years.
851. The Authority is satisfied that the price that WAGN proposes with respect to calculating the cost of unaccounted for gas complies with the requirements of rule 91(1) of the NGR because a tender process was used by WAGN to determine that price.
852. As to the percentage of unaccounted for gas used to forecast the cost of unaccounted for gas, WAGN's confidential submission set out the actual percentage of unaccounted for gas (as a percentage of total gas throughput) for the WAGN GDS for the period from 2005 to 2008, an actual percentage for year 2009 to November 2009 and an estimated volume and percentage in respect of each year of the forthcoming access arrangement period. The Authority has considered this data.
853. The Authority notes that the percentage of unaccounted for gas for 2009 contained in WAGN's confidential submission does not include the data for the whole of 2009. It only includes data to November 2009. The Authority therefore considers that this percentage should not be used for the purpose of calculating the best forecast for the forthcoming access arrangement period.
854. The Authority is also of the view that the percentage of unaccounted for gas for 2008 contained in WAGN's confidential submission should not be used to calculate a forecast for the forthcoming access arrangement period. The data for this year is not typical because of the impact of the Varanus Island incident, which occurred in June 2008. This incident significantly decreased Western Australia's gas supply, thus decreasing the volume of gas distributed through the WAGN GDS.

Accordingly, the percentage of unaccounted for gas as a percentage of total gas throughput recorded for 2008 is an anomaly. It is therefore not reasonable or appropriate to include the percentage for 2008 as a basis of a forecast percentage for the forthcoming access arrangement period.

855. The Authority also notes the 2007/08 Annual Performance Report: Gas Distributors dated April 2009, which was prepared by the Authority based on information provided by WAGN in compliance with reporting requirements set out in gas licences that were current until June 2007. This report indicates that the percentage of unaccounted for gas on the WAGN GDS was 2.8 per cent for 2007/08 and 3.1 per cent for 2008/09. However, this percentage is based on data relating to the WAGN's Albany LPG Distribution System and WAGN's Kalgoorlie Natural Gas Distribution System, which do not form part of the covered pipeline. This data therefore does not reflect the percentage of unaccounted for gas for those parts of the WAGN GDS with which the proposed revised access arrangement is concerned. The Authority therefore considers that it is not reasonable or appropriate to take this data into account.
856. The Authority has also considered the WA Network Holdings Asset Management Plan 2009 – 2014 (issued on 27 November 2009 and attached to WAGN's confidential submission). This document sets out the actual percentage of unaccounted for gas on the WAGN GDS for financial years from 2003/04 to 2007/08. This document is an internal document of WAGN and it contains the most recent data available for the period to 2007/08.
857. WAGN appears to have relied on the percentage of unaccounted for gas for 2008 and 2009 set out in its confidential submission as establishing an increasing trend, thereby justifying a higher proposed percentage for unaccounted for gas. For the reasons set out above the Authority considers that the data available for the 2008 and 2009 years would not be a reasonable basis for a forecast of unaccounted for gas volumes for the forthcoming access arrangement period. The Authority is therefore not satisfied that WAGN's estimated volume of unaccounted for gas over the forthcoming access arrangement period has been arrived at on a reasonable basis or represents the best forecast or estimate possible in the circumstances (rule 74 of the NGR).
858. The Authority is of the view that, in the circumstances, the best estimate of the percentage of unaccounted for gas for the forthcoming access arrangement period would be derived from calculating the average of the percentage of unaccounted for gas for the 2005/06, 2006/07 and 2007/08 financial years, using the most recent internal data from WAGN reflected in the WA Network Holdings Asset Management Plan 2009 – 2014.
859. Adopting this approach, the average forecast unaccounted for gas cost over the 4.5 years of the forthcoming access arrangement period would be \$8.7 million per annum (taking into account an adjustment to demand volumes).

#### *Network costs*

860. A further issue arises in relation to the claim by WAGN for one off costs in the period January to 30 June 2010 incurred as a result of the delayed implementation of the NGL and the NGR in Western Australia and the consequential delay in the change in the level of reference tariffs. WAGN set out the details of this claim in its confidential submission.

861. The Authority is of the view that these one off network costs do not meet the criteria in rule 91(1) of the NGL. This is because WAGN could have lodged the proposed revised access arrangement, without delay, at the expiry of the initial term of the current access arrangement. However, WAGN requested that the Authority grant it an extension of time in order that such proposed revisions would be lodged under the NGL and the NGR, as opposed to under the National Third Party Access Code for Natural Gas Pipeline Systems. The Authority granted that request. However, the Authority is of the view that any costs incurred by WAGN as a result of this decision to request an extension of time are not costs as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services, when it was open to WAGN to lodge its proposed revisions at an earlier time.

*Ancillary services costs*

862. WAGN did not propose that ancillary services should be regarded as pipeline services in their own right, nor reference services. However, the Authority's draft decision is that ancillary services are pipeline services which must be specified as reference services for which terms and conditions including price must be included in the approved access arrangement.

863. Consistent with this decision the forecast operating expenditure incurred in providing the ancillary services will need to be submitted by WAGN and included in the total revenue for the forthcoming access arrangement period. However, in view of WAGN's position regarding ancillary services, no forecasts were provided to the Authority by WAGN in the access arrangement information or other supporting material.

864. For the purpose of this draft decision, the Authority sought such information from WAGN. However, the required forecasts were not available. WAGN was able to provide to the Authority confidential historical cost, revenue and volume information with respect to the ancillary services for the current access arrangement period. The Authority was also provided with aggregate forecast revenue from the ancillary services applying the charges in Annexure C to the Template Haulage Contract, which WAGN has advised reflect the cost of service. No estimate has been provided on the number of times each ancillary service will be used.

865. For the purpose of the Authority's draft decision, and in particular the reference tariffs for ancillary services, it is necessary for the Authority to make an assumption regarding the likely forecast operating expenditure to be incurred by WAGN in the forthcoming access arrangement period in providing the ancillary services and for this operating expenditure to be included in the modelled total revenue. The Authority has made an appropriate assumption about aggregate forecast operating expenditure for ancillary services having regard to the information provided. This modelling assumption is referred to below in Table 26.

866. The Authority requires WAGN to provide forecasts of operating expenditure for ancillary services prior to the final decision and will make any necessary modelling adjustment in light of those forecasts.

867. The Authority notes that it is satisfied that the access arrangement information provided by WAGN in relation to forecast operating expenditure satisfies the access arrangement information requirements of rules 72(1)(e), 72(1)(f) and 42 of the NGR.

The Authority is satisfied that WAGN's forecasts are supported by a statement of the basis of the forecast (rule 74(1) of the NGR).

868. The Authority notes that WAGN's values for forecast operating expenditure in Table 19 of the access arrangement information are inflated using CPI (All Groups, Perth) at the mid-point of the modelling period. The Authority requires inflation to be measured using CPI (All Groups, Eight Capital Cities) at the end point of the modelling period.
869. Table 22 below incorporates the Authority's adjustments and shows the Authority's draft decision values in relation to forecast operating expenditure.

**Table 22 Forecast operating expenditure - Adjusted by the Authority (\$ million December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
Network	12.516	27.431	28.200	28.372	27.834
Marketing	0.177	2.598	1.086	1.091	1.097
Corporate	3.983	7.966	7.966	7.966	7.966
Information Technology	2.791	5.956	6.167	5.839	6.210
FRC	-	-	-	-	-
Regulatory Cost	3.914	5.411	5.403	6.172	6.617
Ancillary services <sup>2</sup>	0.385	0.770	0.770	0.770	0.770
Unaccounted for Gas	4.052	8.709	8.868	9.171	9.394
Total	27.819	58.841	58.459	59.381	59.888

<sup>1</sup> January 2010 to 30 June 2010 only

<sup>2</sup> Assumption by Authority. Forecasts to be provided by WAGN prior to final decision.

### Draft decision

870. The Authority does not approve the values of WAGN's proposed forecast operating expenditure.
871. The Authority concludes that the appropriate values for forecast operating expenditure should be as stated in Table 22 of this draft decision.
872. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

## Calculation of total revenue

### Access arrangement information

873. WAGN set out in Table 28 (page 54) of the access arrangement information the building blocks of total revenue in each regulatory year of the proposed access arrangement. This table is reproduced as Table 23 below.

**Table 23 WAGN's forecast total revenue - (\$ million, December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
Return on Capital Base	44.0	91.9	94.2	96.7	99.1
Return on Working Capital	0.4	1.6	2.0	2.2	2.5
Depreciation	0.3	24.3	26.2	28.2	30.1
Efficiency gains	2.2	2.2	1.0	2.2	1.3
Forecast Operating Expenditure	36.4	59.6	59.2	60.2	60.7
<b>Total</b>	<b>83.4</b>	<b>179.8</b>	<b>182.6</b>	<b>189.5</b>	<b>193.7</b>

<sup>1</sup>: 1 January 2010 to 30 June 2010 only

874. WAGN has not made an explicit estimate of tax for the purpose of determining total revenue.

### Public submissions

#### *WAGN's submission*

875. WAGN's submission relating to total revenue is contained at pages 116 to 126 of its submission. WAGN's submissions in relation to each relevant component of total revenue are discussed above.

#### *Synergy's submission*

876. Synergy, in its submission dated 12 April 2010 (page 3), submitted that the total revenue proposed for the proposed access arrangement period is significantly higher than that for the current access arrangement period, ranging from a 36 per cent increase in 2010/11 to a 47 per cent increase in 2013/14 when compared with the total revenue figure for 2009.

877. Synergy acknowledged the building block approach to determining total revenue as specified in rule 76 of the NGR and submitted that the composition of particular building blocks used by WAGN to determine total revenue needs to be carefully scrutinised by the Authority, particularly given the lack of publicly available information. Synergy stated that if WAGN earns more than a fair return, or if any costs are recovered more than once, then the resulting cost to customers would be above an efficient level.

#### *Other submissions*

878. There were no other public submissions in relation to the total revenue (as opposed to total revenue components or building blocks). The other public submissions in relation to the total revenue components or building blocks are discussed under the appropriate sub-headings below.

### Authority's assessment

879. The Authority notes that it has no separate discretion in relation to the calculation of total revenue and that if it withholds its approval to any of the building blocks in rule 76 of the NGR, then approval must be withheld for total revenue.



880. The Authority has considered WAGN's proposal in respect of each building block of total revenue in accordance with rule 76 of the NGR. As detailed above, the Authority's decision on each building block is as follows:

- a) The Authority does not approve WAGN's proposal regarding the return on the projected capital base;
- b) The Authority does not approve WAGN's proposal in relation to the return on working capital;
- c) The Authority does not approve WAGN's proposal in relation to depreciation on the projected capital;
- d) The Authority approves WAGN's proposal for the estimated cost of corporate income tax;
- e) The Authority does not approve WAGN's proposal concerning the incentive mechanism carryover; and
- f) The Authority does not approve WAGN's forecast of operating expenditure.

881. As a result of the Authority's decision concerning each building block of total revenue required by rule 76 of the NGR above, the Authority does not approve WAGN's proposed figure of total revenue for the forthcoming access arrangement period.

882. Table 24 below shows the Authority's draft decision values in relation to total revenue. WAGN's values in comparison are shown in Table 28 of the access arrangement information.

**Table 24 Total revenue - Adjusted by the Authority - (\$ million, December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14	Present Value
OPEX	27.819	58.841	58.459	59.381	59.888	221.017
Efficiency Gain	1.744	1.306	0.242	1.821	1.140	5.360
AA2 Over Depreciation	-10.413	-	-	-	-	-10.071
Depreciation	10.945	23.672	25.621	27.526	29.445	97.303
Asset Disposal	-	-	-	-	-	-
Return on Asset	26.507	55.487	56.681	58.334	59.886	214.378
Return on Working Capital	-	-	-	-	-	-
<b>Cost of Service</b>	56.602	139.305	141.004	147.062	150.359	527.986

<sup>1</sup> 1 January 2010 to 30 June 2010 only



### **Draft decision**

883. The Authority does not approve WAGN's proposed values for total revenue for the forthcoming access arrangement period. The Authority concludes that the values should be those in Table 24 of this draft decision.
884. As a consequence of the above and other sections of the draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

## **Reference Tariffs**

### **Requirements of the NGL and the NGR**

885. Rule 48(1)(d)(i) of the NGR provides that a full access arrangement must, amongst other things, specify for each reference service the reference tariff.
886. Division 8 of the NGR (rules 92 to 97) set out requirements with which reference tariffs in a full access arrangement must comply. These requirements include:
- a) a mechanism for variation of a reference tariff over the course of the access arrangement period (rule 92 of the NGR);
  - b) the allocation of total revenue between reference services and other services (rule 93 of the NGR);
  - c) determination of the reference tariffs for distribution pipelines (rule 94 of the NGR);
  - d) the Authority's approval of prudent discounts (rule 96 of the NGR ); and
  - e) the mechanics of reference tariff variation (rule 97 of the NGR).
887. As reference tariffs require the provision of financial information by the service provider, rule 73 of the NGR provides that:
- a) the access arrangement information provided must state the basis (whether it be nominal, real or another recognised basis) on which the information is provided;
  - b) all of the financial information provided must be provided on the same basis; and
  - c) all calculations made in the access arrangement proposal or in the access arrangement information must be made on the same basis.
888. If the access arrangement information is in the form of a forecast or estimate, rule 74 of the NGR provides that it must be supported by a statement of its basis, and must be arrived at on a reasonable basis, and must represent the best forecast or estimate possible in the circumstances.
889. If any of the access arrangement information provided is in the nature of an extrapolation or inference, it must be supported by the primary information on which that extrapolation or inference is based (rule 75 of the NGR).

890. The discussion below is set out as follows:

- Prudent discounts – discusses the Authority’s approval of proposed prudent discounts (rule 96 of the NGR).
- Revenue equalisation requirements - discusses the requirement for the Authority to assess the service provider’s demand forecasts (from which forecast revenue can be determined) and the allocation of total revenue to reference services (rule 92(2) of the NGR).
- Reference tariff variation mechanism – discusses the mechanism for adjustment of tariffs over the access arrangement period (rule 97 of the NGR).
- Determination of Reference tariffs – this discusses the reference tariff structure and level for each tariff class (rule 94 of the NGR).
- Impact on small use customers discusses the impact of reference tariffs on small use customers (rule 94(4)(b)(ii) and regulation 7 of the WA Local Regulations).
- Revenue equalisation calculation – this completes the revenue equalisation requirements (initial part outlined in second dot point above) under rule 92(2) of the NGR. This requires equalisation of forecast revenue from reference services over the access arrangement period in present value terms with the portion of total revenue allocated to reference services for the access arrangement period
- Reference tariff post approval matters - discusses the issues of an incentive mechanism and fixed principles (rules 98 and 99 of the NGR).

## Prudent discounts

### Requirements of the NGL and the NGR

891. Rule 96(1) of the NGR provides that the Authority may, on application by a service provider, approve a discount for a particular user or prospective user or a particular class of users or prospective users.

892. Rule 96(2) provides that the Authority may only approve a discount if satisfied that:

- (a) The discount is necessary to:
  - (i) respond to competition from other providers of pipeline services or other energy providers; or
  - (ii) maintain efficient use of the pipeline; and
- (b) the provision of the discount is likely to lead to reference or equivalent tariffs being lower than they would otherwise have been.

893. If the Authority approves a discount under this rule the Authority may also approve allocation of the cost, or part of the cost, of providing the discount to the costs of providing a reference or other service in one or more future access arrangement periods (rule 96(3) of the NGR).

894. There are no specific access arrangement information requirements in relation to prudent discounts.

### **Access arrangement information**

895. WAGN stated on pages 55-56 of the access arrangement information that rule 96(1) of the NGR allows a service provider to provide, in certain circumstances, a reference service to a particular user or class of users at a discounted reference tariff, and to recover the cost of providing the discount from the provision of reference or other services in one or more future access arrangement periods. WAGN noted that the service provider may only recover the cost of providing the discount if the discount is approved by the Authority.
896. Prudent discounts were approved by the Authority for the current access arrangement period because the regulator was satisfied that the discounts were necessary to respond to competition and the discounts would lead to lower reference tariffs as avoidable costs were covered.
897. WAGN submitted that it is continuing to provide prudent discounts, and will recover the cost of their provision through the revised reference tariffs for the proposed access arrangement period. Table 29 (page 56) of the access arrangement information provides the revenue expected to be received from users in respect of reference services provided at discounted reference tariffs.
898. WAGN noted that it has deducted this revenue from the total revenue before setting the reference tariffs for the proposed access arrangement. WAGN submitted that in calculating the expected revenue from the provision of reference services, WAGN has deducted from its customer numbers forecast the numbers of customers expected to be in receipt of prudent discounts during the forthcoming access arrangement period. Similarly, the forecast volumes of gas expected to be delivered to customers in receipt of prudent discounts has been deducted from the forecast volumes of gas expected to be delivered.

### **Public submissions**

#### *WAGN's submission*

899. WAGN submitted, on pages 117-119 of its submission that prudent discounts have been offered by WAGN since the introduction of the initial access arrangement in recognition of:
- a) the fact that haulage tariffs already in existence may have been based on a different pricing mechanism as established under the Gas Distribution Regulations 1998; and
  - b) to mitigate excessive price shock resulting from one charging mechanism over another.
900. WAGN submitted that during the current access arrangement period, prudent discounts continued to be in place in respect of a number of delivery points mainly receiving reference service A1 but also in more limited circumstances reference service A2. WAGN noted that the discounted tariffs were recognised as prudent discounts in that the revenue received contributed to fixed costs and in the absence of the discounts the reference tariffs would have been higher.

901. WAGN submitted on page 119 that it has adopted a non discriminatory policy on the offering of discount tariffs and that if a request is received to consider a discounted tariff based on physical bypass then the discounted tariff will be made available to any user who enquires about access to the delivery point in question. WAGN noted that the tariff may not be the same in each case because it may vary depending on the assumed load and term of contract but the basis for determining the tariff is the same. WAGN submitted that if the same terms and conditions are sought, then the discounted tariff will be the same.

#### *Other submissions*

902. No other public submissions were received in relation to prudent discounts.

#### **Authority's assessment**

903. The Authority may approve an application by a service provider to provide a discount to a user or prospective user, or a particular class of users or prospective users. However, the Authority can only approve the application if two conditions are satisfied. Firstly, the Authority must be satisfied that the discount is a necessary response to competition from other providers of pipeline services or energy sources, or that it promotes efficient use of the pipeline. Secondly, the Authority must be satisfied that the discount will lead to reference or equivalent tariffs that are lower than they otherwise would have been (rule 96(2)).
904. The Authority has considered WAGN's proposed non-discriminatory policy with respect to discounted tariffs. WAGN has proposed to apply the same principle to deciding prudent discounts but has noted that the actual tariff offered to users may not be the same. The Authority has considered both the public submissions and the confidential information provided by WAGN with respect to prudent discounts.
905. Rule 96(2)(a)(i) of the NGR provides for the use of prudent discounts in response to competition from other providers of pipeline services or providers of other fuels. Alternatively, the Authority under rule 96(2)(a)(ii) of the NGR can approve prudent discounts if it is satisfied that those discounts maintain efficient use of the pipeline. The Authority notes WAGN's submission that where prudent discounts are offered, the non-reference haulage revenue received is greater than the avoidable costs of supply to the end use gas consumer. The Authority accepts that if prudent discounts enable the receipt of non-reference haulage revenue that exceeds the avoidable costs of supply, then this maintains efficient use of the pipeline. The Authority can therefore approve the prudent discounts as promoting efficiency.
906. The Authority must also be satisfied under rule 96(2)(b) of the NGR that the discount will lead to reference or equivalent tariffs that are lower than they otherwise would have been. The Authority notes WAGN's submission that the revenue from the discounted tariffs contributed to fixed costs and that the absence of these discounts would have lead to higher reference tariffs. The Authority accepts WAGN's submission that the prudent use of discounts has directly contributed to lower reference tariffs than may otherwise have been possible on the basis that the costs recovered by WAGN exceed the marginal cost of servicing customers receiving prudent discounts.
907. The Authority notes that there were no public submissions received.
908. The Authority is satisfied that WAGN's proposed prudent discounts meet the requirements of the NGR.

## **Draft decision**

909. The Authority approves WAGN's use of prudent discounts as proposed.

## **Revenue equalisation requirements**

### **Requirements of the NGL and the NGR**

910. Rule 92(1) of the NGR provides that a full access arrangement must include a mechanism for variation of a reference tariff over the course of an access arrangement period.
911. The reference tariff variation mechanism must be designed to equalise (in terms of present value):
- a) forecast revenue from reference services over the access arrangement period; and
  - b) the portion of total revenue allocated to reference services for the access arrangement period;
- (rule 92(2) of the NGR).
912. Rule 92(2) of the NGR requires the Authority to first assess the service provider's demand forecasts (from which forecast revenue can be determined) and secondly the allocation of total revenue to reference services.

## **Demand forecasts**

### **Requirements of the NGL and the NGR**

913. Rule 92(2)(a) of the NGR requires the service provider to provide a forecast of the revenue from reference services for the access arrangement period. In order to determine such revenue it is necessary for the service provider to forecast expected demand for reference services over the access arrangement period.
914. The NGR addresses this by requiring, under rule 72(1)(a)(iii), that the access arrangement information must include usage of the pipeline over the earlier access arrangement period showing, for a distribution pipeline, minimum, maximum and average demand, and customer numbers in total and by tariff class.
915. In relation to forecast demand, the access arrangement information must specify the capacity of the pipeline and, to the extent practicable to forecast utilisation of pipeline capacity over the access arrangement period, a forecast of pipeline capacity and utilisation of pipeline capacity over that period and the basis on which the forecast has been derived (rule 72(1)(d) of the NGR).
916. These forecasts must also comply with the requirements of rule 74 of the NGR..

### **Access arrangement information**

917. WAGN has provided a forecast utilisation of pipeline capacity at pages 17 to 19 of the access arrangement information together with information in relation to that forecast.

918. WAGN stated that the WAGN GDS is a system of non-contiguous gas distribution pipelines and associated facilities located in the Perth metropolitan area and in a number of regional centres in the south west of Western Australia.
919. WAGN noted that discrete distribution pipeline segments, or sub-networks, make up the WAGN GDS. These comprise in excess of 12,000 kilometres of high pressure, medium pressure, medium pressure/low pressure systems and low pressure gas distribution pipelines. Gas is delivered into each of these sub-networks from 15 receipt points immediately downstream of meter stations on the DBNGP and from one receipt point on the Parmelia pipeline.
920. WAGN submitted that as a geographically dispersed system of non-contiguous gas distribution pipelines, operating at different pressures, the WAGN GDS does not have a defined capacity, and making forecasts of system capacity is not practicable. WAGN stated that capacity utilisation can, however, be forecast.
921. Forecasts of volumes of gas delivered by tariff class have been made in Table 17 (page 18) of the access arrangement information. Forecast customer numbers by tariff class have been made in Table 18 (page 18) of the access arrangement information. WAGN engaged economics forecaster National Institute of Economics and Industry Research (**NIEIR**), and Western Australian consultant Economic Consulting Services, to assist with the preparation of the volume and customer numbers forecasts. The reports prepared by these entities were attached to WAGN's confidential submission.
922. WAGN noted that volume forecasts for customers in tariff classes A1, A2 and B1 were developed on an industry basis with industry regression models used to forecast gas use from:
- a) changes in industry outputs in the areas supplied with gas delivered through the WAGN GDS; and
  - b) changes in real gas prices.
923. WAGN noted that forecasts for customers in tariff class B2 were generated from a model in which gas sales were related to gas prices, and to the total output of commercial enterprises in the areas supplied with gas delivered through the WAGN GDS.
924. WAGN finally noted that for tariff class B3, residential gas sales forecasts were generated using a regression model in which average gas sales per customer was related to:
- a) real household disposable income per capita; and
  - b) real residential gas prices.
925. WAGN submitted that there was a need for a weather correction to the volume forecasts based on the long term decline in the number of heating degree days as a result of Perth's warmer winter temperatures. WAGN noted that customers in the different tariff classes are not affected uniformly by temperature change, and that a different temperature correction has been made for each class.
926. WAGN further noted (page 19) that NIEIR took into account in its forecasting an apparent decline in gas usage by residential customers (tariff class B3) attributed to



the efficiency of water and space heating appliances and the continued use of solar-electric hybrid hot water systems.

927. WAGN stated the NIEIR's forecasting models use real gas prices as inputs. WAGN submitted that these prices are expected to change in response to changes in gas demand following the introduction of a national emissions trading scheme, which is expected to occur during the forthcoming access arrangement period. WAGN advised that NIEIR sought to estimate the gas price and usage change consequent on the implementation of an emissions trading scheme. WAGN noted the uncertainty surrounding the scheme but noted that it was stated Government policy and its potential impact has been taken into account.

### **Public submissions**

#### *WAGN's submission*

928. WAGN submitted (page 20) materially the same information as provided in the access arrangement information and added that the WAGN GDS delivers gas to some 608,000 delivery points.
929. Attached to WAGN's confidential submission were reports from Economics Consulting Services and NIEIR and an Asset Management Plan.

#### *Other submissions*

930. No other public submissions were received.

### **Authority's assessment**

931. Demand forecasts affect both the calculation of total revenue, and therefore reference tariffs, and underpin the forecasts for capital and operating expenditure. As regards reference tariffs, overstated demand forecasts will result in the reference tariff being set too low to recover total revenue over the access arrangement period, and vice versa. As regards forecasts for capital and operating expenditure, overstated demand forecasts will likely result in overstated capital and operating expenditure forecasts because the service provider will plan for higher usage and growth on the network and the earlier replacement of assets, and vice versa.

#### *Forecast volumes of gas delivered*

932. The Authority is satisfied that the volume forecasts in relation to A1, A2, B1 and B2 customers meet the requirements of rule 74 of the NGR.
933. As regards B3 customers, WAGN has forecast that the volume per customer will decline between 2007/08 and 2010/11, will further decline from 2010/11 to 2011/12 (at a different rate) and then stabilise over the period from 2011/12 to 2013/14. WAGN's volumes for the period from 2007/08 to 2009/10 were provided on a confidential basis. In Tables 17 and 18 of the access arrangement information WAGN has forecast 17.5GJ per annum per B3 customer for 2010/11 with a decline to 17GJ for annum per B3 customer for 2011/12 and through to 2013/14. WAGN has submitted that this forecast is based on:
- a) Slower economic growth, causing a decline in customer numbers;



- b) More efficient gas appliances, solar hot water government rebates and use of reverse cycle air conditioners for space heating, all causing a decline in volume per customer;
  - c) The implementation of the carbon pollution reduction scheme;
  - d) The impact of a decline in heating degree day figures.
934. WAGN has forecast a significant reduction in estimated aggregate B3 customer throughput over the period from 2010/11 to 2013/14, with a consequent and proportionate increase in the reference tariff for B3 customers.
935. The Authority recognises that all of these factors will influence the volume per B3 customer. However, the Authority notes that:
- a) The forecasts relied on by WAGN were prepared in the shadow of the Global Financial Crisis that occurred in 2008 and extended into 2009. However, the economic conditions which were presumed for the purpose of the forecast for the second half of 2009 and into 2010 have largely been avoided. The market for gas distributed by the WAGN GDS has therefore not been as greatly impacted as was forecast for the first half-year of the forthcoming access arrangement period and the recovery towards a long-term growth trend appears to be more rapid than was forecast;
  - b) The Federal Government announced in April 2010 that its proposed carbon pollution reduction scheme has been deferred until at least 2012 such that the impact of this scheme on gas prices will not occur until at least 2012/13. This will reduce the gas price assumptions used by WAGN's consultants for the period from 2010/2011 to 2012/13;
  - c) The State Government has announced a more rapid phase-in of cost-reflective pricing for a competing source of energy, electricity supplied to residential and commercial small use customers;
  - d) Given the difficulty in forecasting heat degree day figures, particularly over a relatively short 4.5 year period, their impact is likely to be minimal or be overcome by the impact of other more certain and influential factors, such as those discussed immediately above;
  - e) The trough in B3 connections for 2009/10 was not as dramatic as that forecast by WAGN's consultants in April 2009. Therefore, the rapid rise in connections forecast toward 2013/14 might not be supported by pent up demand. It is not clear whether the impact of factors such as market promotion by WAGN and projected retail prices for gas over the period to 2013/14 have been taken into account in relation to this aspect of the forecast.
936. The Authority also notes that the variation in B3 connections, and therefore throughput, can be influenced by WAGN promoting greater usage of gas by existing customers and increased customer connections to gas. WAGN has proposed to significantly increase its marketing budget under the proposed revised access arrangement.
937. The Authority also notes that the data for the 2008 year, which forms the starting point for WAGN's forecast for the forthcoming access arrangement period is not

typical by reason of the impact of the Varanus Island incident which occurred in June 2008.

938. Given these factors the Authority is not satisfied that WAGN's forecast of volumes of gas delivered to B3 customers has a reasonable basis or is the best forecast in the circumstances (rule 74 of the NGR).
939. The Authority has concluded that there is a preferable alternative which complies with the requirements of rule 74 (rule 40(3) of the NGR). This alternative forecast has a reasonable basis and is, in the circumstances, a better forecast (rule 74 of the NGR). That alternative is to use the data as to volumes of gas delivered to B3 customers that is contained in WAGN's 2007 and 2008 tariff variation reports and to average that data.
940. The average volume of gas delivered to B3 customers over the 2007 and 2008 years (from the data in WAGN's tariff variation reports) is 19.0GJ per annum per B3 customer. The Authority considers that a reduction should be made to this average value. The Authority's view is that 18.5GJ per annum per B3 customer is a reasonable estimate for the forthcoming access arrangement period. Therefore, for the purpose of this draft decision, the Authority has assumed that 18.5GJ of gas is delivered to each B3 customer for each year of the forthcoming access arrangement period.
941. Table 25 below shows the Authority's draft decision values in relation to forecast volumes of gas delivered to B3 customers. WAGN's values in comparison are shown in Table 17 of the access arrangement information.

**Table 25 Forecast total volume of gas (TJ) delivered to B3 customers per annum - Adjusted by the Authority**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
Tariff Class B3	4,842	11,296	11,568	11,871	12,206

<sup>1</sup> 1 January 2010 to 30 June 2010 only

942. The Authority notes that WAGN's forecast volumes and customer numbers relied on throughput and connection data up to the end of March 2009. Additional data for the 15 months from April 2009 to the end of June 2010 will soon be available. During that 15 month period there has been considerable flux in economic conditions and expectations. Access to the additional data to the end of June 2010 will allow the first half-year of the forthcoming access arrangement period to be evaluated on actuals and the forecasts for the remainder of the forthcoming access arrangement period to be based on those actuals and a contemporary assessment of unfolding economic and financial circumstances effecting the WA economy and the demand for gas haulage services.
943. The Authority requires WAGN's forecast volumes to be updated following the publication of this draft decision.

#### *Forecast customer numbers*

944. The Authority has noted above some concerns in relation to WAGN's forecasts of customer numbers by tariff class. However, the Authority considers that these forecasts are sufficient for the purpose of this draft decision.

945. The Authority will require WAGN's forecast customer numbers to be updated following the publication of this draft decision to incorporate the most recent data.

#### **Draft decision**

946. The Authority approves WAGN's forecast volumes of gas delivered to A1, A2, B1 and B2 customers.
947. The Authority does not approve WAGN's forecast volumes of gas delivered to B3 customers. For the purpose of the draft decision the Authority has assumed a forecast volume of 18.5 GJ for each B3 customer.
948. The Authority approves WAGN's forecast customer numbers by tariff class for the purpose of this draft decision.
949. The Authority requires WAGN to provide updated information on forecast volumes and customer numbers, as discussed above, following publication of the draft decision.
950. As a consequence of the above and other sections of this draft decision relevant to the determination of reference tariffs the Authority requires an amendment to WAGN's proposed reference tariffs as set out in Required Amendment 8.

### ***Allocation of total revenue and costs***

#### **Requirements of the NGL and the NGR**

951. Rule 92(2)(b) of the NGR requires the service provider to provide the portion of total revenue allocated to reference services for the access arrangement period.
952. Rule 93(1) of the NGR provides that total revenue is to be allocated between reference and other services in the ratio in which costs are allocated between reference and other services.
953. Rule 93(2) of the NGR provides that costs are to be allocated between reference services and other services as follows:
- a) costs directly attributable to reference services are to be allocated to those services; and
  - b) costs directly attributable to pipeline services that are not reference services are to be allocated to those services; and
  - c) costs other than costs directly attributable to reference services or other pipeline services, or costs of rebateable services approved to be allocated to reference services, are to be allocated between reference and other services on a basis determined or approved by the Authority.
954. The basis for allocation of these costs must be consistent with the revenue and pricing principles (section 24 of the NGL).
955. Rule 93(3) of the NGR provides that the Authority can permit the allocation of the costs of rebateable services, in whole or in part, to reference services if;

- a) the Authority is satisfied that the service provider will apply an appropriate portion of the revenue generated from the sale of rebateable services to provide price rebates (or refunds) to the users of reference services; and
- b) any other conditions determined by the Authority are satisfied.

956. Rule 93(4) provides that a pipeline service is a rebateable service if:

- a) the service is not a reference service;
- b) substantial uncertainty exists concerning the extent of demand for the service or of the revenue to be generated from the service; and
- c) the market for the service is substantially different from the market for any reference service.

957. There are no specific access arrangement information requirements in relation to the allocation of total revenue.

### **Access arrangement information**

958. WAGN stated at page 55 of the access arrangement information that it does not provide services other than reference services using the WAGN GDS and that all total revenue during the forthcoming access arrangement period has been attributed to the provision of the reference services.

959. WAGN noted at page 55 of the access arrangement information that it offer ancillary services as part of the reference services. However, WAGN stated that the costs associated with these ancillary services have not been included in the calculation of total revenue.

### **Public submissions**

#### *WAGN's submission*

960. WAGN provided materially the same information in its submission on page 117 as provided in the access arrangement information.

#### *Other submissions*

961. No other public submissions were received.

### **Authority's assessment**

962. The Authority notes that under WAGN's proposal total revenue during the forthcoming access arrangement period has been allocated to the provision of reference services apart from the costs and revenue from ancillary services.

963. In this draft decision the Authority has concluded that the forecast operating expenditure incurred in providing the ancillary services must be included in the total cost of providing the reference services. Further, WAGN has not provided these forecasts, and for the purpose of the final decision, WAGN must provide such forecasts which will be included in total revenue.

964. The Authority, however, has been provided with historical revenue, cost and volume information confidentially by WAGN regarding ancillary services. Further, WAGN has proposed that it continues to charge stand alone fees for the provision of each such services (as set out in Annexure C to the Template Haulage Contract). WAGN has submitted that these charges broadly reflect the operating expense incurred in providing these ancillary services. In the circumstances, and subject to substantiation prior to the final decision, the Authority considers it appropriate to proceed on the basis that the operating expense of providing ancillary services as a proportion of total revenue should be allocated directly to the ancillary services, with the consequence that the balance of the total revenue will be recovered through the reference tariffs and any approved prudent discounts. Table 29 below shows the Authority assumed values for Ancillary Services Revenue.

**Table 26 Forecast Ancillary Services Revenue (\$M, December 2009) – Adjusted by the Authority**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14
Ancillary Services' Revenue	0.385	0.770	0.770	0.770	0.770

<sup>1</sup> 1 January 2010 to 30 June 2010 only

965. The Authority notes and accepts WAGN's further submission that there are no pipeline services offered which are non-reference services so that the entirety of the forecast costs which make up total revenue are to be allocated to reference services as outlined above.

#### **Draft decision**

966. The Authority accepts WAGN's proposal with respect to the allocation of total revenue to the reference services.

967. The Authority considers that the forecast operating expenditure incurred for ancillary services will be allocated fully to those services and recovered through stand alone charges for each such service as a component of the reference tariffs.

## **Reference tariff variation mechanism**

### **Requirements of the NGL and the NGR**

968. Rule 97(1) of the NGR provides that a reference tariff variation mechanism may provide for variation of a reference tariff:

- a) in accordance with a schedule of fixed tariffs; or
- b) in accordance with a formula set out in the access arrangement; or
- c) as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax); or
- d) by the combined operation of 2 or more of the above.

969. Under rule 97(3) of the NGR, in deciding whether a particular reference tariff variation mechanism is appropriate to a particular access arrangement, the Authority must have regard to:

- a) the need for efficient tariff structures;
  - b) the possible effects of the reference tariff variation mechanism on administrative costs of the Authority, the service provider, and user and potential users;
  - c) the regulatory arrangements (if any) applicable to the relevant reference service before the commencement of the proposed reference tariff variation mechanism;
  - d) the desirability of consistency between regulatory arrangements for similar service (both within and beyond the relevant jurisdiction); and
  - e) any other relevant factor.
970. A reference tariff variation mechanism must give the Authority adequate oversight or powers of approval over variation of the reference tariff (rule 97(4) of the NGR).
971. Except as provided by a reference tariff variation mechanism, a reference tariff is not to vary during the course of an access arrangement period (rule 97(5) of the NGR).
972. The access arrangement information setting out the approach to setting prices must specify the costs that are to be directly passed through to prices and a demonstration of the proposed pass through clause (rule 72(1)(j)(ii) of the NGR). The access arrangement information must also include the reference tariff variation mechanism proposed and the justification for that mechanism (rule 72(1)(k) of the NGR).
973. The access arrangement information must also contain the information necessary to understand the basis and derivation of the service provider's proposal in respect of the reference tariff variation mechanism (rule 42 of the NGR).
974. As the reference tariff variation mechanism requires the provision of financial information by the service provider, rule 73 of the NGR provides that:
- a) the access arrangement information provided must state the basis (whether it be nominal, real or another recognised basis) on which the information is provided;
  - b) all of the financial information provided must be provided on the same basis; and
  - c) all calculations made in the access arrangement proposal or in the access arrangement information must be made on the same basis.
975. If any of the access arrangement information provided is in the nature of an extrapolation or inference, it must be supported by the primary information on which that extrapolation or inference is based (rule 75 of the NGR).



## ***Reference tariff variation in accordance with formula***

### **Requirements of the NGL and the NGR**

976. Rule 97(1)(a) of the NGR provides that a reference tariff variation mechanism may provide for variation of a reference tariff in accordance with a formula set out in the access arrangement.
977. Rule 97(2) of the NGR provides that a formula for variation of a reference tariff may (for example) provide for:
- a) variable caps of the revenue to be derived from a particular combination of reference services;
  - b) tariff basket price control;
  - c) revenue yield control; or
  - d) a combination of all or any of the above.
978. Rule 97(3) requires the Authority to have regard to a number of factors in determining whether a particular reference tariff variation mechanism is appropriate to a particular access arrangement.

### **Access arrangement proposal**

979. In relation to rule 97(2) of the NGR, WAGN has proposed a price path in which the reference tariffs are set and vary with a formula where WAGN bears the risk for variations in volume over the forthcoming access arrangement period. This means that if volumes vary from the forecasts, reference service revenue will be different from that forecasted.
980. For the period 1 January 2010 to 31 December 2010 the reference tariffs remain the same as at 31 December 2009 WAGN has proposed initial reference tariffs to apply from 1 January 2011 to 30 June 2011. These initial reference tariffs are set out in Annexure A, pages 27 to 31, of the proposed access arrangement which sets out the tariffs for haulage services A1, A2, B1, B2 and B3.
981. The price path is then established by clause 1(a) of Annexure B to the proposed access arrangement which provides for variation of the reference tariffs in accordance with the formula set out in clause 2 of Annexure B. This formula varies over the period of the proposed access arrangement.
982. Clause 2.1 of Annexure B of the proposed access arrangement enables WAGN to vary any haulage tariff by varying one or more tariff components of that haulage tariff during a variation period in accordance with clause 2.
983. Clause 2.6 of Annexure B of the proposed access arrangement provides that if WAGN varies the applicable haulage tariff in accordance with clauses 2.2 to 2.5 because there are differences between actual regulatory capital expenditure and forecast regulatory capital expenditure, the conforming capital expenditure added to the opening capital for the forthcoming access arrangement period shall be adjusted for the forecast depreciation on the differences between the actual regulatory capital expenditure and forecast of regulatory capital expenditure during the forthcoming access arrangement period.



984. Clause 2.7 of Annexure B sets out alternative indexes to the use of CPI (All Groups, Perth) in the event that the Australian Bureau of Statistics ceases to publish quarterly figures for Perth.
985. Clause 4 of Annexure B of the proposed access arrangement requires WAGN to use its reasonable endeavours to give the Authority a variation report at least 30 business days before the date on which the haulage tariff is to be varied, and sets out the information that the report will contain.

### **Access arrangement information**

986. WAGN provided at pages 49-50 of the access arrangement information that the reference tariffs set out in the proposed access arrangement information are in real, December 2009 dollar values and that they must be periodically varied for the effects of inflation during the forthcoming access arrangement period if WAGN is to have the opportunity of recovering its efficient costs of providing reference services.
987. WAGN noted that the proposed access arrangement therefore includes a reference tariff variation mechanism which varies the tariffs, set out in Table 26 (page 47) of the access arrangement information, for the effects of inflation from December 2009 to each of the dates on which varied tariffs are to come into effect.

### **Public submissions**

#### *WAGN's submission – Reference tariff variation in accordance with formula*

988. WAGN submitted at pages 146-149 of its submission that the variation of the reference tariffs for the effects of inflation is effected through formulae set out in Annexure B applying the measure of inflation using the CPI (All Groups, Perth).
989. WAGN submitted that the formulae set out in Annexure B of the proposed access arrangement progressively vary the reference tariffs for 1 January 2011 so that the standing charges are partially adjusted toward the corresponding long run marginal costs during the access arrangement period.
990. WAGN set out on page 146 of its submission the adjustments which apply not only to the standing charges but also to the other charging parameters. These are:
- a) From 1 July 2011, the charging parameters of Tariff A1, Tariff A2, Tariff B1 and Tariff B2 are increased by 5 per cent to partially adjust them toward the first tariff estimates. The charging parameters of Tariff B3 are increased by 4 per cent.
  - b) From 1 July 2012, the charging parameters of Tariff A1, Tariff A2, Tariff B1 and Tariff B2 are further increased by 5per cent to partially adjust them toward the first tariff estimates. The charging parameters of Tariff B3 are increased by 7per cent.
  - c) From 1 July 2013, the charging parameters of Tariff A1, Tariff A2, Tariff B1 and Tariff B2 are again increased by 5per cent to partially adjust them toward the first tariff estimates. The charging parameters of Tariff B3 are increased by 7per cent.
991. WAGN submitted that the formulae of the tariff variation mechanism enable WAGN to recover certain costs which are beyond control, and which could not be predicted

with any great certainty prior to the time the revisions to the access arrangement were approved. WAGN submitted on page 147 that the two principal types of costs which can be recovered through the operation of the formulae are:

- a) Unanticipated increases in regulatory costs; and
- b) The additional costs which arise from unanticipated increases in the price of gas purchased to replace unaccounted for gas.

*WAGN's submission – Requirements of rule 97(3)*

- 992. WAGN submitted on page 149, that the reference tariff variation mechanism of Annexure B does not change the structure of the tariffs for the reference services provided using the WAGN GDS. WAGN stated that the structure of those tariffs is determined in accordance with the provisions of rule 94, which require that consideration be given to economic efficiency.
- 993. WAGN submitted that the reference tariff variation mechanism does not substantially change the procedures previously followed by WAGN and by the Authority in varying the reference tariffs for the WAGN GDS, and should not change the procedures followed by users and potential users in responding to tariff changes. WAGN noted that the mechanism introduces a further step into the scheme of tariff variation which previously applied: variation of the reference tariffs at the commencement of a new access arrangement period to allow for inflation and for recovery of additional regulatory costs incurred in the last year of the previous access arrangement period. WAGN submitted that this should not significantly increase administrative costs and that WAGN will incur the relatively small costs of determining and promulgating the change through issue of a variation report, and amendment of its tariff review. WAGN stated that users are not expected to incur additional administrative costs.
- 994. WAGN submitted that the reference tariff variation mechanism of Annexure B does not change the form of the regulatory arrangements previously applicable to the reference services provided using the WAGN GDS, it only extends the operation of those arrangements to cover a number of gaps in their application.
- 995. WAGN submitted that in Western Australia, there is no other provider of services similar to the reference services provided by WAGN using the WAGN GDS and that there is therefore, no issue of consistency between the reference tariff variation mechanism and regulatory arrangements for similar services.

*The Office of Energy's submission*

- 996. The Office of Energy, in the Attachment to its submission dated 12 April 2010 (page 3), expressed its concern with the proposed reference tariff variation mechanism for unanticipated capital and operating expenditure. While the Office of Energy recognised that such an approach will reduce the business risk to WAGN and encourage it to invest in the network and gate station infrastructure, it reduces the discipline on the organisation to manage its risks and to accurately forecast its costs.
- 997. The Office of Energy expressed the view that unaccounted for gas is a risk generally outside of the control of the network providers and could be considered as part of the reference tariff variation mechanism. There is however scope for the

Authority to require detailed and verified forecasts from WAGN surrounding the price and quantity of unaccounted for gas.

998. The Office of Energy further submitted that it is also concerned that the proposed reference tariff variation mechanism appears to only contemplate tariff increase but does not cater for reference tariff adjustments that reduce tariffs. An equitable mechanism could cater for decreases as well as increases.
999. The Office of Energy submitted that it would like the Authority to consider whether there is a need to go as far as including unexpected capital and operating expenditure in an annual tariff adjustment in order to encourage network investment. There may be more efficient and effective mechanisms than this risk averse approach, for example by pre-approval by the Authority of investment proposals.

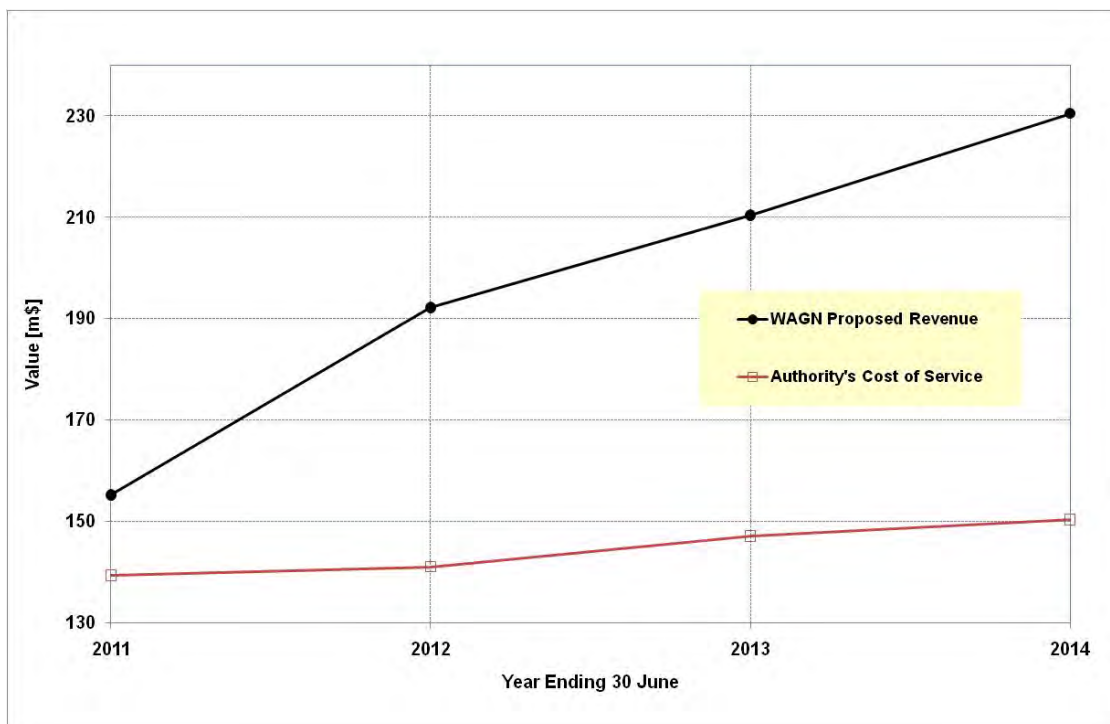
#### *Other submissions*

1000. No other public submissions were received in relation to reference tariff variation in accordance with formula.

#### **Authority's assessment**

1001. The Authority considers it preferable, wherever practicable, to determine reference tariffs with a smooth tariff path, including between access arrangements, rather than a tariff path which has significant and sudden changes in tariffs.
1002. The Authority notes that WAGN proposed an annual escalation of reference tariffs by up to 7 per cent from July 2011.
1003. The Authority also notes the comments in the Alinta and Synergy submissions, supporting a glide path approach rather than the significant step change approach proposed by WAGN.
1004. The Authority has decided, for the reasons set out in this decision, that the total revenue requirement for reference tariffs (cost of service) should be lower than that proposed by WAGN.
1005. WAGN's proposed reference tariff revenue exceeds the Authority's forecast cost of service in this draft decision for each year in the forthcoming access arrangement. Figure 9 illustrates the Authority's forecast cost of service path in comparison with WAGN's proposed total revenue from reference tariffs.

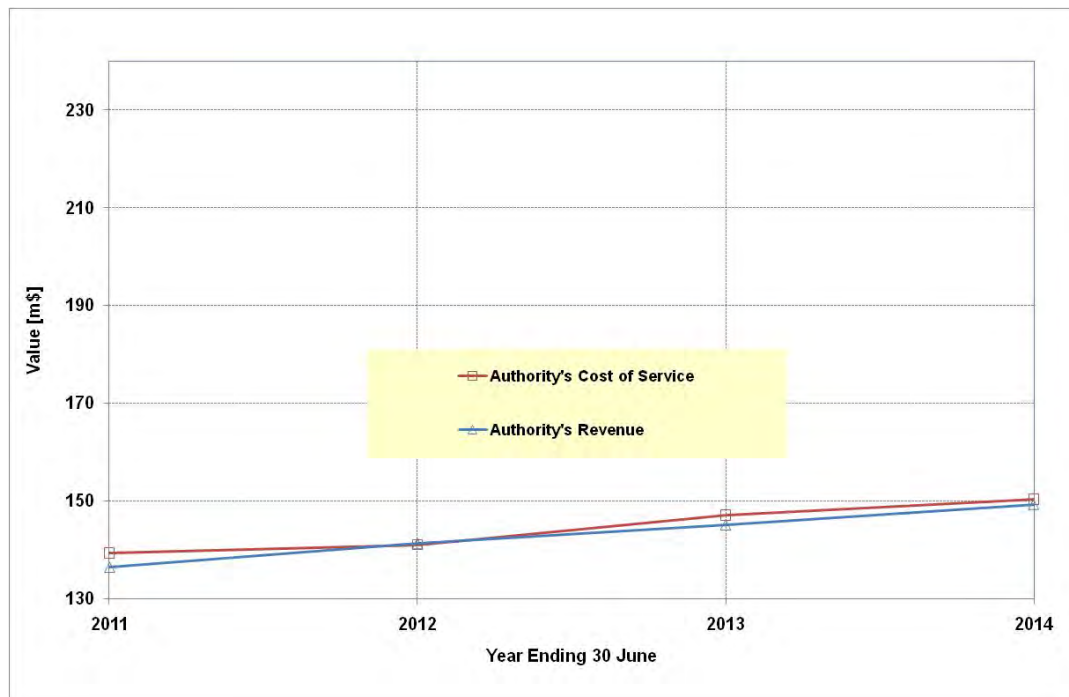
**Figure 9.** WAGN's proposed reference tariff revenue and the Authority's cost of service (\$ million, real dollars as at December 2009)



1006. Due to the reduction in the total revenue requirement determined by the Authority in this draft decision the revenue to be recovered from reference services is reduced. As a consequence, the level of reference tariffs over the forthcoming access arrangement period will also be reduced.

1007. The Authority has determined, based on its considerations under this draft decision, an appropriate tariff path based on an adjustment of reference tariffs on 1 January 2011 and the reference tariffs subsequently remaining constant in real terms.

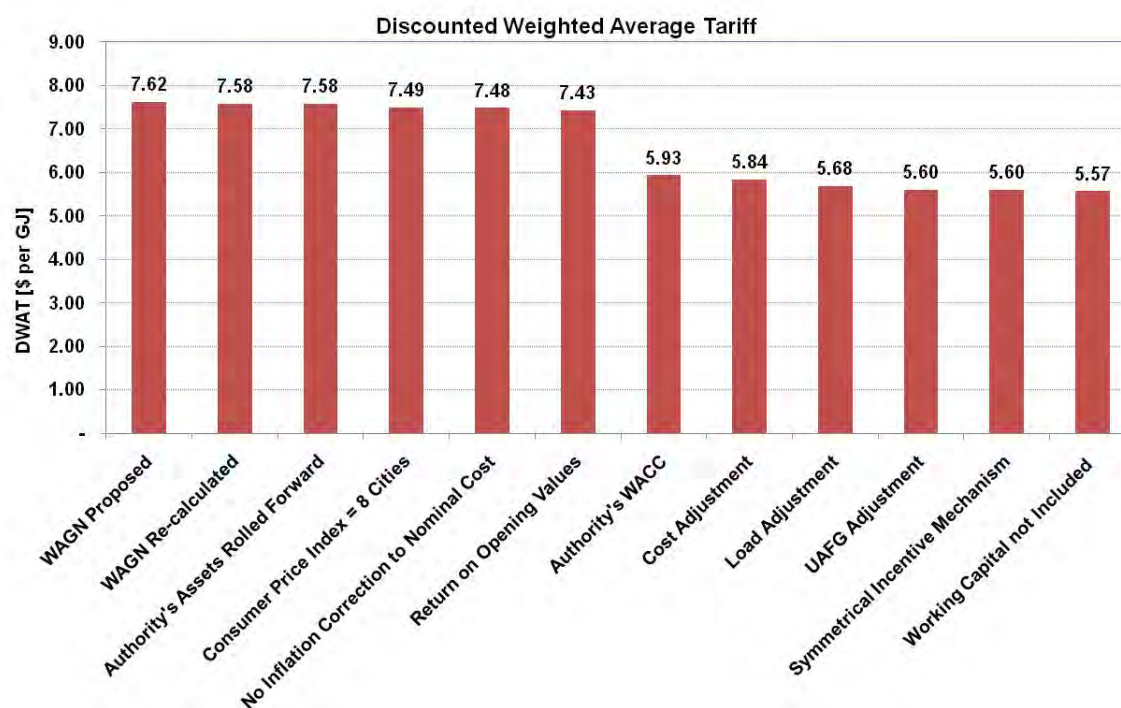
**Figure 10. Authority's cost of service and reference tariff revenue (\$ million, real dollars as at December 2009)**



1008. Figure 10 shows the Authority's reference tariff revenue and cost of service paths over the forthcoming access arrangement period. The Authority's cost of service is the same as that illustrated in Figure 9 and the reference tariff revenue reflects the Authority's tariff path (set out in Table 27) and the Authority's volume forecasts.

1009. A summary of the changes the Authority has made to the WAGN's proposal is shown in Figure 11 below on the basis of the Discounted Weighted Average Tariff (DWAT). DWAT is a measure of cost of energy transported through the distribution system paid by users and it enables a comparison of different costs over time.

1010. Figure 11 shows that WAGN's proposal was for a DWAT of \$7.62/GJ. The Authority's adjustments to WAGN's proposal based on the determinations for key tariff related elements of this draft decision are shown in Figure 11 below resulting in a final DWAT of \$5.57/GJ. This figure shows that the determination with the most significant impact is the WACC which the Authority has determined to be 6.89 per cent (real pre-tax) whereas WAGN has proposed 11.1 per cent (real pre-tax).

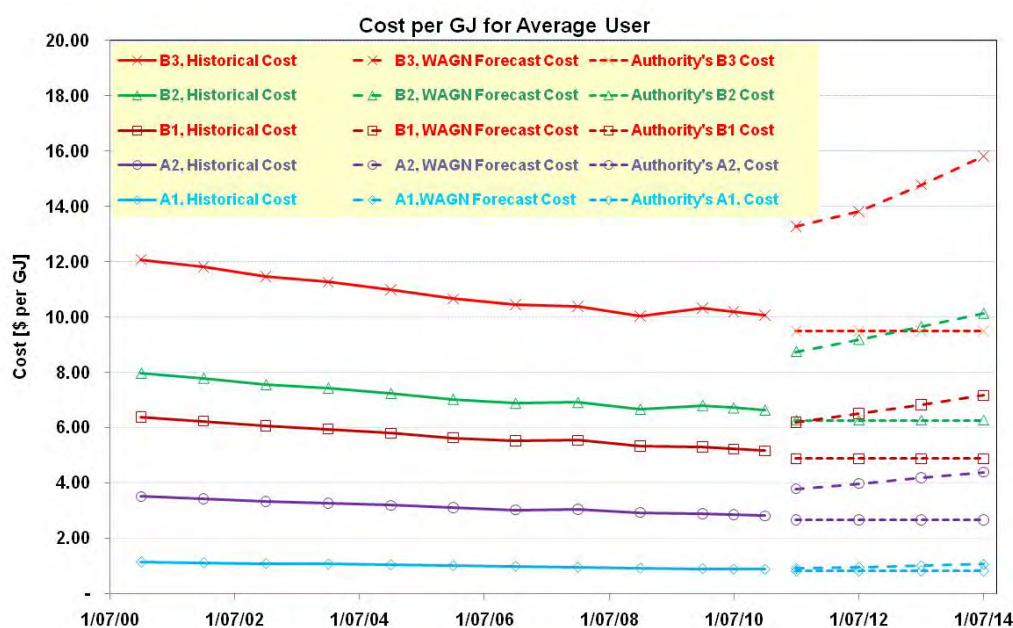
**Figure 11. Discounted weighted average tariff**

1011. As shown in Figure 11 the most significant differences between the DWAT proposed by WAGN and the DWAT determined by the Authority result from the Authority's adjustments in the consumer price index; WACC; cost; load; and UAFG. These items are discussed below.

- Consumer price index – The Authority's requirement to use eight cities CPI to roll forward the capital base rather than WAGN's proposal to use Perth CPI results in a reduction in the DWAT from \$7.58 to \$7.49 per GJ.
- WACC – The Authority has adopted a WACC of 6.89 per cent pre-tax real rather than WAGN's proposed WACC of 11.1 per cent pre-tax real. This is the most significant factor reducing the DWAT value and results in the DWAT reducing from \$7.43 to \$5.93 per GJ.
- Cost adjustment – The Authority has not accepted WAGN's claim for one off costs in the period January to 30 June 2010 incurred as a result of the delayed implementation of the NGL and the NGR in Western Australia and the consequential delay in the change in the level of reference tariffs. This results in the DWAT reducing from \$5.93 to \$5.84 per GJ.
- Load adjustment – WAGN has proposed a significant reduction in the average volume of gas used by about 600,000 B3 customers. The Authority has accepted a smaller reduction in this average volume than proposed by WAGN. This results in the DWAT reducing from \$5.84 to \$5.68 per GJ.
- UAFG adjustment – The Authority has accepted a smaller volume for Unaccounted for Gas (UAFG) than proposed by WAGN. This results in the DWAT reducing from \$5.68 to \$5.60 per GJ.

1012. The Authority has set out in Figure 12 below a graph showing the historic and forecast cost per GJ for the average user of each tariff class. The forecast cost per GJ for the forthcoming access arrangement shows WAGN's proposed tariff path and the tariff path determined by the Authority for each tariff class.



**Figure 12. Historic and forecast cost per GJ for the Average User of each tariff class**

### Tariff variation formula

1013. The Authority notes that WAGN has proposed a complex tariff variation formula to produce its proposed tariff path. This proposed tariff path includes a modelled path in addition to adjustments for several categories of unforeseen capital and operating cost variations. Discussion on relevant elements of WAGN's proposed variation formula is set out below.

### Inflation

1014. The Authority considers WAGN's proposed financial model in real terms as at 31 December 2009 to be appropriate, subject to an adjustment to the way in which inflation is calculated. As previously set out in this draft decision, the Authority does not approve WAGN's proposed use of CPI (All Groups, Perth) at the mid-point of each modelling period and requires the use of CPI (All Groups, Eight Capital Cities) at the end point of each modelling period. Therefore tariffs need to be set to account for inflation by adjusting the real tariffs modelled, using 31 December 2009 dollars, by applying the Authority's above approach.

### Regulatory operating costs

1015. The Authority considers it appropriate to allow a cost pass through of unanticipated regulatory operating costs in a similar manner to the variation mechanism set out under the current access arrangement.

1016. However, the Authority notes that WAGN's proposed tariff variation mechanism for the July 2011 adjustment includes an adjustment for 2009 regulatory operating costs. The Authority notes that these costs relate to the final year of the current access arrangement and are not supported by any argument in WAGN's proposal showing how incorporation of such costs are consistent with the requirements of the NGL and NGR. Therefore the Authority considers that these costs should not be included in WAGN's proposed tariff variation mechanism.



*Regulatory capital costs*

1017. WAGN has proposed the inclusion of unanticipated regulatory capital expenditure in the tariff variation mechanism. The Authority does not consider the inclusion of these costs to be appropriate on the basis that the inclusion of such costs in a tariff variation mechanism is not consistent with the NGL and NGR. The Authority notes any such conforming capital expenditure would be rolled into the capital base at the next revision of the access arrangement. In addition, WAGN also has the option of either seeking pre-approval for this expenditure or resubmitting a revised access arrangement at any time during the forthcoming access arrangement.

**Draft decision**

1018. The Authority does not approve WAGN's proposed tariff variation mechanism.
1019. The Authority requires WAGN to amend its proposed tariff variation mechanism to conform with the Authority's required changes as set out in Required Amendment 7.
1020. The Authority has set out in Appendix 1 a modified version of WAGN's proposed tariff variation mechanism which incorporates the changes required by the Authority as set out in Amendment 8.

***Reference tariff variation as a result of cost pass through*****Requirements of the NGL and the NGR**

1021. Rule 97(1) of the NGR provides that a reference tariff variation mechanism may provide for variation of a reference tariff as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax).

**Access arrangement proposal**

1022. Clause 1(b) of Annexure B in the proposed access arrangement provides for variation of the reference tariffs as a result of the cost pass through for a defined event as set out in clause 3 of Annexure B.
1023. Clause 3.1 of Annexure B of the proposed access arrangement lists the cost pass through events. These are:
- a) WAGN incurs HHV costs that constitute conforming capital expenditure or conforming operating expenditure;
  - b) WAGN incurs physical gate point costs that constitute conforming capital expenditure or conforming operating expenditure;
  - c) WAGN incurs conforming capital expenditure or conforming operating expenditure as a result of, or in connection with, a tax change or regulatory change;
  - d) WAGN incurs conforming capital expenditure or conforming operating expenditure as a result of, or in connection with, any law concerning emissions trading or renewable energy.
  - e) WAGN incurs conforming operating expenditure additional to the amount forecast for the purposes of determining total revenue for the current access

arrangement period because there has been an unanticipated change in the price of gas required to replace unaccounted for gas.

1024. Clause 3.2 of Annexure B provides that if a cost pass through event occurs, WAGN:

- a) Must notify the Authority of the relevant event; and
- b) May vary one or more haulage tariffs to recover any costs incurred or forecast to be incurred by WAGN as a direct or indirect result of the relevant event, provided that those costs have not already been recovered by WAGN.

1025. Clause 3.3 of Annexure B provides that if WAGN varies a haulage tariff in accordance with clause 3.2, the costs referred to in clause 3.2(ii) will be:

- a) Added to the opening base for the forthcoming access arrangement period, after adjustment for any depreciation during the forthcoming access arrangement period, if they are conforming capital expenditure; and
- b) Added to total revenue from the commencement of the forthcoming access arrangement period if they are conforming operating expenditure.

1026. Clause 4 of Annexure B of the proposed access arrangement requires WAGN to use its reasonable endeavours to give the Authority a variation report at least 30 business days before the date on which the haulage tariff is to be varied.

### **Access arrangement information**

1027. WAGN provided, at pages 50-51 of the access arrangement information, details concerning the reference tariff variation as a result of cost pass through. The information provided is materially the same as that in the proposed access arrangement.

### **Public submissions**

#### *WAGN's submission – Reference tariff variation as a result of cost pass through*

1028. WAGN submitted at pages 201-202 of its submission that the reference tariff variation mechanism continues and extends the scheme of tariff variation for defined cost pass through events included in the current access arrangement. WAGN again listed the specific events which give rise to costs which can be recovered through tariff variation for cost pass through and detailed above.

### **Authority's assessment**

1029. In its 2005 draft decision, the Authority considered AGN's proposal for it to pass through regulatory costs which it defined in schedule 2 to part A as costs associated with the submission and approval of the access arrangement, and "AGN's compliance with the Act, Code, its Distribution Licences, the *Energy Coordination Act 1994*, the *Gas Standards Act 1972*, the *Energy Operators (Powers) Act 1979*, *Environmental Protection Act 1986* and all other applicable laws." The Authority notes that in its 2005 draft decision, it required an amendment to the formula for the pass through mechanism but approved the definition of regulatory costs.

1030. In its 2005 final decision, the Authority noted that AGN had accepted its requirement to amend the R factor formula. AGN had worked with the Authority to determine a

formula that enabled the capture of variances of regulatory costs forecast by way of the annual adjustment of reference tariffs.

1031. The Authority notes WAGN's submission that its proposal in this access arrangement continues and extends the tariff variation for defined cost pass through events in the current access arrangement. The requirements of the Code and NGR are different so it is not possible for the Authority simply to approve a proposal on the basis that it was approved under the Code. The Authority is required to reassess WAGN's proposed costs pass through mechanism in light of the requirements set out in the NGR.
1032. Rule 97(1)(c) of the NGR allows a reference tariff variation mechanism that may provide for a reference tariff variation as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax). Clause 3.1 sets out the events that WAGN will consider a cost pass through event. If a cost pass through event occurs, the procedure WAGN will follow is set out in clause 3.2. Clause 3.3 sets out that, if a variation occurs in accordance with clause 3.2, the costs referred to in clause 3.2(ii) will become a part of the opening capital base if conforming capital expenditure, or total revenue if conforming operating expenditure for the next access arrangement period.
1033. The Authority notes that WAGN has proposed in clause 3.1(iv)(A) that a cost pass through event will occur if WAGN incurs conforming capital or operating expenditure as a result of, or in connection with, any law that establishes, changes or regulates the operation of an emissions trading scheme. In considering WAGN's cost pass through proposal in relation to an emissions trading scheme, the Authority must consider both the national gas objective set out in section 23 and the relevant revenue and pricing principles set out in section 24 of the NGL. The relevant revenue and pricing principles include compliance with a 'regulatory obligation or requirement', the definition for which is found in section 6.
1034. The Authority's view is that it would not be appropriate to include arrangements for an emissions trading scheme (clause 3.1(iv)(A)) or a tax on greenhouse gas emissions (clause 3.1(iv)(B)) as a cost pass through event for WAGN until the particulars of such a scheme have been clarified through legislation. The Authority notes that there is considerable uncertainty about whether such legislation may come into effect during the term of the forthcoming access arrangement. The Authority also notes that WAGN can resubmit a revised access arrangement at any time during the course of the forthcoming access arrangement period.
1035. The Authority cannot approve a reference tariff variation mechanism, including by way of a cost pass through, unless it has considered the factors in rule 97(3) of the NGR. The Authority does not consider that there is any material inconsistency between WAGN's proposal with respect to the proposed cost pass through and those factors the Authority must have regard to pursuant to rule 97(3) of the NGR.
1036. In relation to clause 3.1(v) of Annexure B, relating to costs of unaccounted for gas (UAFG), the Authority does not consider the inclusion of these costs as a cost pass through event on the basis that these costs have been included in WAGN's proposal based on its tender information. The Authority notes that there are two elements to the issue of the costs for UAFG. In regard to the first issue relating to the price of UAFG, the Authority considers that this matter is adequately dealt with in WAGN's proposal based on the Authority accepting WAGN's tender price for UAFG. In regard to the second issue relating to the volume the Authority considers that WAGN is best placed to manage the risk of UAFG volumes differing from

forecast volumes. Therefore the Authority does not consider the need for any additional provision for UAFG costs to be necessary. As noted above WAGN can resubmit a revised access arrangement at any time during the course of the forthcoming access arrangement period.

1037. The Authority notes that under WAGN's proposal the cost pass through events would have no impact on tariffs for the forthcoming access arrangement period on the basis that under section 3.3 of Annexure B it is proposed that any costs associated with these events would be incorporated into tariffs for the access arrangement following the forthcoming access arrangement (2014-2019).

### **Draft decision**

1038. The Authority requires that clauses 3.1(iv)(A) and (B) and 3.1(v) of Annexure B be deleted.
1039. The Authority otherwise approves, based on its understanding that the cost pass through events set out under clause 3.1 of Annexure B are not intended to affect tariffs during the forthcoming access arrangement period, the provisions made for cost pass through events set out in clause 3 of Annexure B to the proposed access arrangement.

#### **Required Amendment 7**

The Authority requires clauses 3.1(iv)(A) and (B) and 3.1(v) of Annexure B of the proposed access arrangement to be deleted.

## **Determination of Reference Tariffs**

### **Requirements of the NGL and the NGR**

1040. Rule 94(1) of the NGR provides that for the purpose of determining reference tariffs, customers for reference services provided by means of a distribution pipeline must be divided into tariff classes.
1041. Rule 94(2) of the NGR provides that a tariff class must be constituted with regard to:
- a) the need to group customers for reference services together on an economically efficient basis; and
  - b) the need to avoid unnecessary transaction costs.
1042. Rule 94(3) of the NGR provides that for each tariff class the revenue expected to be recovered should lie on or between:
- a) an upper bound representing the stand alone cost of providing the reference service to customers who belong to that class; and
  - b) a lower bound representing the avoidable cost of not providing the reference service to those customers.
1043. Rule 94(4) of the NGR provides that a tariff, and if it consists of 2 or more charging parameters, each charging parameter for a tariff class:

- a) must take into account the long run marginal cost for the reference service or, in the case of a charging parameter, for the element of the service to which the charging parameter relates;
- b) must be determined having regard to:
  - i) transaction costs associated with the tariff or each charging parameter; and
  - ii) whether customers belonging to the relevant tariff class are able or likely to respond to price signals.

1044. Rule 94(5) of the NGR provides that if, as a result of the operation of sub-rule 94(4) of the NGR, the service provider may not recover the expected revenue, the tariffs must be adjusted to ensure recovery of expected revenue with minimum distortion to efficient patterns of consumption.

1045. The access arrangement information must specify the basis on which reference tariffs have been determined, including the method used to allocate costs and a demonstration of the relationship between costs and tariffs (rule 72(1)(j)(i)).

### **Access arrangement proposal**

1046. Annexure A, pages 27 to 31, of the proposed access arrangement sets out the tariffs for haulage services A1, A2, B1, B2 and B3.

1047. Clause 1.1 of Annexure A of the proposed access arrangement provides that Tariff A1 consists of:

- a) a standing charge which is payable each day regardless of contracted peak rate and regardless of usage;
- b) a demand charge calculated for each day by multiplying the demand charge rate by the user's contracted peak rate and multiplying the resulting amount by the interconnection distance;
- c) a usage charge calculated by multiplying the usage charge rate by the quantity of gas delivered to the user at a delivery point and multiplying the resulting amount by the interconnection distance; and
- d) a daily user specific charge for the user specific delivery facilities.

1048. Subject to the reference tariff variation mechanism, for Tariff A1 from 1 January 2011:

- a) the standing charge is \$46,476.23 divided by 365;
- b) the demand charge rate is:
  - i) \$182.86 for the first 10 kilometres of the interconnection distance; and
  - ii) \$91.43 for any part of the interconnection distance in excess of 10 kilometres;
- c) the usage charge rate is:

- i) \$0.044600 for the first 10 kilometres of the interconnection distance; and
  - ii) \$0.022300 for any part of the interconnection distance in excess of 10 kilometres; and
- d) the user specific charge is to be an amount per day which reflects the costs to WAGN of providing the user specific delivery facilities, which may consist of capital expenditure and operating expenditure, where the component of the user specific charge which reflects capital expenditure is calculated as follows:
  - i) the value of the user specific delivery facilities is to be amortised monthly on an 'in arrears' basis;
  - ii) using a nominal pre-tax WACC of 13.85 per cent; and
  - iii) over the lesser of the duration of the economic life of the user specific delivery facilities and the period during which the user is entitled to take delivery of gas at the delivery point to which the user specific delivery facilities relate under its service agreement.

1049. Clause 1.2 of Annexure A of the proposed access arrangement provides that Tariff A2 consists of:

- a) a standing charge which is payable each day regardless of contracted peak rate and regardless of usage;
- b) a usage charge calculated by multiplying the usage charge rate by the quantity of gas delivered to the user at a delivery point; and
- c) a daily user specific charge for the user specific delivery facilities.

1050. Subject to the reference tariff variation mechanism, for Tariff A2 from 1 January 2011:

- a) the standing charge is \$34,115.00 divided by 365;
- b) the usage charge rate is \$2.20; and
- c) the user specific charge is to be an amount per day which reflects the costs to WAGN of providing the user specific delivery facilities, which may consist of capital expenditure and operating expenditure, where the component of the user specific charge which reflects capital expenditure is calculated as follows:
  - i) the value of the user specific delivery facilities is to be amortised monthly on an 'in arrears' basis;
  - ii) using a nominal pre-tax weighted average cost of capital of 13.85 per cent; and
  - iii) over the lesser of the duration of the economic life of the user specific delivery facilities and the period during which the user is entitled to take



delivery of gas at the delivery point to which the user specific delivery facilities relate under its service agreement.

1051. Clause 1.3 of Annexure A of the proposed access arrangement provides that Tariff B1 consists of:

- a) a standing charge which is payable each day regardless of contracted peak rate and regardless of usage;
- b) a usage charge calculated by multiplying the usage charge rate by the quantity of gas delivered to the user at a delivery point; and
- c) a daily user specific charge for the user specific delivery facilities.

1052. Subject to the reference tariff variation mechanism, for Tariff B1 from 1 January 2011:

- a) the standing charge is \$1,165.50 divided by 365;
- b) the usage charge rate is \$5.34 per gigajoule;
- c) the user specific charge is to be an amount per day which reflects the costs to WAGN of providing the user specific delivery facilities under a service agreement, which may consist of capital costs and operating expenditure, where the component of the user specific charge which reflects capital costs is calculated as follows:
  - i) the value of the user specific delivery facilities is to be amortised monthly on an 'in arrears' basis;
  - ii) using a nominal pre-tax weighted average cost of capital of 13.85 per cent; and
  - iii) over the lesser of the duration of the economic life of the user specific delivery facilities and the period during which the user is entitled to take delivery of gas at the delivery point to which the user specific delivery facilities relate under its service agreement.

1053. Clause 1.4 of Annexure A of the proposed access arrangement provides that Tariff B2 consists of:

- a) a standing charge which is payable each day regardless of usage; and
- b) a usage charge calculated by multiplying the usage charge rate by the quantity of gas delivered to the user at a delivery point.

1054. Subject to the reference tariff variation mechanism, for Tariff B2 from 1 January 2011:

- a) the standing charge is \$270.00 divided by 365; and
- b) the usage charge rate is \$7.00.

1055. Clause 1.5 of Annexure A of the proposed access arrangement provides that Tariff B3 consists of:

- a) a standing charge which is payable each day regardless of usage; and
  - b) a usage charge calculated by multiplying the usage charge rate by the quantity of gas delivered to the user at a delivery point.
1056. Subject to the reference tariff variation mechanism, for Tariff B3 from 1 January 2011:
- a) the standing charge is \$70.00 divided by 365; and
  - b) the usage charge rate is \$9.50.
1057. Clause 2.2 states that unless otherwise stated, all amounts specified in Annexure A are exclusive of GST and expressed in Australian dollars as at December 2009.

### **Access arrangement information**

1058. WAGN detailed its approach to setting reference tariffs in accordance with rule 72(1)(j) of the NGR on pages 39 to 48 of the access arrangement information as follows.

#### *Tariff Classes*

1059. 'Tariff classes' is a new concept that is defined in rule 69 as the customers for a reference service who constitute a tariff class under a full access arrangement.
1060. WAGN stated at page 39 of the access arrangement information that a reference service is provided to a user at each delivery point on the WAGN GDS. WAGN has, therefore, taken WAGN GDS delivery points as representing customers. By treating delivery points as customers, each customer is a customer in relation to only one reference service because only one reference service is provided at each delivery point. WAGN noted that about 609,000 customers are supplied with gas from the WAGN GDS.
1061. WAGN's tariff classes are as follows:
- a) Tariff Class A1 – approximately 70 customers that require in excess of 35 TJ/year supplied at high or medium pressures provided with user specific delivery facilities to accommodate the peak flows of 10 GJ/hour or more. These customers are provided with Service A1.
  - b) Tariff Class A2 – approximately 90 customers that require volumes of gas in excess of 10 TJ/year but less than 35 TJ/year supplied at high or medium pressures with user specific delivery facilities to accommodate the peak flows of at most 10 GJ/hour. These customers are provided with Service A2.
  - c) Tariff Class B1 - approximately 1,200 customers that require volumes of gas which do not exceed 10 TJ/year supplied at high or medium pressures with user specific delivery facilities to accommodate contracted peak rates which are less than 10 GJ/hour. These customers are provided with Service B1.
  - d) Tariff Class B2 - approximately 7,500 customers that can be supplied from the high pressure, the medium pressure and the low pressure parts of the WAGN GDS. These small use customers can be supplied using up to 20 metres of

service pipe, a standard pressure regulator and a standard 12m<sup>3</sup>/hour meter. These customers are provided with Service B2.

- e) Tariff Class B3 - approximately 600,000 customers that can be supplied from the high pressure, the medium pressure and the low pressure parts of the WAGN GDS. These small use customers can be supplied using up to 20 metres of service pipe, a standard pressure regulator and a standard small use meter rated at 6m<sup>3</sup>/hour to 8m<sup>3</sup>/hour. These customers are provided with Service B3.

#### *Charging parameters for each tariff class*

1062. Each of the reference services provided using the WAGN GDS can be divided into a number of elements, and a charging parameter can be assigned to each of these elements. Table 23 (page 41) of the access arrangement information shows the reference services offered by WAGN, and the tariff classes, reference tariffs, service elements and charging parameters associated with each of these reference services.

1063. WAGN stated that the existing structure of the reference tariff for each reference service has been retained as the structure of the proposed reference tariff for each tariff class. WAGN submitted that the reference tariff for each tariff class will have a standing charge and a usage charge. In addition, Tariff A1, A2 and B3 will have a further charging parameter – a user specific charge – which varies between customers in accordance with individual requirements for user specific delivery facilities. Tariff A1 will have a third charging parameter – a demand charge – which is related to the distance from the nearest transmission pipeline, and is designed to avoid inefficient bypass of the WAGN GDS.

#### *Reference tariff determination*

1064. The proposed reference tariffs for the WAGN GDS have been determined by applying the sequence of four steps set out on pages 41-44 of the access arrangement information.

1065. WAGN submitted that the structure of its proposed tariffs satisfy the requirements of rule 94(4) of the NGR based on the following:

- a) account is taken of long run marginal costs;
- b) there are no significant transaction costs associated with each charging parameter; and
- c) since each reference tariff comprises a standing charge and a volume-related charge, customers in each tariff class are likely to have sufficient information to be able to respond to the price signals provided by the tariff payable by customers in that tariff class.

#### *Change required by rule 94*

1066. WAGN stated on pages 44-45 of the access arrangement information that the structure of the reference tariffs applying in the current access arrangement period are essentially unchanged from that established for the initial access arrangement period. Total revenue of the WAGN GDS was allocated to users of reference services on the basis of gas volumes transported through the distribution system,

and the reference tariffs had the declining block structure commonly used by integrated gas retailers. WAGN noted that the reference tariffs established for the initial and current access arrangement periods provided the service provider with a reasonable opportunity of recovering at least its efficient costs, but could not provide signals for efficient investment in, and for efficient operation and use of, the WAGN GDS.

1067. WAGN submitted that rule 94 of the NGR precludes this outcome by requiring that reference tariffs be constructed in such a way that they provide proper signals for efficient investment in, and for efficient operation and use of, distribution pipelines. WAGN submitted that tariffs constructed in accordance with rule 94 are unlikely too be consistent with the retail tariffs determined by an integrated gas retailer.
1068. WAGN has determined, for each of the reference services provided using the WAGN GDS during the forthcoming access arrangement period, the incremental cost of connecting the forecast increase in the number of customers requiring the service. WAGN stated that this incremental cost comprises the incremental capital costs (return and depreciation) and the incremental operating costs. The ratio of the incremental cost to the increase in service requirement has been taken as the long run marginal cost of providing the reference service in question using the WAGN GDS.
1069. WAGN noted that the long run marginal cost is not directly related to volume. It is related to the change in number of connections to the WAGN GDS. Its economic focus is not the end-user of gas, but a prospective user of the distribution pipeline: it provides the correct signal to the prospective user in terms of the efficient cost of an additional connection to the WAGN GDS.
1070. WAGN submitted that it has therefore sought to determine the standing charge component of each reference tariff from the long run marginal cost of providing the corresponding reference service. The usage charge has then been determined as the volume-related charge which allows WAGN the opportunity to recover its total revenue.

#### *First tariff estimates*

1071. Table 24 (page 45) of the access arrangement information shows the tariffs for the WAGN GDS when they are established using the long run marginal costs of the reference services as the standing charges, and a usage charge set to recover (approximately) the remainder of total revenue.
1072. WAGN noted that the first tariff estimates in Table 24 are very different from the reference tariffs prevailing at the end of the current access arrangement period. Table 25 (page 46) of the access arrangement information shows that these tariffs satisfy the stand alone and avoidable costs tests of rule 94(3) of the NGR. WAGN submitted that if they were implemented, they would not allow WAGN to recover its total revenue over the forthcoming access arrangement period as required by the NGR. Moreover, the implementation of the first tariff estimates would be likely to result in significant price shock, particularly for end-users of gas supplied using the B2 and B3 reference services. These end-users are the small use customers which are protected by the WA Local Regulations and discussed below.
1073. In order to address these issues WAGN has determined the reference tariffs for the WAGN GDS by adjusting these first tariff estimates so that:

- a) price shock is avoided, while allowing tariffs to partially adjust toward the first tariff estimates over the forthcoming access arrangement period;
- b) the charges for those reference services for which the demands are least elastic are increased by the largest amounts so as to minimise distortion to efficient patterns of consumption in accordance with rule 94(5); and
- c) the present value of the expected revenue from the resulting reference tariffs is equal to the present value of total revenue.

1074. Table 26 (page 47) of the access arrangement information shows the WAGN GDS reference tariffs exclusive of GST while Table 27 (page 47) shows the stand alone costs, avoidable costs, expected revenue from reference tariffs and total revenue. WAGN submitted that these reference tariffs satisfy the stand alone and avoidable costs tests of rule 94(3) of the NGR and also allow WAGN to recover its total revenue over the forthcoming access arrangement period.

## Public submissions

### *WAGN's submission*

1075. WAGN submitted, on page 126, that the proposed tariffs for the five reference services are to apply from 1 July 2010, and may subsequently be varied in accordance with the methods and formulae of the reference tariff variation mechanism set out in the proposed access arrangement.
1076. WAGN submitted on page 145 that a Microsoft Excel spreadsheet model, which calculated total revenue and the revised reference tariffs for the WAGN GDS was provided in both a confidential and public version with its submission. WAGN submitted that while the public version does not disclose confidential information, it has retained most of the functionality of the (complete) confidential model.
1077. WAGN provided on pages 126-144 of its submission materially the same information as provided in the access arrangement information.

### *Synergy's submissions*

1078. Synergy, in its submission dated 12 April 2010 (pages 5-7), noted its concern that the reference tariffs proposed by WAGN are likely to cause price shocks to customers across many tariff classes, particularly to customers in tariff class A2.
1079. Synergy noted that it currently retails gas to a significant number of A2 tariff class customers consuming between 10 and 35 TJ of gas per annum. These include hospitals, aged care facilities, bakeries, manufacturing plants, food processing and packaging plants, universities and local councils. Synergy submitted that based on the proposed reference tariffs, as much as 60 per cent of an A2 customer's total annual charge will be comprised of a fixed charge of \$34,115 per annum, a significant increase from the current charge of \$556.13 per annum. Synergy submitted that this means that the ability of these customers to respond to usage-based price signals is likely to be severely limited.
1080. Since WAGN released the proposed access arrangement, Synergy stated that it has spoken with a number of customers concerning the intended tariff changes. Table 4.1 (page 6) in Synergy's submission summarised the anticipated annual

price impact on individual classes of customers and customer reaction to the tariff changes.

1081. Synergy, in its submission dated 12 April 2010 (page 6), asked the Authority to carefully scrutinise the reference tariffs proposed for each tariff customer class. Synergy submitted that the proposed increase in capital expenditure for the 2010 to 2013/14 access arrangement period is justified by WAGN as being for planned reinforcement to enable growth in the Perth metropolitan area. Synergy stated that it is prepared to assume that network reinforcement of this type benefits all customers and hence related capital expenditure should be spread across customer classes according to the benefit afforded to each customer class. Synergy submitted that customers in a particular class should not be allocated more than their fair share of costs. Indeed, if customers do not benefit at all from particular expenditure then they should not be allocated any cost.
1082. Synergy submitted on page 7 of its submission that should the Authority determine that all of the proposed reference tariffs are justified, a glide path approach to fixed charges be considered, particularly for A2 tariff customers. Synergy submitted that, as evidenced in Table 4.1 (page 6) of their submissions, A2 customers will be severely impacted by the proposed increases. Synergy stated that it would be happy to discuss this approach further with both WAGN and the Authority.
1083. Synergy, in its submission dated 12 April 2010 (page 7), submitted that some customers that have been assigned to a certain tariff class actually consume significantly more or less than the usage parameters of that particular class. Synergy gave the example that it is aware of some A2 tariff customers consuming 5 to 10 TJ annually and of others consuming in excess of 50 TJ per annum, well outside the 10 to 35 TJ per annum consumption band for that class.
1084. Synergy submitted that generally a customer is assigned to a reference tariff class by WAGN based on its anticipated throughput. Given the proposed significant increases in tariffs, Synergy considered that customers should be given the option of transferring, from the commencement of the 2010 to 2013/14 access arrangement period on 1 January 2011, to a tariff that best corresponds with their anticipated throughput. Synergy submitted that this offer should be made regardless of whether or not the customer's contract is due for renewal at that time.

#### *Alinta's submission*

1085. Alinta, in Attachment A to its submission dated 19 April 2010 (pages 42-43), submitted that the absence or suppression of detailed information on the basis on which WAGN has determined the stand alone and avoidable costs associated with provision of distribution services to each of the five tariff classes means that users and prospective users cannot reasonably be expected to form a view on whether these estimates comply with rule 74 of the NGR.
1086. Alinta further submitted in relation to WAGN's submission that claims that rule 94(5) of the NGR contains an error and has instead interpreted the rule '*as requiring that, should usage Charges have to be increased, the Charges for those References Services for which the demands are least elastic should be increased by the largest amount.*' Alinta does not consider that rule 94(5) contains an error. Alinta submitted that when taken in context, rule 94(5) requires that if the expected revenue for a tariff class does not lie between stand alone cost and the avoidable cost, then within that tariff class, tariffs are adjusted so as to minimise distortion of the efficient patterns of consumption.



1087. Alinta submitted that it is not apparent that rule 94(5) operates to restrict the ability of the service provider to adjust tariffs within each tariff class to ensure that expected total revenue across all tariff classes is equivalent to the relevant total revenue requirement.
1088. Alinta submitted that it appears that the NGR provide significant discretion in the manner in which a service provider may recover the total revenue target from the discrete tariff classes. Alinta further submitted that this is in contrast to the arrangements that appeared to have existed previously, with WAGN noting that it had previously allocated the total revenue requirements to tariff classes on the basis of gas volumes transported through the system in respect of each tariff class.
1089. In the context of small use customers, Alinta submitted that, if the Authority accepted WAGN's proposed revisions, there would be significant increases for real tariff class B2 and B3 users. Alinta argues that WAGN's proposed revisions would result in price shocks and that glide path approach would be more appropriate to avoid such price shocks.

#### *Office of Energy's submission*

1090. In its submission dated 12 April 2010, the Office of Energy addressed the issue of the tariff determination in the context of small use customers and this submission is detailed below. The Office of Energy was broadly supportive of the transition of tariffs and their components to more efficient pricing as this is consistent with the national gas objective. However, the Office of Energy requested the Authority consider the price shock that consumers will experience in both the fixed and variable tariff components. The Office of Energy was concerned that customers' expectations of consistent prices was inconsistent with the tariff structure proposed by WAGN. The Office of Energy generally accepted WAGN's argument that efficient pricing required a re-weighting of the fixed and variable components of the tariff but indicated that it wanted to see a more gradual transition of individual tariff components.
1091. The Office of Energy submitted that the side constraint mechanism utilised on tariff basket approach (which it noted WAGN did not propose, nor did the Office of Energy advocate) may provide a useful guide to the Authority when considering restraints to annual increases for standing and usage charges. A side constraint mechanism restricts tariff growth to a fixed percentage annually, allows customers time to adapt. The Office of Energy saw this as particularly important for domestic gas users.
1092. The Office of Energy argued that if the Authority accepted WAGN's proposal for approximately a 36 per cent increase in annual revenue requirement, then the increase should be applied to the current tariff structure and classes rather than WAGN's proposed structure. The tariff structure alignment could then be adjusted over the term of the access arrangement subject to the side constraint (pages 1 to 2).

#### **Authority's assessment**

1093. Rules 94(1) and (2) of the NGR require that customers of reference services be divided into tariff classes for the purpose of determining reference tariffs where regard should be given to grouping customers on an economically efficient basis and the need to avoid unnecessary transactions costs.

1094. The Authority has considered the grouping of end-use customers into reference tariff classes proposed by WAGN in the context of the requirements of rule 94(2). The Authority considers that each of WAGN's proposed tariff classes has been appropriately constituted with regard to the need to group customers for reference services together on an economically efficient basis and the need to avoid unnecessary transaction costs.
1095. The Authority notes that the submissions from Synergy, Alinta and the Office of Energy concerning the structure and level of WAGN's proposed reference tariffs for each tariff class (as distinct from the grouping of customers to which rule 94(2) is directed). Rules 94(3) and 94(4) of the NGR provide tests regarding the structure of the reference tariffs for each tariff class.
1096. Rule 94(3) of the NGR requires that for each tariff class the revenue should lie between an upper bound (the stand alone cost of providing the reference service) and a lower bound (the avoidable cost of not providing the reference service). The Authority considers that based on the information provided on pages 126 to 138 of WAGN's submission, WAGN has demonstrated that the proposed tariff structure for each tariff class is consistent with the requirements of rule 94(3).
1097. As discussed previously the Authority has determined that the total revenue requirement for reference tariffs should be lower than proposed by WAGN. Within the lower level of total revenue requirement the revenue expected from each tariff class is consistent with rule 94(3) in that the revenue lies between the required upper and lower bounds.
1098. Rule 94(4) of the NGR, sets out the requirements for each charging parameter within a tariff class. These requirements are that the long run marginal cost (rule 94(4)(a)), transactions costs and whether customers are able or likely to respond to price signals (rule 94(4)(b)) need to be taken into consideration.
1099. In considering the requirements of rule 94(4) the Authority has considered WAGN's proposed tariff structure for each tariff class adjusted for the effect of the Authority's reduced total revenue requirement as discussed above. The resultant tariff structure is consistent with WAGN's proposal in that the proportion of revenue from each tariff class recoverable from the standing and usage charges, for each tariff class, is similar to that in WAGN's proposal.
1100. In relation to rule 94(4)(a) the Authority is satisfied that WAGN has demonstrated that the standing charges proposed for each tariff class have been formulated taking into account the long run marginal cost for the reference service. As a consequence, based on the Authority's tariff structure being consistent with WAGN's proposal as outlined above the tariff structure resulting from the Authority's lower total revenue requirement will be consistent with this rule.
1101. The Authority is satisfied that WAGN's proposed replacement of declining block tariffs with a single uniform usage charge for most of the tariff classes takes into account the need to minimise transaction costs as required by rule 94(4)(b)(i) for each tariff class and is appropriate. The Authority notes that the move away from declining block tariff structures is consistent with the Gas Tariff Regulations,<sup>109</sup>

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<sup>109</sup> Office of Energy prepared Interim Report in 2008 –  
([http://www.energy.wa.gov.au/2/3248/64/gas\\_tariffs\\_rev.pm](http://www.energy.wa.gov.au/2/3248/64/gas_tariffs_rev.pm))

which were amended on 1 July 2008 to remove the third level of declining block retail tariffs for domestic gas customers.

1102. With regard to rule 94(4)(b)(ii), the Authority accepts that WAGN's proposed charging parameters for each tariff class are consistent with the ability of customers within each tariff class to respond to price signals with the exception of small use customers (B2 and B3). For the reasons set out in the following section, the Authority is not satisfied that WAGN's proposal has given appropriate regard to the extent to which small use customers are able or likely to respond to price signals.
1103. Rule 94(5) requires that if as a result of rule 94(4) the service provider does not recover the expected revenue then any tariff adjustment to address this revenue shortfall must be made with minimum distortion to efficient patterns of consumption. The Authority notes that when WAGN initially applied rule 94(4) the resulting proposed tariff structure did not allow WAGN to recover its expected revenue and accordingly WAGN adjusted the proposed tariff structure to ensure expected revenue recovery. The Authority is satisfied that this adjustment is consistent with the requirements of rule 94(5).

### **Draft decision**

1104. Based on the above the Authority has determined, as set out in Table 27 below, the reference tariffs applicable to each tariff class based on this draft decision.
1105. The Authority has also modelled the impact of the reference tariffs in Table 27 and WAGN's proposed reference tariffs on a range of consumption levels for each tariff class. These details are included in the Authority's financial model, under Appendix 2 of this draft decision.
1106. In determining the reference tariffs in Table 27, the Authority has also complied with the requirements set out under the WA Local Regulations concerning the impact of distribution tariffs on small use customers. As noted above, this matter is dealt with in the following section.

**Table 27 Authority's Reference Tariffs– (exclusive of GST\$ December 2009)**

Tariff <sup>1</sup>	Charging parameter		1-Jan-10 <sup>2</sup>	1-Jul-10	1-Jan-11	1-Jul-11	1-Jul-12	1-Jul-13
A1	Standing Charge	\$/year	43,722.22	43,164.68	41,994.94	41,994.94	41,994.94	41,994.94
	Demand, First 10 km	\$/GJ km	180.53	178.23	165.23	165.23	165.23	165.23
	Demand, Distance > 10 km	\$/GJ km	90.26	89.11	82.61	82.61	82.61	82.61
	Usage, First 10 km	\$/GJ km	0.04403	0.04347	0.04030	0.04030	0.04030	0.04030
	Usage, Distance > 10 km	\$/GJ km	0.02202	0.02173	0.02015	0.02015	0.02015	0.02015
A2	Standing Charge	\$/year	549.04	542.04	23,900.15	23,900.15	23,900.15	23,900.15
	Usage Charge 1	\$/GJ	4.83	4.77	1.54	1.54	1.54	1.54
	Usage Charge 2	\$/GJ	4.54	4.48	-	-	-	-
	Usage Charge 3	\$/GJ	1.19	1.18	-	-	-	-
B1	Standing Charge	\$/year	549.04	542.04	917.90	917.90	917.90	917.90
	Usage Charge 1	\$/GJ	4.83	4.77	4.21	4.21	4.21	4.21
	Usage Charge 2	\$/GJ	4.54	4.48	-	-	-	-
B2	Standing Charge	\$/year	220.18	217.37	193.60	193.60	193.60	193.60
	Usage Charge 1	\$/GJ	5.59	5.52	5.02	5.02	5.02	5.02
	Usage Charge 2	\$/GJ	4.78	4.72	-	-	-	-
B3	Standing Charge	\$/year	28.23	27.87	50.09	50.09	50.09	50.09
	Usage Charge 1	\$/GJ	9.38	9.26	6.80	6.80	6.80	6.80
	Usage Charge 2	\$/GJ	5.62	5.55	-	-	-	-
	Usage Charge 3	\$/GJ	3.81	3.76	-	-	-	-

1. All Tariffs are real, December 2009 dollars. 2. The reference tariffs for the period 1 January to 31 December 2010 are the same as the current tariffs as approved by the Authority to 31 December 2009. Refer paragraph below for more detail.

1107. It should be noted that in Table 27 the Authority's reference tariffs for the period 1 January 2010 to 30 June 2010 and for the current period 1 July 2010 to 31 December 2010 are based on the reference tariffs approved by the Authority in the current access arrangement for 1 January 2009 to 31 December 2009. These tariffs have remained constant in nominal terms in accordance with rule 92(3)(a) of the NGR which states that "...if there is an interval (the interval of delay) between a revision commencement date stated in a full access arrangement and the date on which revisions to the access arrangement actually commence: (a) reference tariffs, as in force at the end of the previous access arrangement period, continue without variation for the interval of delay;...". In Table 27 the tariffs from 1 January 2010 and from 1 July 2010 are stated in real terms (i.e. December 2009 dollars) to be consistent with the Authority's modelling. As shown in Table 27 the Authority's reference tariffs for each year from 1 January 2011 to the end of the forthcoming access arrangement period are constant in real terms.

#### Required Amendment 8

The Authority requires Annexure A and sections 1 and 2 of Annexure B of WAGN's proposed access arrangement to be amended as follows:

##### Annexure A

Replace the haulage reference tariffs set out under Annexure A with the haulage reference tariffs set out in Table 27.

##### Annexure B (sections 1 and 2)

- Inflation - tariffs need to be set to account for inflation by adjusting the real tariffs modelled, using 31 December 2009 dollars, based on CPI (All Groups, Eight Capital Cities) at the end of each modelling period;
- Regulatory operating costs - clause 2.3(c), which includes the 2009 regulatory operating costs under the tariff variation mechanism for the 1 July 2011 adjustment, should be deleted;
- Regulatory capital costs - references to regulatory capital expenditure should be deleted; and
- The real pre-tax rate of return should be amended to 6.89 per cent.

### *Impact on small use customers and retailers*

#### **Requirements of the NGL and the NGR**

1108. The WA Local Regulations are regulations made under section 10 of the NGA. The WA Local Regulations were proclaimed on 30 December 2009 and became operational from 1 January 2010.

1109. Part 2 of the WA Local Regulations (regulations 4 to 7) makes provision with respect to reference tariffs for supply to small use customers. Part 2 applies in relation to a distribution pipeline and, therefore, is applicable to the GDS and to WAGN's proposed revisions to the current access arrangement for the GDS.

1110. Regulation 6(1) of the WA Local Regulations provides, relevantly, that the Authority must not approve or make an access arrangement for a distribution pipeline if the reference tariff for any small delivery service provided for in the access arrangement varies according to the geographical location of the small delivery point to which the gas is delivered. Regulation 6(4) of the WA Local Regulations provides that regulation 6 applies despite anything in the NGL or NGR to the contrary.

1111. Part 2 Regulation 7 of the WA Local Regulations is set out as follows:

**“Impact on small use customers and retailers to be taken into account**

- (1) When exercising a discretion in approving or making an access arrangement for a distribution pipeline the ERA must take into account the possible impact of the proposed reference tariffs, the method of determining the tariffs and the reference tariff variation mechanisms on –
  - (a) users to whom gas is or might be delivered by means of a small delivery service provided for in the access arrangement; and
  - (b) small use customers to whom gas is or might be delivered by those users.
- (2) In sub-regulation (1) a reference to the impact of something is not limited to the economic impact of that thing.
- (3) A requirement under this regulation to take a matter into account applies –
  - (a) despite anything in the National Gas Law or Rules that would otherwise prevent the matter being taken into account; and
  - (b) in addition to any requirement under the National Gas Law of Rules –
    - (i) for any other matter to be taken into account; or
    - (ii) as to the content of the access arrangement.
  - (c) For the avoidance of doubt, this regulation does not permit the ERA to approve or make an access arrangement that does not include a reference tariff variation mechanism that complies with rule 92 of the Rules.”

1112. For the purpose of these provisions Part 2 regulation 4 of the WA Local Regulations contains the following relevant definitions:

**‘small delivery point** means a delivery point at which gas is delivered to a user for delivery by the user to a small use customer”;

**small use service** means a reference service to the extent that it is or may be used for the delivery of gas to a small delivery point;

**small use customer** means an end user –



- (a) to whom gas is delivered at a delivery point; and
- (b) to whom less than 1 terajoule of gas is delivered at that delivery point in any year; and
- (c) who is not a user'

1113. In deciding whether to approve the reference tariffs in WAGN's proposed revisions the Authority is required to consider the compliance of the reference tariffs applicable to small use customers with the provisions of regulations 6(1) and 7 of the WA Local Regulations, in addition to considering the compliance of the reference tariffs generally with Division 8 of the NGR and the revenue and pricing principles and the national gas objective under the NGL.

1114. Under rule 72(1)(j)(i) of the NGR the access arrangement information must specify the basis on which reference tariffs have been determined, including the method used to allocate costs and a demonstration of the relationship between costs and tariffs.

1115. The access arrangement information must also contain the information necessary to understand the basis and derivation of the service provider's proposal in respect of this element (rule 42 of the NGR).

1116. The access arrangement information, therefore, should include any information regarding how the service provider has taken into account the requirements of the WA Local Regulations in determining reference tariffs for small use customers, in such a way that enables users or prospective users to understand the basis and derivation of the reference tariffs which apply to small use customers.

### **Access arrangement proposal**

1117. WAGN's proposed access arrangement includes reference tariffs for Services A1, A2, B1, B2 and B3. Services A1 and A2 are defined in ways such that the end users cannot be small use customers as defined in the WA Local Regulations. Services B1, B2 and B3 are defined in ways such that the relevant end users could, but are not necessarily small use customers as defined in the WA Local Regulations.

1118. WAGN's proposed revisions, therefore, do not contain reference tariffs specifically for users who deliver gas to small use customers, nor do they differentiate the pricing on the basis of geographical location.

### **Access arrangement information**

1119. WAGN provided access arrangement information in relation to the determination of reference tariffs, including the reference tariffs for Services B1, B2 and B3 which may be provided to users who supply small use customers. WAGN has not, however, provided any access arrangement information specifically directed to the matters which the WA Local Regulations require the Authority to consider with respect to small use customers.

## Public submissions

### *WAGN's submission*

1120. WAGN submitted on page 139 of its submission, that a small delivery service is provided to a small use consumer which refers to a delivery point at which a gas consumer uses less than 1 TJ per annum. WAGN noted that the reference service that generally applies to a small use customer is Service B3 and this is the haulage service provided to a typical residential premise. WAGN submitted further that in constructing the reference services and associated reference tariffs WAGN has not sought to differentiate pricing on the basis of geographic location and that WAGN, therefore, has complied with regulation 6(1) of the WA Local Regulations.
1121. In relation to regulation 7 of the WA Local Regulations WAGN noted, on pages 139-140, in its submission dated 29 January 2010 that this regulation does not override a service provider's ability to recover its total revenue in present value terms over the access arrangement period. WAGN submitted that regulation 7 of the WA Local Regulations should operate together with rule 94(5) of the NGR which allows adjustment of reference tariffs determined in accordance with rules 94(3) and (4) in a way which minimises distortion to efficient patterns of consumption.
1122. In relation to the compliance of the reference tariffs in Table 83 of WAGN's submission with regulation 7 of the WA Local Regulations, WAGN made further submissions at pages 138-144. WAGN prefaced those submissions (at page 139-140) by noting that regulation 7 does not override a service provider's ability to recover its total revenue in present value terms over the access arrangement period and should also operate together with rule 94(5) which allows adjustment of reference tariffs in accordance with rules 94(3) and (4) in ways which minimise distortion to efficient patterns of consumption.
1123. WAGN then submitted that to ensure recovery of total revenue for the forthcoming access arrangement period WAGN has taken into account guiding principles (discussed at section 9.7.1 on page 140), the drivers of costs (discussed at section 9.7.2 at page 195), the consumption profile of reference tariff B3 delivery points (discussed at section 9.7.3 on page 142) and the proportion of total cost that reference tariff comprises of the total cost (discussed at section 9.7.4 on page 143-144).
1124. In the course of those sections of the submissions, WAGN made the following specific submissions directed to the compliance of the reference tariffs in Table 83 (page 136) relevant to small use customers (namely the reference tariffs for Services B2 and B3) with regulation 7 of the WA Local Regulations:
- a) The existing tariff structures – in particular, the structure of reference Tariff B3 – are mainly volume based which results in under recovery of revenues where gas consumption is low. A correction to tariff structure is therefore critical to ensure recovery over the access arrangement period and to ensure that tariffs move to reflect the costs associated with providing the services. This has resulted in changes to the fixed charge and a move to a single variable charge for reference services including B2 and B3. Notwithstanding this, an attempt to minimise price shock as a result of change in tariff structure has been made by seeking to minimise the impact on as many end use gas consumers as possible (page 141).

- b) Service B2 has experienced a relatively small increase in the fixed charge. This is the second largest tariff class in terms of number of delivery points (page 141).
- c) The current structure of reference Tariff B3 is significantly out of alignment with the costs of service delivery. When the reference tariffs were established for the initial access arrangement period the asset class which incurred the largest reduction in depreciated optimised replacement cost was meters and service pipe. The carry forward value of this asset class was reduced by 66 per cent. The bulk of these assets came to the end of their useful life at 31 December 2009. They are to be replaced and this will mean that current costs will increase and therefore provide a more realistic cost of service. Nonetheless, while there is economic support for an increase in the fixed component of reference tariff B3 to in excess of \$200 the proposed increase is much more modest (page 141).
- d) There has been a decrease in average consumption – as illustrated by Figure 6 on page 142 of WAGN's submission dated 29 January 2010 – for reference tariff B3 delivery points. There have been a number of factors leading to the reduction in average consumption over time: increased efficiency of gas appliances; government rebates for solar hot water conversions; reverse cycle air conditioners for space heating; and below cost electricity tariffs encouraging use of electricity over gas. Annual consumption at very low levels (< 2 GJs per year) cannot be encouraged because costs of connection will never be recovered if the tariff does not reflect a fixed charge commensurate with the costs incurred with connection. While regulation 7 of the WA Local Regulations is directed at reducing price shock to small use consumers, it would be inequitable to continue to recover costs from the median consumers of gas rather than from all connections which have caused the costs. An increase in the reference tariff for Service B3 will have a greater impact on small use rather than median users. However, to do other than increase the reference tariff for Service B3 may cause median users to substitute current consumption for another source of energy given that price is a major driver of choice in this segment (pages 142-143).
- e) Retail gas prices for small use gas consumers are regulated. The prices do not explicitly accommodate a pass through of WAGN's haulage tariffs. A review undertaken by the Office of Energy identified that the haulage tariff represented about 40 per cent of the retail tariff. On this basis the proposed increase in the reference tariff as set out in Table 83 (page 136) of WAGN's submission dated 29 January 2010 for the median user of 16GJs per annum will experience an increase of 25 per cent from the end of the calendar year 2009 to 2011 or just under 12 per cent year on year. This would be reflected as a 5 per cent increase in retail tariffs for both 2010 and 2011. In contrast, where only 2 GJs per annum are consumed, the increase is much more substantial in percentage terms being 87 per cent over 2 years or 37 per cent year on year. However, viewed in absolute dollar terms, the increase is \$41.41 per annum from \$47.59 to \$89.00. This would reflect an increase in retail tariffs of 15 per cent. WAGN submitted that this does not represent price shock (pages 143-144).

*The Office of Energy's submission*

1125. The Office of Energy made a submission dated 12 April 2010 which addressed two issues relevant to the compliance of WAGN's proposed revisions with regulation 7 of the WA Local Regulations.
1126. The Office of Energy addressed submissions to the proposed increase in the portion of revenue to be recovered from the standing charge for each tariff class (see pages 1 to 2 of the Attachment):
- a) The Office of Energy supported any transition of tariffs and their components towards more efficient pricing and submitted that any re-weighting of the portion of revenue to be recovered from the standing charge for each tariff that is more efficient than the current situation is consistent with the national gas objective. The Office of Energy, however, asked that the Authority consider price shock applicable to consumers (particularly small use customers) in terms of movements of their relative fixed and variable tariff components. The Office of Energy made further submissions noting the nature and extent of the investments made by both the regulated entity and consumers which the Office of Energy submitted should be considered by the Authority (see the second bullet point on page 1 of the Attachment).
  - b) The Office of Energy noted its understanding that the WAGN proposal if accepted would result in a large increase in the annual total regulated revenue but submitted that the consideration of price shocks should not impact on the level of the revenue requirement determined by the Authority (see third bullet point on page 1 of the Attachment).
  - c) The Office of Energy noted WAGN's submission that efficient pricing for network users requires a re-weighting of the fixed and variable components, however, submitted a more gradual transition from individual tariff components from current levels, within the boundaries of the revenue requirement, should be adopted (see fourth bullet point on page 1 of the Attachment).
  - d) The Office of Energy submitted that in considering the merits of transitioning from the present tariff components to more cost reflective components, the Authority should consider a side constraint to annual increases to both the standing and usage charges. The Office of Energy submitted that this will allow customers time to adapt to changing price structures, and alternatively alter their consumption patterns over time. The Office of Energy noted that consumers of domestic gas (who are typically small use customers under the WA Local Regulations) have very little ability to respond to changing price signals in the short term (see first and second bullet points on page 2 of the Attachment).
  - e) The Office of Energy submitted that should the Authority approve an increase of approximately 36 per cent in the annual revenue requirement as proposed by WAGN then the Authority should apply this increase to current tariff structures and classes, rather than the proposed structure. The Office of Energy submitted that the tariff structure alignment, and the split between fixed and variable charges, could be adjusted over the term of the access arrangement subject to the determined side constraint, and any appropriate smoothing of the adjustment path (see the third and fourth bullet points on page 2 of the Attachment).

1127. Secondly, the Office of Energy addressed submissions to the proposed application of the WA Local Regulations in relation to the proposed reference tariffs (see pages 2 to 3 of the Attachment). The Office of Energy submitted that the proposed increase in the value of the fixed charge relative to the variable charge could potentially impact on small use customers' consumption decisions, and that small use customers should be given the opportunity to adjust to this re-weighting over time. The Office of Energy submitted that the Authority should consider a tariff transition path, in the event that the Authority accepts WAGN's proposed revisions to move towards a more efficient reference tariff pricing structure. The Office of Energy noted that WAGN's proposed pricing structure, including a higher fixed charge and the removal of the declining block tariff, will have greatest impact amongst customers using less than 10 GJ per year and consumers on the B3 tariff using greater than 45 GJ per year in absolute terms. In these circumstances, the Office of Energy noted that the Authority is required by the WA Local Regulations to consider the impacts of this proposed pricing structure on small use customers.

*Alinta's submission*

1128. Alinta made a submission dated 19 April 2010 which addressed the following issues relevant to the compliance of WAGN's proposed revisions with regulation 7 of the WA Local Regulations.

1129. First, Alinta noted that if the Authority were to accept WAGN's proposed revisions to the Access Arrangement as submitted, Alinta estimated that:

- a) (real) tariff class B2 (small business) distribution costs would increase by almost 85 per cent between 2009/10 and 2013/14; and
- b) (real) tariff class B3 (residential) distribution costs would increase by almost 56 per cent between 2009/10 and 2013/14.

(see page 1 of the submission).

1130. Secondly, Alinta submitted that WAGN's submission dated 29 January 2010 and access arrangement information did not contain the information that is reasonably necessary for users and prospective users to understand either the background to the access arrangement proposal or the basis and derivation of the various elements of the access arrangement or the access arrangement proposal as required by rule 42(1) of the NGR (see page 1 of the submission and pages 1 to 2 of Attachment A). While Alinta did not specifically submit that the access arrangement information was insufficient in relation to the issues relevant to small use customers, the implication is that the insufficiency extended to the access arrangement information necessary to understand the issues relevant to small use customers and compliance with regulation 7 of the WA Local Regulations.

1131. Thirdly, Alinta submitted that, counter to WAGN's suggestion that it has determined reference tariffs to avoid price shocks, the changes to reference tariffs proposed by WAGN will result in price shocks (including price shocks to small use customers). Specifically, Alinta submitted it is unclear why WAGN is proposing a material adjustment on 1 January 2011 with much smaller increases in tariffs after that date when the same revenue outcome could have been achieved through a glide-path approach, whereby the required revenue is achieved by adopting the same periodic percentage increase in reference tariffs (see page 2 of the submission, and Tables A.13 and A.14 and pages 43-44 of Attachment A). While Alinta's submission on this point was not specifically directed to price shock for small use customers, the



submission is relevant to price shocks to be experienced by all customers of users of reference services including small use customers.

1132. Fourthly, and more specifically, Alinta submitted that the manner in which WAGN accounted for the requirements imposed by the WA Local Regulations is unclear. Alinta noted that retail gas tariff prices able to be charged by Alinta are regulated by government, with gas tariff caps established by the *Energy Coordination (Gas Tariffs) Regulations 2000* (**Gas Tariff Regulations**). Alinta noted further that there is currently no mechanism in the Gas Tariff Regulations that links gas tariff caps to costs, or that enables changes in costs that are outside of Alinta's control, such as distribution charges, to be passed through to customers. Alinta submitted, consequently, that the potential financial impact on Alinta of the increases being proposed by WAGN to reference tariffs that apply to small use customers supplied under the Gas Tariff Regulations is significant. Alinta submitted further that most small use (residential and business) tariff customers are supplied under Service B2 or B3 although a significant proportion of business tariff customers are supplied under Service B1. Based on information contained in WAGN's submission, Alinta estimated that the total additional costs that will be incurred by retailers in respect of gas supplied to B1, B2 and B3 customers in the forthcoming access arrangement period will be in the order of \$65M to \$70M. Almost all of these costs would be incurred by Alinta and ultimately would be required to be passed through to customers, many of whom would be small use customers (see pages 2 to 3 of the submission, and pages 44 and 45 of Attachment A).

#### *Other submissions*

1133. The Authority received two brief submissions from domestic gas consumers (who the Authority assumes are small use customers for the purpose of the WA Local Regulations) who expressed general concern about increases in their gas costs if WAGN's revisions proposal was to be approved by the Authority.
1134. The Authority received no other submissions relevant to the reference tariffs for small use customers.

#### **Authority's assessment**

1135. The Authority sought information from WAGN regarding the number of reference service B1 end-users who are small use customers. WAGN provided information to the Authority in confidence on this issue. In view of that confidential information, the Authority is satisfied that the small use customers are limited in number and volume and are not material for the consideration of the WA Local Regulations or rule 94(4)(b) as it applies to small use customers. The Authority's assessment below, therefore, is limited to Service B2 and B3, which are predominantly supplied to users who serve small use customers as defined.
1136. In considering the effect of reference tariffs, the Authority is required have regard to the transaction costs of each charging parameter and whether customers belonging to the relevant reference tariff class are able or likely to respond to price signals pursuant to rule 94(4)(b). This rule raises particular issues for the small use customers, most notably users of B2 and B3 reference services in respect of which the WA Local Regulations apply, as explained below.
1137. Under Part 2 of the WA Local Regulations the Authority is required, in relation to distribution pipeline systems, to take into account the possible impact of the proposed reference tariffs, the method of determining these reference tariffs, and

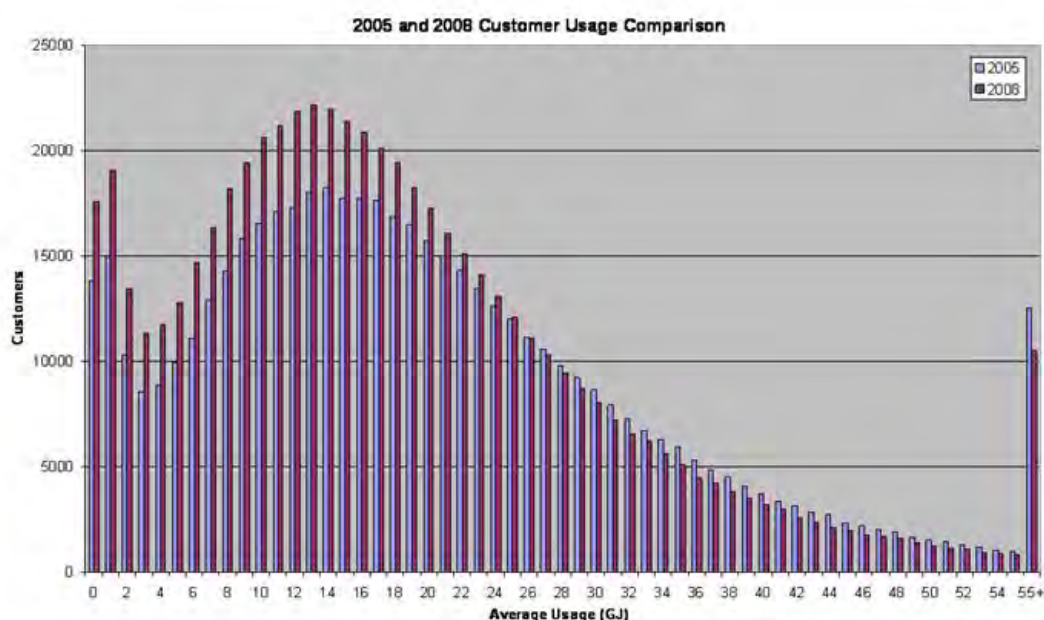


the reference tariff variation mechanisms on small use customers and retailers. These regulations are to be considered in conjunction with the NGL or NGR and, therefore, the Authority must also consider rule 94(4)(b)(ii) of the NGR in relation to the impact of the proposed reference tariffs on retail tariffs for small use customers.

1138. In order to assess the impact of the reference tariffs on small use customers, the Authority has been required to undertake modelling of the retail tariffs for these customers based on two assumptions.

1139. Firstly, the Authority has evaluated the usage of B2 and B3 customers and selected usage categories which reasonably reflect the annual usage for most of these customers. Accordingly, the Authority has selected the average gas usage for B2 customers of 150GJ per annum to represent the B2 customers and four usage values to represent B3 customers (5, 10, 20 and 40 GJ per annum) on the basis that the majority of these customers fall within this usage range. WAGN's Consumption profile for B3 customers in 2005 and 2008 from its supporting submission page 142 is reproduced below.

**Figure 13. WAGN's consumption profile for service B3**



1140. Secondly, the Authority assumed a full pass-through of changes to WAGN's gas reference tariffs to the retail tariffs for the B2 and B3 reference tariff categories. The Authority regards this as a reasonable assumption in the current retail commercial and regulatory environment.

1141. Adopting these assumptions, the Authority's modelling showed that it is likely that WAGN's proposed reference tariffs would result in a significant impact at the retail tariff level on small use customers in the B3 category and, in particular, on those B3 customers with very small levels of usage.

1142. Given increases of this magnitude it is necessary to consider whether small use customers could reasonably be expected to respond by changing to an alternative energy source, rather than to pay the increased retail tariffs. The Authority has compared the likely retail tariff increases for B2 and B3 customers with the equivalent retail price of electricity. In comparison with electricity prices, WAGN's

proposed January 2011 standing charge for B3 customers would be about half the current electricity retail standing charge. The Authority is aware that electricity is a substitute for gas in a number of applications in the small use market. For example, where both reverse cycle air conditioning and gas heating are installed customers can respond in the short term to changes in the relative retail price of gas and electricity. However, for other small use customer applications, such as gas versus electric hot water systems, substitution is generally possible in the longer term when existing appliances are replaced.

1143. The Authority notes that three submissions on WAGN's proposed revisions (Synergy, Alinta and the Office of Energy) expressed concern over WAGN's proposed changes in the reference tariff components for small use customers, in particular the initial increase in the fixed tariff component relative to the variable component, and suggested that such increases were likely to have a significant impact on these customers. These submissions supported a more gradual transition of such increases.
1144. The Authority considers that a significant proportion of small use customers (B2 and B3) may be limited in the extent to which they are able or likely to respond to price signals. The Authority is required to have regard to this matter, as discussed earlier in setting the reference tariffs for small use customers (rule 94(4)(b)(ii) of the NGR).
1145. In deriving the tariff path set out earlier in Table 27 the Authority has given consideration to the impact of these tariff increases on small use customers as discussed above. Under the tariff path set out in Table 27 the impact on the average B2 customer (150 GJ per annum) at retail level, assuming full pass through of changes in distribution tariffs to retail tariffs, would be -1.3 per cent per annum (in real terms). In the case of the B3 customer groups modelled by the Authority (usage of 5, 10, 20 and 40 GJ per annum) the impact at retail level, assuming a full pass through of the changes in distribution tariffs to retail tariffs, would be 5.9 per cent (5 GJ), -0.3 per cent (10 GJ), -0.9 per cent (20 GJ), and 1.9 per cent (40 GJ) per annum (in real terms).
1146. Based on the above the Authority considers that the impact on small use customers from the tariff path under Table 27 is reasonable and consistent with the requirements of the NGL and NGR and the WA Local Provisions.

### **Draft decision**

1147. The Authority is not satisfied that WAGN's proposed tariff structure has been determined with due regard to rule 94(4)(b)(ii) of the NGR, as it applies to small use customers and small users.
1148. The Authority's determined reference tariffs are set out in Table 27. The Authority has considered the impact on small use customers of the tariffs set out in Table 27 and is satisfied that the impact on these customers is reasonable and consistent with the requirements of the NGR and the WA Local Provisions.

## Revenue equalisation calculation

### Authority's assessment

1149. In order to comply with rule 92(2) of the NGR the reference tariff variation mechanism approved by the Authority must equalise the forecast revenue from reference services over the access arrangement period in present value terms with the portion of total revenue allocated to reference services for the access arrangement period.
1150. The Authority's approved reference tariff variation mechanism, and the tariff path it implies, is discussed above. The approved initial reference tariffs and the formula for varying the reference tariffs over the forthcoming access arrangement period are set out in Required Amendment 7 following that discussion.
1151. Applying the approved reference tariffs and variation mechanism, the approved demand forecasts, and the approved prudent discounts and ancillary services revenue, Table 29 sets out the revenue from reference services on a present value basis. This revenue equals the present value of the approved total revenue as required by rule 92(2) of the NGR.

**Table 28 Revenue from reference services (\$ million, December 2009)**

	2010 <sup>1</sup>	2010/11	2011/12	2012/13	2013/14	Present value
Total Tariff Revenue	59.239	132.352	137.243	141.017	145.025	512.335
Revenue from Prudent Discounts	1.851	3.297	3.184	3.363	3.533	12.750
Ancillary Services' Revenue	0.385	0.770	0.770	0.770	0.770	2.901
<b>Total Revenue</b>	<b>61.475</b>	<b>136.419</b>	<b>141.197</b>	<b>145.150</b>	<b>149.328</b>	<b>527.986</b>

<sup>1</sup> 1 January 2010 to 30 June 2010 only

### Draft decision

1152. The Authority is satisfied that the present value of the approved reference service revenue as shown in Table 28 equalises with the present value of the total revenue as shown in Table 29 of this draft decision in accordance with rule 92(2) of the NGR.

## Reference tariff post approval matters

### Incentive mechanism

#### Requirements of the NGL and the NGR

1153. Rule 98(1) of the NGR provides that a full access arrangement may include, and the Authority may require it to include, one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.
1154. An incentive mechanism may provide for the carrying over increments for efficiency gains and decrements for losses of efficiency from one access arrangement period to the next (rule 98(2) of the NGR).

1155. An incentive mechanism must be consistent with the revenue and pricing principles in section 24 of the NGL (rule 98(3) of the NGR).
1156. The access arrangement information must provide a justification for any proposed incentive mechanism (rule 72(1)(l) of the NGR).
1157. The access arrangement information must also contain the information necessary to understand the basis and derivation of the service provider's proposal in respect of this element (rule 42 of the NGR).
1158. As this element requires the provision of financial information by the service provider, rule 73 of the NGR provides that:
- a) the access arrangement information provided in relation to this element must state the basis (whether it be nominal, real or another recognised basis) on which the information is provided;
  - b) all of the financial information provided in relation to this element must be provided on the same basis; and
  - c) all calculations made in the access arrangement proposal or in the access arrangement information must be made on the same basis.
1159. As this access arrangement information is in the form of a forecast or estimate, rule 74 of the NGR provides that it must be supported by a statement of its basis, and must be arrived at on a reasonable basis, and must represent the best forecast or estimate possible in the circumstances.
1160. If any of the access arrangement information provided in relation to this element is in the nature of an extrapolation or inference, it must be supported by the primary information on which that extrapolation or inference is based (rule 75 of the NGR).

### **Access arrangement information**

1161. The access arrangement information, at page 53, states there is no incentive mechanism for the proposed access arrangement period.

### **Public submissions**

#### *WAGN's submission*

1162. WAGN noted at page 8 of its submission that incentives are provided by a price control which caps the reference tariffs for the access arrangement period. WAGN submitted that the price control acts as an effective incentive mechanism because the tariffs are capped for an extended period, that period being the access arrangement period. If, during this period, the service provider can lower its costs, or increase its sales of the reference services, relative to the forecast of costs and levels of service provision made for determining the reference tariffs, the service provider is able to earn increased profits at least until the end of the access arrangement period.
1163. WAGN made no other submissions in relation to the incentive mechanism.

*The Office of Energy's submission*

1164. The Office of Energy, in the Attachment to its submission dated 12 April 2010 (pages 3-4), noted that WAGN has not proposed an incentive mechanism in its proposed access arrangement. The Office of Energy further noted an increase in operating expenditure, both in the final year of the current access arrangement and throughout the proposed access arrangement.
1165. The Office of Energy submitted that the merits of an incentive mechanism that would apply to the operating expenditure of WAGN be considered. The Office of Energy stated that this potentially delivers benefits to all users of the network, as well as allowing WAGN to retain revenue should it out-perform its approved forecasts. The Office of Energy further noted that regulatory regimes that minimise inputs relative to outputs deliver benefits across the network, resulting in lower prices in the long term.

**Authority's assessment**

1166. The Authority notes that WAGN has made a proposal with respect to the incentive mechanism carry over which is discussed above.
1167. The Authority notes that rule 98(1) of the NGR establishes that the reason for an incentive mechanism is to encourage efficiency in the provision of services. This is consistent with the national gas objective. WAGN's has submitted that, by capping reference tariffs, there is an incentive mechanism which is in place for the whole of the access arrangement period.
1168. The Authority notes WAGN's submission that the capping of reference tariffs enables it to earn increased profits until the end of the access arrangement period if it is able to lower its costs or increase its sales of reference services. This mechanism provides an incentive for WAGN to increase efficiency in the use of the WAGN GDS by enabling it to retain cost benefits from that increased efficiency as increased profits.
1169. In its 2005 draft decision, the Authority considered AGN's proposed incentive mechanism. Pursuant to sections 8.44 to 8.46 of the Code, a service provider could establish an incentive mechanism within its reference tariff policy. In the 2005 draft decision, the Authority considered that the proposed incentive mechanism was not appropriate for inclusion and required a number of amendments in order to provide for an appropriate mechanism that expressly applied to both efficiency gains or losses for determining the efficiency carry-over for the final year of the access arrangement period (see 2005 draft decision paragraphs 502 to 533). While AGN generally accepted the requirement to amend, it did not accept required amendment 37. In its 2005 final decision, the Authority required that the incentive mechanism provide for a rolling carryover mechanism of no longer than five years (paragraphs 591 to 609).
1170. The Authority notes that there is a significant difference between the Code and NGR with respect to the requirements for an incentive mechanism. The Code provided that the incentive mechanism should be designed to achieve four objectives – to provide incentive to increase sales, to provide incentive to minimise overall costs, to provide incentive to develop new services in response to the needs of the market, and to provide incentive to undertake only prudent new facilities investment and to incur only prudent non-capital costs (section 8.46). The NGR is less specific,

requiring only that the incentive mechanism encourage efficiency in the provision of services (rule 98(1)).

1171. Because of the requirements of the Code, in making its 2005 draft decision, the Authority required amendments to AGN's proposed incentive mechanism to carve out from the incentive mechanism those costs that were not demonstrably linked to the objectives of section 8.46 of the Code such as savings in capital costs. Similarly, the Authority could only approve an incentive mechanism under the NGR to the extent that the gains, or losses, were directly attributable to efficiency. Only those savings that are attributable to efficiency can then be carried over into the reference tariff in the next access arrangement.
1172. In considering WAGN's proposed revisions, the Authority has to consider the national gas objective. As the national gas objective requires an access arrangement to encourage efficiency the Authority should consider whether WAGN's proposed revisions generally contain mechanisms that encourage efficiency. The Authority notes Office of Energy's submission on this point that an explicit incentive mechanism ought to be included achieve this.
1173. While the Authority notes that WAGN's access arrangement does not include an express incentive mechanism, WAGN has submitted that there is an implied incentive mechanism by way of the cap on reference tariffs. The Authority accepts WAGN's submission on this point. The capping of reference tariffs does create an appropriate incentive for WAGN to achieve increased efficiency by way of retained additional profits earned as a result of decreased costs or increased sales of reference services.
1174. The Authority notes that it does have full discretion with respect to the incentive mechanism and could therefore require such a mechanism to be included. However, the Authority accepts WAGN's submission that the capping of reference tariffs will provide WAGN with an incentive to earn increased profits during the access arrangement period if it promotes efficient use of the pipeline, either by decreasing operating costs or increasing sales of the reference service. Alternatively, WAGN will reduce its profits over the access arrangement period if it fails to improve efficiency beyond that allowed for in the proposed access arrangement.
1175. The Authority accepts WAGN's submission with respect to the incentive mechanism provided by the price control which caps reference tariffs for the access arrangement period. The Authority does not consider it necessary to include a further, express incentive mechanism.

#### **Draft decision**

1176. The Authority approves WAGN's proposal not to include an incentive mechanism in its revised access arrangement.

### ***Fixed principles***

#### **Requirements of the NGL and the NGR**

1177. Rule 99(1) of the NGR provides that a full access arrangement may include a principle declared in the access arrangement to be fixed for a stated period. This



period may be fixed for a period extending over 2 or more access arrangement periods (rule 99(2) of the NGR).

1178. A fixed principle is binding on the Authority and the service provider for the period for which the principle is stated to be fixed (rule 99(3) of the NGR). However:

- a) the Authority may vary or revoke a fixed principle at any time with the service provider's consent; and
- b) if a rule is inconsistent with a fixed principle, the rule operates to the exclusion of the fixed principle;

(rule 99(4) of the NGR).

1179. There are no specific access arrangement information requirements in relation to this element of the access arrangement. Accordingly, the relevant requirement is the general requirement that the service provider provides the Authority with all of the information necessary to understand the basis and derivation of the service provider's proposal in respect of this element (rule 42 of the NGR).

1180. As fixed principles require the provision of financial information by the service provider, rule 73 of the NGR provides that:

- a) the access arrangement information provided must state the basis (whether it be nominal, real or another recognised basis) on which the information is provided;
- b) all of the financial information provided must be provided on the same basis; and
- c) all calculations made in the access arrangement proposal or in the access arrangement information must be made on the same basis.

1181. If any of the access arrangement information provided is in the nature of an extrapolation or inference, it must be supported by the primary information on which that extrapolation or inference is based (rule 75 of the NGR).

### **Access arrangement proposal**

1182. Clause 11.1(a) of the proposed access arrangement sets out the fixed principles approved by the Authority in the current access arrangement for a period of 10 years. The fixed principles are as follows:

- (i) the financing structure (being a 60/40 debt/equity ratio) that has been assumed for the purposes of determining the Rate of Return for the WAGN GDS;
- (ii) the straight-line method of depreciation for each group of assets referred to in part 9; and
- (iii) that FRC costs that are incurred, or are expected to be incurred, in the delivery of Reference Services are included as a component of Operating Expenditure;
- (iv) the inclusion of:

(A) HHV Costs that are Conforming Capital Expenditure in the Opening Capital Base for the WAGN GDS at the Revision Commencement Date; and

(B) in Total Revenue HHV Costs that are Operating Expenditure for the Next Access Arrangement Period in respect of the WAGN GDS,

in respect of which Reference Tariffs have been varied as a Cost Pass Through Event.'

1183. Clause 11.1(b) of the proposed access arrangement sets out the fixed principles to be approved by the Authority for 10 years commencing on 1 January 2011. These proposed fixed principles are as follows:

(i) the Cost Pass Through Events and variation mechanism set out in clauses 2 and 3 of Annexure B;

(ii) the inclusion of:

(A) Physical Gate Point Costs that constitute Conforming Capital Expenditure in the Opening Capital Base for the WAGN GDS for the Next Access Arrangement Period; and

(B) Physical Gate Point Costs that constitute Conforming Operating Expenditure in Total Revenue for the Next Access Arrangement Period in respect of the WAGN GDS,

in respect of which Reference Tariffs have been varied as a Cost Pass Through Event.'

### **Access arrangement information**

1184. WAGN did not provide any access arrangement information in relation to the fixed principles set out in clause 11.1(a) of the proposed access arrangement. WAGN provided access arrangement information in relation to the fixed principles set out in clause 11.1(b) of the proposed access arrangement. This access arrangement information is outlined in the context of the reference tariff variation mechanism and the cost pass through events discussed above. . and .

### **Public submissions**

1185. No public submissions were received in relation to the fixed principles.

### **Authority's assessment**

1186. The Authority notes that clause 36 of Part B of the current access arrangement sets out the fixed principles approved in accordance with sections 8.47 and 8.48 of the Code which apply for a period of 10 years commencing 25 August 2005. However, the Authority notes that clause 36(1)(a), which provides for the method of calculation of the total revenue, and clause 36(1)(f), which provides for the method of allocating revenue between services, have been deleted from the proposed access arrangement.

1187. The Authority notes that those fixed principles which were approved prior to the commencement of the NGR are still binding on the Authority (rule 99(3)). However, the Authority may vary or revoke a fixed principle with the consent of the service provider (rule 99(4)(a)). In this case, the service provider has proposed to revoke two previously approved fixed principles. The Authority therefore exercises its discretion under rule 99(4)(a) to revoke the fixed principles with respect to the method of calculating total revenue and the method of allocating revenue between services.
1188. While the remaining fixed principles are similar to those set out in clause 36 of Part B of the current access arrangement, there have been some amendments. Clauses 11.1(a)(i) and 11.1(a)(ii) have been amended from the current clauses 36(1)(b) and 36(1)(c) as a consequence of the transition from the Code to the NGL/NGR. The Authority does not consider these amendments to be material.
1189. The Authority notes that clause 11.1(a)(iii) is similar to the current clause 36(1)(d). Currently, the fixed principle is that Full Retail Contestability (**FRC**) costs are included as a component of non-capital costs for the fixed period; however, the proposed access arrangement amends this so that FRC costs incurred, or expected to be incurred, in the delivery of reference services are included as a component of operating expenditure. This change is a consequence of the NGR's reference to operating expenditure as opposed to non-capital costs. As the term "non-capital cost" is generally synonymous with "operating expenditure", the Authority does not consider the amendment material. Further, the current clause 36(1)(c) refers to the FRC costs as those costs described in clause 25(2). These are those FRC costs incurred in the delivery of the reference service. The Authority therefore considers that there is no material difference between the proposed and current clauses.
1190. The Authority has considered the proposed clause 11.1(a)(iv) and compared it with the current clause 36(1)(e)(i). The proposed clause 11.1(a)(iv)(A) provides that one of the fixed principles is that HHV costs that are conforming capital expenditure are included in the opening capital base for the WAGN GDS at the revisions commencement date. What the Authority previously approved in clause 35(1)(e)(i) was that HHV costs which are new facilities investment are included in the capital base from the commencement of the next access arrangement period. Clause 12 of part B of the current access arrangement defines HHV costs as meaning the new facilities investment and non-capital costs incurred in relation to the management of heating value blending, which have not already been recovered by AGN and which do not exceed the amount that would be incurred by a prudent service provider acting efficiently. Annexure B of the proposed access arrangement defines HHV costs only as costs incurred in connection with the heating value blending for the WAGN GDS. The Authority notes that the amendment is a consequence of the commencement of the NGR and therefore does not alter the effect of the fixed principle.
1191. The Authority has also considered the proposed clause 11.1(a)(iv)(B) and compared it with the current clause 36(1)(e)(ii). The proposed clause 11.1(a)(iv)(B) provides that HHV costs that are operating expenditure are to be included in total revenue for the next access arrangement period. This is similar to the current clause 36(1)(e)(ii) which provides that the HHV costs that are non-capital costs are to be included in the total revenue for the next access arrangement period. As "non-capital costs" is synonymous with "operating expenditure", the Authority does not consider this amendment to be material.

1192. The Authority notes that the proposed clauses 11.1(iv)(A) and 11.1(iv)(B) only apply in respect of reference tariffs that have been varied as a cost pass through event. Clause 3 of annexure B defines a “cost pass through event” as including WAGN incurring HHV costs that constitute conforming capital expenditure or conforming operating expenditure. Currently, clauses 36(1)(e)(i) and 36(1)(e)(ii) apply in respect of reference tariffs which have been varied under the trigger event adjustment mechanism. Clause 11 of part B of the current access arrangement sets out that a trigger event adjustment approach allows for the fair and reasonable recovery of HHV costs. While there is a difference in the approach to HHV costs recovery between the proposed and current access arrangements, the Authority does not consider the difference is sufficient to warrant it revisiting its previous decision with respect to this fixed principle.
1193. The Authority notes that those fixed principles which were approved prior to the commencement of the NGR are still binding on the Authority (rule 99(3)). However, the Authority may vary or revoke a fixed principle with the consent of the service provider (rule 99(4)(a)). In this case, the service provider has proposed amendments to the previously approved fixed principles which are generally a consequence of the commencement of the NGR and which are generally immaterial. The Authority therefore exercises its discretion under rule 99(4)(a) to vary the previously approved fixed principles.
1194. The Authority notes that WAGN has proposed two new fixed principles to take effect for 10 years from 1 January 2011. Clause 11.1(b)(i) fixes the costs pass through events and variation mechanism set out in clauses 2 and 3 of annexure B. Clause 11.1(b)(ii)(A) provides that physical gate point costs constituting conforming capital expenditure is to be included in the opening capital base for the WAGN GDS for the next access arrangement period. Clause 11.1(b)(ii)(B) provides that physical gate point costs constituting conforming operating expenditure be included in total revenue for the next access arrangement period. Both of these proposed fixed principles only apply in respect of reference tariffs which have been varied as a cost pass through event.
1195. The Authority has considered the reference tariff variation mechanism and the cost pass through events above.
1196. If cost pass through events and variation mechanism are fixed principles, there is increased certainty about the extent to which tariffs will be variable in response to those factors set out in the annexure B which are outside of WAGN’s control. The Authority must consider whether WAGN’s proposed fixed principles meet the national gas objective. The Authority notes that one aspect of the national gas objective is to promote efficient investment in natural gas services. The Authority must therefore consider whether the proposed fixed principles promote efficient investment in the WAGN GDS.
1197. The Authority does not consider that the inclusion of the cost pass through events and variation mechanism as set out in clause 2 and 3 of Annexure B to be consistent with the objective of the NGL. The Authority considers that as this is the first revised access arrangement for WAGN under the NGL it would not be prudent to fix these important mechanisms in place for 10 years at this time.
1198. The Authority notes that a fixed principle may be fixed for a period extending over 2 or more access arrangement periods (rule 99(2)). WAGN has proposed that the principles in clause 11.1(b) remain in effect for 10 years from 1 January 2011 which is the proposed commencement date for the proposed access arrangement. With

the revisions commencement date proposed as 1 July 2014, these principles will be fixed for the duration of the next 2 access arrangement periods and will still be in effect when the subsequent access arrangement commences on 1 July 2019. The Authority does not consider this to be inconsistent with the national gas objective; particularly, the promotion of efficient investment in natural gas services.

1199. The Authority notes the formatting of clause 11 and in particular, the use of 11.1 when there is no subsequent clause 11.2. The Authority does not consider it likely that there is a clause 11.2 which has been omitted from the proposed access arrangement but requires this clause to be reformatted to reduce the risk of potential confusion about the completeness of clause 11.

### Draft decision

1200. The Authority does not approve clause 11.1(b)(i) of WAGN's proposed access arrangement.

#### Required Amendment 9

The Authority requires clause 11.1(b)(i) of WAGN's proposed access arrangement to be deleted.

## Terms and Conditions of Reference Services

### Requirements of the NGL and the NGR

1201. Rule 48(1)(d)(ii) of the NGR provides that a full access arrangement must specify for each reference service the other terms and conditions on which the reference service will be provided.
1202. There are no specific criteria for the assessment of the reference service terms and conditions. The revenue and pricing principles do not have any application (as these terms and conditions, by definition, do not concern revenue or pricing).
1203. The only assessment criteria for terms and conditions of reference services, therefore, are contained in the provision in rule 100 of the NGR which provides that 'all provisions' of an access arrangement must be consistent with the national gas objective in section 23 of the NGL.
1204. Therefore, all provisions of WAGN's proposed revisions concerning reference services, including the terms and conditions, must be consistent with the objective of promoting efficient investment in and efficient operation and use of, natural gas services for the long term interest of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.
1205. There are no specific access arrangement information requirements for an access arrangement proposal concerning the reference service terms and conditions. Accordingly, the only access arrangement information required for these provisions is information that is reasonably necessary for users and prospective users to understand:
- a) the background to the access arrangement proposal; and

- b) the basis and derivation of the access arrangement proposal  
(rule 42 of the NGR).

### **Access arrangement proposal**

1206. The proposed access arrangement contains numerous individual terms and conditions for reference services.
1207. There are many terms and conditions which are either unchanged from terms and conditions under the current access arrangement or in respect of which there have been no submissions questioning the proposal, and which comply with the national gas objective and may be approved. In those cases, the Authority approves the proposed access arrangement and it is unnecessary for the Authority to make specific reference to the proposed revision in its reasoning for this draft decision.
1208. In the following sections of the draft decision the Authority considers separately the proposed access arrangement for individual terms and conditions, which raise material issues regarding compliance with the national gas objective. The relevant revision proposal and public submissions, and the Authority's assessment and any required amendments are detailed below.

### **Access arrangement information**

1209. WAGN did not provide any access arrangement information in relation to any of the proposed terms and conditions for the reference services.

### **Public submissions**

#### *WAGN submission*

1210. WAGN's submission, dated 29 January 2010 (pages 4-5), made a general submission in relation to the Template Haulage Contract (discussed below), but otherwise did not make any submissions in relation to individual terms and conditions for reference services under the Template Haulage Contract.

#### *Other submissions*

1211. Synergy in its submission dated 12 April 2010, and Alinta in Attachment B dated 19 April 2010, made submissions in relation to the terms and conditions for reference services under the Template Haulage Contract. These submissions are discussed, where applicable, in the relevant sections below regarding individual terms and conditions. Where no reference is made to any public submissions, no submissions were received on the relevant clause.

## **Template haulage contract**

### **Access arrangement proposal**

1212. Under the current access arrangement for the GDS the terms and conditions of reference services are set out in Part C of the access arrangement. Under the proposed access arrangement, however, the terms and conditions are set out in a Template Haulage Contract, Annexure C to the proposed access arrangement.



1213. The individual terms and conditions proposed under the Template Haulage Contract are considered by the Authority in the sections of the draft decision following this section. In this section of the draft decision the Authority considers WAGN's proposal to set out the reference service terms and conditions as a Template Haulage Contract under Annexure C to the proposed access arrangement.

## Public submissions

### *WAGN submission*

1214. In section 1.3 of its submission dated 29 January 2010 (page 4) WAGN noted that there was no requirement under the Code and no requirement under the NGR for an access arrangement to include a pro forma contract. However, WAGN submitted that some prospective users of the GDS, in the absence of a pro forma contract, have viewed terms and conditions set out in the access arrangement as being only indicative or incomplete and therefore a legitimate subject of negotiation in settling an access arrangement. WAGN also noted that negotiations with prospective users risk becoming unnecessarily protracted when they are advised that in seeking changes by negotiation they are no longer seeking reference services and so reference tariffs are not applicable.

1215. WAGN submitted that this issue may be addressed by incorporating the terms and conditions on which it will provide the reference services in a proposed Template Haulage Contract. The purpose of the Template Haulage Contract would be to clarify to prospective users in their application for access to GDS reference services that WAGN would provide these reference services, at reference tariffs, on the terms and conditions set out in the Template Haulage Contract. WAGN noted that the Template Haulage Contract would have been closely scrutinised by the Authority in the process of approving the proposed revisions to the access arrangement.

### *Other submissions*

1216. Alinta, in Attachment B to its submission dated 19 April 2010 (page 1), submitted that many of the key concepts in the Template Haulage Contract are dealt with in a fragmented, and sometimes materially inconsistent way. Alinta highlighted three examples:

- a) Curtailment events are set out in clause 7.2, but the Template Haulage Contract contains many other rights to curtail in clauses 6.6, 7.3, 14.5, 15.1 and 15.2;
- b) Payment of haulage charges and force majeure are dealt with in clauses 4.2(a), 4.2(b) and 11(b); and
- c) The approved system pressure protection plan is dealt with in clause 1.1(a), 5.9, 5.10, 7.2(e), 15.1(b) and 17.1(b).

1217. Alinta considered that the Template Haulage Contract would be much more approachable for potential users if it dealt with each key concept in one regime in one part of the contract.

1218. No other public submissions were received with respect to the form of the Template Haulage Contract.

## Authority's assessment

1219. The Authority accepts WAGN's submission that the use of a Template Haulage Contract in lieu of the terms and conditions for reference services being contained in the access arrangement is desirable and may enhance efficiency and the reduce the potential for confusion. The Authority notes Alinta's submission that in some instances the Template Haulage Contract as drafted and submitted by WAGN deals with the same subject matter in more than one place and that this may give rise to confusion. However, the Authority considers that the appropriate way of addressing this issue is not, as Alinta's submission suggests, to require WAGN to redraft the Template Haulage Contract so that there is no overlap of subject matter, but rather for the Authority to require amendment to particular clauses of the Template Haulage Contract where this issue arises, to eliminate any inconsistency or ambiguity. The following sections of the draft decision relating to particular clauses addresses such issue as and when they arise.

## Draft decision

1220. The Authority accepts WAGN's proposal to express the terms and conditions for reference services in the form of a Template Haulage (Annexure C to the proposed access arrangement), subject to the required amendments in this draft decision.

## Conditions precedent

### Access arrangement proposal

1221. Clause 1.1(a)(i) in the Template Haulage Contract sets out that a condition precedent to the Template Haulage Contract is that the service provider must have approved an system pressure protection plan in accordance with clause 5.7 of the proposed access arrangement.

1222. Clauses 1.1(a)(ii)(A) to (D) of the Template Haulage Contract set out the prospective user's obligation to demonstrate to WAGN's satisfaction that it:

- a) able to comply, and will continue to be able to comply, with the approved system pressure protection plan;
- b) has the prudential and financial standings to meet the minimum requirements specified by the service provider;
- c) has the insurance specified in clause 15.3; and
- d) has a gas supply agreement with sufficient contractual entitlements to firm gas transportation capacity on at least one interconnected pipeline for delivery to at least one receipt point to meet the aggregate contracted peak rates that the prospective user has requested at the delivery point on the same sub-network.

1223. Clauses 1.1(b) to (e) of the Template Haulage Contract contain the remaining conditions precedent. Clause 1.1(b) imposes on the users to use their best endeavours to ensure each condition precedent is satisfied as soon as practicable but no later than 30 business days after signing the haulage contract. Clause 1.1(c) sets out that the users must keep the service provider informed of any circumstance

that may result in the conditions precedent not being satisfied. The users must also promptly advise the service provider as each condition precedent is satisfied.

1224. Clause 1.1(d) sets out that the conditions precedent shall benefit only the service provider. The service provider retains the absolute discretion to vary a condition precedent or not require a user to comply with a condition precedent. If the service provider does either of these, the user must be given written notice.
1225. Under clause 1.1(e), the service provider also retains the absolute discretion to terminate the haulage contract if the user has not complied, or the service provider has not waived the compliance requirement, within 30 business days of signing the haulage contract by written notice to the user.

### Public submissions

1226. In attachment B to its submission dated 19 April 2010 (pages 1-3), Alinta queried whether there would be a standard system pressure protection plan or whether all users would propose their own. Alinta submitted that the process for approval of the system pressure protection plan itself is not clear. Alinta argued that if the service provider is to approve each user's plan, then it should not have the right to approve in its 'absolute discretion' but rather as a service provider acting reasonably. Further, a user should only be required to have the system pressure protection plan approved once and not every time the application procedure is triggered under the Template Haulage Contract
1227. Alinta also queried whether there was to be a standard system pressure protection plan that the service provider approves for all users or whether each user is expected to propose its own. Alinta submitted that the process for approving a system pressure protection plan under the haulage contract is not clear. Alinta argued that if the service provider is to approve each user's system pressure protection plan then its right to approve should be as a provider operating reasonably rather than with absolute discretion. Alinta further argued that a user should only have its system pressure protection plan approved once and note each time the application procedure is invoked under the haulage contract.
1228. Alinta noted that clause 1.1(a)(ii) requires users to demonstrate to the service provider's satisfaction all of the conditions set out at clauses 1.1(a)(ii)(A) to (E). Alinta submitted that this should be amended to the service provider's 'reasonable satisfaction'.
1229. Alinta noted that clause 1.1(a)(ii)(A) requires a user to, and will, comply with the approved system pressure protection plan for the duration of the haulage contract. Alinta submitted that this condition should relate only to the status of the user's ability to comply at the time for satisfaction of the condition only. It will be difficult for the user to demonstrate future compliance throughout the haulage contract, thus Alinta argued this part of the clause should be deleted as the ongoing obligation to comply is already set out elsewhere in the contract in clauses 5.10 and 17.1(a) and (b).
1230. Alinta argued that the obligation under clause 1.1(a)(ii)(B), requiring a user's prudential and financial standing to meet the minimum prudential and financial requirements specified by the service provider in the access offer, is unreasonable and may create a barrier to entry. Alinta submitted that the service provider has rights to security under clause 15.2 which are also unconstrained. Alinta submitted that this clause should be amended so that the requirement for the prudential and

financial requirements, and the right to call security, are relative to the maximum amount of the user's likely outstanding indebtedness to the service provider at any time and considering the service provider's rights to curtail or terminate.

1231. Alinta expressed concern about the condition precedent set out in clause 1.1(a)(ii)(D) of the Template Haulage Contract which requires a user to have in place a gas supply agreement providing gas transportation sufficient to meet the aggregate of all the contracted peak rates at delivery points on the same sub-network. Alinta argued that this condition should contemplate the possibility that a user may have more than one gas supply agreement or may have a gas transportation agreement that is separate from the gas supply agreement. Alinta also expressed concern as to the manner in which it may be required to demonstrate satisfaction of this condition precedent. It argued that the issue should be dealt with as an ongoing warranty or covenant rather than a broad condition precedent with an obligation that may require the disclosure of commercially sensitive information.
1232. Alinta submitted that the condition set out in clause 1.1(a)(ii)(E) should relate only to the status of the user's ability to deliver gas at the time for the satisfaction of the condition only and not for the duration of the haulage contract. The demonstration of future compliance is 'so difficult as to be misconceived'.
1233. Alinta also queried clause 1.1(d) because each of the conditions precedent contain an element of the service provider's approval or satisfaction hence the user is not in a position to advise the service provider that the conditions precedent have been satisfied. Alinta submitted that the onus to advise as to the satisfaction of the conditions precedent ought to be reversed.
1234. Similarly, Alinta argued that clause 1.1(f) of the Template Haulage Contract required amendment to make it clear that it is the service provider, and not the user, that determines whether the conditions precedent have been satisfied. Alinta submitted that there was an inconsistent approach to the concepts of 'satisfy' and 'comply' which added to the 'opaqueness' of the clause. It recommended that the word 'satisfy' should be used throughout.
1235. Alinta also questioned why this clause was clause 1.1 when there was no subsequent clause in the conditions precedent. Alinta queried whether this suggested a missing clause 1.2.
1236. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1237. The Authority notes its draft decision at 200 to 208 above that the conditions precedent to access to pipeline services generally (as opposed to reference services) in clause 5.5 of the proposed access arrangement be deleted as contrary to the NGL and NGR. The Authority has accepted, however, that a pre-condition of access to pipeline services may be the prior approval of a system protection plan or another means of addressing the risk of system de-pressurisation. The Authority has required WAGN to amend clause 5.7 of the proposed access arrangement to expand the menu of options from which a user may select in order to address the system de-pressurisation risk from a single option (the approval of a system pressure protection plan) to a range of options including the approval of such a plan (see the Authority's draft decision in relation to clause 5.7 of the proposed access arrangement at 226 to 241 above).

1238. The Authority's draft decision regarding pre-conditions on access to pipeline services generally is not applicable to reference services. The NGL and NGR require the terms and conditions of access to reference services to be specified in the access arrangement and, in the Authority's opinion, those terms and conditions may include pre-conditions which must be satisfied prior to access being granted, so long as the relevant pre-condition would promote the national gas objective. The pre-conditions proposed by WAGN in clause 1 of the Template Haulage Contract, therefore, fall to be assessed by the Authority by reference to the national gas objective and may be approved if they are consistent with that objective.
1239. The Authority has considered the system pressure protection plan at above. As mentioned above, the Authority's decision is to require the access arrangement to make provision for a system pressure protection plan to be a pre-condition to service along with a range of other options. For those users who choose to avail themselves of this method of addressing the risk of system de-pressurisation it will be consistent with the national gas objective for the approval of a system pressure protection plan by WAGN to be a pre-condition to access.
1240. Under the Authority's required amendments with respect to clause 5.7 of the proposed access arrangement, WAGN is required to amend to include provisions consistent with clauses 28 to 34 of the current access arrangement which the Authority considers would address the risk of system de-pressurisation in a manner consistent with the national gas objective. Those provisions will set out provisions regarding the process of approval and content of a system pressure protection plan which in the Authority's view will comply with the national gas objective.
1241. In the circumstances, where the Template Haulage Contract requires approval and compliance with a system pressure protection plan to be a condition of access to reference services, it should instead require compliance by the user with clause 5.7 of the proposed access arrangement. In this way, whichever of the options the user chooses under clause 5.7 of the proposed access arrangement, compliance with the relevant option will be a pre-condition to access to the reference service.
1242. To achieve this, WAGN should be required to amend the Template Haulage Contract by deleting clauses 1.1(a)(i), 1.1(a)(ii)(A) and 1.1(a)(ii)(D), and replacing with a clause which provides for compliance by the user with the pre-condition to access in clause 5.7 of the access arrangement as a pre-condition to provision of the reference service.
1243. With respect to clause 1.1 (ii)(B), (C), (E) and (F), the Authority notes that while WAGN has not made a submission explaining the reasons for the clause, it is evident that the clause has been included to protect WAGN's ability to continue to provide a service. The Authority considers that it will be consistent with the national gas objective if WAGN is able to depend on the creditworthiness, prudential and financial standing, insurance coverage, gas delivery capacity, membership of a retail market scheme and security of the parties with whom it is contracting. If WAGN cannot make effective decisions about the contracting party, it cannot ensure efficient investment in and efficient operation of the GDS. Without this information, WAGN may jeopardise its ability to offer its services. The Authority therefore accepts clauses 1.1 (ii)(C), (C), (E) and (F).
1244. With respect to clauses 1.1(b) to (f), the Authority considers these to be procedural issues. These are, therefore, matters of detail in relation to the commercial arrangements between contracting parties, and not matters which go to compliance of WAGN's proposed revisions with the national gas objective, which is the matter

for the Authority's assessment. In these circumstances, the Authority considers that it should not approve the more detailed provisions regarding the procedure for the prospective users compliance with the conditions precedent. In the event that WAGN and any proposed user wish to agree regarding more specific or detailed compliance with the conditions precedent then there is provision for bilateral agreement about those matters in clause 30(2)(e) of the Part C of the current access arrangement. The Authority therefore does not accept clauses 1.1 (b) to (f) of the Template Haulage Contract.

### **Draft decision**

1245. WAGN is required to amend the Template Haulage Contract by deleting clauses 1.1(a)(i), 1.1(a)(ii)(A) and 1.1(a)(ii)(D), and replacing with a clause which provides for compliance by the user with the pre-condition to access in clause 5.7 of the access arrangement as a pre-condition to provision of the reference service.
1246. The Authority requires that clauses 1.1(b), (c), (d), (e), (f) of the Template Haulage Contract be deleted.

#### **Required Amendment 10**

The Template Haulage Contract should be amended as follows:

- a) Delete clauses 1.1(a)(i), 1.1(a)(ii)(A) and 1.1(a)(ii)(D), and replace with a clause which provides for compliance by the user with the pre-condition to access in clause 5.7 of the access arrangement as a pre-condition to provision of the reference service under the haulage contract.
- b) Delete clauses 1.1 (b), (c), (d), (e), (f).

## ***Duration of haulage contract***

### **Access arrangement proposal**

1247. Clause 2 of Template Haulage Contract sets out the duration of the haulage contract for provision of the reference service. Under the proposed clause, the Haulage Contract will commence on 8.00am the day after the day on which the contract is executed by both parties or all conditions precedent are fulfilled. The contract will end earlier of the user is no longer being entitled to take delivery of gas as any delivery point or when the contract is terminated under clauses 12.7, 14 or as otherwise provided for under the contract.

### **Public submissions**

1248. There were not public submissions on clause 2 of the Template Haulage Contract.

### **Authority's assessment**

1249. Clause 2 of the Template Haulage Contract differs from the duration clause in the current access arrangement. Currently, a haulage contract only has to specify the duration of the contract, the date from which the user is entitled to take gas and the duration of any options to extend the contract.



1250. The Authority notes that clause 2 of the Template Haulage Contract does not specify a minimum period for the contract. While it may be reasonable to specify a minimum period, the Authority considers that this may create a barrier to entry and could be inconsistent with the national gas objective.
1251. The haulage contract is for access to a reference service. The Authority considers that the right to access to a reference service is created under the access arrangement and expires on that access arrangement being revised or expiring. However, the Authority recognises that the haulage contract may extend into the subsequent access arrangement, as set out under Clause 2, but that the terms and conditions, including price, of the reference service under the new access arrangement are likely to be different.
1252. In order for Clause 2 of the Template Haulage Contract to be consistent with the NGL and NGR, and the national gas objective, the clause needs to be amended to provide that from the date of expiry or revision of the access arrangement the haulage contract will continue, subject to the user's agreement, by varying this contract to incorporate the terms and conditions of the subsequent access arrangement.
1253. Further, clause 2 of the Template Haulage Contract provides for the earlier termination of the haulage contract, including under clause 12.7 of the Template Haulage Contract. For the reasons set in the following sections of this draft decision the Authority requires that clause 12.7 should be deleted and, as a consequence, the reference to termination under that clause should be deleted from clause 2 of the Template Haulage Contract.

**Draft decision**

1254. The Authority requires clause 2(b) of the Template Haulage Contract to be amended so that a haulage contract for reference services can only extend past the date of revision or expiry of the access arrangement with the user's agreement and on the basis of this contract being varied to incorporate the terms and conditions of the subsequent access arrangement.

### Required Amendment 11

Clause 2(b) of the Template Haulage Contract should be amended to read:

This Haulage Contract:

b) ends on the earlier of:

- i) when the access arrangement is revised or expires in accordance with the NGL and NGR and <user> does not agree to continue this Haulage Contract on the basis of the Haulage Contract being varied to incorporate the terms and conditions of the access arrangement which replaces the current access arrangement.
- ii) when <user> is no longer entitled to take delivery of Gas at any Delivery Point under this Haulage Contract; or
- iii) when it is terminated under clause 14 or as otherwise provided for under this Haulage Contract.

## ***Fees and charges***

### *Obligation to pay for Haulage Services*

#### **Access arrangement proposal**

1255. Clause 4.1 of the Template Haulage Contract sets out the users obligation to pay for the haulage service. Under this provision, a user is obliged to pay the haulage charge for each haulage service and all other amounts payable under the contract. The Template Haulage Contract sets out the manner and times for payment in clause 9. The service provider must, by virtue of the operation of clause 4.1(b) comply with clause 9 when claiming payment. The clause also makes provision for the service provider to recovery any other monies payable by users either under the contract or at law.

#### **Public submissions**

1256. In attachment B to its submission dated 19 April 2010 (page 3), Alinta submitted that clause 4.1(c) is redundant, and confusing as clause 4.1(a) does not in any way purport to be exclusive or cover the field. Alinta considers clause 4.1(c) should be deleted. There were no other public submissions.

#### **Authority's assessment**

1257. The Authority notes that there is no equivalent to this clause in the current access arrangement. The Authority also notes that WAGN has not made a submission in support of the inclusion of this clause.

1258. The Authority has considered the argument made by Alinta with respect to clause 4.1(c). While the Authority agrees that the provision in clause 4.1(a) is not

exclusive, the Authority does not consider there is duplication between clauses 4.1(a) and (c) that is likely to cause confusion.

### **Draft decision**

1259. The Authority approves clause 4.1 of the Template Haulage Contract.

### *Ongoing obligation to pay*

### **Access arrangement proposal**

1260. Clause 4.2(a) of the Template Haulage Contract sets out the users' ongoing obligation to pay. The obligation to pay continues even if the service provider is unable to provide, undertake or complete one or more haulage services due to: (i) an act or omission by the user preventing the service provider from providing, undertaking or completing the haulage service, (ii) the haulage service not being able to be provided or undertaken in respect of the delivery point, or (iii) an event of force majeure.

1261. Similarly, clause 4.2(b) of the Template Haulage Contract sets out that users are obliged to pay the haulage charge for each haulage service and any other amounts due under the contract even if the users use the haulage service intermittently or irregularly or under any of the other circumstances set out in parts (ii) to (v) of this clause.

### **Public submissions**

1262. In its submission dated 12 April 2010 (page 8), Synergy expressed concern that the effect of clause 4.2(a) was that users will have to pay the haulage charge to WAGN for each haulage service to which the user has obtained access even if it is WAGN that is unable to provide the haulage service in respect of a delivery point. Synergy submitted that users should not have to pay for a haulage service it does not receive.

1263. In attachment B to its submission dated 19 April 2010 (pages 3-4), Alinta has argued that users should not be expected to pay for a haulage service which the service provider is not able to provide. Alinta submitted that this extended to all elements of the haulage charge including the standing charge, demand charge, user specific charge and usage charge. Alinta argued that, in an event of force majeure, users should only face an ongoing obligation to pay if the event of force majeure affects only the user but the service provider remains ready, willing and able to satisfy its obligations under the haulage contract. However, if it is the service provider affected by the event of force majeure, there should be no obligation on the users to pay. Alinta further submitted that clause 11(b) be amended to reflect this position.

1264. No other submissions were received with respect to this clause.

### **Authority's assessment**

1265. The Authority notes that clause 4.2(a)(ii) has the effect of requiring the user to pay for service even if the service provider is unable to provide service. This applies in any circumstance, even those that constitute force majeure or whether or not it is the service provider that is at fault. The Authority notes that there is no equivalent provision in the current access arrangement nor has WAGN made a submission justifying the necessity of this provision, which provides it with a more favourable

commercial position than under the current access arrangement. The Authority does not consider that WAGN could impose this provision on users in a competitive market and, therefore, the clause is inconsistent with the national gas objective and should be deleted.

1266. In relation to clauses 4.2(a)(iii) and 4.2(b)(v), the Authority notes that the rights of parties in events of force majeure are set out in clause 11 (discussed below). The Authority is concerned that 4.2(a)(iii) and 4.2(b)(v) duplicate the provisions of clause 11 and there is, therefore, potential for inconsistency to arise between the two provisions. The Authority considers that the parties' rights in the event of force majeure are properly dealt with in the context of clause 11 and the duplicate provisions in clauses 4.2(a)(iii) and (b)(v) should be deleted.

### **Draft decision**

1267. The Authority does not consider it necessary for clause 4.2 to deal with events of force majeure and therefore requires that clauses 4.2(a)(iii) and (b)(v) be deleted from the Template Haulage Contract.

#### **Required Amendment 12**

Clauses 4.2(a)(ii), 4.2(a)(iii) and 4.2(b)(v) should be deleted from the Template Haulage Contract.

## ***Receipt and delivery of gas, delivery points and the delivery point register***

### ***Receipt and delivery of gas***

#### **Access arrangement proposal**

1268. Clause 5.1 of the Template Haulage Contract sets out that users 'may take delivery of Gas at each Delivery Point identified in the Delivery Point Register'. Users take delivery on the terms and conditions set out in the Template Haulage Contract.
1269. The Delivery Point Register must be established pursuant to clause 5.4 of the Template Haulage Contract. The Register is discussed below.

#### **Public submissions**

1270. No public submissions were received with respect to this clause.

#### **Authority's assessment**

1271. Clause 5.1 is an amendment of clause 4 in Part C of the current access arrangement. Currently, users 'are entitled to take delivery of Gas at each Delivery Point identified in the Haulage Contract'. Users take delivery on the terms and conditions set out in the Template Haulage Contract.
1272. The Authority notes that WAGN proposes to amend the wording from a user 'will be entitled to take' to a user 'may take'. It also proposes to amend where delivery

points are identified from the Template Haulage Contract itself to the delivery point register. The Authority does not consider that these changes are inconsistent with the national gas objective and therefore accepts the changes.

#### **Draft decision**

1273. The Authority accepts clause 5.1 of the Template Haulage Contract.

#### *Obligation to accept and deliver gas*

#### **Access arrangement proposal**

1274. Clause 5.2 of the Template Haulage Contract sets out the service provider's obligations to accept and deliver gas. The obligations are to accept the gas delivered to the receipt point by one or more related shippers and deliver gas to users at a delivery point. The service provider's obligations are subject to the terms and conditions of the Template Haulage Contract. Further, the service provider is obliged to use reasonable endeavours to deliver gas to users at a delivery point at the nominal delivery pressure for the delivery point.

#### **Public submissions**

1275. In attachment B to its submission dated 19 April 2010 (page 4) Alinta submitted that the words 'use reasonable endeavours to' should be deleted.

1276. No other public submissions were received with respect to this clause.

#### **Authority's assessment**

1277. This is similar to clause 5(1) in Part C to the current access arrangement.

1278. The Authority notes that the differences between clause 5(1) in Part C to the current access arrangement and the proposed clause 5.2 will not materially impact on matters relevant to the national gas objective. Indeed, the main effect of the amendment is to supplement the service provider's obligations by specifying that the service provider must use reasonable endeavours to deliver gas at the nominal delivery pressure.

#### **Draft decision**

1279. The Authority approves clause 5.2 in the Template Haulage Contract.

#### *Receipt and delivery of gas*

#### **Access arrangement proposal**

1280. Clause 5.3 of the Template Haulage Contract sets out users' entitlements to the receipt and delivery of gas.

#### **Public submissions**

1281. No public submissions were received with respect to this proposed clause.

### **Authority's assessment**

1282. The Authority notes that clauses 5.1 and 5.3 are both titled 'Receipt and delivery of Gas'. This duplication has the potential to create confusion for the parties and is unnecessary. The Authority requires that this clause be retitled 'Start Date and End Date for receipt and delivery of gas'.
1283. Clause 5.3 clarifies, for the purpose of the Template Haulage Contract, the start date and end date for the receipt and delivery of gas. The inclusion of this clause is simply a consequence of the establishment of a delivery point register which is discussed below.
1284. The Authority considers the proposed clause 5.3 in the Template Haulage Contract to be acceptable.

### **Draft decision**

1285. The Authority requires clause 5.3 to be retitled.

#### **Required Amendment 13**

Clause 5.3 of the Template Haulage Contract should be retitled: 'Start Date and End Date for the receipt and delivery of gas'.

### *Delivery point register*

#### **Access arrangement proposal**

1286. Clause 5.4 of the Template Haulage Contract sets out the service provider's obligations to establish and maintain the delivery point register. It also sets out the requirement for what the delivery point register must record.

#### **Public submissions**

1287. In attachment B to its submission dated 19 April 2010 (page 4), Alinta submitted that the service provider should be required to give on request by a user an extract of the delivery point register containing the user's delivery points and should also be required to provide users with periodic notification (e.g. once every 12 months) as to delivery points falling within a certain period (for example, within 12 months after the date of the notice).
1288. Alinta further submitted in relation to clause 5.4(j)(iii) and (iv) of the Template Haulage Contract. That clause provides that the delivery point register will record certain information relating to Service A1, including information about user specific delivery facilities and user specific charges. Alinta submitted that there may not be user specific delivery facilities and no user specific charge as these facilities may already be installed or amortised. Alinta considered that the provisions should recognise that this information may not be relevant.



## Authority's assessment

1289. Alinta's submission regarding the provision of information asserted that the service provider should have an obligation to provide the information without providing any reasons why the requested amendment would be consistent with the national gas objective. As such the submission does not provide a substantiated basis for the Authority to require WAGN to make amendments.
1290. In relation to Alinta's submission regarding the recording of details for user specific facilities and user specific charges, the Authority considers that it is clear from the relevant clause that if there are no user specific delivery facilities or charge then the information need not be recorded in the delivery point register.
1291. The Authority notes further that WAGN has obligations pursuant to the Retail Market Rules to establish and maintain a delivery point register. Rule 403 of the Retail Market Rules provides as follows:
- “403. Other laws and instruments
- (1) Where these rules and any law, relevant Access Arrangement or licence condition imposed by the Energy Coordination Act 1994 impose different standards for performance in relation to the same matter, each of REMCo, a participant, a pipeline operator and a prescribed person must comply with the most stringent standard for performance in respect of that matter.
- (2) Subject to rule 403(1), if there is any inconsistency between these rules and any law, Access Arrangement or licence condition imposed by the Energy Coordination Act 1994, then:
- the law, Access Arrangement or licence condition will prevail to the extent of the inconsistency; and
- by virtue of rule 7(1), each of REMCo, a participant, a pipeline operator and a prescribed person (as applicable) is excused from performing its obligations under these rules to the extent of the inconsistency.”
1292. In light of rule 403 of the Retail Market Rules it is unnecessary in cases where there is potential overlap between the Retail Market Rules and an access arrangement proposal for the Authority to undertake a comparison and to attempt to address any inconsistency by requiring amendments. Rule 403(1) of the Retail Market Rules ensures that the most stringent performance standards in whichever instrument will take precedence, and any inconsistency will be resolved by rule 403(1).
1293. In the present case, therefore, the only task for the Authority is to consider whether or not the WAGN's proposed revisions are consistent with the national gas objective, without needing to enquire into or compare clause 5.4 with the Retail Market Rules regarding the delivery point register.
1294. The Authority considers that clause 5.4 is consistent with the national gas objective.

## Draft decision

1295. The Authority approves clause 5.4 of the Template Haulage Contract.

## *New delivery points and increasing contractual peak rate*

### **Access arrangement proposal**

1296. Clause 5.5(a) of the Template Haulage Contract sets out that users may request to add a new delivery point, increase the contracted peak rate for a delivery point or change the end date for a delivery point. Clause 5.5(b) states that such a request is subject to the application procedure (discussed above) and the user being a current user for the delivery point at the time the adjustments are made.

### **Public submissions**

1297. In attachment B to its submission dated 19 April 2010 (page 4), Alinta argued that the service provider should, pursuant to clause 5.5(a), be obliged to agree to a request to add a delivery point, increase the contracted peak rate for the delivery point to which service A1, A2 or B1 applies, or change an end date for a delivery point to a later date. Clause 5.5(a) states that these are subject to the service provider's approval. Alinta argued that the service provider should be obliged to agree unless there are technical or commercial reasons to reject the User's application. Alinta expressed concern that the service provider's discretion is too broad.
1298. Alinta submitted, with respect to clause 5.5(b), that the application process for an existing user to increase capacity should only apply to the extent strictly necessary to allow the service provider to determine whether the WAGN GDS has the capacity required to cope with the User's request and to comply with queuing requirements. Alinta argued that it should not be necessary for a user just requesting increased capacity to trigger a further obligation on the user to provide information as to prudential and financial matters when that information will already have been provided and the haulage contract already contains provisions about ongoing obligations in relation to security and insurances.
1299. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1300. The Authority sees merit in Alinta's submissions, having regard to the national gas objective.
1301. The requests governed by these provisions are by the current user and, therefore, WAGN should already have all of the information which would be gained by requiring the user to follow the procedure for initial access to pipeline services. The information, therefore, is not required to facilitate the efficient operation of the gas pipeline.
1302. Further, as the clause as drafted does not restrict in any way WAGN's ability to refuse a request, this clause could result in a request being refused on grounds inconsistent with the national gas objective.

### **Draft decision**

1303. The Authority requires that clause 5.5 in the Template Haulage Contract be amended to constrain the grounds on which a request may be refused and not to require the user to follow the application procedure.

### Required Amendment 14

Clause 5.5(a) of the Template Haulage Contract should be amended as follows:

- (a) Subject to clause 5.5(b), **<User>** may request **<Service Provider>** to:
- i) add a new Delivery Point to the Delivery Point Register;
  - ii) increase the Contracted Peak Rate for a Delivery Point to which Service A1, Service A2 or Service B1 applies; or
  - iii) change the End Date for a Delivery Point to a date which is later than the End Date specified in the Delivery Point Register for the Delivery Point,
- and, if ~~<Service Provider>~~ agrees, **<Service Provider>** must make appropriate adjustments to the Delivery Point Register, subject to **<Service Provider>** withholding consent on reasonable grounds, based on technical or commercial considerations.

Clause 5.5(b)(i) should be deleted.

### *Deregistration of delivery points*

#### **Access arrangement proposal**

1304. Clause 5.6(a) sets out that users must request the service provider to deregister the delivery Point if, at the End Date, there is no other user identified as the current user. Clause 5.6(b) states that the user will have to pay the haulage charge and any other amounts payable under the Template Haulage Contract in respect of the delivery point until the delivery point is deregistered. The end date is deemed not to occur until the delivery point is deregistered.

#### **Public submissions**

1305. In attachment B to its submission dated 19 April 2010 (page 5), Alinta argued that it is the service provider which maintains the Delivery Point Register and is there the party with the relevant information to deregister a delivery point. Alinta submitted that, if the User is to be required to apply for deregistration, the service provider must be obliged to provide the relevant end date information to the User in a timely manner. Further, the User ought not be obliged to make the payments referred to under clause 5.6(b) until the service provider has given that information. Finally, Alinta submitted that the obligation to apply for deregistration must be subject to any application to an extension to the end date.

1306. No public submissions were received with respect to this proposed clause.

#### **Authority's assessment**

1307. This clause is different from the clause 17(c) of Part A of the current access arrangement. Currently, a deregistration service is an ancillary service offered by WAGN.

1308. The Authority considers it evident that the purpose of this clause is enable the service provider to fulfil its obligations under the REMCo Retail Market Rules with respect to the maintenance of a delivery point registry.
1309. The Authority has considered Alinta's submission with respect to this clause. The Authority notes Alinta's concern that end date information be provided to a user in a timely manner prior to that end date to enable the user to request deregistration. The Authority considers that the ideal situation is one where the end date and date of deregistration are the same to ensure the potential for users to have to make payments under clause 5.6(b) is minimised and notes that clause 5.3(c)(ii)(C) expressly allows that one of the end dates to be the date of deregistration. The Authority considers that it is consistent with the national gas objective, in particular the efficient operation of the gas pipeline, to require the service provider to provide information to a user prior to the end date.

### **Draft decision**

1310. The Authority requires that clause 5.6 of the Template Haulage Contract be amended to require the service provider to provide information about deregistration to users prior to the end date.
1311. The Authority approves clause 5.6(b) but notes that it will become 5.6(c) following this required amendment.

#### **Required Amendment 15**

Clause 5.6 of the Template Haulage Contract should be amended as follows:

- Delete clause 5.6(a) and replace with the following:
  - (a) No later than 30 days prior to the End Date, <Service Provider> will give written notice to <user> specifying the procedure to Deregister the Delivery Point.
  - (b) If on the End Date for a Delivery Point no other user is identified as the Current user for the Delivery Point under the Retail Market Rules or <user> has not applied for an extension to the End Date, then <user> must request <Service Provider> to Deregister the Delivery Point.
- Renumber clause 5.6(b) as 5.6(c).

### ***Receipt points***

#### **Access arrangement proposal**

1312. Clause 5.7(a) of the Template Haulage Contract sets out that there is to be only one receipt point for each interconnected pipeline for each sub-network. This condition applies even if there is more than one physical gate point.

1313. If there is more than one physical gate point then, pursuant to clause 5.7(b), the several physical gate points are treated as a single receipt point for the purpose of gas flows, users' rights to deliver gas, the service provider's obligations to receive gas and any curtailment. Further, the service provider has no responsibility to manage how gas delivered to the receipt point is apportioned between, or physically transported to, physical gate points.

### **Public submissions**

1314. No public submissions were received with respect to this clause of the Template Haulage Contract.

### **Authority's assessment**

1315. The Authority notes that the proposed clause 5.7 of the Template Haulage Contract is substantially the same as clause 64(1) and (2) of Part A of the current access arrangement. Sub-sections 64(3) and 64(4) have been deleted.
1316. The Authority also notes the WAGN did not make a submission in relation to this proposed clause. The Authority considers it evident that the sub-sections from the current access arrangement which have not been incorporated into the Template Haulage Contract are dealt with by the REMCo Rules. It therefore agrees with WAGN's deletion of these sub-sections.

### **Draft decision**

1317. The Authority accepts clause 5.7 in the Template Haulage Contract.

## *Gas quality and gas quality data*

### **Access arrangement proposal**

1318. Clause 5.8 of the Template Haulage Contract sets out the terms and conditions for gas quality and gas quality data. The clause places an obligation on users to ensure that gas delivered to receipt points to be delivered through the GDS is compliant with the gas quality specifications. To ensure compliance with clause 5.8(a), clause 5.8(b) states that users must, on each gas day or more frequently if reasonably requested to do so, provide gas quality data and written evidence of compliance. Users must indemnify the service provider from any claim brought against the service provider arising out of gas delivered to a receipt point that does not meet the gas quality specifications (clause 5.8(c)).
1319. Further, under clause 5.8(d), users must acknowledge and agree that the service provider does not control the quality of gas in the GDS, the service provider makes no warranty or guarantee about the gas quality and the service provider cannot be held liable to the user in respect of loss, damage or other consequence suffered by the user because delivered gas does not comply with the gas quality specifications.
1320. The gas quality specifications are set out in Annexure A to the Template Haulage Contract.

### **Public submissions**

1321. Under Part A of the current access arrangement, all gas that enters the GDS must comply with gas quality specifications (section 22). Similarly, under clause 15 of

Part C, gas entering and being transported through the GDS must comply with gas quality specifications.

1322. In attachment B to its submission dated 19 April 2010 (page 5), Alinta noted that the requirement in 5.8(b) to report to the service provider about gas quality data may place users in breach of their contractual commitments. It cited the contractual restraint imposed on it which would prevent it from passing information about gas quality data to anyone, including the service provider. Alinta submitted that information about gas quality data should be provided by operators of the interconnected pipelines to the service provider directly under the Interconnection Agreements that exist between those parties.
1323. Alinta expressed concern that, under the proposed clause, users would have to agree that the service provider has no control over the quality of gas in the GDS. It argued that the service provider may have no control over the quality of gas entering the GDS, it did have control over the quality of gas once it was in the system.
1324. Alinta noted that clause 5.8(d)(iii) has the effect of excluding from the service provider any liability for out-of-specification gas. Alinta argued that liability should not be excluded when it was wilful deceit, negligence or fraud on the part of the service provider that caused the gas delivered to be out of specification.
1325. There were no other public submissions.

#### **Authority's assessment**

1326. The Authority notes that the *Gas Supply (Gas Quality Specification) Act 2009 (Act)* and *Gas Supply (Gas Quality Specifications) Regulations 2010* came into effect on 27 March 2010, after WAGN submitted its proposed revisions.
1327. This Act will enable future producers to supply leaner quality gas to transmission pipelines in Western Australia. The change aims to encourage the development of gas fields which contain gas outside current transmission pipeline delivery specifications. The downstream effects of this change are being addressed in the gas distribution pipeline systems, through an appliance rectification program for pre-1980's gas appliances and changes to the *Gas Standards (Gas Supply and System Safety) Regulations 2000*. It is understood from the Office of Energy that the *Gas Standards (Gas Supply and System Safety) Regulations 2000* is likely to be further amended to adopt the Western Australian standard specification in part 1 of Schedule 1 of the *Gas Supply (Gas Quality Specifications) Regulations 2010* during the term of this access arrangement.
1328. It is noted that the *Gas Standards (Gas Supply and System Safety) Regulations 2000* were changed in January 2010 and now largely adopt *AS 4564-2005: Specification for general-purpose natural gas* with additional limits on higher heating value to be not less than 37.0 MJ/m<sup>3</sup> and not more than 42.3 MJ/m<sup>3</sup> plus odourising requirements.
1329. The Authority considers it appropriate for the gas quality specifications in the Template Haulage Contract to be the more stringent of the Western Australian standard specification in the *Gas Supply (Gas Quality Specifications) Regulations 2010* and the *Gas Standards (Gas Supply and System Safety) Regulations 2000*, as proclaimed from time to time. The Authority therefore requires WAGN to amend Annexure A to the Template Haulage Contract.



1330. The Authority has considered Alinta's submission regarding clause 5.8(b), in particular its argument that Alinta would be contractually restrained from complying with this clause in the Template Haulage Contract. The Authority notes that this is a new clause with no equivalent in the current access arrangement. The Authority also notes Alinta's submission that the information the clause proposes to collect from users could be collected from interconnecting pipeline operators. The Authority does not consider that this clause is consistent with the efficient operation of the gas pipeline and consequently is inconsistent with the national gas objective. Therefore, the Authority does not approve clause 5.8(b).

1331. The Authority notes that, pursuant to clause 5.8(d)(iii), a service provider would have no direct or indirect liability in connection with the delivery of gas that does not comply with the gas quality specification. The Authority does not accept that this clause is appropriate or consistent with the national gas objective as there could be circumstances, as outlined in Alinta's submission, where the service provider is responsible for, or contributes towards, the delivered gas being out of specification. Under these circumstances, this clause would not be appropriate. Therefore, the Authority does not approve clause 5.8(d)(iii) in the Template Haulage Contract.

### Draft decision

1332. The Authority requires WAGN to amend Annexure A to the Template Haulage Contract so that it reflects the most stringent gas specification parameters applying under either the Western Australian standard specification in the *Gas Supply (Gas Quality Specifications) Regulations 2010* or the *Gas Standards (Gas Supply and System Safety) Regulations 2000*.

1333. The Authority requires the deletion of clauses 5.8(b) and 5.8(d)(iii).

#### Required Amendment 16

Annexure A to the Template Haulage Contract should be amended as follows:

- Delete 1(a) and replace with "the gas specification requirements detailed under the *Gas Standards (Gas Supply and System Safety) Regulations 2000*".
- Rename 1(b) to 1(c),
- Insert 1(b) as "the gas specification requirements detailed under part 1 of Schedule 1 (Western Australian standard specification) under *Gas Supply (Gas Quality Specifications) Regulations 2010*".
- Delete the table under Annexure A.

### Required Amendment 17

Clauses 5.8(b) and 5.8(d)(iii) should be deleted from the Template Haulage Contract.

## *Gas balancing*

### **Access arrangement proposal**

1334. Clause 5.9 sets out the users' obligations including those with respect to gas balancing and the System Pressure Protection Plan. These obligations are to ensure that users deliver into the sub-network the same amount of gas that they receive from the sub-network.

### **Public submissions**

1335. In its submission dated 12 April 2010 (page 8), Synergy expressed concern that, pursuant to clause 5.9(c), a user must agree that nothing in the haulage contract makes the service provider liable to the user in respect of any loss, damage or other consequence suffered by the user. Synergy argued that WAGN should be liable where that loss, damage or other consequence suffered by the user was caused, or contributed to, by WAGN's negligence, or breach of contract or regulatory obligations.
1336. In its submission dated 19 April 2010, Alinta noted that clause 5.9(a) states that the user must ensure deliveries into each sub-network equate to the gas the user receives from that sub-network. Alinta submitted that the absolute obligation set out in clause 5.9(a) should be replaced with an obligation on the user to use reasonable endeavours in good faith to ensure that its deliveries into the sub-network equate to the gas received from that sub-network.
1337. Alinta also raised its concern with the requirement under clause 5.9(c) that nothing in the haulage contract makes the service provide liable for loss, damage or other consequence suffered by the user in connection with a failure by the operator of an interconnected pipeline to deliver gas into the GFS at a receipt point. Alinta argued that the service provider should be liable to the extent that it contributed to such loss, damage or other consequence.
1338. Alinta raised the further concern that, pursuant to clause 5.9(d)(iv) a user must ensure its related shippers' or related swing service providers' conduct does not cause any user loss or damage. Alinta submitted that this obligation should be limited to that relating to the WAGN GDS and not to conduct in general.
1339. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1340. The Authority notes that clause 5.9 has amended the clause 16 in Part C to the current access arrangement.
1341. Under clause 5.9(a), a user must ensure it procures the injection of an amount of gas into the sub-network equal to the user's good faith estimate, acting as a

reasonable and prudent person, of the quantity of gas the user is likely to withdraw from the sub-network on that day. WAGN has not made a submission in support of its amendment, the effect of which is to place an absolute obligation on a user to ensure the delivery and receipt of gas on each gas day is balanced. The Authority does not consider this clause, which significantly increases a user's obligations, to be appropriate or consistent with the national gas objective. Therefore the Authority does not approve clause 5.9(a) of the Template Haulage Contract.

1342. The Authority notes that clause 5.9(b) of the Template Haulage Contract is similar to clause 16(2) of Part C to the current access arrangement. The Authority considers clause 5.9(b) complies with the national gas objective.
1343. The Authority notes that clause 5.9(c) is a new clause for which there is no equivalent in the current access arrangement. The Authority further notes that WAGN has not provided any submission with respect to this clause. It seems evident that the effect of this clause is to excuse WAGN from liability for any loss, damage or other consequence arising out of the failure of a third party (that is, the operator of an interconnected pipeline) or the user's breach of the haulage contract. The Authority considers that it is not consistent with the national gas objective for WAGN to be liable for a failure of a third party nor for a breach by the user. The Authority therefore accepts this clause.
1344. The Authority has considered clause 5.9(d) and notes that it is materially the same as clause 17(1) in Part C to the current access arrangement but with the addition of clause 5.9(d)(iii). Clause 5.9(d)(iii) sets out that users must comply with its approved system pressure protection plan. This appears to be an appropriate obligation to place on users having regard to the Authority's acceptance of system pressure protection plans as being consistent with the national gas objective. The Authority's consideration of system pressure protection plan is discussed elsewhere in this draft decision. The Authority accepts clause 5.9(d).
1345. The Authority has considered clause 5.9(e) and notes that it is similar to clause 17(2) of Part C to the current access arrangement. The differences between the clauses are evidently a consequence of changes in terminology used in this proposed access arrangement and are not considered material. The Authority therefore accepts clause 5.9(e).
1346. The Authority has considered clause 5.9(f) and notes that its effect is that the provisions of clause 5.9 do not limit the operation of clause 7 which is discussed below.

#### **Draft decision**

1347. Clause 5.9(a) of the Template Haulage Contract should be amended to reflect clause 16(1) in Part C to the current access arrangement.

### Required Amendment 18

Clause 5.9(a) of the Template Haulage Contract should be amended to read:

For each Gas Day, <user> must ensure that it ~~delivers~~ procures the injection of an amount of Gas into each Sub-network that is equal to the <user> <user>'s good faith estimate, acting as a reasonable and prudent person, of the quantity of Gas receives from that Sub-network on that <user> is likely to withdraw from the Sub-network on that Gas Day.

## *System pressure protection plan*

### **Access arrangement proposal**

1348. Clause 5.10 sets out that a user must comply with its approved system pressure protection plan. If a user suspects that there is or is likely to be a breach of the approved system pressure protection plan, the user must notify the service provider as soon as practicable after it becomes aware of, or suspects, the breach.

### **Public submissions**

1349. In its submission dated 19 April 2010 (page 6), Alinta argued that this clause is effectively redundant because of the operation of clause 5.9(d)(iii). Alinta also expressed concern about the apparent inconsistencies between this clause and clauses 7.2(e) and 15.1(b).
1350. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1351. The Authority notes that this clause has simplified the operation of clauses 32 to 34 of Part A to the current access arrangement. In the current access arrangement, clause 32 provides that clause 33 applies to any user who entered into a service agreement prior to the start of the second access arrangement period and, at the time that period starts, complies with Part A, clause 29(a) which sets out the first option for a system pressure protection plan. Clause 33 sets out that users to whom the clause applies must not cease complying with their system pressure protection plan unless the user has submitted, and WAGN has approved, a system pressure protection plan and an enforceable undertaking.
1352. Clause 34 of the current access arrangement sets out that if a user does not comply with clause 33, WAGN may exercise any remedy available under the access arrangement that would have been available had the user breached an undertaking made under Part A clause 28(a)(ii) and made the representation or warranty under Part A clause 65.
1353. The Authority has considered Alinta's submission regarding the apparent inconsistencies. Pursuant to clause 5.9(d)(iii), a user has to ensure that its conduct, and that of its related shippers complies with the approved system pressure protection plan. Pursuant to clause 5.10(a) users must comply with their approved system pressure protection plan; there is no express provision for a user's related

shipper to also comply. However, as there is an overlap in the two provisions, there is the possibility of an inconsistency which should be addressed. The Authority considers that this potential inconsistency can be dealt with by requiring clause 5.10(a) to be deleted.

1354. Clause 5.10(b) places the users under an obligation to notify the service provider at any time it knows or suspects that there is a breach of the approved system protection plan. This is not the same as the obligations set out in 7.2(e) and 15.1(b) as contended in Alinta's submission. Pursuant to clause 7.2(e), the service provider can exercise its rights of curtailment if, in its opinion as a reasonable and prudent pipeline operator, the user is in breach of its approved system pressure protection plan. Pursuant to clause 15.1(b), the service provider has the right to deliver written notice to the user that it must provide written evidence that it is complying, and will continue to comply, with the approved system pressure protection plan. The Authority does not accept Alinta's submission that there is any inconsistency in these three provisions as they set out respectively that:

- a) the user must notify the service provider if it knows or suspects a breach of the approved system pressure protection plan (clause 5.10(b));
- b) the service provider can exercise its rights of curtailment if there is a breach of the approved system pressure protection plan by the user (clause 7.2(e)); and
- c) the service provider can give notice that it requires written evidence from the user of compliance with the approved system pressure protection plan (clause 15.1(b)).

1355. The Authority does not accept Alinta's submission and considers that clause 5.10(b) places an obligation on the user to report an actual or suspected breach of the approved system pressure protection plan which is consistent with the efficient operation of the gas pipeline.

1356. The Authority notes that there is no equivalent to clause 31 of Part A to the current access arrangement in the Template Haulage Contract. This clause set out that the term 'system pressure charge' meant an amount reflecting WAGN's cost of providing the system pressure service under the service agreement. The Authority considers that it is reasonable not to include a similar clause in the Template Haulage Contract.

### **Draft decision**

1357. The Authority's decision about the system protection plan is set out above in this draft decision.

1358. The Authority does not approve clause 5.10(a) of the Template Haulage Contract.

1359. The Authority approves clause 5.10 (b) of the Template Haulage Contract.

### Required Amendment 19

Clause 5.10(a) of the Template Haulage Contract should be deleted.

## *Emergencies*

### **Access arrangement proposal**

1360. Clause 5.11 of the Template Haulage Contract sets out the responsibilities of both parties in the event of an emergency. The clause gives the service provider the discretion to act without notice if that action is necessary to prevent injury, death, loss or damage to persons or property. However, as soon as practicable, the service provider must provide written notice to the affected user. The user is obliged to comply with any reasonable instruction given by the service provider during or related to the emergency, and the user will be liable for injury, death, loss or damage resulting from non-compliance. The service provider rights under the law, access arrangement of haulage contract are not limited by the provisions in clause 5.11.

### **Public submissions**

1361. In its submission dated 19 April 2010 (page 6), Alinta expressed concern that, under clause 5.11(d) a user will be liable for any injury, death, loss or damage, whether direct or indirect, suffered by reason of the user's failure to comply with an instruction regarding an emergency. Alinta submitted that users should not be liable for indirect loss or damage.

1362. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1363. The Authority notes that clauses 5.11(a), (b) and (c) are essentially the same as clauses 21(1), (2) and (3) in Part C to the current access arrangement.

1364. The Authority notes that clause 5.11(d) is similar to clause 21(4) in Part C to the current access arrangement except for the addition of the words 'be it direct or indirect' after the phrase 'and the <user> is liable to the <Service Provider> for any injury, death, loss or damage'. If there was no contractual provision then the issue of liability of the respective parties would be determined according to law. The Authority considers that an access arrangement can set out regulated terms and conditions that adjust the liability between the parties. WAGN is proposing to change the existing liability arrangements by adding the words 'be it direct or indirect' to this clause. The Authority considers it likely that users have a legitimate expectation of the continuation of existing liability arrangements, which should only be adjusted if it can be clearly demonstrated that the current arrangements are inconsistent with the national gas objective. There is no apparent reason referable to the national gas objective to justify the change in scope of liability, which the Authority notes can always be the subject of commercial discussions and agreement. The Authority also notes that clause 5.11(d) could contradict clause 16.1. Therefore, the Authority requires that the words 'be it direct or indirect' be deleted from clause 5.11(d) of the Template Haulage Contract.



1365. The Authority notes that clause 5.11(e) has no counterpart in the current access arrangement. The Authority has considered this clause and accepts its addition to the Template Haulage Contract.

#### **Draft decision**

1366. The Authority requires that clause 5.11(d) of the Template Haulage Contract be amended to delete the words 'be it direct or indirect'.

#### **Required Amendment 20**

The words 'be it direct or indirect' should be deleted from clause 5.11(d) of the Template Haulage Contract.

### ***Operational provisions***

#### ***Title to gas***

#### **Access arrangement proposal**

1367. Clause 6.1 of the Template Haulage Contract sets out that the service provider has title to, and control and possession of, all gas in the GDS. The users agree to indemnify the service provider against any claim brought by any person in respect to any Gas delivered into the GDS if that person claims an interest in, or claim of any nature over, the gas or in respect of any unpaid amounts incurred before or arising out of delivery of the gas to the service provider.

#### **Public submissions**

1368. In its submission dated 12 April 2010 (page 8), Synergy expressed concern about clause 6.1(b) whereby a user must indemnify WAGN against any claim brought by any person against WAGN in respect of any gas delivered into the GDS. Synergy submitted that, since the gas entering the GDS must meet specification, the onus should be in WAGN to accept or reject the gas at the gate station rather than deliver out of specification gas, particularly as a user may not have any notice of, or a way to prevent, out of specification gas.

1369. No other submissions were received with respect to this clause.

#### **Authority's assessment**

1370. The Authority notes that this clause is essentially the same as clause 11 in Part C to the current access arrangement which, in its 2005 draft decision, the Authority approved.

1371. The Authority does not consider that the minor changes to the wording between clause 11 in Part C of the current access arrangement and clause 6.1 of the Template Haulage Contract are sufficient to make out a case that the amended clause would not be consistent with the national gas objective.

### **Draft decision**

1372. The Authority approves clause 6.1 of the Template Haulage Contract

### *Only user may take delivery, title and possession of gas*

#### **Access arrangement proposal**

1373. Clause 6.2 sets out that it is only users who can receive gas delivered by the service provider at a delivery point under the haulage contract. It also sets out that by delivery, the service provider will transfer title to and control and possession of the gas to the user effective at the delivery point. The title is free and clear of all claims.

#### **Public submissions**

1374. In its submission dated 19 April 2010 (page 6), Alinta argued that the user does not receive gas at the delivery point; it is in fact the end user who receives the gas. Alinta submitted that this clause should be amended to reflect that it is the user who is entitled to receive the gas and that title passes to the user. The control and possession of the gas pass to the end user.

1375. No other public submissions were received with respect to this clause

#### **Authority's assessment**

1376. The Authority notes that clause 6.2 is similar to clause 12 in Part C to the current access arrangement. However, clause 12(3) has been deleted. The Authority considers this deletion appropriate as the Template Haulage Contract has no bearing on what happens to the gas after delivery pursuant to any agreement a user may have with a third party.

1377. The Authority considers clause 6.2 to be consistent with the national gas objective.

### **Draft decision**

1378. The Authority approves clause 6.2 of the Template Haulage Contract.

### *Commingling permitted*

#### **Access arrangement proposal**

1379. Clause 6.5 of the Template Haulage Contract sets out that the service provider may commingle with other gas in the GDS any gas delivered into the GDS and deliver commingled gas where and when it considers necessary or convenient.

#### **Public submissions**

1380. In its submission dated 19 April 2010 (page 9), Alinta argued that it is improbable that a service provider would elect not to commingle gas delivered into the GDS with other gas in that system and not deliver the gas in a commingled state. Alinta submitted that the last line of clause 6.5 should be deleted as a 'nonsense'.

1381. No other public submissions were received with respect to this clause.

**Authority's assessment**

1382. The Authority notes that clause 6.5 of the Template Haulage Contract is the same as clause 19 of Part C to the current access arrangement.
1383. The Authority does not consider that Alinta's submission on the commingled gas issue has merit or raises any legitimate concern that clause 6.5 is inconsistent with the national gas objective.

**Draft decision**

1384. The Authority approves clause 6.5 of the Template Haulage Contract.

*Interconnection issues***Access arrangement proposal**

1385. Clause 6.6 of the Template Haulage Contract sets out provisions relating to interconnection issues and the responsibilities of the parties if an interconnection event occurs. An 'Interconnection Event' is defined in clause 22 as 'an event as a result of which a Physical Gate Point associated with a Receipt Point is not, or ceases to be, the subject of a current Interconnection Arrangement.' If the service provider is negligent or in default in the exercising of its powers under clause 6.6(a)(ii) then the service provider will be liable to the user for direct damage suffered. Pursuant to clause 6.6(e), and subject to clause 6.6(f), the service provider can disclose information about the operation of interconnection to the operator of an interconnected pipeline. Under clause 6.6(f), the service provider has to use reasonable endeavours not to disclose information that identifies details of users.

**Public submissions**

1386. In its submission dated 19 April 2010 (page 7), Alinta expressed concern about the provisions of clauses 6.6(a)(ii)(B) and 6.6(d) on the basis that the service provider must be required to act reasonably in exercising the rights it has under this provision, particularly in light of the potential consequences to users. Alinta argued that there may be many reasons other than termination or breach so the reasons for there not being an interconnection agreement must be expanded to include all events other than the default of, or failure to reasonably agree by, an interconnected pipeline operator. Alinta further argued that the requirement for negligence should be removed and clause 6.6(d) should be removed.
1387. Alinta also argued that clause 6.6(e) should be amended so that the service provider must require the operator of an interconnected pipeline to keep information it receives from the service provider confidential and only use the information for the operation of the interconnected pipeline. Further, the service provider must indemnify users for loss or damage caused by the service provider's breach.
1388. No other public submissions were received with respect to this clause.

**Authority's assessment**

1389. The Authority notes that clause 6.6(a) of the Template Haulage Contract is substantially similar to clause 26 of Part A to the current access arrangement except

for the deletion of the requirement that the service provider act as a reasonable and prudent person.

1390. The Authority notes that clauses 6.6(b) to (f) have no counterparts in the current access arrangement. WAGN has not made a submission in support of these clauses so it has not sought to justify the necessity for amending the rights and responsibilities of the parties in respect of interconnection issues. The Authority, however, considers it evident that these clauses have been included to set out the relative rights, responsibilities and liabilities in the event of an interconnection event, the meaning for which is given in clause 22.1
1391. The Authority notes that the Template Haulage Contract does not contain an equivalent of clause 25 in Part A to the current access arrangement. This clause set out the availability of an interconnection service.
1392. The Authority has considered Alinta's submission with respect to clause 6.6(e). The Authority notes that clause 6.6(e) is subject to clause 6.6(f) which requires the service provider must use reasonable endeavours to present information in a way that does not disclose a user's identity. There is no express obligation in this clause that the information is subject to the confidentiality provision in clause 20.2. Making clause 6.6(e) also subject to clause 20.2 should deal adequately with Alinta's concerns about the service provider's obligations to keep information confidential except as allowed under the haulage contract. The Authority therefore requires that clause 6.6(e) be amended to make it subject to the provisions of clause 20.2.

### **Final decision**

1393. The Authority requires that clause 6.6(e) of the Template Haulage Contract be amended to also make it subject to clause 20.2.

#### **Required Amendment 21**

Clause 6.6(e) of the Template Haulage Contract should be amended to read:

Subject to clause 6.6(f) and clause 20.2, <Service Provider> may disclose to an operator of an Interconnected Pipeline information which <Service Provider> determines, as a reasonable and prudent network operator, to be the minimum amount of information required to be disclosed for operational reasons relating to the interconnection of that, or any other, Interconnected Pipeline with the WAGN GDS.

### ***Delivery facilities installation, maintenance and operation***

#### **Access arrangement proposal**

1394. Clause 6.7 sets out the provisions relating to the delivery facilities installation, maintenance and operation. The clause limits the extent to which the service provider will be liable to a user or user's customer for damage caused while installing, maintaining or operating delivery facilities. The clause also sets out the circumstances in which the service provider will indemnify users for the value of any

compensation the user is required to pay its customers for damage suffered by such customers. In addition, the clause sets out the extent to which users will be required to indemnify the service provider for claims against the service provider resulting from damage to users or customers.

### Public submissions

1395. In its submission dated 12 April 2010 (page 8), Synergy submitted that clause 6.7(b) was unreasonable. It argued that the service provider should, at its own expense, take all reasonable steps to restore the land or premises to its prior condition. Synergy submitted that a retail user should not be liable to the service provider for the service provider's unilateral actions which negatively impact on the retail user's customer.
1396. Synergy also argued that clause 6.7(d) only provides for the service provider to indemnify the user to the extent of the lesser of the two values set out in clauses 6.7(d)(i) and 6.7(d)(ii). Synergy submitted that the service provider should instead indemnify the user to the extent of the greater of the two values to ensure that a user is, through no fault of its own, left out of pocket.
1397. In its submission dated 19 April 2010 (pages 7-8), Alinta expressed concern that the clause only makes the service provider liable to pay compensation for, or in respect of, or make good any damage by the service provider, its officers, servants or agent. Alinta submitted that the service provider's liability should be extended to also cover the actions of its contractors and subcontractors.
1398. Alinta also argued that the service provider should be required to consult with users as to restoration of the land or premises and that any restoration should be at the service provider's expense. Alinta then submitted that clauses 6.7(c), (d), (e) and (f) are unreasonable and inconsistent with clauses 6.7 (a) and (b). On this basis, Alinta considered that these clauses should be deleted.
1399. No other public submissions were received with respect of this clause.

### Authority's assessment

1400. The Authority notes that clause 6.7 of the Template Haulage Contract is very similar to clause 62 in Part C to the current access arrangement. The only material difference is between the current clause 62(2) and the proposed clause 6.7(b). Clause 6.7(b) allows that the service provider now has 'absolute discretion' with respect to the provision of the clause. Further, where there has been damage or disturbance to the land the service provider will have two options – to fill in the ground to restore it to approximately its previous level, which is the only option under the current clause, or at the user's expense and without the user's prior consent, restore the land to the extent reasonably practicable.
1401. The Authority also notes that the change in the time in which a party must discharge its obligation to indemnify under clauses 6.7(d) and (e) has been amended from 30 days to 20 business days. The Authority does not consider that this materially changes the length of time a party has to act pursuant to this clause.
1402. The Authority has considered Alinta's submission with respect to the actions of WAGN's contractors and sub-contractors and considers that WAGN would be liable for such acts under the doctrine of vicarious liability. Therefore, there is no 'gap' that needs to be filled, and the Authority does not accept Alinta's submission on the

basis that there is no issue relevant to the national gas objective that the submission addresses. The parties can agree a bilateral arrangement adjusting the usual vicarious liability rules if they think fit. In such circumstances there does not appear to be any scope for the abuse of market power by WAGN as the sole supplier in such negotiations.

1403. The Authority is not satisfied that the changes to clause 6.7(b) are consistent with the national gas objective in particular the efficient operation of the gas pipeline. The Authority notes that WAGN has not sought to justify the amendment nor explain the problems with the clause 6.7(b) in the current access arrangement which it seeks to address with this amendment. The Authority therefore rejects clause 6.7(b) of the Template Haulage Contract.

### **Draft decision**

1404. The Authority requires clause 6.7(b) to be amended to remove the service provider's absolute discretion in deciding on what action to take.

#### **Required Amendment 22**

Clause 6.7(b) of the Template Haulage Contract should be amended to read:

If, in the course of installing user Specific Delivery Facilities or Standard Delivery Facilities, <Service Provider> causes damage to land or premises including the opening or breaking up any sealed or paved surface, or damaging or disturbing any lawn, landscaping or other improvement, then <Service Provider> will if necessary and ~~in its absolute discretion~~ acting as a reasonable and prudent person either:

- i) fill in any ground to restore it to approximately its previous level; or
- ii) at <User>'s expense and ~~without~~ after obtaining prior consent from <User>, restore the land or premises including the sealed or paved surface, lawn, landscaping or other improvement to the extent reasonably practicable.

## ***Curtailment***

### ***Curtailment events***

#### **Access arrangement proposal**

1405. Clause 7.2 sets out the service provider's rights with respect to curtailment. The clause sets out the events which trigger the service provider's right to curtail. These events include actions by the user, a fall in the level of capacity in the GDS, emergency, safety concerns or other circumstance permitted under the haulage contract or at law.



## Public submissions

1406. In its submission dated 19 April 2010 (page 8), Alinta expressed concern about some of the curtailment events set out in clause 7.2. Specifically, Alinta submitted, with respect to clause 7.2(d), that a curtailment can only be made in a sub-network in respect of which the service provider has refused to accept gas. Alinta submitted there were similar problems with clauses 7.2 (g), (i) and (k). It also argued that if the curtailment was as a result of a fall in the level of capacity pursuant to clause 7.2(h), the curtailment should be pro rata across all users in proportion to their total capacity rights to the GDS or the affected sub-network.

1407. No other submissions were received with respect to this clause.

## Authority's assessment

1408. The Authority notes that clause 7.2 of the Template Haulage Contract is essentially the same as clause 23 in Part C to the current access arrangement.

1409. The Authority notes that clause 7.2(j) has no equivalent provision in the current access arrangement. Clause 7.2(j) provides that a curtailment event occurs if the service provider undertakes any of the activities in clause 7.3 which is further discussed below. The Authority considers this clause is consistent with the national gas objective.

1410. As clause 7.2 of the Template Haulage Contract does not substantially or materially amend clause 23 in Part C to the current access arrangement, the Authority does not consider it necessary to reconsider this clause. The Authority has considered Alinta's submission with respect to clause 7.2(h) that the curtailment should be on a pro rata basis. Clause 7.2(h) is the same as clause 23(1)(b)(i) in the current access arrangement. The Authority notes that Alinta has not made a substantive submission setting out how clause 23(1)(b)(i) is adversely affecting users under the current access arrangement. On this basis the Authority therefore approves this clause.

1411. The Authority has also considered Alinta's submission with respect to clauses 7.2(d), (i) and (k); in particular, Alinta's suggestion that clauses 7.2 (d), (j), (i) and (k) be redrafted in a similar manner to clause 7.2(f). Alinta's submission addresses the practical issue of whose service gets curtailed and its complaint is that the curtailment has to be confined to the same sub-network so that other users on different sub-networks do not have to bear the burden of curtailment. The Authority notes that these clauses are the same as clauses 23(1)(a)(v), 23(1)(b)(ii) and 23(1)(c)(i) respectively in the current access arrangement. The Authority considers that these clauses in the Template Haulage Contract are consistent with the national gas objective and, on this basis, the Authority approves clause 7.2.

## Draft decision

1412. The Authority approves clause 7.2 of the Template Haulage Contract.

## *Curtailment for certain activities*

## Access arrangement proposal

1413. Clause 7.3 sets out that the service provider's discretion to, at any time by arrangement or on the provision of at least 10 days' written notice, wholly or partially

curtail gas deliveries that are necessary to undertake any extension or expansion work or perform maintenance or operational activities.

### **Public submissions**

1414. In its submission dated 12 April 2010 (page 8), Synergy submitted that the 10 day time frame to be insufficient.
1415. In its submission dated 19 April 2010 (page 8), Alinta submitted that the service provider must be required to give 90 days written notice.
1416. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1417. The Authority notes that clause 7.3 is the equivalent of clause 24 in Part C to the current access arrangement. However, in the Template Haulage Contract, the time for notice has been reduced from 30 to 10 days. The Authority notes that in the draft decision for the current access arrangement it approved as reasonable a reduction in the notice period from 90 to 30 days. WAGN has not made a submission in support of this reduction nor has it sought to provide evidence that the present notice period is operating in a way that is inconsistent with the national gas objective.
1418. The Authority does not approve the reduction of time form notice of curtailment for the purposes of clause 7.3.

### **Draft decision**

1419. The Authority requires that the time for notice in clause 7.3(b) of the Template Haulage Contract be amended to 30 days.

#### **Required Amendment 23**

Clause 7.3(b) of the Template Haulage Contract should be amended to read

b) at any time at least 40 30 days after giving <User> written notice,

### *Service provider's right to refuse to accept gas at receipt point*

#### **Access arrangement proposal**

1420. Clause 7.4 of the Template Haulage Contract sets out the service provider's rights to refuse to accept, wholly or partly, the quantity of gas delivered to a receipt point by either the user or a related shipper. The clause then sets out the circumstances in which the service provider can exercise its right to refuse to accept gas at a receipt point.

### **Public submissions**

1421. In its submission dated 19 April 2010 (pages 8-9), Alinta submitted that clause 7.4(f), which allows the service provider to refuse to accept gas at a receipt point if

either party experiences an event of force majeure, is redundant. Alinta indicated that clause 11 sets out each party's rights and obligations with respect to force majeure, including provision for proper notice to be given. Alinta submitted that clause 7.4(f) should be deleted.

1422. Alinta also submitted that clause 7.4(i), which allows a service provider to refuse to accept gas if a user is in default of the haulage contract, should be deleted as the proper procedure for dealing with a user in default is set out in clause 14.5 so is therefore redundant.

1423. No other public submissions were received with respect to this clause.

### **Authority's assessment**

1424. The Authority notes that clause 7.4 is generally the same as clause 5(2) in Part C to the current access arrangement but that clause 7.4(b) has no equivalent in the current access arrangement. With the exception of clause 7.2(b), there has not been any material change to this clause.

1425. The Authority has considered clause 7.4(b) and considers that it is consistent with the efficient operation of the gas pipeline for the service provider to have the right to refuse delivery from a user or related shipper complying with the gas specifications if gas being delivered to the receipt point by another user or related shipper does not comply with the gas specifications.

1426. The Authority has considered the submission by Alinta with respect to clauses 7.4(f) and (i) which Alinta contends are redundant because of other provisions in the Template Haulage Contract. With respect to clause 7.4(f), the Authority does not consider there to be a duplication of this provision with the provisions for force majeure set out in clause 11. Clause 11 does not specify that an additional remedy in an event of force majeure is curtailment or refusal to accept. As these may be appropriate responses from a prudent service provider in an event of force majeure, the Authority considers that making provision in clause 7.4 for the remedies of curtailment or refusal to accept in an event of force majeure is consistent with the national gas objective.

1427. With respect to clause 7.4(i), the Authority notes that clause 14.5 specifically provides for curtailment or refusal to accept to be additional remedies in the event of a user being in default of the haulage contract. The Authority considers it is better for the parties' understandings of their rights that there be no potential for confusion which may arise if two clauses make similar provisions. The Authority recognises that the service provider should be able to resort to the remedies of curtailment or refusal of acceptance if a user is in default. This remedy is more appropriately dealt with in clause 14.5 and does not require duplication in clause 7.4(i). The Authority, therefore, does not accept clause 7.4(i) of the Template Haulage Contract.

### **Draft decision**

1428. The Authority does not approve clause 7.4(i) of the Template Haulage Contract.

#### Required Amendment 24

Clause 7.4 of the Template Haulage Contract should be amended so that clause 7.4(i) is deleted.

#### *User to comply with notice of curtailment*

##### **Access arrangement proposal**

1429. Clause 7.5 sets out the users' obligations to comply with curtailment notices. The service provider may provide the user with notice of the curtailment and this notice will set out the requirements with which the user must comply. The service provider may choose to provide in the notice reasons for the curtailment.

##### **Public submissions**

1430. In attachment B to its submission dated 19 April 2010 (pages 9-10), Alinta submitted that the service provider must be obliged to provide reasons for the curtailment in the curtailment notice unless such reasons have already been provided by way of any warning provided to a user pursuant to clause 7.8(c).

1431. Alinta also submitted that clause 7.5(d) should be amended to provide that a service provider must provide prior notice of the curtailment in all cases other than emergencies.

##### **Authority's assessment**

1432. The Authority notes that there is no equivalent to this clause in the current access arrangement.

1433. The Authority has considered clause 7.5 and notes that clause 7.5(a) only provides that the service provider 'may' give notice to the user. The Authority believes that the efficient operation of the gas pipeline and the long term interests of consumers demand that users should have a greater degree of certainty about curtailment, so there should be an onus on the service provider to give appropriate notice.

##### **Draft decision**

1434. Clause 7.5(a) of the Template Haulage Contract should be amended so that the service provider must give notice to the user.

**Required Amendment 25**

Clause 7.5(a) of the Template Haulage Contract should be amended to read:

In order to effect a Curtailment under this Haulage Contract (including under clause 7.2) <Service Provider> ~~may~~ must issue a notice to <User> requiring <user> to:

- i) Curtail receiving Gas at one or more Delivery Points and Curtail delivering Gas to every associated Receipt Point; and
- ii) comply with any other condition necessary to effect the Curtailment or refusal to accept Gas.

*User to comply with notice of refusal to accept gas***Access arrangement proposal**

1435. Clause 7.6 sets out the users' obligations to comply with a notice of refusal to accept gas. The service provider may provide notice following which the user must cease delivering gas and comply with any other condition to effect the refusal to accept gas. The service provider may choose to give reasons for its refusal to accept gas.

**Public submissions**

1436. In attachment B to its submission dated 19 April 2010 (page 9), Alinta submitted that the service provider must be obliged to provide reasons for the refusal to accept gas in the notice unless such reasons have already been provided by way of any warning provided to a user pursuant to clause 7.8(c).

1437. Alinta also submitted that clause 7.5(d) should be amended to provide that a service provider must provide prior notice that it will refuse to accept gas in all cases other than emergencies.

**Authority's assessment**

1438. The Authority notes that there is no equivalent to this clause in the current access arrangement.

1439. The Authority has considered clause 7.6 and notes that clause 7.6(a) only provides that the service provider 'may' give notice to the user. The Authority believes that users should have a greater degree of certainty about a refusal to accept gas so there should be an onus on the service provider to give notice.

**Draft decision**

1440. Clause 7.6(a) should be amended so that the service provider must give notice to the user.

#### Required Amendment 26

Clause 7.6(a) of the Template Haulage Contract should be amended to read:

In order to enforce a refusal to accept Gas under clause 7.4, <Service Provider> ~~may~~ must issue a notice to <User> requiring <user> to:

- i) cease delivering Gas to a Physical Gate Point or Receipt Points and Curtail taking delivery from any and all associated Delivery Points; and
- ii) comply with any other condition necessary to effect the Curtailment or refusal to accept Gas.

### *Service provider entitled to recover reasonable costs*

#### **Access arrangement proposal**

1441. Clause 7.7 of the Template Haulage Contract sets out that a service provider is entitled to recover reasonable costs incurred in curtailing under clauses 7.2 or 7.3, or refusing to accept gas under clause 7.4. This entitlement is limited to circumstances where the user has breached the haulage contract or there has been a negligent act or omission by the user or related shipper.

#### **Public submissions**

1442. No submissions were received with respect to this clause.

#### **Authority's assessment**

1443. The Authority notes that there is no equivalent to clause 7.7 of the Template Haulage Contract in the current access arrangement.

1444. The Authority has considered clause 7.7 and accepts it as consistent with the national gas objective.

#### **Draft decision**

1445. The Authority approves clause 7.7 of the Template Haulage Contract.

### *Method of curtailment or refusal to accept*

#### **Access arrangement proposal**

1446. Clause 7.8 of the Template Haulage Contract sets out the method of curtailment or refusal to accept delivery of gas. Under clause 7.8, the service provider has an absolute discretion to determine which delivery points will be curtailed, the quantity of gas it refuses to accept and the receipt points at which it will refuse to accept. The service provider may exercise its rights under clauses 7.2, 7.3 and 7.4 even if the cause is contributed by one or more other users. Where practicable, the service provider will use reasonable endeavours to provide warning in advance of the curtailment or refusal to accept. The users acknowledge that it remains the users'



responsibility to balance the gas it delivers with the gas it receives from the sub-network on each gas day and there is no obligation on the service provider to wholly or partly curtail the amount or pressure of gas deliveries to avoid swing service on a sub-network on a gas day.

### **Public submissions**

1447. In attachment B to its submission dated 19 April 2010 (pages 9-10), Alinta submitted that, pursuant to clause 7.8(c), the service provider should also be required, where possible, to provide the users with updated information in relation to the magnitude, duration and any related information during the curtailment or refusal to accept. This would enable users to remain fully informed and allow the users to better manage their customers.

### **Authority's assessment**

1448. The Authority notes that clause 7.8(c) of the Template Haulage Contract is substantially similar to clause 22(3) of Part C to the current access arrangement. Clauses 7.8(a), (b) and (d) do not have equivalent provisions in the current access arrangement.
1449. The Authority notes that clause 7.8(a) gives the service provider an absolute discretion to exercise its rights. Clause 7 sets out the obligations of each party with respect to curtailment plan and these procedures should be followed. Further, consistent with the national gas objective, the service provider should only be able to exercise its rights acting as a reasonable and prudent service provider. The Authority therefore does not accept clause 7.8(a) of the Template Haulage Contract.
1450. The Authority notes Alinta's submission that the service provider should be required to provide updated information in relation to the magnitude or duration of any curtailment or refusal to accept. Given that WAGN has a right to curtail or refuse delivery in certain circumstances, and the user has an obligation to continue paying during the period of curtailment or refusal to accept, it is unlikely that, in a competitive market, WAGN would not be required to provide on-going information to the user during the process. The Authority considers that this is not a submission going to a commercial matter, but rather is a matter where there is potential for the service provider to harm the competitive process by reason of the fact that the service provider is a monopoly supplier. The Authority considers that it is consistent with the national gas objective to accept Alinta's proposal that users be provided with on-going information.

### **Draft decision**

1451. The Authority requires an amendment to clause 7.8(a) to indicate that the service provider does not have an absolute discretion to act but must instead act as a reasonable and prudent service operator.
1452. The Authority requires that a clause 7.8(d) be added, and existing clause 7.8(d) be renumbered 7.8(e), to require a service provider to provide ongoing information about curtailment and refusal to accept.

#### Required Amendment 27

Clause 7.8(a) of the Template Haulage Contract should be amended to read:

When exercising its rights under clauses 7.2, 7.3 or 7.4, <Service Provider> shall determine, ~~in its absolute discretion~~ acting as a reasonable and prudent service operator:

- i) which Delivery Points it will Curtail and the order of that Curtailment; or
- ii) the quantity of Gas that it refuses to accept delivery of and Receipt Points at which it will refuse to accept,

as the case may be.

#### Required Amendment 28

Insert a new clause as 7.8(d) to read:

- d) <Service Provider> will where practicable use reasonable endeavours to provide <User> with reasonable on-going notice during a period of Curtailment under clause 7.2 or refusal to accept delivery of Gas under clause 7.4 as to the magnitude and expected duration of the ongoing Curtailment or refusal to accept delivery of Gas.

Existing clause 7.8(d) should consequentially be renumbered as clause 7.8(e).

## ***Metering***

### ***Operating meters***

#### **Access arrangement proposal**

1453. Clause 8.1 of the Template Haulage Contract provides that user specific and standard delivery facilities for haulage services will be designed, adjusted, operated and maintained:

- a) so as to achieve the best accuracy of measurement which is technically and economically feasible; and
- b) consistently with the standard of a prudent network operator acting efficiently.

#### **Public submissions**

1454. Alinta, in Attachment B to its submission dated 19 April 2010 (page 10), submitted that user specific delivery facilities and standard delivery facilities should also be designed, adjusted, operated and maintained in compliance with all laws. There were no other public submissions.

**Authority's assessment**

1455. Under the current access arrangement, clause 28 of Part C, WAGN is obliged to design, adjust, operate and maintain user specific and standard delivery facilities for haulage services to standards consistent with the standards which WAGN's proposed revision would require. The Authority notes that an additional requirement under the current access arrangement for WAGN 'to achieve the lowest sustainable cost of delivering Services' has been deleted in WAGN's proposed revisions, although this has not been the subject of any adverse submissions.
1456. The Authority does not consider it necessary, as Alinta suggests, for the Template Haulage Contract to provide an additional obligation to comply with all laws with respect to this matter. This is because WAGN is already bound to comply with those laws. In the absence of any submission suggesting that the standards proposed by WAGN are inadequate in any respect, the Authority is satisfied that clause 8.1 should be approved.

**Draft decision**

1457. Clause 8.1 of the Template Haulage Contract is approved.

*Use of gas quality data from other locations***Access arrangement proposal**

1458. Clause 8.2 of the Template Haulage Contract provides that the service provider may use gas quality data from equipment at one or more other locations to estimate gas quality at a delivery point in order to calculate quantities of gas delivered to a delivery point which binds the parties.

**Public submissions**

1459. Alinta, in Attachment B to its submission dated 19 April 2010 (page 10), submitted that the data from equipment located in one sub-network should only be used to estimate gas quantity at other locations (delivery points) in that sub-network. Alinta submitted that clause 8.2 should be amended to specify this limitation. There were no other public submissions.

**Authority's assessment**

1460. Clause 29 of Part C of the current access arrangement provides that WAGN 'may use gas quality data from equipment at one or more locations to estimate gas quality at a delivery point in order to calculate energy flow rates for, and quantities of gas delivered to, a delivery point.' The Authority considers that clause 8.2 of the Template Haulage Contract is, in substance, in the same terms, except for the proposed deletion of the reference to the use of data to calculate energy flow rates. Given that WAGN's proposed deletion is of a right WAGN itself has under the current access arrangement, and in the absence of any submissions, the Authority accepts WAGN's proposal to delete it.
1461. Alinta's submission regarding sub-networks does not contain any explanation of the reason why it says the restriction on WAGN's use of gas quality data is required having regard to the national gas objective. The Authority does not consider it necessary to limit clause 8.2 as suggested by Alinta.

### **Draft decision**

1462. Clause 8.2 of the Template Haulage Contract is approved.

### *Access to the delivery point and relevant land and premises*

#### **Access arrangement proposal**

1463. Clause 8.3 of the Template Haulage Contract provides for the service provider to have unfettered access to the land and premises on, or through which, the standard or user specific delivery facilities are to be, or are, installed. If the service provider does not have unfettered access, the user may be required to pay an amount reasonable to the service provider to cover any costs incurred in order to obtain access to the land or premises. These costs do not limit any other entitlements of the service provider.

#### **Public submissions**

1464. The Authority did not receive any public submissions in relation to this clause of the Template Haulage Contract.

#### **Authority's assessment**

1465. The equivalent provision to clause 8.3 in the Template Haulage Contract is found in clause 3(3) of Part C of the current access arrangement. The Template Haulage Contract supplements the current access arrangement by enabling WAGN to recover reasonable costs in obtaining access to land or premises where it does not have unfettered access. The imposition of these costs has not been the subject of any public submissions and as a result the Authority considers that, as the costs are limited to those reasonable to cover costs incurred in obtaining access, clause 8.3 of the Template Haulage Contract is consistent with the national gas objective.

### **Draft decision**

1466. Clause 8.3 of the Template Haulage Contract is approved.

### *Invoicing and payment*

#### *Invoicing*

#### **Access arrangement proposal**

1467. Clause 9.1(a) of the Template Haulage Contract provides that the service provider may claim payment twice a month for each and every haulage charge or other amounts payable under the haulage contract, and clause 9.1(b) obliges the service provider to use reasonable endeavours to make payment claims on the first and sixteenth days of each month.

1468. Clause 9.1(c) of the Template Haulage Contract sets out the components of a payment claim, including an invoice summarising the haulage charges payable together with a notice showing each delivery point.

**Public submissions**

1469. In its submission dated 12 April 2010 (page 8), Synergy submitted its concerns regarding the provision of network billing fields. In particular Synergy commented that each payment claim should include the network billing fields relevant to that delivery point and considered that this amendment would greatly assist users in ensuring that data is accurate.
1470. Synergy further submitted that in relation to clause 9.1(c), the payment claim comprising a summary of the haulage charges payable by the user should include the calculation of those charges.
1471. Alinta, in Attachment B to its submission dated 19 April 2010 (page 10), also submitted that in relation to clause 9.1(c)(i) and (ii), the service provider should be required to give a breakdown of the calculation of the Haulage Charges set out in Payment Claims.
1472. There were no other public submissions in relation to clause 9.1 of the Template Haulage Contract.

**Authority's assessment**

1473. Under the current access arrangement, clause 30(1) of Part C, WAGN will invoice the user on approximately the first and eleventh business days of each month with each invoice reflecting all meter readings taken during the invoicing period.
1474. Clause 30(2) of the current access arrangement sets out what each invoice will contain including all charges payable in respect of each delivery point, a summary of metering information used to calculate the charges, all other amounts which are payable in arrears or credited or debited for the invoicing period and any outstanding amounts from previous invoicing periods.
1475. The first change to the current invoicing procedure is under clause 9.1(a) and (b) of the Template Haulage Contract. The proposed provision only obliges WAGN to render invoices twice a month (rather than on the first and eleventh business day) and inserts a new 'reasonable endeavours' obligation to render invoices on the first and sixteenth days. In practice, it is likely that invoices will be rendered along the same pattern as previously, and for this reason the change does not appear to be one of substance, and should be approved. The Authority notes also that there have been no submissions challenging this proposed change.
1476. The second change is to alter the procedure from a simple procedure under which WAGN is obliged to render invoices for each delivery point containing certain basic information, to a far more complex procedure one where a 'global' invoice is rendered summarising the charges for all delivery points and various other information set out in clause 9.1(c)(i)(A) to (F), and then a separate notice is required to be given by WAGN specifying a number of matters, including details about each delivery point, adjustments based on previous disputed claims, such other information as WAGN reasonably considers appropriate and such other information as the parties agree.
1477. The variation to the current invoicing requirements has attracted submissions from users in relation to the content of the more highly prescriptive invoicing and notification system. In this respect Synergy has submitted that network billing fields should be included, and both Synergy and Alinta have raised the need for clause

9.1(c) of the Template Haulage Contract to include a detailed breakdown of the calculation of the haulage charges payable by the user in the payment claim.

1478. The Authority considers that the matters which have been the subject of submissions are matters of detail in relation to the commercial arrangements between contracting parties, and not matters which go to compliance of WAGN's proposed revisions with the national gas objective, which is the matter for the Authority's assessment. In these circumstances, the Authority considers that it should not approve the more detailed provisions regarding the contents of invoices proposed by WAGN in clause 9.1(c) of the Template Haulage Contract and WAGN's proposed revisions should be amended to revert to the provisions regarding the contents of invoices in clause 30(2) of Part C of the current access arrangement. In the event that WAGN and any proposed user wish to agree regarding more specific or detailed invoices then there is provision for bilateral agreement about those matters in clause 30(2)(e) of the Part C of the current access arrangement.

### **Draft decision**

1479. The Authority approves clause 9.2(a) and (b) of the Template Haulage Contract.

1480. The Authority does not approve the invoicing procedure set out in clause 9.1(c) of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 9.2(c) to be consistent with the invoicing procedure currently set out in clause 30(2) of Part C of the current access arrangement.

#### **Required Amendment 29**

Clause 9.1 of the Template Haulage Contract should be amended to delete clause 9.1(c) which sets out WAGN's proposed revised invoicing procedure.

Clause 9.1 of the Template Haulage Contract should be amended to include an invoicing procedure consistent with clause 30(2) of Part C of the current access arrangement.

### ***Payment claim review process***

#### **Access arrangement proposal**

1481. Clause 9.2(a) of the Template Haulage Contract provides that within three business days of receiving a payment claim, a user must inform the service provider of the items in the payment claim notice that are on the one hand correct and payable and on the other disputed. Clauses 9.2(b) to (h) of the Template Haulage Contract then set out a detailed dispute notification and resolution process to be followed with respect to those items which are disputed by the user.

#### **Public submissions**

1482. In Annexure B to its submission dated 19 April 2010 Alinta submitted that WAGN's revisions proposal should not be accepted by the Authority in a number of respects, as follows.



1483. First, in relation to clause 9.2(a), Alinta submitted that the user should:

- a) be given at least 10 (rather than 3) business days to respond to the payment claim as to whether any line items are disputed;
- b) do so in a single return notice (rather than separate notices); and
- c) provide details of the reasons for any dispute (which is not provided for under WAGN's revisions proposal); and
- d) if the user does not dispute any line item the user should be taken to agree to pay (rather than having to lodge a payment notice).

1484. Secondly, in relation to clause 9.2(b) Alinta submitted that:

- a) if the service provider disagrees with the user's dispute notice, then the service provider must provide reasons;
- b) if the service provider agrees with the user, then no reasons need to be provided and the user's dispute is taken to be agreed.

1485. Thirdly, in relation to clause 9.2(c) Alinta submitted that:

- a) there should be a streamlined process for an appropriate expert (accountant or similar) to determine the dispute;
- b) the user should not be required to pay if WAGN does not agree that a line item is incorrect;
- c) if WAGN does not issue a resolution notification within the time specified the disputed line item should not be payable; and
- d) generally, it would be more appropriate to have a payment/dispute regime akin to that which operates under the current haulage contract between WAGN and Alinta, involving payment of interest on disputed amounts ultimately determined to be payable which would discourage lodgement of marginal disputes.

1486. Fourthly, in relation to clause 9.2(f), Alinta submitted that in cases where there will be no future payment claims by the service provider to adjust for resolution of disputed amounts, the amount will be a debt owed to the user by the service provider (rather than the haulage contract remaining on foot for this purpose).

1487. There were no other submissions in relation to this clause of WAGN's revisions proposal.

### **Authority's assessment**

1488. Under the current access arrangement disputed invoices are addressed in clause 32 of Part C. WAGN's revisions proposal for the payment claims review process in clause 9.2 of the Template Haulage Contract is materially different from the current access arrangement in a number of respects. WAGN did not, however, make any submission to the Authority substantiating or explaining the reasons for the proposed revisions.

1489. In relation to clause 9.2(a) of the Template Haulage Contract, the Authority notes that each of the amendments proposed by Alinta to clause 9.2(a) set out above would simply reinstate the current position regarding notification of invoice disputes under clause 32(1). In circumstances where WAGN has failed to make any submission substantiating or explaining the reasons for the proposed variations, the Authority accepts Alinta's submission and clause 9.2(a) should be amended accordingly so as to reflect the current provisions in clause 32(1) of Part C of the current access arrangement.
1490. In relation to clause 9.2(b), the Authority notes that under the current access arrangement there are no specific provisions prescribing the mechanism for resolving a notified invoice dispute, including no provisions such as clause 9.2(b) prescribing WAGN's response to a user dispute notification. The Authority considers that in circumstances where neither WAGN nor any other party has substantiated a need for the access arrangement to prescribe a specific invoice dispute resolution mechanism, the Authority should maintain the status quo. The parties are not prejudiced by this as they have available to them a variety of means of resolving such a dispute (i.e. arbitration under the access arrangement, judicial determination by a court or an agreed alternative dispute resolution method). Further, so long as neither party can benefit commercially from prolonging a dispute (this is addressed by the provisions regarding the payment of interest discussed below) the parties will have the incentive to pursue the most efficient method for resolving their dispute (including to agree to a streamlined alternative dispute resolution method) without a process being prescribed for them in the access arrangement. In summary, the Authority considers the process for WAGN to respond to an invoice dispute notification should remain a commercial matter for bilateral agreement, and the Authority should not approve clause 9.2(b), and the other paragraphs of clause 9.2 which follow and are contingent on clause 9.2(b), namely 9.2(c) – (h).
1491. In relation to clause 9.2(c) of the Template Haulage Contract Alinta has raised a number of issues, which require separate consideration.
1492. First, the Authority notes Alinta's submission that the access arrangement should prescribe a streamlined process for an appropriate expert (accountant or similar) to determine the dispute. The Authority's comments above in relation to clause 9.2(b), equally, address this submission. That is, the use of alternative dispute resolution mechanisms to resolve invoice disputes is a commercial matter that should be left for bilateral agreement. Further, so long as the parties do not have commercial incentives to refuse to agree to such mechanisms (e.g. because they may benefit commercially by forcing the other party to go through expensive or protracted arbitration or a court process) then the parties will have appropriate incentive to use (including to agree to use) the most efficient dispute resolution methods. The Authority, therefore, does not accept this part of Alinta's submission.
1493. Secondly, Alinta submits that the user should not be required to pay if WAGN does not agree that a line item is incorrect as proposed under clause 9.2(c)(iii), and if WAGN does not issue a resolution notification within the time specified the disputed line item should not be payable as proposed under clause 9.2(c)(iv). Both of these provisions are consequential upon WAGN's proposed revision in clause 9.2(b) to require WAGN to make a formal response to any invoice notification by a user, known as a resolution notification. For the reasons set out below, the Authority does not approve the inclusion of clause 9.2(b) and therefore the related provisions of 9.2(c)(iii) and (iv) should not be approved either.

1494. Thirdly, Alinta submits in relation to clause 9.2(c) that it would be more appropriate to have a payment/dispute regime akin to that which operates under the current haulage contract between WAGN and Alinta, involving payment of interest on disputed amounts ultimately determined to be payable which would discourage lodgement of marginal disputes. The Authority notes that the regime referred to is provided for under the current access arrangement in clause 32(1) – which makes provision in relation to interim payment of disputed invoices – and clauses 32(2) and (3) – which provide reciprocal provisions for payment of interest by WAGN and the user respectively if unsuccessful in a dispute. WAGN's proposed revisions, however, do not contain any equivalent provisions and if approved would in effect delete these provisions. The Authority notes that the current access arrangement under clause 32, imposes an equal risk of paying interest on whichever party is unsuccessful in any invoice dispute. The Authority sees merit in Alinta's submission that this discourages either party from pursuing marginal or unmeritorious disputes for strategic reasons. The Authority considers that WAGN's proposed revisions should be amended to reinstate the provisions in clauses 32(1), (2) and (3) of Part C so as to provide for the unsuccessful party to an invoice dispute to bear an interest burden.
1495. In relation to Alinta's submission about clause 9.2(f) of the Template Haulage Contract, the Authority notes that the subject matter of this provision – the adjustment of disputed payments at the end of a haulage contract – is addressed by clause 30(4) of Part C of the current access arrangement. A related issue, namely the mechanism for adjusting for disputed invoices during the haulage contract is dealt with by clause 30(3). The substance of Alinta's submission about clause 9.2(f) is that it removes the current procedure for adjusting for disputed invoices at the end of a haulage contract, and that Alinta requires it to be reinstated. However, for the reasons set out above the Authority does not propose to approve clause 9.2(f) of the Template Haulage Contract because it is contingent on the resolution notice procedure proposed by WAGN which has not been accepted. The effect of that decision is that there is no equivalent to clauses 30(3) and 30(4) of the Part C of the current access arrangement. Clause 9.2 of the Template Haulage Contract should be amended to reinstate those clauses, which will in effect accept Alinta's submission about clause 9.2(f).

### **Draft decision**

1496. The Authority does not approve the payment claim review process in clause 9.2 of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 9.2 to:
- a) be consistent with clause 32 of Part C of the current access arrangement with respect to user notification of disputes, interim payment of disputed invoices by the user and the charging of interest to the unsuccessful party to an invoice dispute;
  - b) delete the proposed provision by which WAGN must make and notify to the user a decision with respect to each disputed item of an invoice, and the provisions consequential on that procedure; and
  - c) incorporate the provisions regarding adjustments for disputed invoices in clauses 30(3) and (4) of Part C of the current access arrangement.

### Required Amendment 30

Clause 9.2(a) of the Template Haulage Contract should be amended to provide that the user should:

- i) be given at least 10 (rather than 3) business days to respond to a payment claim as to whether any line items are disputed;
- ii) do so in a single return notice (rather than separate notices); and
- iii) provide details of the reasons for any dispute (which is not provided for under WAGN's revisions proposal); and
- iv) if the user does not dispute any line item the user should be taken to agree to pay (rather than having to lodge a payment notice).

Clause 9.2 of the Template Haulage Contract should be amended to delete clause 9.2(b) regarding the giving of a resolution notification by WAGN, and all provisions contingent on that notification, namely 9.2(c) to (h).

Clause 9.2 of the Template Haulage Contract should be amended to be consistent with the provisions of:

- i) clauses 30(3) & (4) of Part C of the current access arrangement with respect to adjustments for payments under disputed invoices;
- ii) clause 32(1) of Part C of the current access arrangement with respect to the interim payment of disputed invoices; and
- iii) clauses 32(2) and (3) of Part C of the current access arrangement with respect to the payment of interest on resolution of invoice disputes.

### *Accounting for errors after payment has been made – claims by user*

1497. Clause 9.4 of the Template Haulage Contract provides that if a user considers there has been an error in a payment claim after payment has been made then a user may give a retrospective dispute notification providing details of the error. If a user provides a retrospective dispute notification, then the service provider must, within 5 business days of receiving it, issue a notice of its decision.

1498. Clause 9.4(d) of the Template Haulage Contract states that if the service provider has not agreed that a line item is incorrect, then the dispute payment claim stands.

### **Public submissions**

1499. Alinta, in Attachment B to its submission dated 19 April 2010 (page 11), considered that there should be a streamlined process for determination of the retrospective claim by an accountant or similar expert in the circumstances where the service provider does not agree that there has been an error in a previous payment claim where the user has already paid the disputed amount.

1500. There were no other public submissions.

### Authority's assessment

1501. The Authority notes that in the current access arrangement, clause 33 of Part C provides for an adjusting payment to be made where there has been a payment error. Currently the party required to make the payment is given 10 business days after receiving written notice of the payment error to make the adjusting payment.
1502. The Authority notes that Alinta's submission to prescribe a streamlined process in the Template Haulage Contract to determine a dispute was also raised with respect to clause 9.2 of the Template Haulage Contract and discussed above at 1485.
1503. The Authority reiterates that while the current access arrangement provides for the correction of payment errors, there are no specific provisions prescribing the mechanism for resolving a payment error. The Authority considers that in circumstances where neither WAGN nor any other party has substantiated a need having regard to the national gas objective for the access arrangement to prescribe a specific resolution mechanism, the Authority should maintain the status quo. The Authority considers that the process for accounting for errors after payment has been made should remain a commercial matter for bilateral agreement, and the Authority should not approve clause 9.4.

### Draft decision

1504. The Authority does not approve clause 9.4 of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 9.4.

#### Required Amendment 31

Clause 9.4 of the Template Haulage Contract should be amended to delete clause 9.4(a) regarding the giving of a retrospective resolution notification by WAGN, and all provisions contingent on that notification, namely 9.4(b) to (i).

Clause 9.4 of the Template Haulage Contract should be amended to be consistent with the provisions of clause 33 of Part C of the current access arrangement with respect to correction of payment errors.

### *Accounting for errors after payment has been made – claims by service provider*

#### Access arrangement proposal

1505. Clause 9.5 of the Template Haulage Contract provides that if a service provider considers there has been an error in a payment claim after payment has been made then the service provider may give a retrospective dispute notification providing details of the error. If the service provider issues such a notice, clause 9.5(b) provides that the next payment claim will be adjusted to account for any amounts attributable to the error.

#### Public submissions

1506. Alinta, in Attachment B to its submission dated 19 April 2010 (page 11), submitted that there is no process of review, or disputing a retrospective error notification and

that the method to account for any errors is simply to adjust the next payment claim. Alinta suggested that a process for resolving any dispute about that notification should be included in the provision rather than pushing it into the next payment claim. There were no other public submissions.

### **Authority's assessment**

1507. As with clause 9.4 of the Template Haulage Contract dealt with above at 1497 to 1504, the Authority does not consider it necessary to include in the Template Haulage Contract a mechanism for resolving payment errors. The Authority considers that in circumstances where neither WAGN nor any other party has substantiated a need for the access arrangement to prescribe a specific resolution mechanism having regard to the national gas objective, the Authority should maintain the status quo. The Authority considers that the process for accounting for errors after payment has been made should remain a commercial matter for bilateral agreement, and the Authority should not approve clause 9.5.
1508. Alinta suggested in its submissions that a process for resolving any dispute about that notification should be included in the provision rather than pushing it into the next payment claim. In order to approve clause 9.5, the Authority requires the Template Haulage Contract to revert to the provisions in the current access arrangement which requires that an adjusting payment is to be made within 10 business days after receiving written notice. The effect of this decision negates Alinta's submission that notification should be included in the provision rather than pushing it into the next payment claim.

### **Draft decision**

1509. The Authority does not approve clause 9.5 of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 9.5.

#### **Required Amendment 32**

Clause 9.5 of the Template Haulage Contract should be amended to delete clause 9.5(a) regarding the giving of a retrospective error notification by WAGN, and all provisions contingent on that notification, namely 9.5(b) and 9.5(c).

Clause 9.5 of the Template Haulage Contract should be amended to be consistent with the provisions of clause 33 of Part C of the current access arrangement with respect to correction of payment errors.

### ***Guaranteed service level payments***

#### **Access arrangement proposal**

1510. Clause 9.6 of the Template Haulage Contract governs the guaranteed service level scheme (**GSL**) as amended by the service provider from time to time. Clause 9.6(a) states that the user acknowledges that the service provider operates a GSL. Clause 9.6(b) of the Template Haulage Contract states that a user agrees to comply with any obligations imposed on it under the GSL.



## Public submissions

1511. Alinta, in Attachment B to its submission dated 19 April 2010 (page 12), submitted that as the GSL may be amended by the service provider, it is not appropriate that the user is required to agree to comply with an obligation imposed by the GSL. There were no other public submissions.

## Authority's assessment

1512. Under the current access arrangement, clause 35 of Part C, there is no provision requiring the user to acknowledge that WAGN operates a GSL and to agree to comply with any obligations imposed on it under the GSL. The Authority sees merit in Alinta's submission and considers that clause 9.6(b) in effect, gives WAGN a right to vary the access arrangement without following the process for variation to the access arrangement specified in the NGL and NGR. Further, if the substantive operation of the provision may vary during the access arrangement period the Authority is not able to assess whether, at this point in time, WAGN's proposed revisions are consistent with the national gas objective. The Authority therefore requires WAGN to delete clause 9.6(a) and clause 9.6(b) of the Template Haulage Contract.

1513. The Authority also notes that clause 35(2) of Part C of the current access arrangement, which provides that WAGN is not required to make a payment to a small use customer as a result of failing to satisfy a GSL where WAGN's failure was caused by an event or circumstance not within WAGN's control, has been deleted from this section. The Authority notes that WAGN's proposed revision removes a benefit to WAGN. In the circumstances, and as the proposed deletion of the clause has not been the subject of any submissions, the Authority does not require its inclusion in the Template Haulage Contract.

## Draft decision

1514. The Authority does not approve clause 9.6(a) and 9.6(b) of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 9.6.

### Required Amendment 33

Clauses 9.6(a) and 9.6(b) of the Template Haulage Contract should be deleted.

## Tax

### Access arrangement proposal

1515. Clauses 10.1(a) and 10.1(b) of the Template Haulage Contract sets out the position in relation to various taxation matters under the haulage contract.

1516. Clauses 10.2(a) to 10.2(h) of the Template Haulage Contract concern the GST implications arising under the haulage contract.

## Public submissions

1517. There were no public submissions in relation to tax.

## Authority's assessment

1518. The Authority considers that clauses 10.1 and 10.2 deal with a subject matter, namely taxation, that is the subject of a separate and distinct legal and regulatory system. WAGN's proposed revisions, if approved, would involve the Authority imposing on the parties to a haulage contract, obligations which intrude on their obligations under taxation legislation. As such the Authority would be going beyond its jurisdiction as an economic regulator and entering the arena of tax regulation.

1519. The Authority notes that it is always open to the parties to commercial contracts to reach agreement regarding the adjustment of liabilities for tax under the taxation laws having regard to their respective taxation position. The Authority considers that it should not approve clause 10 in its entirety and that any provisions relating to the taxation requirements of the parties are best dealt with by commercial arrangement after the parties have considered their respective legal and accounting positions.

## Draft decision

1520. The Authority does not approve clause 10 of the Template Haulage Contract. In order to be approved, clause 10 requires amendment.

### Required Amendment 34

Clauses 10.1 and 10.2 of the Template Haulage Contract should be deleted.

## Force Majeure

### Access arrangement proposal

1521. Clause 11 of the Template Haulage Contract sets out the rights and obligations of the parties in the event of force majeure, the definition for which is in clause 22.1. Clause 11 provides that a party is excused from all performance except the obligation to pay the haulage charge or other amounts payable in the event of force majeure. The inability to pay is expressly said to not constitute force majeure. The party claiming the benefit of force majeure must follow the procedure set out in clause 11(d). Specific reference is made to fact that a party can determine the settlement of strikes, lock outs, stoppages, restraints of labour and other industrial disturbances on terms in its best interests. There is also provision for either party to terminate the haulage contract if the force majeure is claimed for a consecutive period of at least 1 year.

## Public submissions

1522. In attachment B to its submission dated 19 April 2010 (page 12), Alinta argued that if the service provider does not provide the haulage service, including an event of force majeure, then the user should not have to pay the haulage charge. However, if the force majeure only prevents the user from using the haulage service, then the

user should pay the haulage charge. Alinta submitted that a consistent regime to the effect should be set out in the one place in the haulage contract.

1523. Alinta also argued that the requirement to resume full performance should be to do so without delay rather than as soon as reasonably practicable. Alinta held that this was particularly so where the user is required to pay the haulage charge during an event of force majeure, which Alinta argued in the context of clause 4.2(a)(iii) and 4.2(b)(v) it should not have to do so (see discussion above).

1524. No other submissions were received with respect to this clause.

### **Authority's assessment**

1525. The Authority notes that clause 11 is, in parts, similar to clause 37 in Part C to the current access arrangement. Clause 37(3) of the current access arrangement has been deleted while amendments to clause 37(5)(a) have been made to provide that a party claiming the benefit of force majeure must provide periodic updates to the other party as the status of each occurrence or circumstance on request of the other party, specify the likely duration of the occurrence or circumstance and give notice once it is able to resume full performance of its obligations.

1526. The Authority has considered the deletion of clause 37(3) from the current access arrangement. The Authority notes that WAGN has not sought to justify the deletion nor set out evidence to show that clause 37(3) is unworkable. The Authority does not accept the deletion of clause 37(3). The Authority considers that the required amendment addresses the concern raised in the Alinta submission discussed above.

1527. The Authority has considered Alinta's submission regarding clause 11(d)(iv). The clause requires the party claiming the benefit of force majeure to resume full performance as soon as reasonably practicable. Alinta submitted that the party should be obliged to resume full performance without delay. The Authority notes that this provision is the same as 35(5)(c) in the current access arrangement. In the absence of a submission setting out the way this clause is adversely impacting on the parties, the Authority does not consider it necessary to require an amendment to this clause.

### **Draft decision**

1528. The Authority requires that an equivalent of clause 37(3) in the current access arrangement be inserted into clause 11, with a consequential amendment to clause 11(b) and renumbering of the clause.

#### **Required Amendment 35**

Clause 11 of the Template Haulage Contract should be amended by inserting under a new clause 11(c), the equivalent of clause 37(3) of the current access arrangement.

Clause 11(b) should also be amended so that it is subject to clause 11(c).

## ***Variation***

### ***Replacement of haulage services***

#### **Access arrangement proposal**

1529. Clause 12.1 of the Template Haulage Contract outlines the process and circumstances where the service provider may vary the haulage contract to replace the haulage service.

#### **Public submissions**

1530. In its submission dated 12 April 2010 (page 8), Synergy submitted that in relation to clause 12.1(a) a user should also be able to request to WAGN, in writing, to replace the haulage service with a different haulage service. Synergy also submitted that WAGN should be required to use reasonable endeavours to meet the request.

1531. Alinta, in Attachment B to its submission dated 19 April 2010 (page 12), submitted that in relation to clause 12.1(b), the period of consultation with the user prior to issuing any service replacement notice should be increased from 10 to at least 20 business days to allow a user time to gather sufficient evidence and information as to why the notice should not be given. Alinta stated that the decision by the service provider on this issue has significant commercial consequences for Alinta and its relevant customer/s.

1532. There were no other public submissions in relation to clause 12.1 of the Template Haulage Contract.

#### **Authority's assessment**

1533. Clause 18 of Part A of the current access arrangement is, in substance, the same as proposed clause 12.1(a) of the Template Haulage Contract. Under clause 18, WAGN may at any time where permitted by clause 19 of Part A (of which clause 12.1(c) of the Template Haulage Contract is the equivalent) provide written notice to the user to vary the haulage contract to allocate a replacement reference service at that delivery point.

1534. The Authority sees no reason consistent with the national gas objective why it is necessary, as Synergy suggests, for clause 12.1(a) of the Template Haulage Contract to provide for the user to be able to request WAGN to replace the haulage service. The clause is intended to provide the service provider with the ability to require the user to take the appropriate reference service in circumstances where because of the making of a determination under retail market regulation or the user's pattern of usage it is more appropriate for the user to take another reference service. This is consistent with ensuring the efficient recovery of costs by the service provider. There is no reciprocal rationale which would justify the user having a similar right, as suggested by Synergy. The Authority is satisfied, therefore, that clause 12.1(a) should be approved as proposed.

1535. Clause 20 of Part A of the current access arrangement is the equivalent of clause 12.1(b) of the Template Haulage Contract. Clause 20 of Part A of the current access arrangement requires WAGN to give the user 10 business days warning that it proposes to give the notice to replace the haulage service and the user may then provide information to WAGN regarding why the notice should not be given.

1536. The Authority notes that WAGN's proposed revisions include the addition to clause 12.1(b) of a time limitation on the user providing information. The proposed revision, if approved, would require the user to provide the relevant information no later than five business days prior to the notice being given. There was no such previous restriction. The effect of WAGN's proposed revisions, therefore, would be to reduce from 10 business days to 5 business days the time within which the user may gather and submit as to why the notice should not be given.
1537. Alinta submitted that the period of consultation prior to issuing the notice should be increased to at least 20 business days. Alinta did not in its submission indicate whether or not it supported WAGN's proposed time limitation on the provision of information of no later than 5 business days prior to the notice being given. Therefore, the Authority assumes that Alinta's position is either that the user should have either 15 or 20 business days to gather and submit information to the service provider regarding why the notice should not be given, an increase of either 10 or 15 business days to the effective position under WAGN's proposed revisions.
1538. The Authority considers that a service provider should have the ability to reallocate a haulage service in circumstances where it can be demonstrated that the haulage service being provided is not suitable for the user in question. Such ability is consistent with the national gas objective and the efficient recovery of its costs through reference tariffs. By the same token, the reallocation of a reference service has the potential to affect the user's business interests (for example, if a user is forced onto an inappropriate reference service then the user may have to pay more than it should for the reference services) and by extension the interests of consumers who purchase services from the user.
1539. In circumstances where Alinta has provided substantiation of the reason why it considers the time frame too short (as opposed to merely asserting that it does), and given that the reallocation of the reference service could materially affect a user's interests and the interests of consumers, the Authority sees merit in Alinta's submission. Equally, the Authority sees merit in WAGN's proposal that the user be required to submit any information at least 5 business days prior to the notice being given, to give WAGN time to consider the information before giving the notice. The Authority, therefore, considers that clause 12.1(b) of the Template Haulage Contract should be approved subject to the period of time prior to giving notice that the service provider must consult with the user being increased from 10 business days to 20 business days.
1540. The remaining provisions of clause 12.1 of the Template Haulage Contract are broadly consistent with clauses 18 to 21 of the current access arrangement and were not the subject of any submissions. Consistent with the national gas objective the Authority considers that the clause should otherwise be approved.

### **Draft decision**

1541. Clauses 12.1(a) and (c) to (e) of the Template Haulage Contract should be approved as proposed by WAGN. Clause 12.1(b) of the Template Haulage Contract should be approved subject to increasing the period of time prior to giving notice that the service provider must consult with the user being increased from 10 business days to 20 business days.

### Required Amendment 36

Clause 12.1(b) of the Template Haulage Contract should be amended by deleting the words '10 Business Days' in the first line and inserting the words '20 Business Days'.

## *Revisions to access arrangement affecting the haulage contract*

### **Access arrangement proposal**

1542. Clauses 12.2, 12.3 and 12.4 of the Template Haulage Contract set out provisions which apply where the access arrangement is revised so as to affect the pipeline services offered, the description of pipeline services and the terms and conditions of pipeline services respectively.
1543. These clauses provide for variation to the haulage contract entered into between the service provider and the user either automatically or in accordance with a procedure for WAGN to provide notice to the user as to the appropriate amendment. There are dispute resolution procedures in the event of a dispute about any variation proposed by WAGN. Under each proposed clause the variations provided for apply to the period after the revisions to the access arrangement take effect.

### **Public submissions**

1544. Alinta, in Attachment B to its submission dated 19 April 2010 (page 12), submitted that clause 12.4 is an unacceptable and unilateral interference with contractual rights. Alinta also submitted that the provisions of clause 12(2) (relating to revisions affecting the pipeline services offered), and clause 12(3) (relating to revisions affecting the description of pipeline services) must only operate where the Pipeline Services are sufficiently similar for the new or varied pipeline services to be able to operate within the existing terms and conditions. Amendments to the access arrangement are made at the instance of the service provider and the service provider must take into account the existing contractual rights of users when planning and proposing variations to, or new, pipeline services. If the terms and conditions are required to be changed to accommodate the varied or new pipeline service, the service provider must seek the agreement of users.
1545. No other public submissions were received in relation to clauses 12.2 to 12.4 of the Template Haulage Contract.

### **Authority's assessment**

1546. There are no equivalent clauses in the current access arrangement to clauses 12.2 to 12.4 in the Template Haulage Contract which provide for the variation of the haulage contract on a revision to the access arrangement.
1547. Under the NGL and NGR, as was the case under the Code, a service provider is obliged to provide access to reference services on the terms and conditions specified in an approved access arrangement. Reference services provided by a service provider to a user, therefore, are not provided pursuant to a contractual obligation to do so, but rather a statutory obligation defined by the approved access arrangement triggered by a user making a request for access to a reference service.



1548. Under this access system the user's access right and the service provider's access obligation only operate for so long as the access arrangement remains in force. In other words, on the access arrangement expiring, or being revised (whichever comes first) the user's access rights and the service provider's access obligations cease. Such rights and obligations may, of course, be extended by a succeeding access decision.
1549. The Authority considers, in light of the above, that clauses 12.2 to 12.4 of the Template Haulage Contract are not consistent with the national gas objective as these clauses purport to bind the service provider and the user to access rights and obligations that may only be created by a subsequent access decision.
1550. The Authority notes that Amendment 37 in this draft decision provides a user with the right to have the Template Haulage Contract continue beyond the date of revision or expiry of the access arrangement with the user's agreement and on the basis of this contract being varied to incorporate the terms and conditions of the subsequent access arrangement.

### **Draft decision**

1551. Clauses 12.2 to 12.4 of the Template Haulage Contract are not approved and should be deleted.

#### **Required Amendment 37**

Clauses 12.2, 12.3, and 12.4 should be deleted from the Template Haulage Contract.

### ***Pricing if access arrangement is not revised by the revision commencement date***

#### **Access arrangement proposal**

1552. Clause 12.5 of the Template Haulage Contract provides that if the access arrangement is not revised before the revision commencement date, then from the revision commencement date and until the access arrangement is revised:
- a) the tariff components for each tariff for the relevant pipeline services will be adjusted annually with the first adjustment to occur on the revision commencement date and then on each year after that date in accordance with the formula provided; and
  - b) the terms and conditions for the pipeline services are amended to incorporate the new tariff calculation.

#### **Public submissions**

1553. No public submissions were received in relation to clause 12.5 of the Template Haulage Contract.

### Authority's assessment

1554. Under rule 49(1) of the NGR a full access arrangement (of which WAGN's proposed revisions are an example) must contain a review submission date and a revisions commencement date.
1555. Under rule 3 of the NGR the revision commencement date is defined as the date fixed in the access arrangement as the date on which revisions resulting from a review of an access arrangement are intended to take effect.
1556. Rule 93(3) of the NGR then provides that if there is an interval between a revision commencement date stated in a full access arrangement and the date on which the revisions to the access arrangement actually commence:
- a) reference tariffs, as in force at the end of the previous access arrangement period, continue without variation for the interval of the delay; but
  - b) the operation of this sub rule may be taken into account in fixing reference tariffs for the new access arrangement period.
1557. The effect of rule 93(3) is that the reference tariffs as at the intended date on which revisions to the access arrangement are to commence (and replace the reference tariffs) continue without variation until the revisions to the access arrangement are approved.
1558. Given that the NGR in rule 93(3) determines the reference tariffs which are to apply if an access arrangement is not revised by the revision commencement date until the access arrangement is revised it is not possible for an access arrangement to contain provisions containing a provision inconsistent with rule 93(3). Clause 12.5 of the Template Haulage Contract purports to do so and for that reason is non-compliant with the NGR and should not be approved.

### Draft decision

1559. The Authority does not approve clause 12.5 of the Template Haulage Contract which should be deleted.

#### Required Amendment 38

Clause 12.5 should be deleted from the Template Haulage Contract.

### *Continued application of variation provisions*

#### Access arrangement proposal

1560. Clause 12.6 of the Template Haulage Contract states that the provisions set out in clauses 12.2 to 12.5 apply, with appropriate modifications, on each successive revision of the access arrangement for the duration of the haulage contract.

**Public submissions**

1561. No submissions were received in relation to clause 12.6 of the Template Haulage Contract.

**Authority's assessment**

1562. Clause 12.6 of the Template Haulage Contract is consequential on clauses 12.2 to 12.5 of the Template Haulage Contract. Given the Authority's draft decision not to approve clauses 12.2 to 12.5 of the Template Haulage Contract, clause 12.6 should not be approved.

1563. In any event, clause 12.6 purports to provide for the continuation of haulage contracts beyond the date of revision or expiry of the access arrangement. For the reasons set out above 1551 with respect to clauses 12.2 to 12.4 it is not possible for access rights and obligations created by a regulated access decision to extend beyond the period of operation. Any access rights or obligations which post-date the revision or expiry of an access arrangement can only be created by a further decision of a regulator or a commercial contract.

**Draft decision**

1564. The Authority does not approve clause 12.6 of the Template Haulage Contract, which should be deleted from the Template Haulage Contract.

**Required Amendment 39**

Clause 12.6 should be deleted from the Template Haulage Contract.

*Right to terminate if access arrangement terminates or expires***Access arrangement proposal**

1565. Clause 12.7 of the Template Haulage Contract states that if the access arrangement terminates or expires, the service provider may terminate the Haulage Contract by giving 20 business days written notice to the user at any time.

**Public submissions**

1566. Alinta, in Attachment B to its submission dated 19 April 2010 (pages 12-13), submitted that the Haulage Contract takes effect as a contract independently of the access arrangement in force at the time it is entered into and that clause 12.7 should be deleted. There were no other public submissions in relation to clause 12.7 of the Template Haulage Contract.

**Authority's assessment**

1567. There is no equivalent in the current access arrangement to clause 12.7 of the Template Haulage Contract. Clause 12.7 purports to confer a right on a service provider to give notice of termination of the haulage contract within 20 business days after the access arrangement is terminated or expires.

1568. As discussed earlier, the Authority considers that the effect of an access arrangement which sets out terms and conditions for reference services being terminated or expiring is that the statutorily imposed terms and conditions on which such reference services are provided cease also.
1569. The Authority has determined earlier in this draft decision (when considering clause 2(b) of the Template Haulage Contract) a user has a right to extend a haulage contract for reference services past the date of revision or expiry of the access arrangement with the user's agreement and on the basis of this contract being varied to incorporate the terms and conditions of the subsequent access arrangement. Amendment 37 of this draft decision requires clause 2(b) to be amended accordingly. Clause 12.7 is not consistent with Amendment 7 and should therefore be deleted.
1570. Finally, while the Authority agrees with Alinta's conclusion that clause 12.7 should be deleted, the Authority does not, however, agree with Alinta's reasoning to the effect that the haulage contract operates independently of the access arrangement. As set out above the Authority's position is that the haulage contract operates as part of the access arrangement.

#### **Draft decision**

1571. The Authority does not approve clause 12.7 of the Template Haulage Contract, which should be deleted.

#### **Required Amendment 40**

Clause 12.7 should be deleted from the Template Haulage Contract.

### *Review of haulage contract in response to regulatory event*

#### **Access arrangement proposal**

1572. Clause 12.8 of the Template Haulage Contract provides that if there is regulatory event which has a material effect on the operation of the haulage contract, then the service provider may give notice to the user specifying the amendments to the Haulage Contract that it considers necessary to address the regulatory event.
1573. The clause then provides for the variation to take effect from a date specified in the notice, unless the user triggers a dispute resolution procedure which ultimately leads to arbitration of the dispute under clause 18.3 of the Template Haulage Contract.

#### **Public submissions**

1574. No public submissions were received in relation to clause 12.8 of the Template Haulage Contract.

#### **Authority's assessment**

1575. The Authority notes that the terms of a haulage contract for provision of a reference service are statutorily imposed, rather than contractually agreed. Therefore, if a

user makes a request for access to a reference service in the form required by the access arrangement, the user has a right to access to the reference service on the terms set out in the access arrangement. Those terms continue until the access arrangement is either; (1) revised - in which case, under this draft decision, the haulage contract would be extended subject to the user's agreement and incorporation of the terms and conditions of the replacement access arrangement or (2) expires - in which case the haulage contract also expires or the haulage contract is otherwise terminated by either party in accordance with its terms.

1576. If external circumstances change (for example as in the present case where there is a regulatory event or a change in the law) and the service provider wishes to alter the terms and conditions on which the user will have access to the reference service, the service provider may not unilaterally alter the terms and conditions of access, nor may the service provider force the user into arbitration of terms.

1577. The Authority notes that under an arbitration of an access dispute under Chapter 6 of the NGL the dispute resolution body must give effect to the applicable access arrangement. Therefore, it is not possible for a service provider to attempt to vary the terms and conditions of access to a reference service by notifying an access dispute for arbitration under Chapter 6.

1578. The Authority considers, for the above reasons, that clause 12.8 of the Template Haulage Contract cannot be approved as it purports to provide a mechanism for varying the terms and conditions of access to a reference service other than in accordance with the procedure for such variation provided for under the NGL and NGR. This may be achieved either by WAGN lodging an application under rule 65 of the NGR to vary the access arrangement, lodging revisions to the access arrangement, or by seeking the inclusion in the access arrangement of a mechanism by which the reference tariffs or terms and conditions of access to a reference service may be varied prior to the expiry or revision of the access arrangement.

### **Draft decision**

1579. The Authority does not approve clause 12.8 of the Template Haulage Contract, which should be deleted.

#### **Required Amendment 41**

Clause 12.8 should be deleted from the Template Haulage Contract.

### ***Amendment generally***

#### **Access arrangement proposal**

1580. Clause 12.9 of the Template Haulage Contract states that the parties may at any time in writing amend the Haulage Contract by agreement.

#### **Public submissions**

1581. No public submissions were received in relation to clause 12.9 of the Template Haulage Contract.

### Authority's assessment

1582. There is no provision in the current access arrangement equivalent to clause 12.9 of the Template Haulage Contract. The parties to a commercial contract may at any time agree to vary the terms of such a contract and clause 12.9 is equivalent to a clause contained in many written contracts which provides, in the interests of certainty and efficiency, that any such variation also be in writing. However, a haulage contract entered into on the terms and conditions set out in the Template Haulage Contract is a contract for the provision of services on statutorily regulated terms and conditions, which is relevant to whether a clause such as clause 12.9 is appropriate in the context of the Template Haulage Contract.
1583. In considering this issue, it is important to bear in mind an agreed variation between parties to a haulage contract for a reference service could be inconsistent with the terms set out in Template Haulage Contract. In such a case the varied haulage contract would no longer satisfy the requirements for being a contract for the provision of a reference service.
1584. The Authority also notes that under WAGN's proposed revisions it is open at any time for WAGN and a user to negotiate and agree terms and conditions for supply of a haulage service other than on regulated terms (i.e. to negotiate a contract for the provision of a non-reference service).
1585. Consequently, the Authority does not consider clause 12.9 of the Template Haulage Contract to be consistent with the national gas objective.

### Draft decision

1586. The Authority does not approve clause 12.9 of the Template Haulage Contract and requires this clause to be deleted.

#### Required Amendment 42

Clause 12.9 should be deleted from the Template Haulage Contract.

## *Assignment, novation and capacity trading*

### *Bare transfers*

#### Access arrangement proposal

1587. Clause 13.2 of the Template Haulage Contract states that a user may transfer, by way of subcontract, all or any of its contracted peak rate at a delivery point to another party without the consent of the service provider.
1588. Clause 13.2(b) provides that the user must immediately give written notice to the service provider of the subcontract and its likely duration, the identity of the third party and the amount of capacity transferred.



## Public submissions

1589. Alinta, in Attachment B to its submission dated 19 April 2010 (page 13), considered that in the case of a bare transfer, there should be no requirement to provide any information to the service provider. There were no other public submissions.

## Authority's assessment

1590. Rule 105 of the NGR requires the transferor to immediately give notice to the service provider of the subcontract and its likely duration, the identity of the third party and the amount of the contracted capacity transferred. Clause 13.2(b) of the Template Haulage Contract reflects rule 105 of the NGR in allowing a user to transfer, without the service provider's consent and by way of subcontract, all or any of the user's contracted capacity to another.

1591. The Authority does not agree with Alinta's submissions in relation to clause 13.2 as this clause of the Template Haulage Contract is consistent with the NGR and the Authority is satisfied that clause 13.2 should be approved.

## Draft decision

1592. Clause 13.2 of the Template Haulage Contract is approved.

## Other transfers

### Access arrangement proposal

1593. Clause 13.3(a) of the Template Haulage Contract states that a user may request the service provider, in writing, for consent to transfer all or any of its contracted peak rate at a delivery point to a third party other than by way of a bare transfer.

1594. Clause 13.3(b) provides that the service provider must not withhold its consent except on reasonable grounds, based on commercial or technical considerations.

1595. Clause 13.3(c) provides that without limiting the service provider's discretion to withhold consent, the service provider may make its consent to a transfer conditional on:

- a) the third party making an application under, and the transfer being subject to, the application procedure;
- b) the third party complying with one or more of the preconditions to and restrictions on the provision of pipeline services; or
- c) the user reimbursing the service provider for costs.

## Public submissions

1596. Alinta, in Attachment B to its submission dated 19 April 2010 (page 13), submitted that in relation to clause 13.3(c), there should be no requirement to comply with the elements of the application procedure and the pre-conditions that relate to capacity issues for a transfer, where no increase or decrease in capacity is being sought. There were no other public submissions.

## Authority's assessment

1597. Clause 40(3) of Part A of the current access arrangement provides that WAGN may make its consent to a transfer conditional on the satisfaction of any or all of the preconditions set out clauses 28 to 46 of Part A of the current access arrangement. The Authority notes that WAGN has proposed to introduce into the Template Haulage Contract the requirement for the third party to make an application under the application procedure set out in the Template Haulage Contract. The Authority notes Alinta's submission in relation to clause 13.3(c). The Authority considers the requirement that the third party comply with the application procedure is consistent with the national gas objective, in particular the efficient operation of the gas pipeline. As the third party will be taking over liability for the capacity it is, therefore, important that the service provider has the information about the third party which is ordinarily obtained when a user requests a service.
1598. The Authority refers to its decision regarding clause 5.5 of the proposed access arrangement above 200 to 208, and the required deletion of the pre-conditions in the proposed access arrangement. As a result, the Authority requires the references to the pre-conditions set out in the access arrangement in clauses 13.3(c)(i) and 13.3(c)(ii) to be deleted. The Authority notes, however, that it has accepted certain pre-conditions in clause 1 of the Template Haulage Contract and requires an amendment to refer to these pre-conditions as set out in clause 1 of the Template Haulage Contract, not in the proposed access arrangement.

## Draft decision

1599. The Authority does not approve clauses 13.3(c)(i) and 13.3(c)(ii) of the Template Haulage Contract.

### Required Amendment 43

Clause 13.3(c)(i) of the Template Haulage Contract should be amended to read:

- (i) Third Party making an Application under and the transfer being subject to, the Application Procedure ~~(including in particular the pre-conditions to and restrictions on the provision of Pipeline Services specified in the Access Arrangement);~~

Clause 13.3(c)(ii) should read:

- (ii) Third Party complying with one or more pre-conditions to and restrictions on the provision of Pipeline Services specified in the Access Arrangement Template Haulage Contract, as directed by **<Service Provider>** in writing;

## Costs

### Access arrangement proposal

1600. Clause 13.5(a) of the Template Haulage Contract provides that the user must reimburse the service provider for all reasonable costs the service provider incurs in

processing a transfer under clause 13.2 or processing and determining a request for the transfer of its contracted peak rate under clause 13.3.

1601. Clauses 13.5(b) and 13.5(c) concern the service provider providing a quote for the costs referred to in clause 13.5(a).

### **Public submissions**

1602. Alinta, in Attachment B to its submission dated 19 April 2010 (page 13), submitted that the service provider is not required to process anything under clause 13.2 and this reference in clause 13.5(a) should be deleted. Alinta also noted that there is an incorrect clause reference in clause 13.5(c). There were no other public submissions.

### **Authority's assessment**

1603. Clause 44 of Part A of the current access arrangement provides for the user to reimburse WAGN for all reasonable costs incurred in processing and determining a transfer request. Alinta submitted that in relation to clause 13.2, there should be no requirement for the user to provide written notice to the service provider of the bare transfer (see draft decision above at 1602. However, the requirement to provide written notice is imposed under the NGR and the Authority approved clause 13.2 as proposed by WAGN. The Authority considers it reasonable for the user to reimburse the reasonable costs of the service provider in these circumstances and is satisfied that clause 13.5(a) and (b) of the Template Haulage Contract should be approved.
1604. The Authority notes Alinta's submissions regarding the incorrect clause reference in clause 13.5(c) of the Template Haulage Contract to clause 13.3(b). The Authority agrees that this appears to be an incorrect reference and that the correct reference should be clause 13.5(b).

### **Draft decision**

1605. The Authority does not approve clause 13.5(c) of the Template Haulage Contract and requires WAGN to amend this provision to refer to the correct clause.

#### **Required Amendment 44**

Clause 13.5(c) of the Template Haulage Contract should read:

- (c) A quote provided under clause 13.35(b) does not limit the costs which must be reimbursed under clause 13.5(a) provided that it is prepared in good faith.

### *Novation rights*

#### **Access arrangement proposal**

1606. Clause 13.6(a) states that a user may novate the Haulage Contract with the service provider's prior written consent, and such consent must not be unreasonably withheld. The service provider's consent will not be unreasonably withheld if it is

withheld on the ground that, if the novation occurred, there would be in the service provider's opinion, an increase in the commercial or technical risk to the service provider.

1607. Clause 13.6(b) provides that the service provider may make its consent to a novation conditional on:

- a) compliance with the pre-conditions set out in the access arrangement; and
- b) the user reimbursing the service provider a reasonable fee.

1608. Clause 13.6(c) provides that the service provider may novate the Haulage Contract on giving reasonable written notice to the user.

### **Public submissions**

1609. Alinta, in Attachment B to its submission dated 19 April 2010 (page 13), submitted that in relation to clause 13.6(a), the determination that there would be an increase in commercial or technical risk must be in the service provider's reasonable opinion.

1610. Alinta further submitted that clause 13.6(c) should be amended to provide that the service provider may only novate the contract with the user's written consent and execution of an appropriate deed of novation. The user may withhold its consent on reasonable commercial or technical grounds or give its consent on conditions on reasonable technical or commercial grounds.

1611. There were no other public submissions.

### **Authority's assessment**

1612. Clause 46 of Part C of the current access arrangement provides that the service provider's consent will not be unreasonably withheld if it is withheld on the ground that if the novation occurred, in the service provider's opinion formed acting as a reasonable and prudent person, there would be an increase in the commercial or technical risk to the service provider. The Authority accepts Alinta's submission in relation to clause 13.6(a) that a reasonable standard is required for WAGN to make a determination and requires WAGN to amend clause 13.6(a) to state that the service provider's opinion must be formed acting as a reasonable and prudent person.

1613. The Authority notes the inclusion of clause 13.6(b)(i) concerning the compliance with the pre-conditions set out in the access arrangement in WAGN's proposed revisions. As noted above at 200 to 208, as a result of the required deletion of the pre-conditions in the access arrangement, the Authority requires WAGN to delete the reference in clause 13.6(b)(i) to the pre-conditions specified in the access arrangement and insert the reference to the pre-conditions in clause 1 of the Template Haulage Contract.

1614. The Authority accepts that clause 13.6(b)(ii) of the Template Haulage Contract is consistent with clause 43(3) of Part C of the current access arrangement and requires no amendment.

1615. Clause 13.6(c) of the Template Haulage Contract provides for WAGN to novate the haulage contract on giving reasonable written notice. The Authority notes that there is no equivalent provision to clause 13.6(c) in the current access arrangement.

1616. Alinta submitted that in relation to clause 13.6(c), the clause should be amended to provide that the service provider may only novate the contract with the user's written consent and execution of an appropriate deed of novation. The Authority does not agree with Alinta's submission and considers that a user's consent should not be required in the event that the service provider novates the contract.

1617. The Authority considers that clause 13.6(c) is appropriate and consistent with the national gas objective.

### **Draft decision**

1618. The Authority does not approve clause 13.6 of the Template Haulage Contract and requires amendments to this clause.

#### **Required Amendment 45**

- Clause 13.6(a) of the Template Haulage Contract should read:
 

(a) <User> may novate this Haulage Contract with <Service Provider>'s prior written consent, and such consent must not be unreasonably withheld. <Service Provider>'s consent will not be unreasonably withheld if it is withheld on the ground that, if the novation occurred, there would be, in <Service Provider>'s opinion acting as a reasonable and prudent person, an increase in the commercial or technical risk to <Service Provider>.
- Clause 13.6(b)(i) of the Template Haulage Contract should read:
 

(i) the person to whom it is proposed the Haulage Contract will be novated to complying with one or more pre-conditions to and restrictions on the provision of Pipeline Services specified in the ~~Access Arrangement~~ Template Haulage Contract, as directed by <Service Provider> in writing;

### *Changing a receipt or delivery point*

#### **Access arrangement proposal**

1619. Clause 13.7(a) of the template Haulage Contract provides a user to request, in writing, from the service provider for consent to change a delivery point or receipt point.

1620. Clause 13.7(b) deals with a request to change a receipt point and provides that a service provider cannot withhold its consent to a request to change a receipt point unless it has reasonable grounds based on technical or commercial considerations. Clause 13.7(b) then goes on to provide that the service provider may give its consent subject to conditions only if they are reasonable based on commercial or technical grounds or if the user satisfies one or more of the pre-conditions specified in the Application Procedure.

1621. Clause 13.7(c) deals with a request to change a delivery points and states that a request for consent to change a delivery point is subject to the Application procedure, in particular the pre-conditions to and restrictions on the provision of pipeline services.

### **Public submissions**

1622. Alinta, in Attachment B to its submission dated 19 April 2010 (page 13), submitted that in relation to clause 13.7(b) and (c), the service provider should only to be permitted to impose the application procedure or pre-conditions where such conditions are relevant to the request. Alinta is concerned that the full application procedure for changes to delivery points in particular may impose an unnecessary and costly burden on the user. There were no other public submissions.

### **Authority's assessment**

1623. Rule 106 of the NGR provides that the service provider must not withhold its consent to change the user's receipt or delivery points unless it has reasonable grounds, based on technical or commercial considerations. Clause 13.7(b)(ii) of the Template Haulage Contract imposes this requirement in respect of changing a receipt point, but clause 13.7(c) does not for delivery points.
1624. The Authority notes also that both clauses 13.7(b)(iii) (for receipt points) and 13.7(c) (for delivery points) do not confine the service provider to withholding its consent to reasonable commercial or technical grounds as required by rule 106. Further, both clauses as drafted purport to impose on the change of delivery point conditions with which a user must comply when first seeking access to the pipeline. These conditions are not suitable for an application for a change of receipt or delivery point, being directed to issues relevant to whether access should be granted in the first place. Therefore, in the absence of any justification from WAGN the Authority is unable to conclude that the imposition of these conditions on a change of a receipt or a delivery point is necessary from the point of view of the national gas objective. Clause 13.7(b)(iii) and clause 13.7(c) should both be deleted.
1625. Notwithstanding the required deletion of clause 13.7(b)(iii) the Authority is satisfied that clauses 13.7(b)(i) and (ii), providing conditions on the change of a receipt point only, are consistent with rule 106 and should be approved.
1626. In relation to changes of delivery points, the Authority notes that the effect of this draft decision is that the Template Haulage Contract will not include a provision for the change of a delivery point, by virtue of the deletion of clause 13.7(c). The Authority notes, however, that in any event clause 8 of the proposed access arrangement will, if amended in accordance with this draft decision, provide terms and conditions for change of a delivery point which will apply to reference services, which could be also included by amendment in the Template Haulage Contract. If WAGN was to propose such an amendment in response to this draft decision, and if the provisions were in the same terms as clause 8 of the proposed access arrangement as amended, they are likely to comply with the national gas objective.

### **Draft decision**

1627. The Authority does not approve clause 13.7 of the Template Haulage Contract as submitted. In order to be approved, WAGN will have to amend clause 13.7.



**Required Amendment 46**

Clauses 13.7(b)(iii) and 13.7(c) should be deleted.

***Default and Termination******Default by user*****Access arrangement proposal**

1628. Clause 14.2 of the Template Haulage Contract provides that a user is in default in one of the following circumstances:

- a) if there is any adverse change in the business or financial condition of the user or an event occurs which could, in the reasonable opinion of the service provider materially affect the user's ability to meet its obligations to the service provider under the haulage contract; or
- b) if the user is in default under any other contract with the service provider.

**Public submissions**

1629. No submissions were received in relation to default by a user.

**Authority's assessment**

1630. The Authority notes that the corresponding provision to clause 14.2(a) of the Template Haulage Contract is clause 38(d) of Part C in the current access arrangement and that it is materially the same as provided for in the current access arrangement.

1631. The Authority notes that clause 38(f) of Part C of the current access arrangement provides for a party to be in default 'if the party is in default under any other Haulage Contract between the parties'. Clause 14.2(b) of the Template Haulage Contract has extended this provision to cover 'any other contract with the <Service provider>'.

1632. The Authority considers that clause 14.2(b) extends the current circumstances where the user may be in default to include other contracts beyond haulage contracts. The Authority considers that if the parties wanted such a default provision to apply, this would be more appropriately achieved by way of a bilateral agreement between the parties.

**Draft decision**

1633. The Authority approves clause 14.2(a) of the Template Haulage Contract.

1634. The Authority does not approve clause 14.2(b) of the Template Haulage Contract and requires clause 14.2(b) to be confined only to other haulage contracts between the parties. In order to be approved, WAGN will have to amend clause 14.2.

#### Required Amendment 47

Clause 14.2(b) should be amended to read:

- (b) if <user> is in default under any other Haulage eContract between the parties with the ~~<Service Provider>~~;

## Security and insurance

### *Relationship between the parties*

#### Access arrangement proposal

1635. Clause 15.1 of the Template Haulage Contract provides that the service provider may, by written notice, from time to time require the user to:

- a) pay all amounts owing under the Haulage Contract;
- b) provide written evidence that the user has the ability to comply, is complying and will comply, with its approved system pressure protection plan; and
- c) provide written evidence that the user is complying with gas quality specifications.

#### Public submissions

1636. Alinta, in Attachment B to its submission dated 19 April 2010 (page 14), submitted that clause 15.1(b) should be deleted and that the ongoing requirement in relation to the approved system pressure protection plan should be reserved to the warranty in clauses 17.1(a) and (b). Alinta commented that the additional requirement in clause 15.1(b) is not reasonable in light of the various other obligations imposed on the user in relation to the approved system pressure protection plan under the Haulage Contract.

1637. Alinta also commented on clause 15.1(c) stating that the service provider will receive gas quality data directly from the relevant pipeline owner. Alinta argued that the user ought not to be required to provide written evidence which will only ever be evidence of a contractual position rather than the physical position reflected in the gas quality data (the physical position being most important to the service provider).

1638. There were no other public submissions.

#### Authority's assessment

1639. Clause 3 (1) of Part C of the current access arrangement provides for WAGN to request, from time to time, a user to pay all amounts owing under a haulage contract to continue to receive one or more reference services. This clause is reflected in clause 15.1(a) of the Template Haulage Contract and the Authority accepts this clause as proposed by WAGN.

1640. Clause 15.1(b) of the Template Haulage Contract is, in part, provided for in clause 3(1)(d) of Part C of the current access arrangement. Clause 3(1)(d) states that

WAGN may from time to time require a user to provide evidence of the identity of its related shippers. Clause 15.1(b) of the Template Haulage Contract goes further than this by allowing WAGN to request a user to provide written evidence that the user has the ability to comply with the approved system pressure protection plan.

1641. The Authority notes Alinta's comments in relation to clause 15.1(b) concerning the obligations imposed on the user in relation to the system pressure protection plan throughout various provisions of the Template Haulage Contract, including under clause 17.1(a) and 17.1(b).
1642. The Authority has approved the approval of system pressure protection plans by some users of reference services as consistent with the national gas objective given the safety and technical risks associated with system depressurisation. The Authority considers that it is consistent with that draft decision for the Template Haulage Contract to provide a mechanism to ensure compliance by users who have a system pressure protection plan. Proposed clause 15.1(b) of the Template Haulage Contract achieves this in a manner consistent with the national gas objective and the Authority does not, therefore, accept Alinta's submission.
1643. Clause 15.1(c) of the Template Haulage Contract is not contained in the current access arrangement.
1644. The Authority in this draft decision has approved requirements for compliance by users and their related shippers with gas quality specifications as consistent with the national gas objective and the safety and technical risks associated with commingling of gas. The Authority considers that it is consistent with that draft decision for the Template Haulage Contract to provide a mechanism to ensure compliance by users with gas quality specifications. Proposed clause 15.1(c) of the Template Haulage Contract achieves this in a manner consistent with the national gas objective and the Authority does not, therefore, accept Alinta's submission.

#### **Draft decision**

1645. Clause 15.1 of the Template Haulage Contract is approved.

#### *Security for performance*

#### **Access arrangement proposal**

1646. Clause 15.2(a) of the Template Haulage Contract provides that the service provider may, by written notice, from time to time require the user to provide security for the performance of its obligations under the Haulage Contract.
1647. Clause 15.2(b) states that the service provider may require the user to provide security in the form of a bank guarantee by giving the user written notice specifying:
- a) the period of time for which the bank guarantee will be effective; and
  - b) the amount in dollars that the bank guarantee is to be for.
1648. Clauses 15.2(c) and 15.2(f) concerns the user providing the service provider with a bank guarantee as set out in Annexure B of the Template Haulage Contract, while clauses 15.2(g) to 15.2(k) of the Template Haulage Contract govern the effect of the bank guarantee in the event of default by the user.

## **Public submissions**

1649. Alinta, in Attachment B to its submission dated 19 April 2010 (page 14), submitted that clause 15.2(b)(i) should be amended so that the bank guarantee expires with the expiry or termination of the Haulage Contract. Alinta notes that this would be consistent with clause 15.2(j).
1650. Alinta further submitted that the reference to 2 months' haulage charges in clause 15.2(b)(ii) should be replaced with a requirement that the security be limited to the minimum amount necessary to protect the service provider's legitimate business interests.
1651. There were no other public submissions.

## **Authority's assessment**

1652. Under the current access arrangement, clause 3(1)(a) of Part C enabled WAGN to request a user to provide security for the performance of its obligations under the haulage contract in the form of a bank guarantee that applies 'for the duration of the haulage contract'. The Authority agrees with Alinta's submission concerning the expiration of the bank guarantee and considers that clause 15.2(b)(i) should revert back to the current access arrangement's provision that the bank guarantee applies for the duration of the haulage contract.
1653. Clause 3(1)(a) of Part C of the current access arrangement goes on to provide that the guarantee will be 'for at least an amount that is equal to AGN's reasonable estimate of all fees and charges that will be incurred by the user under the haulage contract in the 2 months following the date of estimation, and if necessary an amount if, in AGN's reasonable opinion, a greater amount is necessary to protect AGN's legitimate business interests.' In relation to clause 15.2(b)(ii), Alinta submitted that the reference to 2 months' haulage charges in clause 15.2(b)(ii) should be replaced with a requirement that the security be limited to the minimum amount necessary to protect the service provider's legitimate business interests. In the absence of compelling submissions from Alinta requiring a change, the Authority considers that there is no need to change the status quo under the current access arrangement.
1654. In relation to clauses 15.2(c) to (k) of the Template Haulage Contract, the Authority considers that these clauses cover matters of detail in relation to commercial arrangements between contracting parties, and not matters which go to compliance of WAGN's proposed revisions with the national gas objective which is the matter for the Authority's assessment. In these circumstances, the Authority considers that it should not approve the more detailed provisions regarding the provision of security proposed by WAGN in clause 15.2(c) to (k), including the form of the guarantee contained in Annexure B of the Template Haulage Contract.

## **Draft decision**

1655. The Authority does not approve clauses 15.2(c) to 15.2(k) of the Template Haulage Contract together with Annexure B of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 15.2.

**Required Amendment 48**

Clauses 15.2(c) to 15.2(k) of the Template Haulage Contract should be deleted.

Annexure B to the Template Haulage Contract should be deleted.

*Insurance***Access arrangement proposal**

1656. Clause 15.3(a) of the Template Haulage Contract states that the user must meet the service provider's minimum insurance and prudential requirements, including requirements as to its ability to meet all financial obligations under the Haulage Contract.

1657. Clause 15.3(a) goes on to set out the minimum insurance requirements and includes:

- a) third party liability insurance; and
- b) workers compensation insurance.

1658. Clause 15.3(b) and (c) provide for the service provider to request the user to provide evidence of the matters in clause 15.3(a).

**Public submissions**

1659. Alinta, in Attachment B to its submission dated 19 April 2010 (page 14), considered that the relevant qualification in clauses 15.3(a)(i)(A) and 15.3(a)(ii)(A) should be that the insurer is supervised by the Australian Prudential Regulation Authority.

1660. Alinta submitted that in relation to clause 15.3(a)(i)(B), the requirement to have the service provider approve the manner in which its interest is noted in the insurance policy is not acceptable.

1661. There were no other public submissions.

**Authority's assessment**

1662. Clause 61(1) of Part C of the current access arrangement provides that a haulage contract will require the user to procure and maintain liability insurance with insurers for such amount as WAGN may require and the user must arrange for endorsement of the interests of WAGN on the policy. Clause 61(2) of Part C of the current access arrangement goes on to provide that WAGN may require the user to provide evidence of the matters in clause 61(1).

1663. Clause 15.3 of the Template Haulage Contract introduces a detailed provision governing the insurance and prudential obligations that the user must meet. The Authority considers that the particulars set out in clause 15.3(a) of the Template Haulage Contract go beyond compliance requirements of WAGN with the national gas objective, and relate to commercial arrangements between contracting parties. The Authority considers that it should not approve the more detailed provisions set

out in clause 15.3(a) and require WAGN to amend the clause to revert back to the simple insurance requirements provided for under clause 61 of Part C of the current access arrangement.

1664. The Authority notes Alinta's submission that clause 15.3(a)(i)(B), which requires the service provider to approve the manner in which its interest is noted on the insurance policy, is unacceptable. In the absence of substantive reasons supporting this submission, the Authority accepts that it is reasonable for the user to at least arrange for the endorsement of WAGN's interests on the insurance policy as required under the current access arrangement.

1665. In light of the above changes to clause 15.3, Alinta's submission regarding the insurer being supervised by the Australian Prudential Regulation Authority, does not require further comment. In the event that WAGN and any proposed user wish to agree regarding more specific or detailed insurance issues then there is provision for bilateral agreement about those matters.

### **Draft decision**

1666. The Authority does not approve clause 15.3 of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 15.3.

#### **Required Amendment 49**

Clause 15.3 of the Template Haulage Contract should be amended to delete clauses 15.3(a) to 15.3(c) and to replace these clauses with insurance requirements consistent with clause 61 of Part C of the current access arrangement.

## ***Liability of parties***

### ***Liability for negligence and default limited to direct damage***

#### **Access arrangement proposal**

1667. Clause 16.1(a) of the Template Haulage Contract provides that if a party is negligent or defaults in respect of its obligations under the Haulage Contract, then the party is liable to the other party for, and indemnifies the other party against, any direct damage to the other party caused by or arising out of the negligence or default.

1668. Clause 16.1(b) states that the service provider is not liable to the user for direct damage or indirect damage caused by or arising out of :

- a) any refusal to accept gas at a receipt point or curtailment of gas deliveries to the user undertaken under the Haulage Contract or otherwise pursuant to law;
- b) any non-delivery of gas into the WAGN GDS; or
- c) the service provider acting in accordance with its rights under the Haulage Contract or otherwise pursuant to law.



## Public submissions

1669. In relation to clause 16.1(b)(i), Synergy, in its submission dated 12 April 2010 (pages 8-9), submitted that there should be a comma after the word 'point' in the first line and another comma immediately before the word 'undertaken' in the second line to ensure that the qualifier of 'undertaken under this Haulage Contract or otherwise pursuant to law' applies to both refusal to accept gas and curtailment.
1670. Alinta, in Attachment B to its submission dated 19 April 2010 (page 15), also provided submissions in relation to clause 16.1(b)(i) stating that the provision must be clarified so that it is only where the refusal to accept gas or curtailment is undertaken as permitted by the contract that liability will be excluded.
1671. In relation to clause 16.1(b)(ii), Synergy submitted that the sentence 'through no fault of the service provider' should be added at the end of the paragraph.
1672. Alinta also provided submissions in relation to clause 16.1(b)(ii) stating that this provision must also be clarified to ensure that liability is only excluded where the non-delivery has not been caused by or contributed to by the service provider or its officers, employees, agents, contractors, subcontractors or other representatives.
1673. There were no other public submissions.

## Authority's assessment

1674. The Authority notes that clause 16.1(a) in the Template Haulage Contract is materially the same as clause 48(1) of Part C of the current access arrangement. Clause 16.1(a) has not been the subject of any submission and the Authority is satisfied that clause 16.1(a) of the Template Haulage Contract should be approved.
1675. Under the current access arrangement, clause 48 of Part C, WAGN is 'not liable to the user for Direct Damage or Indirect Damage caused by or arising out of any curtailment of Gas deliveries to the user, or any non-delivery of Gas into the AGN GDS'. The Authority notes, in clause 16.1(b)(i) of the Template Haulage Contract, the inclusion of the provision whereby WAGN is not liable to the user arising out of 'any refusal to accept gas at a Receipt Point' is different from the current access arrangement, although this has not been the subject of any adverse submissions.
1676. The Authority notes both Synergy and Alinta's submissions in relation to clause 16.1(b)(i) requiring amendment to clarify that it is only where the refusal to accept gas or curtailment is undertaken as permitted by the contract that liability will be excluded. The Authority accepts that clause 16.1(b)(i) of the Template Haulage contract requires amendment to clarify this qualification.
1677. The Authority considers it necessary, as suggested by both Synergy and Alinta, that clause 16.1(b)(ii) of the Template Haulage Contract should be amended to apply only where non-delivery has not been caused by WAGN. The Authority does not consider this clause appropriate in a competitive market as it effectively creates a situation whereby WAGN can escape liability for damage that they may have caused or contributed. In light of the requirement for terms and conditions of the access arrangement to comply with the national gas objective, the Authority does not approve clause 16.1(b)(ii) of the Template Haulage Contract.

## Draft decision

1678. The Authority approves clause 16.1(a) of the Template Haulage Contract.

1679. The Authority does not approve clause 16.1(b) of the Template Haulage Contract.

### Required Amendment 50

Clause 16.1(b)(i) and (ii) of the Template Haulage Contract should be amended to read:

- (i) any refusal to accept gas at a Receipt Point or Curtailment of Gas deliveries to <user><sub>1</sub> undertaken in accordance with the terms of this Haulage Contract or otherwise pursuant to Law;
- (ii) any non-delivery of Gas into the WAGN GDS where non-delivery has not been caused, or contributed to, by the <Service Provider>;

## Extended operation of clause 16.3

### Access arrangement proposal

1680. Clause 16.4 of the Template Haulage Contract provides that, to the extent that the service provider is not liable to the user as a result of indirect damage, the user is to indemnify the service provider against indirect damage for any upstream person or downstream person.

### Public submissions

1681. Alinta, in Attachment B to its submission dated 19 April 2010 (page 15), submitted that it did not accept that the user should indemnify the service provider against any liability for indirect damage for any third person. Alinta submitted that to do so would increase Alinta's own liability to its customers and suppliers under its existing contractual arrangements and is not acceptable. There were no other public submissions.

### Authority's assessment

1682. Clause 51 of Part C of the current access arrangement is similar to clause 16.4 of the Template Haulage Contract except that reference to the 'Upstream Person' has been included into the Template Haulage Contract.

1683. In relation to Alinta's submission concerning clause 16.4 of the Template Haulage Contract, the Authority notes that a user is, under the current access arrangement, already required to indemnify WAGN for a downstream person's claim. The Authority does, however, consider that a user's liability will increase under WAGN's proposed revisions as the user will now also be liable to indemnify WAGN for an upstream person's claim.

1684. The Authority considers this to be a significant change as WAGN is, through its proposed revisions, effectively seeking to enhance the current position afforded to it

under the current access arrangement by being indemnified by the user for any claim made against WAGN by an upstream person.

1685. The Authority considers that clause 16.4 of the Template Haulage Contract, as amended by WAGN from clause 51 of Part C of the current access arrangement, is not consistent with the national gas objective of promoting efficient investment in natural gas services in the interests of consumers of natural gas.

### **Draft decision**

1686. The Authority does not approve clause 16.4 of the Template Haulage Contract. In order to be approved, WAGN will have to amend clause 16.4.

#### **Required Amendment 51**

Clause 16.4 of the Template Haulage Contract should be amended to delete any reference to the 'Upstream Person'.

### *Set-off*

#### **Access arrangement proposal**

1687. Clause 16.8 of the Template Haulage Contract provides that the service provider may set-off amounts owing to the user under other contracts between the parties against amounts payable by the user under the Haulage Contract.

#### **Public submissions**

1688. Alinta, in Attachment B to its submission dated 19 April 2010 (page 15), submitted that it did not accept the service provider's right to set-off. Alinta submitted that both Alinta and the service provider are parties to other significant commercial contracts and it is neither appropriate nor acceptable to merge the payment obligations under the different agreements. Alinta has asserted that clause 16.8 should be deleted. There were no other public submissions.

#### **Authority's assessment**

1689. The Authority notes that there is no equivalent provision to clause 16.8 in the current access arrangement.
1690. The Authority notes Alinta's submission in relation to clause 16.8 of the Template Haulage Contract and considers that the right to set-off is not a matter which goes to compliance of WAGN's proposed revisions with the national gas objective. The right to set-off is governed by a body of law and the Authority does not consider it necessary for this to be provided for in the Template Haulage Contract. The Authority considers that if the parties wish to adjust the position under the laws governing set-off this would be more appropriately done by way of a bilateral agreement. The Authority does not approve clause 16.8 of the Template Haulage Contract and requires it to be deleted.

## Draft decision

1691. The Authority does not approve clause 16.8 of the Template Haulage Contract.

### Required Amendment 52

Clause 16.8 of the Template Haulage Contract should be deleted.

## *Representations and warranties*

### Access arrangement proposal

1692. Clause 17.1 of the Template Haulage Contract sets out the user's representations and warranties while clause 17.2 sets out the service provider's representations and warranties and clause 17.3 sets out representations and warranties generally.

### Public submissions

1693. Alinta, in Attachment B to its submission dated 19 April 2010 (pages 15-16), submitted in relation to clause 17.1, many of the representations or warranties were not governed by a materiality threshold and are accordingly a hair trigger for default. Alinta suggested that clause 17.1(b), (c), (d) and (e) be amended to contain a materiality threshold.

1694. Alinta commented that it was not appropriate in clause 17.1(h) to include a warranty that can be triggered by the threat of an action or proceeding given the significance of the consequences of a breach of warranty. Alinta considered that the warranty contained in clause 17.1(h) is too broad and should be deleted.

1695. Alinta further submitted that clause 17.1(m) of the Template Haulage Contract should be deleted. Alinta asserted that a user has contractual arrangements with pipeline operators and gas suppliers, and can seek to enforce its rights under those arrangements. However, a user cannot procure their compliance with the Retail Market Scheme. Alinta noted that the service provider has its own contractual arrangements with operators of interconnected pipelines and should seek to enforce any compliance directly.

1696. There were no other public submissions.

### Authority's assessment

1697. Clause 60 of Part C of the current access arrangement states that a haulage contract is to specify the representations and warranties made by the user to the service provider and vice versa. The Authority notes that under the current access arrangement there are no specific provisions prescribing the representations and warranties for each party. The Authority further notes that WAGN have set out, in clause 17 of the Template Haulage Contract, the representations and warranties to be made by the user, the service provider and the representations and warranties generally made by both parties.

1698. The Authority considers, that the representations and warranties made by each party is a matter of commercial negotiation and agreement between contracting

parties. The Authority does not consider approving representations and warranties of a contractual nature as a matter which goes to WAGN's compliance of the national gas objective. In these circumstances, the Authority considers that it should not approve the detailed provisions listing the representations and warranties of each party and WAGN's proposed revisions should be amended to revert to the provisions in clause 60 of Part C of the current access arrangement to simply state that the haulage contract will specify the representations and warranties made by the user to the service provider and vice versa.

1699. In light of this decision, the Authority does not consider it necessary to discuss the submissions made by Alinta.

### **Draft decision**

1700. The Authority does not approve clauses 17.1 to 17.3 of the Template Haulage Contract.

#### **Required Amendment 53**

Clauses 17.1 to 17.3 of the Template Haulage Contract should be deleted and replaced with equivalent provisions to those in clause 60 of Part C of the current access arrangement.

## ***Dispute resolution***

### ***Parties to attempt to resolve***

#### **Access arrangement proposal**

1701. Clause 18.1(a) of the Template Haulage Contract sets out the dispute resolution process arising out of, or in connection to the Haulage Contract.

1702. Clause 18.1(b) of the Template Haulage Contract provides that the parties must use reasonable endeavours to resolve the dispute within 20 business days from receiving written notice.

1703. Clause 18.1(c) of the Template Haulage Contract states that the parties are to meet within 5 business days if initial attempts to resolve the dispute fail and the parties are to use their best endeavours to resolve the dispute.

1704. Clause 18.1(d) provides that all discussions held and documents exchanged by the parties under clause 18.1 are on a without prejudice basis.

#### **Public submissions**

1705. Alinta, in Attachment B to its submission dated 19 April 2010 (page 16), submitted that in relation to clause 18.1(c), the parties should meet after 10 business days.

1706. There were no other public submissions.

### **Authority's assessment**

1707. The Authority notes that clause 55(1) of Part C of the current access arrangement is substantially the same as provided for in clause 18.1(a) of the Template Haulage Contract.
1708. Clause 55(2) of Part C of the current access arrangement provides that if the dispute remains unresolved for a period of 30 days, the parties are to meet within five business days after the end of a 30 day period and use their best endeavours to resolve the dispute. The Authority notes that the change from '30 days' in clause 55 of Part C to '20 Business Days' in clause 18.1(b) of the Template Haulage Contract in relation to the time frame of the initial period to attempt to resolve the dispute before the parties meet. The Authority considers that this is materially the same time frame and for consistency in the Template Haulage Contract, accepts the reference to 20 business days in clause 18.1(b).
1709. The Authority notes Alinta's suggestion to increase the time frame which parties have to meet following the initial dispute resolution process from five business days, as provided for in clause 18.1(c) of the Template Haulage Contract and in clause 55(2) of Part C of the current access arrangement, to 10 business days. Alinta have not, however, provided any reasons supporting the need for a user to have an extended period of time than what is currently provided for. In the absence of such information, the Authority is not in a position to assess the submission having regard to the national gas objective and does not, therefore, accept Alinta's submission to amend clause 18.1(c).
1710. The Authority also notes that clause 18.1(d) of the Template Haulage Contract is a new provision not contained in the current access arrangement, and the Authority accepts WAGN's proposal to include a term which will encourage open discussion and assist in resolving the dispute.
1711. The Authority notes that there have been no submissions in relation to the dispute resolution process, as a whole, provided for in clause 18 of the Template Haulage Contract. The Authority notes that the dispute resolution process outlined in clause 18.1 of the Template Haulage Contract is in addition to any rights the parties have at law, through the access disputes procedure under Chapter 6 of the NGL and through any other provisions that the parties may otherwise make by commercial agreement.

### **Draft decision**

1712. The Authority approves clause 18.1 of the Template Haulage Contract.

### *Disposition of unresolved disputes*

### **Access arrangement proposal**

1713. Clause 18.2 of the Template Haulage Contract states that if the dispute remains unresolved 10 business days after the authorised officers first meet as referred to in clause 18.1(c), then a party may refer the dispute to arbitration under clause 18.3.



**Public submissions**

1714. There were no public submissions in relation to clause 18.2 of the Template Haulage Contract.

**Authority's assessment**

1715. The Authority notes that there has been a change in the requirement to refer a dispute to arbitration from clause 56 of Part C of the current access arrangement to that provided for in clause 18.2 of the Template Haulage Contract. The current access arrangement provides that if a dispute remains unresolved, and the dispute is of a kind that the arbitrator under the Code may hear and determine, then the dispute must be referred to arbitration in accordance with the Code. It is only in circumstances where the dispute is not of a kind that is appropriate for the arbitrator under the Code to deal with, that the matter must be referred to arbitration, in accordance with clause 57 of Part C of the current access arrangement.
1716. Clause 18.2 of the Template Haulage Contract only provides the option, however, for a party to refer the dispute to arbitration under clause 18.3 of the Template Haulage Contract if the dispute remains unresolved for 10 business days.
1717. The Authority notes that clause 5.4 of the proposed access arrangement provides that any access dispute between WAGN and a user may be dealt with under chapter 6 of the NGL through a dispute resolution body. 'Dispute resolution body' is defined in section 9(1) of the NGA as the 'WA arbitrator' which is in turn defined in clause 9 to mean the Western Australian Energy Disputes Arbitrator under Part 6 Division 3 of the Energy Arbitration and Review Act 1998.
1718. The Authority notes that clause 18.2 of the Template Haulage Contract removes the obligation to first ensure that the dispute is not one that can be dealt with under NGL, before the parties refer the dispute to arbitration under clause 18.3 of the Template Haulage Contract. The Authority considers this to be a significant change from the current access arrangement and also makes clause 5.4 of the proposed access arrangement redundant.
1719. The Authority does not consider it appropriate to approve a dispute resolution process that is, in effect, significantly different from the current access arrangement and inconsistent with the procedure set out in the NGL. The Authority notes that in the event WAGN and any proposed user require more detailed dispute resolution procedures, then they may do so by commercial agreement.

**Draft decision**

1720. The Authority does not approve clause 18.2 of the Template Haulage Contract.

#### Required Amendment 54

Clause 18.2 of the Template Haulage Contract should be amended to revert back to the two alternatives for the parties to proceed to arbitration as set out in clause 56 of Part C of the current access arrangement, with appropriate references to the NGL.

### *Arbitration*

#### **Access arrangement proposal**

- 1721. Clauses 18.3(a) to 18.3(j) of the Template Haulage Contract sets out the process and procedure in relation to referring a dispute to arbitration.
- 1722. Clause 18.3(b) of the Template Haulage Contract introduces a time frame of 14 days in which either party may request the president of the Law Society of Western Australia to nominate an arbitrator.
- 1723. Clause 18.3(f) provides that the arbitrator must decide whether or not to be bound by the rules of evidence.

#### **Public submissions**

- 1724. No public submissions were received in relation to this clause 18.3 of the Template Haulage Contract.

#### **Authority's assessment**

- 1725. The Authority notes that clauses 57(1), (3), (5), (7) and (8) of Part C of the current access arrangement are, in substance, the same as clauses 18.3(a), (e), (g), (i) and (j) of the Template Haulage Contract. In the absence of any submissions, the Authority is satisfied that clauses 18.3(a), (e), (g), (h), (i) and (j) of the Template Haulage Contract should be approved.
- 1726. The Authority notes three changes in clause 18.3 of the Template Haulage Contract from the current access arrangement.
- 1727. First, clause 18.3(b) of the Template Haulage Contract introduces a time limit, not provided in clause 57(2) of the current access arrangement, that if the parties cannot agree on a person to be the arbitrator within 14 business days of the dispute being referred to arbitration, then either party can request the president of the Law Society of Western Australia to nominate an arbitrator. The Authority considers this clause to be consistent with the national gas objective and should therefore be approved.
- 1728. Secondly, the Authority also highlights the position in clause 57(4) of the current access arrangement and in section 198 of the NGL which provide that in a dispute hearing, the arbitrator is not bound by the rules of evidence. In contrast, clause 18.3(f) of the Template Haulage Contract enables the arbitrator to decide whether or not to be bound by the rules of evidence and also provides for the parties to make submissions before the arbitrator makes its decision regarding the rules of evidence. The Authority does not consider it appropriate for the Template Haulage

Contract to contain fundamental changes to the NGL procedure for dispute resolution.

1729. Thirdly, the Authority notes that provisions in clauses 18.3(c) and 18.3(d) of the Template Haulage Contract are not contained in the current access arrangement. The Authority considers these provisions to be appropriate and consistent with the national gas objective..

### **Draft decision**

1730. The Authority does not approve clause 18.3(f) of the Template Haulage Contract.

#### **Required Amendment 55**

Clause 18.3(f) of the Template Haulage Contract should be deleted.

## ***Notices and addresses for notices***

### **Access arrangement proposal**

1731. Clause 19(a) of the Template Haulage Contract provides that notices, or other communications provided to the service provider by the user, or vice versa, must be provided in accordance with the format and procedure specified in the Retail Market Scheme.
1732. Clause 19(b) sets out the provisions concerning electronic mail if the Retail Market Rules do not specify a format and procedure for providing a notice, consent or other communication.
1733. Clause 19(c) of the Template Haulage Contract states that where notices or other communications are not provided in accordance with clauses 19(a) or 19(b), the service provider may recover from the user the reasonable additional costs involved in dealing with that notice or other communication.
1734. Clause 19(d) and 19(e) of the Template Haulage Contract provide the details of the service provider and user's address for service, including by email.

### **Public submissions**

1735. Alinta, in Attachment B to its submission dated 19 April 2010 (page 16), submitted that the obligation in clause 19(c) of the Template Haulage Contract is not acceptable and should be deleted in its entirety.
1736. There were no other public submissions.

### **Authority's assessment**

1737. The Authority notes that clauses 63 to 65 of Part C of the current access arrangement are, in substance, materially the same as clauses 19(a) and 19(c) to 19(e) of the Template Haulage Contract. Alinta's submission in relation to clause 19(c) noted that this clause was unacceptable but did not provide any reasons for

this view. The Authority considers that clauses 19(a) and 19(c) to 19(e) are consistent with the national gas objective and should be approved.

1738. The Authority notes that clause 19(b) has been inserted into the Template Haulage Contract, and that there is no equivalent provision in the current access arrangement. The Authority considers clause 19(b) of the Template Haulage Contract which enables notice to be given electronically, is consistent with the national gas objective. Therefore the Authority considers that this clause 19(b) should be approved.

#### **Draft decision**

1739. The Authority approves clause 19 of the Template Haulage Contract.

### ***Intellectual property, confidentiality and information exchange***

#### ***Intellectual property***

#### **Access arrangement proposal**

1740. Clause 20.1(a) of the Template Haulage Contract provides for all documents, tools software, reports provided by or on behalf of a party under the haulage contract to remain the property of that party. The clause goes on to state that nothing in the haulage contract assigns any intellectual property rights to the other party.

1741. Clause 20.1(b) of the Template Haulage Contract provides that all documents, tools, software, reports created under the haulage contract including intellectual property rights are owned absolutely by the service provider on creation.

#### **Public submissions**

1742. Alinta, in Attachment B to its submission dated 19 April 2010 (page 16), submitted that clause 20.1 should be amended to provide that all documents, tools, software, reports etc created by the user are owned by the user. There were no other public submissions.

#### **Authority's assessment**

1743. The Authority notes that there is no equivalent provision to clause 20.1 in the current access arrangement.

1744. The Authority considers that the ownership of intellectual property is a matter relating to the commercial arrangements between the service provider and the user rather than a matter that goes to compliance of WAGN's proposed Template Haulage Contract with the national gas objective, which is the matter the Authority has to consider. In these circumstances, the Authority considers that it should not approve the provision regarding intellectual property. In the event that WAGN and any proposed user wish to agree regarding aspects of intellectual property then they may do so by bilateral agreement or failing agreement, arbitration or other dispute resolution.

#### **Draft decision**

1745. The Authority does not approve Clause 20.1 of the Template Haulage Contract.

**Required Amendment 56**

Clause 20.1 of the Template Haulage Contract should be deleted.

*When disclosure of confidential information is permitted***Access arrangement proposal**

1746. Clause 20.2 of the Template Haulage Contract sets out the exceptions to the rule that confidential information must not be disclosed.
1747. Clause 20.2(c) provides that disclosure is permitted at the request of the party to whom the information relates where the information is about the use of pipeline services or the acquisition or consumption of gas.

**Public submissions**

1748. Alinta, in Attachment B to its submission dated 19 April 2010 (page 16), submitted that the intent and effect of clause 20.2(c) of the Template Haulage Contract is not clear and that this provision should be deleted. There were no other public submissions.

**Authority's assessment**

1749. Clause 20.2(c) of the Template Haulage Contract is a new provision that is not in the current access arrangement.
1750. The Authority considers that the issue of disclosure of confidential information is a matter relating to the commercial arrangements between the service provider and the user rather than a matter that goes to compliance of WAGN's proposed Template Haulage Contract with the national gas objective, which is the matter the Authority has to consider. In these circumstances, the Authority considers that it should not approve the provision regarding the disclosure of confidential information. In the event that WAGN and any proposed user wish to agree regarding aspects of confidentiality then they may do so by bilateral agreement or, failing agreement, arbitration or other dispute resolution.

**Draft decision**

1751. The Authority does not approve Clause 20.2 of the Template Haulage Contract.

**Required Amendment 57**

Clause 20.2 of the Template Haulage Contract should be deleted.

*Other provisions concerning disclosure*

**Access arrangement proposal**

1752. Clause 20.3 of the Template Haulage Contract provides in the case of permitted disclosure, a party must use reasonable endeavours to make the disclosure on terms which preserve as far as practicable the confidentiality of the information.

**Public submissions**

1753. Alinta, in Attachment B to its submission dated 19 April 2010 (pages 16-17), submitted that the reasonable endeavours obligation is insufficient and that clause 20.3(a) needs to be tightened to oblige the disclosing party to ensure that confidentiality is maintained. Alinta suggested that the recipients of the confidential information should be bound by appropriate and enforceable confidentiality undertakings. There were no other public submissions.

**Authority's assessment**

1754. Clause 66(3) of Part C of the current access arrangement is written in nearly identical terms to clause 20.3(a) of the Template Haulage Contract.

1755. Alinta's submission regarding disclosure does not contain any explanation of the reasons supporting its view that clause 20(3) should be changed. The Authority does not consider it necessary to require recipients of confidential information to be bound by confidentiality undertakings as suggested by Alinta. The Authority considers this clause to be appropriate and consistent with the national gas objective.

**Draft decision**

1756. Clause 20.3 of the Template Haulage Contract is approved.

*Format for information exchange*

**Access arrangement proposal**

1757. Clause 20.4(a) of the Template Haulage Contract provides that any information provided by the user or the service provider to the other party must be provided in accordance with the format and procedure specified in the Retail Market Rules.

1758. Clause 20.4(b) of the Template Haulage Contract states that where information is not exchanged in accordance with clause 20.4(a), the service provider may recover from the person providing or requesting the information the reasonable additional costs involved in dealing with the information.



**Public submissions**

1759. In its submission dated 12 April 2010 (page 9), Synergy submitted that in relation to clause 20.4(b) of the Template Haulage Contract, a user should also be able to recover reasonable costs incurred by it if information is not exchanged in accordance with clause 20.4(a). There were no other public submissions.

**Authority's assessment**

1760. Clause 36 of Part C of the current access arrangement contains a similarly worded provision to that of clause 20.4 of the Template Haulage Contract.

1761. Synergy's submission proposes that the cost recovery mechanism be reciprocal in the sense that at present the clause does not provide for the user (as opposed to the service provider) to recover reasonable costs if information is not exchanged in the required format. The Authority considers it consistent with the national gas objective for similar cost recovery provisions to apply to both service provider and user. The clause should be amended accordingly.

**Draft decision**

1762. Clause 20.4 of the Template Haulage Contract should be amended to provide for similar cost recovery provisions to apply to both service provider and user.

**Required Amendment 58**

Clause 20.4 of the Template Haulage Contract should be amended to read:

- (b) Where information is not exchanged in accordance with clause 20.4(a), **<Service Provider>** or **<User>** may recover from the person providing or requesting the information the reasonable additional costs involved in dealing with the information.

**Media announcements****Access arrangement proposal**

1763. Clause 20.5(a) of the Template Haulage Contract provides that a party must not issue any media release or publicity about the haulage contract without prior written consent from the other party, which must not be unreasonably withheld or delayed.

1764. Clause 20.5(b) goes on to confirm that clause 20.5 does not authorise the disclosure of confidential information.

**Public submissions**

1765. No submissions were received in relation to media announcements.

**Authority's assessment**

1766. The Authority considers that clause 20.5 of the Template Haulage deals with subject matter that goes beyond compliance with the national gas objective and relates to

commercial matters to be dealt with between the contracting parties. The Authority considers that it should not approve clause 20.5 and that any provisions relating to media announcements are best dealt with by commercial arrangement.

### **Draft decision**

1767. The Authority does not approve clause 20.5 of the Template Haulage Contract.

#### **Required Amendment 59**

Clause 20.5 of the Template Haulage Contract should be deleted.

## ***Miscellaneous***

### ***Applicable law***

#### **Access arrangement proposal**

1768. Clause 21.1 sets out that the applicable law to cover the haulage contract is the law of the state of Western Australia and the parties submit to the jurisdiction of Western Australia.

#### **Public submissions**

1769. No submissions were received in relation to the applicable law.

#### **Authority's assessment**

1770. The Authority notes that there is no equivalent to the proposed clause 21.1 in the current access arrangement. The Authority also notes that no party made a submission with respect to this clause.

1771. The Authority considered whether the applicable was a matter of detail in relation to the commercial relationship between WAGN and the users and, as such, not a matter pertaining to WAGN's compliance with the national gas objective. The Authority considers that for WAGN's actions to be consistent with the national gas objective, particularly the need to effectively and efficiently manage the pipeline, WAGN needs to have certainty about the laws that will govern the contractual and other relationships between it and users. Certainty about the applicable law and jurisdiction will provide WAGN a firm basis on which it can base its decisions thereby facilitating efficient operation of the GDS.

### **Draft decision**

1772. The Authority approves clause 21.1 of the Template Haulage Contract.

## *Election*

### **Access arrangement proposal**

1773. Clause 21.2 of the Template Haulage Contract sets out the rights of a party to make an election not to exercise a right. The party making this election must notify the other party in writing (clause 21.2(a)). This provision is reinforced by Clause 21.2(b) which sets out that no conduct of a party operates as an election not to exercise a right, neither does it operate as an estoppel to preclude enforcement of that right or prevent exercise of that right. If a party makes an election not to exercise a right on one or more occasions it does not operate as an election to exercise the right in future or as an estoppel precluding enforcement if the right arises again. If a party exercises a right under the haulage contract, it does not prevent a further exercise of that right or any other right.

### **Public submissions**

1774. No submissions were received.

### **Authority's assessment**

1775. The Authority notes that there is no equivalent to this proposed clause in the current access arrangement. The Authority also notes that no submissions were received with respect to this clause.

1776. The Authority considered whether the exercise of a right of election was a matter of detail in relation to the commercial relationship between WAGN and the users and, as such, not a matter pertaining to WAGN's compliance with the national gas objective. The Authority considers that for WAGN to meet the national gas objective, particularly the need ensure the efficient and effective operation of the GDS, it needs to ensure that it, and its users, can elect to not exercise a right under the haulage contract if it is expedient to do so. As such, ensuring that the rights of the parties clearly allow for an election to not exercise a right, and setting out the consequences of an election not to exercise a right, enables for a more efficient business practice. This in turn allows for more efficient operation of the GDS. By expressly allowing for situations where a party may, for business efficacy, elect not to exercise a right, the haulage contract facilitates WAGN's effective and efficient operation of the GDS.

### **Draft decision**

1777. The Authority approves clause 21.2 of the Template Haulage Contract.

## *Entire agreement*

### **Access arrangement proposal**

1778. Clause 21.3 sets out that the haulage contract constitutes the entire agreement between the parties. Prior negotiations, representations, proposals and agreements, whether oral or written with respect to the subject matter of the haulage contract are expressly excluded.

### **Public submissions**

1779. No public submissions were received with respect to this clause.

### **Authority's assessment**

1780. The Authority notes that there is no equivalent to this proposed clause in the current access arrangement. The Authority also notes that no submissions were received with respect to this clause.

1781. The Authority considered whether the issue of an entire agreement was a matter of detail in relation to the commercial relationship between WAGN and the users and, as such, not a matter pertaining to WAGN's compliance with the national gas objective. The Authority considers that for WAGN's actions to be consistent with the national gas objective, particularly the need to ensure the efficient and effective operation of the GDS, it needs to ensure that both parties to the agreement understand the subject matter of the agreement in its entirety. By ensuring that both parties to the agreement have a common understanding of the subject matter of the haulage contract, and a common understanding of what is expressly not part of the contract, the parties can operate more efficiently together thereby facilitating efficient operation of the GDS.

### **Draft decision**

1782. The Authority approves clause 21.3 of the Template Haulage Contract.

### *Stamp duty and costs of haulage contract*

#### **Access arrangement proposal**

1783. Clause 21.4 sets out that the user is responsible for any stamp duty assessable or payable on this haulage contract. Further, each party must bear its own legal and other costs of preparing the haulage contract.

### **Public submissions**

1784. No public submissions were received with respect to this clause.

### **Authority's assessment**

1785. The Authority notes that there is no equivalent to this proposed clause in the current access arrangement. The Authority also notes that no submissions were received with respect to this clause.

1786. The Authority considers that the issue of stamp duty and legal costs is a matter of detail in relation to the commercial arrangements between the service provider and the users rather than a matter that goes to compliance of WAGN's proposed Template Haulage Contract with the national gas objective, which is the matter the Authority has to consider. In these circumstances, the Authority considers that it should not approve the provision regarding stamp duty and legal costs.

### **Draft decision**

1787. The Authority does not approve clause 21.4 of the Template Haulage Contract.

**Required Amendment 60**

Clause 21.4 of the Template Haulage Contract should be deleted.

*Severance***Access arrangement proposal**

1788. Clause 21.5 sets out that if any provision of the haulage contract is held illegal or unenforceable by a tribunal, court or arbitrator of competent jurisdiction, the remaining provisions of the haulage contract will have full force and effect.

**Public submissions**

1789. No public submissions were received with respect to this submission.

**Authority's assessment**

1790. The Authority notes that there is no equivalent to this proposed clause in the current access arrangement. The Authority also notes that no submissions were received with respect to this clause

1791. The Authority considered whether the issue of severance was a matter of detail in relation to the commercial relationship between WAGN and the users and, as such, not a matter pertaining to WAGN's compliance with the national gas objective. The Authority considers that for WAGN's actions to be consistent with the national gas objective, particularly the need to ensure the efficient and effective operation of the GDS, it needs to ensure that both parties have certainty about their contractual relationship. By ensuring that the haulage contract can remain in full force and effect despite any provision being held illegal or unenforceable provides the parties with confidence about the certainty of their contractual relationship. Contractual certainty and confidence in the contractual process will assist in facilitating investment in the GDS thereby enabling WAGN to meet that part of its obligations under the national gas objective.

**Draft decision**

1792. The Authority approves clause 21.5 of the Template Haulage Contract.

*Further assurance***Access arrangement proposal**

1793. Clause 21.6 sets out that each party must execute any document and perform any subsequent action necessary to give full effect to the haulage contract, whether prior or subsequent to the performance of the haulage contract.

**Public submissions**

1794. No public submissions were received with respect to this clause.

### **Authority's assessment**

1795. The Authority notes that there is no equivalent to this proposed clause in the current access arrangement. The Authority also notes that no submissions were received with respect to this clause.
1796. The Authority considered whether the issue of further assurances was a matter of detail in relation to the commercial relationship between WAGN and the users and, as such, not a matter pertaining to WAGN's compliance with the national gas objective. The Authority considers that for WAGN to meet the national gas objective, particularly the need ensure the efficient and effective operation of the GDS, it needs to ensure that both parties have certainty about their contractual relationship. By ensuring that both parties are obliged to execute any document and perform any action necessary to give effect to the haulage contract provides both parties with certainty about their contractual relationship. Effective contractual relationships facilitate efficient operation of the GDS, and will also encourage effective investment as potential investors will require certainty about the parties' obligations.

### **Draft decision**

1797. The Authority approves clause 21.6 of the Template Haulage Contract.

## **Counterparts**

### **Access arrangement proposal**

1798. Clause 21.7 sets out that the haulage contract may be executed in any number of counterparts. These counterparts are all taken together and deemed to constitute one and the same document.

### **Public submissions**

1799. No public submissions were received with respect to this clause.

### **Authority's assessment**

1800. The Authority notes that there is no equivalent to this proposed clause in the current access arrangement. The Authority also notes that no submissions were received with respect to this clause.
1801. The Authority considered whether the issue of counterparts was a matter of detail in relation to the commercial relationship between WAGN and the users and, as such, not a matter pertaining to WAGN's compliance with the national gas objective. The Authority considers that for WAGN's actions to be consistent with the national gas objective, particularly the need to ensure the efficient and effective operation of the GDS, it needs to ensure that both parties have certainty about their contractual relationship. By ensuring that if the haulage contract is executed in any number of counterparts then all of the counter parts are deemed to be one and same document provides the parties with confidence about the certainty of their contractual relationship if there are counterparts. Contractual certainty and confidence in the contractual process will assist in facilitating investment in the GDS thereby enabling WAGN to meet that part of its obligations under the national gas objective.



**Draft decision**

1802. The Authority approves clause 21.7 of the Template Haulage Contract.

**Interpretation****Dictionary****Access arrangement proposal**

1803. Clause 22.1 of the Template Haulage Contract sets out a table of the terms and their definitions that apply to the Template Haulage Contract.

**Public submissions**

1804. In its submission dated 12 April 2010 (page 9), Synergy submitted that the definition of 'direct damage' should be extended to include a loss of goodwill or business reputation. There were no other public submissions in relation to the dictionary.

1805. Alinta, in its submission dated 19 April 2010 (pages 2-4), submitted in relation to the use of 'CPI All Groups, Perth' that the standard regulatory practise, including in Western Australia, has been to define the CPI as the Consumer Prices Index, All Groups, Eight Capital Cities. Alinta commented that neither WAGN nor its access arrangement information has explained why it has elected to adopt CPI All Groups, Perth rather than to continue the current (and standard) practice of using the CPI All Groups, Eight Capital Cities.

**Authority's assessment**

1806. The Authority notes that the definition of 'Direct Damage' is, in substance, the same as the definition in Schedule 2 of Part A of the current access arrangement. The Authority also notes that the term 'Direct Damage' is not defined in the NGL. The Authority has considered Synergy's submission but without a substantive submission setting out why the definition in clause 22.1 is not effective, the Authority does not consider it necessary to require an amendment.

1807. The Authority notes that the definition in relation to 'CPI' has been changed from 'CPI All Groups' to 'CPI All Groups, Perth'. The Authority accepts Alinta's submission that this change is out of kilter with standard regulatory practice and the Authority does not accept the revision.

1808. The Authority notes that there is some inconsistency between the definitions in the Template Haulage Contract and the NGL and NGR. The Authority considers that the definitions in the Template Haulage Contract and NGL and NGR should be the same to avoid inconsistency and uncertainty with respect to the operation of the Template Haulage Contract.

1809. The Authority notes that the terms 'REMC0', 'REMC0 Registry', 'Retail Market Rules' and 'Retail Market Scheme' are defined in terms which refer to current laws and regulations, whereas in each case there is the possibility during the forthcoming access arrangement period that the laws and regulations referred to may vary or be replaced so that the definitions become outdated. The definitions of these terms should be amended to cater for such changes in the relevant laws or regulations.

1810. The Authority considers that the term 'Service Provider' should be amended to include the reference to a 'covered pipeline service provider'. The Authority also requires 'Covered Pipeline Service Provider' to be defined.
1811. In relation to the term 'Small Use Customer', WAGN have adopted the definition used in the Energy Co-ordination Act 1994 (WA) and in the current access arrangement. The Authority notes, however, that the WA Local Regulations, also define 'Small Use Customer' but adopt a different definition. The Authority does not see the need for any amendment, in the absence of any submissions addressing the issue.

### **Draft decision**

1812. The Authority requires that the definition of 'CPI' to be amended from CPI All Groups, Perth' to 'CPI All Groups, Eight Capital Cities'.
1813. The Authority requires that the following definitions be amended to read the same as the corresponding definition in the NGL and NGR:
- a) Access Arrangement;
  - b) Delivery Point;
  - c) End user;
  - d) National Gas Rules;
  - e) Receipt Point;
  - f) Regulator; and
  - g) User.
1814. The Authority requires that the following definitions be amended to provide for changes in laws and regulations affecting them:
- a) REMCo;
  - b) REMCo Registry;
  - c) Retail Market Rules;
  - d) Retail Market Scheme.
1815. The term 'Service Provider' is to be amended to refer to 'Covered Pipeline Service Provider' which in turn should be defined in terms consistent with the NGL and NGR.

## Required Amendment 61

Clause 22.1 of the Template Haulage Contract should be amended as follows:

- 1) The definition of CPI should refer to 'CPI All Groups Eight Capital Cities'.
- 2) The following definitions should read the same as the corresponding definitions in the NGL and NGR:
  - a) Access Arrangement;
  - b) Delivery Point;
  - c) End user;
  - d) National Gas Rules;
  - e) Receipt Point;
  - f) Regulator; and
  - g) User.
- 3) The following definitions should read as follows:
  - a) 'REMCo' means the Retail Energy Market Company Limited (ABN 15 103 318 556), or any other corporation managing the retail energy market.
  - b) 'REMCo Registry' has the meaning given to that term in the Retail Market Rules, as amended from time to time, or any other rules applying to the retail energy market.
  - c) 'Retail Market Rules' means the rules applying under the Retail Market Scheme, as amended from time to time, or any other scheme applying to the retail energy market.
  - d) 'Retail Market Scheme' means the retail market scheme, including the Retail Market Rules, approved under section 11ZOJ of the *Energy Coordination Act 1994 (WA)* as applying in respect of the WAGN GDS, as amended from time to time, or any other scheme applying to the retail energy market.
- 4) The terms 'Service Provider' and 'Covered Pipeline Service Provider' should read:
 

**'Service Provider'** has the meaning given to that term under the National Gas Access Law and for the purposes of this Haulage Contract, WAGN is the Covered Pipeline Service Provider for the WAGN GDS.

**'Covered Pipeline Service Provider'** means a service provider that provides or intends to provide pipeline services by means of a covered pipeline.

### *Rules for interpreting haulage contract*

#### **Access arrangement proposal**

1816. Clause 22.2 of the Template Haulage Contract sets out the rules for interpreting the Template Haulage Contract.

#### **Public submissions**

1817. No submissions were received in relation to the interpretation rules for Template Haulage Contract.

#### **Authority's assessment**

1818. The Authority notes that Schedule 1 of Part A of the current access arrangement sets out the interpretation provisions for the current access arrangement. The Authority considers, however, that clause 22.2 of the Template Haulage Contract, which provides for the interpretation of the haulage contract, goes beyond compliance with the national gas objective and relates to commercial matters to be dealt with between the contracting parties. The Template Haulage Contract is not a complete document, and therefore the Authority considers that such interpretational issues are best dealt with by the contracting parties at the time of entering into the haulage contract.

#### **Draft decision**

1819. The Authority does not approve clause 22.2 of the Template Haulage Contract.

Required Amendment 62

Clause 22.2 of the Template Haulage Contract should be deleted.

### *Specific terms and conditions*

#### *User specific delivery facilities*

#### **Access arrangement proposal**

1820. Clauses 2(b) of Schedules 1 to 3 of the Template Haulage Contract provides that the service provider will design and construct all user specific delivery facilities, and will have regard to the user's reasonable requirements in doing so.

1821. Clauses 2(c) of Schedules 1 and 2, clause 2(d) of Schedule 3, clauses 2(b) of Schedules 4 and 5 of the Template Haulage Contract provides that the service provider will own, operate and maintain, and may from time to time modify, any user specific delivery facilities.

## Public submissions

1822. Alinta, in Attachment B to its submission dated 19 April 2010 (page 17), submitted in relation to clauses 2(b) of Schedules 1 to 3 of the Template Haulage Contract, that given the user will incur the cost of user specific delivery facilities, the obligation on the service provider should be to design and construct the user specific delivery facilities with regard to the user's requirement. Alinta submitted that the requirement to be 'reasonable' should be deleted.
1823. Alinta, in Attachment B to its submission dated 19 April 2010 (page 17), submitted in relation to clauses 2(c) of Schedules 1 and 2, clause 2(d) of Schedule 3, clauses 2(b) of Schedules 4 and 5 of the Template Haulage Contract, that given the user will also incur the costs of user specific delivery facilities, 'it seems reasonable that the service provider be required to liaise with the user if it intends to modify any user specific delivery facilities'

## Authority's assessment

1824. The Authority notes that clauses 2(b) of the Schedules 1 to 5 are identical to clauses 2(2) of the Schedules 1 to 3 in Part C of the current access arrangement and that clauses 2(c) of Schedules 1 to 5 are identical to clauses 2(2) in Schedules 1 and 4, 2(4) in Schedules 2 to 3 in Part C of the current access arrangement.
1825. The Authority considers that Alinta's submission that the word 'reasonable' be deleted from clauses 2(b) of Schedules 1 to 3 lacks merit with respect to consistency with the national gas objective. The national gas objective includes 'to promote efficient ...operation and use of, natural gas services for the long term interests of consumers...' and, while the Authority recognises that the user is bearing the cost of the user specific delivery facilities, if the service provider were obliged to have regard to unreasonable user requirements, then this could interfere materially with the efficient operation of the gas pipeline.
1826. In relation to Alinta's second submission, given that the user is paying for the user specific delivery facilities, which are being installed solely for the purpose of enhancing the user's business, the user is best placed to provide direction as to the most efficient means of modifying the facilities. If the service provider failed sufficiently to consult with the user, there is a risk that the facilities could be modified in a manner which might cause inefficiency in the operation of the gas pipeline and, therefore, Alinta's proposal is consistent with the national gas objective and should be accepted.

## Draft decision

1827. The Authority approves clauses 2(b) of Schedules 1 to 3.
1828. The Authority does not approve clauses 2(c) of Schedules 1 and 2, clause 2(d) of Schedule 3 and clauses 2(b) of Schedules 4 and 5 of the Template Haulage Contract which should be amended to include an obligation on the service provider to liaise with the user if intending to modify user specific delivery facilities.

### Required Amendment 63

The following clauses of the Template Haulage Contract:

- a) Clauses 2(c) of Schedules 1 and 2;
- b) Clause 2(d) of Schedule 3; and
- c) Clauses 2(b) of Schedules 4 and 5

should be amended to read as follows:

**<Service Provider>** will own, operate and maintain, and may from time to time modify, subject to consultation with <User>, any User Specific Delivery Facilities.

### *Unfettered access*

#### **Access arrangement proposal**

1829. Clauses 2(e) of Schedules 1 and 2, clause 2(f) of Schedule 3, clauses 2(d) of Schedules 4 and 5 of the Template Haulage Contract provide that the user must provide or procure unfettered access to all land or premises to which access is required to allow the service provider to undertake specified activities.
1830. Clauses 9(c)(ii) of Schedules 1 and 2, clauses 8(c)(ii) of Schedules 3 to 5, clauses 7(c)(ii) of Schedules 4 and 5, clauses 9(c)(ii) of Schedules 4 and 5, clauses 10(c)(ii) of Schedules 4 and 5 and clauses 11(c)(ii) of Schedules 4 and 5 of the Template Haulage Contract provide that the user must ensure that the service provider has unfettered access to the relevant land or premises in order to the service provider to undertake the specified activities.

#### **Public submissions**

1831. Alinta, in Attachment B to its submission dated 19 April 2010 (page 17), submitted that specific clauses in Schedules 1 to 5 of the Template Haulage Contract are all repetitive and redundant because the issue of unfettered access to all land and premises to which access is required is dealt with satisfactorily in clause 8.3 of the Template Haulage Contract. Alinta considered that the specific clauses should be deleted.

#### **Authority's assessment**

1832. The Authority notes that there are provisions concerning unfettered access in the terms and conditions of reference services set out in the Schedules of Part C of the current access arrangement.
1833. The Authority considers, as Alinta suggests, that the inclusion of specific clauses that the user must provide unfettered access to the service provider is superfluous. The Authority notes that clause 8.3 of the Template Haulage Contract provides that the user acknowledges that the service provider's ability to provide a haulage service to the user delivery point is subject to the user ensuring that the service



provider has unfettered access to the land and premises which the standard delivery or user specific facilities are to be installed.

1834. The Authority agrees with Alinta's submission and considers that the clauses in the Schedules of the Template Haulage Contract that refer to unfettered access should be deleted.

### **Draft decision**

1835. The Authority does not approve clauses 2(e) of Schedules 1 and 2, clause 2(f) of Schedule 3, clauses 2(d) of Schedules 4 and 5, clauses 9(c)(ii) of Schedules 1 and 2, clauses 8(c)(ii) of Schedules 3 to 5, clauses 7(c)(ii) of Schedules 4 and 5, clauses 9(c)(ii) of Schedules 4 and 5, clauses 10(c)(ii) of Schedules 4 and 5 and clauses 11(c)(ii) of Schedules 4 and 5 of the Template Haulage Contract.

#### **Required Amendment 64**

The following clauses of the Template Haulage Contract should be deleted:

- a) Clauses 2(e) of Schedules 1 and 2;
- b) Clause 2(f) of Schedule 3;
- c) Clauses 2(d) of Schedules 4 and 5;
- d) Clauses 9(c)(ii) of Schedules 1 and 2;
- e) Clauses 8(c)(ii) of Schedules 3 to 5;
- f) Clauses 7(c)(ii) of Schedules 4 and 5;
- g) Clauses 9(c)(ii) of Schedules 4 and 5;
- h) Clauses 10(c)(ii) of Schedules 4 and 5; and
- i) Clauses 11(c)(ii) of Schedules 4 and 5.

### *Nominal delivering pressure*

#### **Access arrangement proposal**

1836. Clause 4(b) of Schedules 1 to 3 of the Template Haulage Contract provide that the pressure described in the Schedule will be amended to the pressure that the service provider determines, in its absolute discretion from time to time, as the minimum nominal operating pressure for the main to which the delivery point is connected.

#### **Public submissions**

1837. Alinta, in Attachment B to its submission dated 19 April 2010 (pages 17 - 18), submitted that the end user facilities will be engineered to receive gas between a range of pressures. Alinta stated that there must be some assurance that there is an absolute minimum to which the service provider may amend the nominal

pressure which is published and understood at the time the haulage contract is entered into and will be complied with.

### Authority's assessment

1838. The Authority notes that clauses 4(2) in Schedules 1 to 3 of Part C of the current access arrangement provide that the pressure set out in under clause 4(1) of the Schedules will not exceed that pressure adopted by WAGN from time to time as the minimum nominal operating pressure for the main to which the delivery point is connected.
1839. The Authority notes that under both the current access arrangement and WAGN's proposed revisions the service provider has discretion to adopt a minimum nominal operating pressure, albeit expressed in different terms. Alinta's proposal, therefore, that there be a minimum nominal operating pressure to which the service provider may amend the nominal pressure involves a departure from the position previously approved by the Authority.
1840. Nevertheless the Authority, taking into consideration the national gas objective, sees merit in Alinta's submission. The Authority considers that there is a risk of inefficiency in the operation of the gas pipeline where user facilities have been engineered with specifications that may be breached if the service provider has unlimited discretion in relation to minimum delivery pressures.

### Draft decision

1841. Clause 4(b) of Schedules 1 to 3 of the Template Haulage Contract should be amended to provide that the determination of a minimum nominal operating pressure is a matter for agreement, and failing agreement arbitration under Chapter 6 of the *National Gas Access (WA) Act 2009*, rather than a matter for the service provider's absolute discretion.

#### Required Amendment 65

Clauses 4(b) of Schedules 1 to 3 of the Template Haulage Contract should be amended as follows:

- b) Notwithstanding clause 4(a) of this Schedule the pressure described at clause 4(a) of this Schedule will be amended from time to time to the pressure that **<Service Provider>** and **<User>** agree determines, ~~in its absolute discretion from time to time~~, as the minimum nominal operating pressure for the main to which the Delivery Point is connected.

### Telemetry readings

#### Access arrangement proposal

1842. Clause 5(b) of Schedules 1 and 2 of the Template Haulage Contract states that the service provider will endeavour to take telemetry readings every day.

## Public submissions

1843. Alinta, in Attachment B to its submission dated 19 April 2010 (page 18), considered that 'endeavour to' should be deleted. The Retail Market Rules (v6.0) require that the network operator obtain the meter reading data for a gas day daily after the end of the gas day (rule 142).

## Authority's assessment

1844. Clauses 5 in Schedules 1 to 3 of Part C of the current access arrangement provide that WAGN will be responsible for calculating and recording the quantity of gas delivered to the user at the delivery point by telemetry reading. The clause goes on to state that WAGN will endeavour to take such telemetry readings every day.

1845. The Authority notes that rule 142 of the Retail Market Rules state that 'for each interval meter, the network operator must obtain the meter reading data for a gas day daily after the end of the gas day'.

1846. The Authority notes that while the Schedules in the Template Haulage Contract reflect the Schedules in the current access arrangement, the Authority requires WAGN to amend clauses 5(b) of Schedules 1 and 2 to be consistent with the obligation placed on the service provider in the Retail Market Rules.

## Draft decision

1847. The Authority does not approve clauses 5(b) of Schedules 1 and 2 of the Template Haulage Contract and requires amendment to be consistent with rule 142 of the Retail Market Rules.

### Required Amendment 66

Clause 5(b) of Schedules 1 and 2 of the Template Haulage Contract should read:

- (b) **<Service Provider>** will endeavour to take such Telemetry readings each day.

## *Exceeding contracted peak rate*

### Access arrangement proposal

1848. Clause 8(a) of Schedule 1 of the Template Haulage Contract sets out the formula for calculating the overrun charge.

1849. Clause 8(c) of Schedule 1 of the Template Haulage Contract provides that if the user's instantaneous flow rate for a delivery point exceeds its contracted peak rate for a delivery point on:

- a) three or more days during any 30 day period; or
- b) eight or more days during a year,

then the service provider may notify the user of this fact and whether:

- c) the service provider is prepared to, having regard to the restrictions and pre-conditions specified in the application procedure, increase the user's contracted peak rate ...; or
- d) the service provider is not prepared to, having regard to the restrictions and pre-conditions in the application procedure, increase the user's contracted peak rate.

### **Public submissions**

1850. No submissions were received in relation to exceeding the contracted peak rate.

### **Authority's assessment**

1851. The Authority notes that clauses 7 to 9 of Schedule 1 of Part C of the current access arrangement set out the terms and conditions in relation to exceeding contracted peak rate for service A1.

1852. The Authority notes that clause 8(a) of Schedule 1 calculates 'OSR' to be the 'Overrun Service Rate' which is calculated by multiplying the usage charge rate for the delivery point for the month by 200. Clause 7 of Schedule 1 of the current access arrangement provides for 'OSR' to be calculated by multiplying the average reference tariff application under the haulage contract for the month by two. The Authority considers that the proposed calculation of 'OSR' is reasonable and consistent with the national gas objective and therefore that clause 8(a) should be accepted.

1853. WAGN's proposed revisions to clause 8(c) of Schedule 1, delete the requirement that WAGN must, as soon as reasonably practicable, notify the user of the user's instantaneous flow rate for a delivery point exceeding its contracted peak rate, and instead insert the option that WAGN may notify the user. The Authority required in the 2005 draft decision, that where AGN proposed notification be discretionary, an amendment be made either making notification mandatory in defined circumstances, or conferring a right on a user who is incurring overrun charges to nominate an increased contractual peak rate or having flow control installed. AGN accepted the requirement to amend and made notification mandatory.

1854. The Authority notes that WAGN have, in clause 8(c) of Schedule 1 of the Template Haulage Contract, proposed that notification be discretionary. The Authority considers, that as WAGN monitors the system, they are best positioned to identify when the user exceeds the contracted peak rate. The Authority considers that it is necessary for WAGN pass on such information to the user as soon as practicable so that the user can in turn take the necessary steps to manage future gas consumption so that it does not continue to exceed its contracted peak rate. The Authority notes that if there is no obligation on WAGN to notify the user, as soon as reasonably practicable, this may create a situation where the user continues to exceed its contracted peak rate and in the short term, the user may incur penalty. In the long term, this situation may result in the user requiring a higher contracted peak rate which they may not necessarily be consistent with appropriate demand management. Alternatively, the Authority would require for WAGN to confer a right on the user to install a flow control so that the user may itself monitor its usage.

**Draft decision**

1855. The Authority approves clause 8(a) of Schedule 1 of the Template Haulage Contract. The Authority does not approve clause 8(c) of Schedule 1 of the Template Haulage Contract. The Authority considers that in order to ensure that the user receives the most efficient economic outcome and that Schedule 1 is consistent with the national gas objective, WAGN must amend clause 8(c) to either make notification mandatory, or confer a right on a user to have a flow control installed.

**Required Amendment 67**

Clause 8(c) of Schedule 1 of the Template Haulage Contract should be amended to either make notification mandatory or confer a right upon a user to have a flow control installed.

*Deregistering a delivery point***Access arrangement proposal**

1856. Clause 9(c)(i) of Schedules 1 and 2, clause 8(c)(i) of Schedule 3 and clauses 7(c)(i) of Schedules 4 and 5 of the Template Haulage Contract provide that the service provider is not liable to the user in respect of any claim, loss or damages if it fails to permanently deregister the delivery point.

**Public submissions**

1857. Alinta, in Attachment B to its submission dated 19 April 2010 (page 18), submitted that liability should not be excluded in circumstances of wilful default, negligence or fraud on the part of the service provider.

**Authority's assessment**

1858. Clause 9 of Schedules 1 and 2, clause 8 of Schedule 3 and clauses 7 of Schedules 4 and 5 have no equivalent in the current access arrangement. These clauses of the Template Haulage Contract address deregistration of delivery points.
1859. The Authority has not received any submissions on these clauses other than Alinta's submission challenging the unrestricted exclusion of WAGN's liability when deregistering a delivery point.
1860. The Authority notes that clause 16 of the Template Haulage Contract deals comprehensively with the issue of liability between the parties to a haulage contract, including the circumstances in which the service provider's liability is to be excluded.
1861. The exclusion of liability provisions in clause 16 of the Template Haulage Contract are sufficient to address that issue regarding deregistration of a delivery point.
1862. The Authority considers that, as the matter of exclusion of liability is dealt with adequately by clause 16 of the Template Haulage Contract, the Authority should not approve a broader exclusion of liability clause for a specific matter in the absence of a submission by the service provider explaining why a broader exclusion is required.

### **Draft decision**

1863. Clause 9 of Schedules 1 and 2, clause 8 of Schedule 3 and clauses 7 of Schedules 4 and 5 to the Template Haulage Contract are not approved.

#### **Required Amendment 68**

The following clauses of the Template Haulage Contract should be deleted:

- a) clause 9 of Schedules 1 and 2
- b) clause 8 of Schedule 3; and
- c) clauses 7 of Schedules 4 and 5

### *Specific terms and conditions for Service B2 and B3*

#### **Access arrangement proposal**

1864. Specific terms and conditions for service B2 and B3 are contained in Schedule 4 and Schedule 5 respectively.

#### **Public submissions**

1865. Alinta, in Attachment B to its submission dated 19 April 2010 (page 18), submitted that where previously the same specific terms and conditions applied in respect of the B2 and B3 services, WAGN have proposed to change these.

#### **Authority's assessment**

1866. The Authority notes that in the current access arrangement, the specific terms and conditions for service B2 and B3 are contained in one schedule, Schedule 4 of Part C of the current access arrangement. While the Authority notes Alinta's submission in relation to Schedules 4 and 5, it also notes the absence of any statement from Alinta suggesting that an amendment is required. Without justified reasoning, the Authority does not consider it necessary to amalgamate Schedule 4 and Schedule 5 of the Template Haulage Contract as suggested by Alinta.

### **Draft decision**

1867. The Authority does not require any additional amendments to Schedule 4 and Schedule 5 of the Template Haulage Contract.

### *Ancillary services*

#### **Access arrangement proposal**

1868. Schedules 1 to 5 of the Template Haulage Contract set out terms and conditions in relation to deregistering a delivery point, and Schedules 4 and 5 of the Template Haulage Contract set out the terms and conditions in relation to:

- a) applying a meter lock to a delivery point;



- b) removing a meter lock from a delivery point;
- c) disconnecting a delivery point; and
- d) reconnecting a delivery point.

### Public submissions

1869. Alinta, in Attachment B to its submission dated 19 April 2010 (page 18), submitted that the Retail Market Rules (v6.0) set out the network operator's obligations when disconnecting and reconnecting delivery points. Alinta suggested that the timeframes in Schedules 4 and 5 may not be consistent with these obligations. Alinta provided an example:

1870. Where the network operator receives a valid disconnection notice, the network operator must (subject to law), within two business days after receiving a valid disconnection notice, disconnect and undertake a meter reading of, and obtain the meter reading data for, the delivery point.

1871. Alinta further submitted that the form of the 'transactions' associated with these services may be prescribed by the Retail Market Rules (v6.0) and/or the B2B Service Order Specification, and therefore must be consistent. Alinta provided an example:

The B2B Service Order Specification specifies the manner in which the user must request the service provider apply a meter lock.

### Authority's assessment

1872. The Authority notes its draft decision above that the ancillary services are to be reference services. By virtue of rule 48(1)(h) of the NGR a full access arrangement must contain the terms and conditions on which the reference services will be supplied.

1873. The terms and conditions for the ancillary services the subject of Alinta's submission, therefore, must be included in WAGN's proposed revisions.

1874. Rule 403 of the Retail Market Rules provides as follows:

#### **403. Other laws and instruments**

- (1) Where these rules and any law, relevant Access Arrangement or licence condition imposed by the *Energy Coordination Act 1994* impose different standards for performance in relation to the same matter, each of REMCo, a participant, a pipeline operator and a prescribed person must comply with the most stringent standard for performance in respect of that matter.
- (2) Subject to rule 403(1), if there is any inconsistency between these rules and any law, Access Arrangement or licence condition imposed by the *Energy Coordination Act 1994*, then:
  - (a) the law, Access Arrangement or licence condition will prevail to the extent of the inconsistency; and

- (b) by virtue of rule 7(1), each of REMCo, a participant, a pipeline operator and a prescribed person (as applicable) is excused from performing its obligations under these rules to the extent of the inconsistency.

1875. The Authority considers that rule 403 of the Retail Market Rules addresses Alinta's concerns and no amendment is required.
1876. Alinta's concern is that there may be inconsistency or different performance standards under the access arrangement and the Retail Market Rules. However, rule 403 of the Retail Market Rules recognises that such inconsistency or differences may arise and provides a mechanism for resolving it. It is not an argument against WAGN's terms and conditions for ancillary services that they may be inconsistent or prescribe different performance standards from the Retail Market Rules.
1877. In the absence of any submission from Alinta or any other party or any other information being before the Authority suggesting that the terms and conditions are not consistent with the national gas objective the Authority sees no justification for requiring WAGN to amend the terms and conditions for ancillary services.
1878. The Authority is satisfied that the terms and conditions for the ancillary services in the schedules are consistent with the national gas objective and should be approved.

#### **Draft decision**

1879. The terms and conditions for ancillary services in Schedules 1 to 5 of the Template Haulage Contract are approved.

#### **Service levels**

##### **Access arrangement proposal**

1880. The Template Haulage Contract does not make specific provision for service standards or levels in the provision of reference services.

##### **Public submissions**

1881. In its submission dated 12 April 2010, Synergy made a general submission in relation to the use of a Template Haulage Contract.
1882. Synergy expressed concern that service standards in the haulage contract needed clarification to ensure consistency of service standards with the parties' obligations under regulatory instruments and Retail Market Rules. Unless there is consistency, retailers may not meet their regulatory, commercial or contractual obligations. Synergy argued that the provisions of the Template Haulage Contract should facilitate compliance with agreed service levels thereby improving standards of service to customers and improved retail competition in the WA gas market (page 7). Synergy did not, however, provide particulars of any inconsistency between service standards in the Template Haulage Contract and other regulatory, commercial or contractual obligations.
1883. Synergy also submitted that certain service levels essential to contestable gas customers should be included in the Template Haulage Contract. Synergy stated

that the inclusion of service standards for A1, A2 and B1 customers, particularly concerning timeframes, are necessary to ensure that these customers and their retailers are treated fairly and equitably.

1884. Synergy included in their submissions a service levels table (a copy has been reproduced below at 30) which they considered essential for inclusion in the Template Haulage Contract. Synergy submitted that the timeframes have been proposed in consultation with customers. Synergy suggested the possibility of holding a public forum with the Authority, WAGN and other interested parties to discuss the service levels further.

**Table 29 Service levels for Services A1, A2 and B1 proposed by Synergy**

Request for	Tariff Class	Timeframe Perth Metro	Timeframe Non-Metro
Meter & service connection	A1 (>35 TJ) A2 (10-35 TJ) B1 (<10 TJ)	40 BDs 20 BDs 10 BDs	Synergy would like to discuss with the Authority and WAGN reasonable timeframes that are achievable on a reasonable cost basis.
Meter &/or service upgrade	A1 A2 B1	40 BDs 20 BDs 10 BDs	
Regulator removal – disconnect service in street	A1/A2/B1	5 BDs	
Regulator reinstallation – reconnect service in street	A1/A2/B1	5 BDs	
Permanent service disconnection	A1/A2/B1	10 BDs	
Special read	A1/A2/B1	2 BDs	
Cluster development	A1/A2/B1	10 BDs	
Emergency change over	A1/A2/B1	2 hours	
Apply/remove meter lock	A1/A2/B1	5 BDs	
Meter retake and test	A1/A2/B1	10 BDs	
Meter data accuracy response	A1/A2/B1	2 hours	
Dissatisfied customer	A1/A2/B1	5 hours	
Commercial Gas Connection Enquiry response	A1/A2/B1	5 BDs	
Other Service Order Response	A1/A2/B1	5 BDs	

### Authority's assessment

1885. The Authority notes that WAGN has not made any proposal for comprehensive service standards to be included in the access arrangement for Services A1, A2 and B1.

1886. In considering this issue, the Authority notes that the NGL and NGR provide for access arrangement proposals to be submitted by the service provider, being the

operator of the gas pipeline in which investments have been made. Under this model it is for the service provider to propose terms and conditions of supply of pipeline services and for the Authority to consider whether to accept that proposal or not.

1887. The Authority considers that in the present case, where the service provider has been silent on the issue and has made no proposal, the Authority should not intervene at the request of a user to impose terms and conditions on the service provider.

1888. The Authority notes that Synergy did not articulate any reasons requiring WAGN to incorporate specified service levels into the access arrangement to ensure consistency with the national gas objective. As recognised by Synergy's submission there are a range of regulatory and contractual instruments which establish a range of service level requirements and the Authority is not satisfied that the national gas objective would necessarily be served by an access arrangement review being used as the forum to specify comprehensive service level requirements for particular kinds of services.

#### **Draft decision**

1889. The Authority does not require the Template Haulage Contract to be amended to include comprehensive service levels for Services A1, A2 and B1.

### ***Calculating other charges***

#### **Access arrangement proposal**

1890. Annexure C to the Template Haulage Contract contains provisions for calculating the charges for the ancillary services, namely:

- a) deregistering a delivery point;
- b) applying a meter lock;
- c) removing a meter lock;
- d) disconnecting a delivery point; and
- e) reconnecting a delivery point.

1891. Annexure C to the Template Haulage Contract specifies with respect to these ancillary services the charges as at December 2009 for each (clause 1), a mechanism for annual variation of the charges (clause 2) and interpretation provisions (clause 3).

#### **Public submissions**

1892. In its submission dated 29 January 2010, WAGN noted at page 171 that the above services were offered 'as part of the reference services'. WAGN stated that costs associated with provision of ancillary services have not been included in the total revenue. WAGN did not make any further submission to the Authority about the proposed calculation of charges for ancillary services as set out in Annexure 3 to the Template Haulage Contract.

1893. The Authority did not receive any other public submissions on this issue.

### **Authority's assessment**

1894. The Authority has discussed aspects of WAGN's proposal in relation to ancillary services earlier in this draft decision.

1895. The Authority has concluded that WAGN is required to specify the ancillary services as a reference service in the proposed revised access arrangement. However, WAGN has not included any forecast operating expenditure for the ancillary services in the total revenue, and the Authority has indicated that WAGN must include forecast operating expenditure in relation to the ancillary services in the total revenue prior to the final decision.

1896. For the purpose of the draft decision, pending provision of the further information by WAGN, the Authority has made an assumption regarding the forecast operating expenditure which is likely to be incurred in providing the ancillary services over the forthcoming access arrangement period. In this draft decision the forecast operating expenditure assumed by the Authority for ancillary services is as set out earlier.

1897. The Authority has also concluded that in allocating the total revenue to reference services, that portion of the total revenue assumed to be referable to the provision of ancillary services should be allocated directly to the ancillary services and, therefore, should be recovered through specific charges for the ancillary services, rather than through the reference tariffs for haulage services.

1898. Annexure C to the Template Haulage Contract sets out proposed charges for each of the ancillary services which WAGN proposes to charge during the forthcoming access arrangement period, together with a mechanism for varying them.

1899. The charges for the ancillary services were proposed by WAGN on the basis that they are not charges for reference services. WAGN did not, therefore, in its access arrangement information or other supporting material supplied to the Authority provide any forecast cost information which might have provided a justification by reference to the national gas objective for the charges as reference tariffs.

1900. However, for the purpose of the Authority's draft decision, WAGN was able to provide to the Authority confidential historical cost, revenue and volume information with respect to the ancillary services for the current access arrangement period.

1901. The Authority is generally satisfied, having considered the historical information provided by WAGN that the charges for ancillary services in Annexure C to the Template Haulage Contract have been set on a basis which is likely to recover the operating expenditure which the Authority has assumed WAGN is likely to incur in providing the services. As such, the Authority is satisfied that the charges should be approved as reference tariffs consistent with the national gas objective and the revenue and pricing principals, subject to provision of further information by WAGN prior to the final decision validating that conclusion.

1902. The Authority notes that the ancillary services are predominantly supplied to users with Services B2 and B3, that is, users with a small end-use customer base. The Authority is satisfied further that on the basis of the historical data provided, the charges for the ancillary services proposed in Annexure C also comply with the requirements of rule 94 of the NGR and appropriately take account of the

requirements of regulation 7 of the WA Local Regulations concerning the impact on small users (retailers) and small use customers.

1903. The Authority has considered the proposed variation method applicable to the charges for ancillary services and is satisfied it complies with the requirements of rule 92(2) of the NGR.

#### **Draft decision**

1904. The Authority approves WAGN's proposal in relation to the charges for ancillary services set out in Annexure C to the Template Haulage Contract as reference tariffs compliant with the requirements of the NGL and NGR.
1905. The Authority's approval is subject to provision by WAGN prior to the final decision of forecast costs for the provision of ancillary services over the period of the forthcoming access arrangement which validate those charges as recovering the costs of providing the ancillary services.
1906. The Authority approves WAGN's proposed variation method in respect of the ancillary services charges set out in Annexure C to the Template Haulage Contract.
1907. The Authority notes that it may be appropriate prior to the date of effect of the revised access arrangement to require WAGN to amend its access arrangement information accordingly.

## **Other Access Arrangement Provisions**

### **Queuing requirements**

#### **Requirements of the NGL and the NGR**

1908. Rule 48(1)(e) of the NGR provides that a full access arrangement must set out the queuing requirements if the access arrangement is to contain queuing requirements.
1909. Rule 103(1) of the NGR provides that an access arrangement must contain queuing requirements if:
- a) the access arrangement is for a transmission pipeline; or
  - b) the access arrangement is for a distribution pipeline and the Authority notified the service provider that the access arrangement must contain queuing requirements.

#### **Access arrangement proposal**

1910. WAGN's GDS is not a transmission pipeline and the Authority did not notify WAGN that the proposed access arrangement had to contain queuing requirements. As a result, WAGN did not set out any queuing requirements in the proposed access arrangement.



**Draft decision**

1911. The Authority does not require the inclusion of any queuing requirements in the proposed access arrangement.

## Capacity trading requirements

**Requirements of the NGL and the NGR**

1912. Rule 48(1)(f) of the NGR provides that a full access arrangement must set out the capacity trading requirements.

1913. Rule 105(1) of the NGR provides that capacity trading requirements must provide for transfer of capacity:

- a) in accordance with the rules of a gas market that are applicable to the service provider; or
- b) if there are no such applicable rules governing transfer of capacity – in accordance with rule 105 of the NGR.

1914. Rule 105(2) of the NGR provides that a user may, without the service provider's consent, transfer, by way of subcontract, all or any of the user's contractual capacity to another with the following consequences:

- a) the transferor's rights against, and obligations to, the service provider are (subject to paragraph (b)) unaffected by the transfer; but
- b) the transferor must immediately give notice to the service provider or:
  - i) the subcontract and its likely duration;
  - ii) the identity of the third party; and
  - iii) the amount of the contracted capacity transferred.

1915. Rule 105(3) of the NGR provides that a user may, with the service provider's consent, transfer all or any part of the user's contracted capacity to another with the following consequences:

- a) the transferor's rights against, and obligations to, the service provider are terminated or modified in accordance with the capacity trading requirements; and
- b) a contract arises between the service provider and the third party on terms and conditions determined by or in accordance with the capacity trading requirements.

1916. Rule 105(4) of the NGR provides that the service provider must not withhold its consent under sub-rule 105(3) unless it has reasonable grounds, based on technical or commercial considerations, for doing so.

1917. Rule 105(5) of the NGR provides that an adjustment of the rights and liabilities under sub-rule 105(3) does not affect rights or liabilities that had accrued under, or in relation to, the contract before the transfer took effect.

1918. Rule 105(6) of the NGR provides that the capacity trading requirements may specify in advance conditions under which consent will or will not be given, and conditions to be complied with if consent is given.

### **Access arrangement proposal**

1919. Clause 6.1 of the proposed access arrangement states that a user's right to transfer its contracted capacity to another person will be set out in the user's service agreement with WAGN. The clause further provides that the terms and conditions for the transfer of contracted capacity for reference services (defined in the proposed access arrangement as Haulage Services) are set out in clauses 13.1 to 13.5 of the Template Haulage Contract.

1920. Clause 6.2 of the proposed access arrangement states that the terms and conditions for transfers of capacity will (as reflected in service agreements) be consistent with clause 6.3 and 6.4 of the proposed access arrangement.

1921. Clause 6.3(a) sets out the consequences of a user, transferring by way of subcontract without WAGN's consent, all or any of the user's contracted capacity to another.

1922. Clause 6.3(b) sets out the consequences of a user transferring, with WAGN's prior written consent, all of any of the user's contracted capacity to another.

1923. Clause 6.3(c) provides that WAGN must not withhold its consent unless it has reasonable grounds, based on commercial or technical considerations, for doing so.

1924. Clause 6.3(d) states that an adjustment of rights and liabilities under clause 6.3(b) does not affect the rights or liabilities that had accrued under, or in relation to, the service agreement before the transfer took effect.

1925. Clause 6.4(a) of the proposed access arrangement provides that WAGN will only give its consent to transfer contracted capacity for haulage services if the following conditions are satisfied:

- a) the third party complies with the application procedure;
- b) the third party satisfies the preconditions specified; and
- c) the user reimburses WAGN for all reasonable costs incurred in processing and determining its request for consent.

1926. Clause 6.4(b) of the proposed access arrangement states that WAGN's rights to withhold its consent on reasonable grounds based on commercial or technical considerations are not limited by clause 6.4(a) of the proposed access arrangement.

### **Access arrangement information**

1927. There are no specific access arrangement information requirements in relation to capacity trading requirements.

1928. WAGN did not provide any access arrangement information in relation to the application procedure.

## Public submissions

1929. Alinta, in Attachment B to its submission dated 19 April 2010 (page 19), submitted in relation to clause 6.3(a)(ii) that as the transfer is by way of subcontract, or bare transfer, it has no contractual effect on, or operational implications for, the relationship between the user and the service provider. Alinta submitted that the provision of this information is unnecessary and inappropriate.
1930. Alinta, in Attachment B to its submission dated 19 April 2010 (page 19), submitted that, as clause 6.4(a)(ii) of the proposed access arrangement is an assignment of existing contracted peak capacity at existing delivery points with a contracted peak rate, most of the requirements of clause 5.5 are irrelevant. Alinta states that WAGN should specify which preconditions are relevant.

## Authority's assessment

1931. Under rule 48(1)(f) of the NGR that the access arrangement must set out capacity trading requirements.
1932. The requirement under rule 48(1)(h) of the NGR is a requirement applicable to all haulage services whether reference services or non-reference services.
1933. The Authority notes that the combined effect of clauses 6.1 and 6.2 is that terms and conditions for transfers of capacity:
- a) in the case of non-reference services will be set out in services agreements which must be consistent with clauses 6.3 and 6.4 of the proposed access arrangement;
  - b) in the case of reference services are set out in the Template Haulage Contract, in clauses 13.1 to 13.5.
1934. The Authority notes its discussion on clauses 13.1 to 13.5 of the Template Haulage Contract are dealt with above at 1587 to 1605. The Authority is satisfied that the combined effect of clauses 6.1 and 6.2 is that the capacity trading requirements are specified in the access arrangement as required by rule 48(1)(h) of the NGR.
1935. The further question is whether the capacity trading requirements as so specified are compliant with the requirements of rules 105(2), (3), (4) and (5) of the NGR.
1936. The requirements in clause 6.3(a) of the proposed access arrangement regarding bare transfers without consent (where the transferor remains liable) are consistent with the requirements of rule 105(2) of the NGR. Alinta's submission on clause 6.3(a)(ii) is inconsistent with the requirements under rule 105(2).
1937. The requirements in clause 6.3(b), (c) and (d) regarding transfers of capacity (where the transferor has no further liability after the transfer) are consistent with rule 105(3), (4) and (5) of the NGR and should be approved.
1938. The Authority notes that rule 105(6) of the NGR allows the capacity trading requirements to specify in advance conditions under which consent will be given.
1939. Clause 6.4(a) and (b) of the proposed access arrangement concerns the advance conditions with which a third party must comply in order for WAGN to provide its consent to a transfer.

1940. The requirement in clause 6.4(a)(i) of the proposed access arrangement that the third party comply with the application procedure in clause 5.5 is consistent with the national gas objective, in particular the efficient operation of the gas pipeline. The third party will be taking over liability for the capacity and it is, therefore, important that the service provider has the information about the third party which is ordinarily obtained when a user requests a service. The clause should be approved.
1941. Clause 6.4(a)(ii) of the proposed access arrangement provides that WAGN may make it a condition of its consent the third party satisfies one or more of the pre-conditions set out in clause 5.5 of the proposed access arrangement. In light of the Authority's decision that clause 5.5 of the proposed access arrangement should be deleted, this clause should be deleted also.
1942. Clause 6.4(a)(iii) of the proposed access arrangement provides that the user is required to reimburse WAGN for all reasonable costs incurred in processing and determining its request for consent. This is consistent with the requirement under clause 44 of the currently approved access arrangement and with the Authority's approval of clause 13.5 of the Template Haulage Contract in this draft decision above. In light of this, and without any submission disputing this clause, the Authority concludes that clause 6.3(a)(iii) is not inconsistent with the national gas objective and therefore clause 6.3(a)(iii) should be approved.
1943. The capacity trading provisions applicable to reference services are set out in clauses 13.1 to 13.5 of the Template Haulage Contract and are considered above.

#### **Draft decision**

1944. Clause 6 of the proposed access arrangement and clauses 13.1 to 13.5 of the Template Haulage Contract comply with the requirement set out in rule 48(1)(f) of the NGR that an access arrangement must set out the capacity trading requirements.
1945. Clause 6.4(a)(ii) of the proposed access arrangement should be deleted as it refers to compliance with preconditions in clause 5.5 of the proposed access arrangement which the Authority requires to be deleted..

#### **Required Amendment 69**

Clause 6.4(a)(ii) of the proposed access arrangement should be deleted.

## **Extension and expansion requirements**

### **Requirements of the NGL and the NGR**

1946. Section 18 of the NGL provides as follows:

For the purpose of this Law -

- a) an extension to, or expansion of the capacity of, a covered pipeline must be taken to be part of the covered pipeline; and
- b) the pipeline as extended or expanded must be take to be a covered pipeline,

if, by operation of the extension and expansion requirements under an applicable access arrangement, the applicable access arrangement will apply to pipeline services provided by means of the covered pipeline as extended or expanded.

1947. Regulation 4(1) of the *National Gas Access (WA) (Part 3) Regulations 2009* provides that for the purposes of the definition of designated pipeline in section 2 of the NGL a pipeline listed in Schedule 1 is prescribed to be a designated pipeline. Schedule 1 includes the GDS as a distribution pipeline for Western Australia in subclause 3(1) and in clause 3(2):

Extensions to and expansions of the capacity of a pipeline listed in subclause (1) where, by operation of an applicable access arrangement or under the NGL, those extensions or expansions are to be treated as part of the pipeline.

1948. Rule 48(1)(g) of the NGR provides that a full access arrangement must set out the extension and expansion requirements.
1949. Rule 104(1) of the NGR provides that extension and expansion requirements may state whether the applicable access arrangement will apply to incremental services (i.e. pipeline services provided by means of extension to, or expansion of the capacity of, the pipeline) to be provided as a result of a particular extension to, or expansion of the capacity of the pipeline, or may allow for later resolution of that question on a basis stated in the requirements.
1950. The extension and expansion requirements included in a full access arrangement must, if they provide that an applicable access arrangement is to apply to incremental services, deal with the effect of the extension or expansion on tariffs (rule 104(2) of the NGR).
1951. The extension and expansion requirements cannot require the service provider to provide funds for work involved in making an extension or expansion unless the service provider agrees (rule 104(3) of the NGR).
1952. There are no specific access arrangement information requirements in relation to the extension or expansion requirements in an access arrangement.

### **Access arrangement proposal**

1953. Clause 7.1 of the proposed access arrangement provides, subject to clause 7.2, that an extension or expansion is part of the GDS if:
- a) the extension or expansion is part of, or directly connected with, an existing sub-network; or
  - b) WAGN has made a determination that an extension or expansion is part of the GDS.
1954. Clause 7.2(a) of the proposed access arrangement provides that WAGN may decide that an extension or expansion is not part of the GDS by making a written determination to that effect. Clause 7.2(b) provides that an extension or expansion that is excluded is not to be treated as part of the GDS.
1955. Clause 7.3 of the proposed access arrangement provides that if WAGN makes a written determination that an extension or expansion is part of the GDS under clause 7.1 or that an extension or expansion is not part of the GDS under clause 7.2

it will provide a copy of that written determination to the Authority as soon as practicable.

1956. Clause 7.4 of the proposed access arrangement states that where WAGN is obliged to offer to connect a premise to the WAGN GDS under a distribution licence, WAGN will not impose surcharges or seek capital contribution in respect of standard delivery facilities for those costs that WAGN is obliged to bear under the distribution licence.

### **Access arrangement information**

1957. WAGN did not provide any access arrangement information in relation to this proposal.

### **Public submissions**

1958. The Authority did not receive any public submissions in relation to the extension and expansion requirements.

### **Authority's assessment**

1959. The extension and expansions policy under the current access arrangement is contained in clauses 58 to 63 of Part A. Clause 7 of the proposed access arrangement is broadly similar to clauses 58 to 63 of Part A of the current access arrangement, with the exception that under clause 7.2 of the proposed access arrangement there is no requirement for WAGN to obtain the Authority's consent before determining that an extension or expansion which would otherwise become part of the GDS is to be an excluded extension or expansion. This is in contrast to clause 61(1) of the current access arrangement which requires WAGN to obtain the Authority's consent to such an exclusion.
1960. Rule 104(2) of the NGR provides that extension and expansion requirements may state whether the applicable access arrangement will apply to incremental services (i.e. pipeline services provided by means of extension to, or expansion of the capacity of, the pipeline) to be provided as a result of a particular extension to, or expansion of the capacity of the pipeline, or may allow for later resolution of that question on a basis stated in the requirements.
1961. The Authority is not satisfied that clause 7 of WAGN's proposed access arrangement provides a mechanism for determining whether the applicable access arrangement will apply to incremental services pursuant to rule 104(1) of the NGR. Clause 7 provides for WAGN to determine whether or not an extension or expansion will be part of the covered pipeline subject only to notifying the Authority. The proposed access arrangement, in the Authority's view, does not meet the requirements of rule 104(1) of the NGR. The Authority does not consider that the mechanism proposed by WAGN allows for 'later resolution of that question on a basis stated in the requirements', as set out under rule 104(1) of the NGR. Under WAGN's proposed revision the question is resolved not 'later' but at the time of the extension or expansion. Further, the discretion of WAGN cannot properly be described as a 'basis stated in the requirements' which allows for 'later resolution'. However, a provision similar to that under the current access arrangement which provides for the Authority to determine whether or not an extension or expansion should be covered could be a 'basis stated in the requirements' allowing for 'later resolution'.



1962. The Authority is not satisfied that the provision for WAGN to determine that an extension or expansion be excluded from coverage is consistent with the national gas objective for the reasons following.
1963. The Authority notes the analysis and the draft decision of the Australian Energy Regulator dated November 2009 regarding the access arrangement proposal for the ACT, Queanbeyan and Palerang gas distribution network.
1964. At pages 184 to 187 of that draft decision the Australian Energy Regulator discussed the extension and expansion requirements for a gas distribution network. The Authority notes and endorses Australian Energy Regulator's conclusions at pages 185 to 186 regarding the appropriate extension or expansion requirements with respect to different classes of extensions or expansions, having regard to the national gas objective. The Australian Energy Regulator concluded as follows:
- a) High pressure pipeline extensions: These extensions have characteristics similar to transmission pipelines and should not receive default coverage. The extension may be for a variety of different reasons to which different considerations under the national gas objective apply. It is appropriate to require the service provider to apply and the regulator to consider on each occasion whether it is appropriate in the circumstances for the proposed extension to be covered and whether this is in accordance with the national gas objective.
  - b) Low and medium pressure pipeline extensions: It is appropriate for these extensions to have default coverage subject to notifying the regulator. Such extensions are often embedded in and occur throughout the network. Coverage by default is likely to contribute to the promotion of efficient investment in and use of the services in the interests of consumers.
  - c) Expansions: Default coverage, subject to regulator notification, is appropriate as this will address any concerns regarding the potential for a service provider to exercise market power.
1965. The Authority endorses the Australian Energy Regulator's reasoning and considers it equally applicable to WAGN's proposed revisions. Therefore, clauses 7.1, 7.2 and 7.3 should be amended to reflect similar provisions to the Australian Energy Regulator's draft decision above in relation to the coverage of extensions and expansions.
1966. Consistent with rule 104(2) clause 7.1(c) of the proposed access arrangement, which states that any extension or expansion will not affect reference tariffs, is approved.
1967. The remaining clause is clause 7.4 of the proposed access arrangement, concerning recovery of costs through surcharges. This provision has its equivalent in clause 62(3) of part A in the current access arrangement. The provision is included for consistency with the relevant licence condition and therefore should be approved.

**Draft decision**

1968. The extensions and expansions policy in clause 7 of the proposed access arrangement should be amended so that:

- a) High pressure pipeline extensions are not covered automatically. Instead, in each case the service provider is required to seek and obtain the Authority's determination as to whether the extension will be covered;
- b) Low and medium pressure pipeline extensions will be covered; and
- c) Expansions will be covered.

1969. Clause 7.1(c) of the proposed access arrangement concerning the effect of extensions or expansions on reference tariffs is approved and should be reflected in the amended clause 7.

1970. Clause 7.4 of the proposed access arrangement is approved.

#### Required Amendment 70

Clauses 7.1, 7.2 and 7.3 of the proposed access arrangement should be deleted and replaced with the following:

##### 7.1 Extensions of high pressure pipelines

- i) If WAGN proposes a high pressure pipeline extension of the covered pipeline it must apply in writing to the Authority for a decision on whether the proposed extension will be taken to form part of the covered pipeline and will be covered by this access arrangement. The application must describe the extension and set out why the extension is necessary.
- ii) The application referred to in (i) above must be made before the proposed high pressure pipeline extension comes into service.
- iii) After considering WAGN's application and undertaking such consultation as the Authority considers appropriate the Authority will inform WAGN of its decision.
- iv) The Authority's decision referred to in (iii) above may be made on such reasonable terms as determined by the Authority and will have the effect stated in the decision.
- v) An extension under this clause 7.1 will not affect reference tariffs during a current access arrangement period.

##### 7.2 Extensions of medium and low pressure pipelines

- i) Any low or medium pressure pipeline extension of the covered pipeline will be treated as part of the covered pipeline and accordingly covered by this access arrangement.
- ii) No later than 20 business days following the expiration of the financial year WAGN must notify the Authority of all low and medium pressure pipeline during that year including all extensions commenced in progress or completed.

iii) The notice must describe each extension and set out why the extension was necessary.

iv) An extension under this clause 7.2 will not affect reference tariffs during a current access arrangement period.

### 7.3 Expansions

i) All expansions of the capacity of the covered pipeline carried out by WAGN will be treated as part of the covered pipeline and accordingly covered under this access arrangement.

ii) No later than 20 business days following the expiration of the financial year WAGN must notify the Authority of all expansions of the covered pipeline during that year including all expansions commenced, in progress or completed.

iii) The notice must describe each expansion and set out why the expansion was necessary.

iv) An expansion under this clause 7.2 will not affect reference tariffs during the current access arrangement period.

## Changing receipt and delivery points

### Requirements of the NGL and the NGR

1971. Rule 48(1)(h) of the NGR provides that a full access arrangement must state the terms and conditions for changing receipt and delivery points.

1972. Rule 106 of the NGR provides that an access arrangement must provide for the change of a receipt or delivery point in accordance with the following principles:

- a) a user may, with the service provider's consent, change the user's receipt or delivery point;
- b) the service provider must not withhold its consent unless it has reasonable grounds, based on technical or commercial considerations, for doing so;

(rule 106(1) of the NGR).

1973. The access arrangement may specify in advance conditions under which consent will or will not be given, and conditions to be complied with if consent is given (rule 106(2) of the NGR).

1974. There are no specific access arrangement information requirements in relation to changing receipt and delivery points.

### Access arrangement proposal

1975. Clause 8.1(a) of the proposed access arrangement provides that the terms and conditions for changing receipt points and delivery points are to be specified in the

service agreement. Clause 8.1(a) also provides that in the case of reference services (defined in the proposed access arrangement as Haulage Services) the required terms and conditions are set out in clauses 5.3 and 5.4 of the Template Haulage Contract.

1976. Clause 8.1(b) of the proposed access arrangement states that the terms and conditions for changing a receipt point or delivery point will be governed by the principles specified in clause 8.2.

1977. Clause 8.2 of the proposed access arrangement set outs the principles that govern changing receipt points and delivery points and include:

- a) a user may, with the prior written consent of WAGN, change the user's receipt or delivery point;
- b) WAGN must not withhold its consent unless it has reasonable grounds, based on technical or commercial considerations;
- c) WAGN will only give its consent where a user makes a request for consent in writing;
- d) WAGN may make it a condition of its consent that the user satisfies one or more of the pre-conditions set out in clause 5.5 of the proposed access arrangement.

1978. Clause 8.2(b) of the proposed access arrangement states that WAGN's rights to withhold its consent on reasonable grounds based on commercial or technical considerations are not limited by clause 8.2(a) of the proposed access arrangement.

### **Access arrangement information**

1979. WAGN did not provide any access arrangement information in relation to this proposal.

### **Public submissions**

1980. No public submissions were received in relation to clause 8 of the proposed access arrangement.

### **Authority's assessment**

1981. Under rule 48(1)(h) of the NGR the access arrangement must state the terms and conditions for changing receipt and delivery points.

1982. The reference to receipt and delivery points is a reference to the points at which gas is injected into or taken out of the GDS whether the relevant haulage service is a reference service or a non-reference service.

1983. Therefore, the requirement under rule 48(1)(h) of the NGR is a requirement concerning the terms and conditions for changing receipt and delivery points applicable to all haulage services whether reference services or non-reference services.

1984. The Authority is satisfied that the requirement in clause 8.1(b) that each service agreement must contain terms and consistent governed by the principles set out in

clause 8.2 of the proposed access arrangement is sufficient to comply with the requirement that the access arrangement state the terms and conditions for changing receipt and delivery point for all pipeline services.

1985. The further question is whether the principles governing the terms and conditions in clause 8.2 are compliant with rule 106 of the NGR.
1986. The requirement in clause 8.2(a)(i) that the user may change receipt or delivery points with the service provider's prior consent is consistent with rule 106(1)(a) of the NGR and should be approved.
1987. Clause 8.2(a)(i) and (iii) of the proposed access arrangement requires a user's request to change a receipt or delivery point, and the service provider's consent, to be in writing. While rule 106 of the NGR requires neither a request nor consent to be in writing, the Authority considers that these provisions are consistent with the principles in rule 106 of the NGR and should be approved.
1988. Clause 8.2(a)(ii) and 8.2(b) of the proposed access arrangement regarding the grounds on which a service provider may withhold consent is consistent with rule 106(1)(b) of the NGR and should be approved.
1989. Clause 8.2(iv) provides that WAGN may make it a condition of its consent to a change of receipt or delivery point that the user satisfies one or more of the pre-conditions set out in clause 5.5 of the proposed access arrangement. Given that the Authority's decision is that clause 5.5 should be deleted, clause 8.2(iv) should also be deleted.
1990. Finally, the Authority notes that clause 8.1(a) of the proposed access arrangement provides that the terms and conditions for changing a receipt point or a delivery point for a reference service are set out in clauses 5.3 and 5.4 of the Template Haulage Contract.
1991. The Authority, contrary to WAGN's position in clause 8.1(a) of the proposed access arrangement, does not consider that the terms and conditions in clauses 5.3 and 5.4 of the Template Haulage Contract are 'for changing a receipt point or a delivery point' as stated in clause 8.1 of the proposed access arrangement.
1992. Clause 5.3 of the Template Haulage Contract sets out terms regarding the start and end dates for delivery points whereas clause 5.4 sets out terms regarding the delivery point register to be maintained by the service provider.
1993. While clause 5.3 and 5.4 of the Template Haulage Contract may have some operation in relation to a delivery point that is changed they do not contain any terms or conditions for the change, nor do they contain any terms or conditions at all regarding receipt points. It appears to the Authority that the intended reference may have been to clause 13.7 of the Template Haulage Contract. If that is the case, WAGN should address this issue by inserting the correct reference to clause 13.7 of the Template Haulage Contract.
1994. Therefore, there are no terms and conditions regarding this matter in the Template Haulage Contract, which is contrary to the statement in clause 8.1(a) that a user's service agreement (which in the case of a user of reference services is the haulage contract) will specify the terms and conditions.

1995. The Authority concludes that the Template Haulage Contract should be amended to include the terms in clause 8 as amended in accordance with this draft decision.

#### **Draft decision**

1996. Clause 8 of the proposed access arrangement complies with the requirement set out in rule 48(1)(h) of the NGR that an access arrangement contain provisions for changing receipt and delivery points.

1997. Clause 8.2(a)(iv) should be deleted as it refers to compliance with preconditions in clause 5.5 of the proposed access arrangement which as stated above the Authority does not approve.

1998. To ensure that the service agreements for reference services contain terms and conditions for changing receipt and delivery points the Template Haulage Contract should be amended to include a term identical to clause 8.2 of the proposed access arrangement as amended in accordance with this draft decision. The second sentence of clause 8.1(a) of the proposed access arrangement is incorrect and should be deleted.

#### **Required Amendment 71**

The second sentence of clause 8.1(a) of the proposed access arrangement should be deleted.

Clause 8.1(a)(iv) of the proposed access arrangement should be deleted.

The Template Haulage Contract should be amended to insert a term in identical terms to clause 8 of the proposed access arrangement as amended in this draft decision.

## **Definitions and interpretation**

### **Access arrangement proposal**

1999. Clause 12 of the Proposed Revised access arrangement contains the dictionary for terms used throughout the access arrangement. Annexure A and Annexure B each contain a dictionary that applies to that Annexure.

### **Access arrangement information**

2000. WAGN did not provide any access arrangement information in relation to this proposal.

### **Public submissions**

2001. Alinta, in its submission dated 19 April 2010 (pages 2-4), submitted in relation to the use of 'CPI All Groups, Perth' that the standard regulatory practise, including in Western Australia, has been to define the CPI as the Consumer Prices Index, All Groups, Eight Capital Cities. Alinta commented that neither WAGN nor its access arrangement information has explained why it has elected to adopt CPI All Groups,



Perth rather than to continue the current (and standard) practice of using the CPI All Groups, Eight Capital Cities.

### **Authority's assessment**

2002. The Authority notes that the definition in relation to 'CPI' has been changed from 'CPI All Groups, Eight Capital Cities' to 'CPI All Groups, Perth'. The Authority accepts Alinta's submission that this change is not consistent with standard regulatory practice and the Authority does not accept the revision.
2003. The Authority notes that there is some inconsistency between the definitions in the access arrangement and the NGL and NGR. The Authority considers that the definitions in the access arrangement and NGL and NGR should be the same to avoid inconsistency and uncertainty in the operation of the access arrangement.
2004. The Authority notes that the terms 'Retail Market Rules' and 'Retail Market Scheme' are defined in terms which refer to current laws and regulations, whereas in each case there is the possibility during the forthcoming access arrangement period that the laws and regulations referred to may vary or be replaced so that the definitions become otiose. The definitions of these terms should be amended to cater for such changes in the relevant laws or regulations.

### **Draft decision**

2005. The Authority requires that the definition of 'CPI' to be amended from 'CPI All Groups, Perth' to 'CPI All Groups, Eight Capital Cities'.
2006. The Authority requires that the following definitions be amended to read the same as the corresponding definition in the NGL and NGR:
- a) Delivery Point;
  - b) National Gas Access (WA) Legislation;
  - c) National Gas Regulations
  - d) National Gas Rules;
  - e) Receipt Point;
  - f) Reference Tariff Variation Mechanism; and
  - g) User.
2007. The Authority requires that the following definitions be amended to provide for changes in laws and regulations affecting them:
- a) Retail Market Rules; and
  - b) Retail Market Scheme.
2008. The Authority otherwise accepts the definitions set out in clause 12 of the proposed access arrangement.

#### Required Amendment 72

The definition of CPI in clause 12 of the proposed access arrangement should be amended to CPI All Groups, Eight Capital Cities.

#### Required Amendment 73

The following definitions should be amended to read the same as the corresponding definitions in the NGL and NGR:

- a) Delivery Point;
- b) National Gas Access (WA) Legislation;
- c) National Gas Regulations
- d) National Gas Rules;
- e) Receipt Point;
- f) Reference Tariff Variation Mechanism; and
- g) User.

#### Required Amendment 74

Retail Market Rules' means the rules applying under the Retail Market Scheme, as amended from time to time, or any other scheme applying to the retail energy market.

'Retail Market Scheme' means the retail market scheme, including the Retail Market Rules, approved under section 11ZOJ of the Energy Coordination Act 1994 (WA) as applying in respect of the WAGN GDS, as amended from time to time, or any other scheme applying to the retail energy market.

## Other Post Approval Matters

### Review submission date

#### Requirements of the NGL and the NGR

2009. Rule 49(1)(a) of the NGR provides that a full access arrangement must contain a review submission date.

2010. Rule 48(1)(i) of the NGR provides that if there is to be a review submission date the access arrangement must state the review submission date and the revision commencement date.
2011. As a general rule, the review submission date will fall four years after the access arrangement takes effect or the last revision commencement date (rule 50(1)(a) of the NGR).
2012. If a service provider, as part of an access arrangement proposal, proposes to fix a review submission date in accordance with the general rule, the Authority must accept that part of the proposal (rule 50(2) of the NGR).
2013. There are no specific access arrangement information requirements in relation to the review submission date.

### **Access arrangement proposal**

2014. WAGN has stated the review submission date in clause 2.2(a) of the proposed access arrangement as 1 July 2013.

### **Access arrangement information**

2015. WAGN did not provide any access arrangement information in relation to this proposal.

### **Public submissions**

#### *WAGN Submissions*

2016. In its submissions, WAGN stated that a shorter third access arrangement period will bring forward the next revisions to the access arrangement and this will reduce uncertainty which would otherwise surround the revisions. In particular, it stated that it will provide relative certainty of the reference tariffs for the proposed access arrangement for a period of four and a half years, not five years.
2017. WAGN submitted that the net effect of bringing forward the revision submission date will be insignificant. WAGN stated that its decisions to invest will not be affected and there will be no impact on the efficient operation of the WAGN GDS. WAGN further submits that shortening the access arrangement period by six months will have no effect on its reasonable opportunities to recover at least the efficient costs of providing the reference services using the WAGN GDS nor will it weaken incentives for improved efficiency in the provision of reference services.

#### *Other submissions*

2018. There were no other public submissions in relation to this issue.

### **Authority's assessment**

2019. According to the general rule, the review submission date should be 1 January 2014. However, WAGN has adopted the review submission date of 1 July 2013 which is six months earlier than the general rule.

2020. The Authority has no discretion in relation to the review submission date however, the Authority can only approve the date proposed if it is satisfied that the date is consistent with the national gas objective and the revenue pricing principles.

2021. The Authority is satisfied that WAGN's submission regarding this issue provides an appropriate basis for the Authority to conclude that the proposed date is consistent with the national gas objective and the revenue pricing principles.

### **Draft decision**

2022. Clause 2.2(a) of the proposed access arrangement is approved.

## **Revision commencement date**

### **Requirements of the NGL and the NGR**

2023. Rule 49(1)(b) of the NGR provides that a full access arrangement must contain a revision commencement date.

2024. Rule 48(1)(i) of the NGR provides that if there is to be a review submission date the access arrangement must state the review submission date and the revision commencement date.

2025. As a general rule the revision commencement date will be 5 years after the access arrangement took effect or the last revision commencement date (rule 50(1)(b) of the NGR).

2026. If a service provider, as part of an access arrangement proposal, proposes to fix a revision commencement date in accordance with the general rule, the Authority must accept that part of the proposal (rule 50(2) of the NGR).

2027. There are no specific access arrangement information requirements in relation to the revision commencement date.

### **Access arrangement proposal**

2028. WAGN has stated the revision commencement date in clause 2.2(b) of the proposed access arrangement as 1 July 2014.

### **Access arrangement information**

2029. WAGN did not provide any access arrangement information in relation to this proposal.

### **Public submissions**

#### *WAGN Submissions*

2030. WAGN's submissions in relation to the revision commencement date are the same as those with respect to the review submission date. 2017

**Authority's assessment**

2031. According to the general rule, the revision commencement date should be 1 January 2015. WAGN has adopted the revision commencement date of 1 July 2014 which is six months earlier than the general rule.
2032. As stated above in the review submission date, the Authority can only approve this earlier date if it is satisfied that the date is consistent with the national gas objective and the revenue pricing principles.
2033. The Authority is satisfied that WAGN's submission regarding this issue provides an appropriate basis for the Authority to conclude that the proposed date is consistent with the national gas objective and the revenue pricing principles.

**Draft decision**

2034. Clause 2.2(b) of the proposed access arrangement is approved.

**Trigger events****Requirements of the NGL and the NGR**

2035. Rule 51 of the NGR provides that the review submissions date fixed in an access arrangement advances to an earlier date if:
- a) the access arrangement provides for acceleration of the review submission date on the occurrence of a trigger event;
  - b) the trigger event occurs; and
  - c) the review submissions date determined, in accordance with the access arrangement, by reference to the trigger event, is earlier than the fixed date.
2036. A trigger event may consist of any significant circumstance or conjunction of circumstances (rule 51(2) of the NGR).
2037. Examples of a trigger event include:
- a) a re-direction of the flow of natural gas through the pipeline;
  - b) a competing source of natural gas becomes available to customers served by the pipeline;
  - c) a significant extension, expansion or interconnection occurs;
- (see note to rule 51(2) of the NGR).
2038. The Authority may insist on the inclusion in an access arrangement of trigger events and may specify the nature of the trigger events to be included (rule 51(3) of the NGR).
2039. There are no specific access arrangement information requirements in relation to trigger events.

### **Access arrangement proposal**

2040. No trigger events were proposed in WAGN's proposed revisions.

### **Public submissions**

2041. The Authority did not receive any submissions in relation to trigger events for WAGN's proposed revisions.

### **Authority's assessment**

2042. Pursuant to section 3.17(ii) of the Code Schedule 1 of Part A of the current access arrangement provides for two revisions trigger events:

- a) if the actual received volume for a calendar year exceeds the sum of the forecast delivered volume for the year and the forecast unaccounted for gas for the year by more than 25 per cent; and
- b) if a relevant change (defined to mean certain specified regulatory changes or tax changes) takes effect and the net direct and indirect impact of the change on WAGN's business would be to increase forecast costs by 2.5 per cent or more.

2043. In considering whether it is appropriate for the present trigger events to continue, or for other trigger events to be specified, the Authority must consider whether or not a proposed trigger event would be consistent with the national gas objective.

2044. The Authority notes the requirement of rule 51(2) of the NGR which requires there to be circumstances or a conjunction of circumstances which is or are 'significant' in order for a trigger event to be justified. The Authority also notes the examples of trigger events given in rule 51(2) of the NGR which provide guidance as to the intent of the provisions.

2045. The Authority notes the recent final decision of the AER for the Jemena NSW GDS (June 2010). In this decision (Revision 14.30), the AER required the inclusion of an acceleration of review date submission date triggers which apply if an amendment the NGL or NGR takes effect or the National Energy Retail Law or the National Energy Retail Rules commence operation in NSW and this affects the terms and conditions on which users or customers obtain access under the access arrangement, and this results in more favourable conditions for users or customers than under the access arrangement. In these circumstances the service provider is required to notify the AER within a month and the AER, after consultation must decide whether or not the circumstances constitute a trigger event.

2046. The Authority does not consider that a trigger event of this nature is necessary for the WAGN GDS for the forthcoming access arrangement period. The Authority notes that:

- a) the proposed access arrangement is for a period of 4.5 years, not 5 years;
- b) the proposed access arrangement will not come into effect until 1 January 2011, one year into the 4.5 year access arrangement period; and
- c) WAGN is to lodge its proposed revisions for the next access arrangement 12 months before that next access arrangement is to apply (i.e. June 2013).



2047. The combined effect of these circumstances is that, in any event, there will be only 2.5 years before WAGN is required to lodge the proposed revisions for the next access arrangement. Unlike other pipeline systems, which would normally have 4 years before being required to lodge the proposed revisions for the next access arrangement, due to the above factors, this is significantly reduced for the WAGN GDS.
2048. As a result of this short time frame, the Authority does not consider it appropriate in these circumstances to require WAGN to include a trigger event in the proposed access arrangement.
2049. The Authority notes further that in the current access arrangement there are trigger events in relation to volumes exceeding forecast and regulatory or tax changes impacting on WAGN. The Authority does not consider that there is any justification for either kind of trigger event to be included in the proposed access arrangement.
2050. In the case of the risk of volumes substantially exceeding forecast the Authority notes its decision above setting out the Authority's reasons for requiring amendment to WAGN's forecast volumes for Service B2 and B3. The Authority is satisfied that the relevant required amendments will address any material risk of under-forecasting. Similarly in the case of regulatory or tax changes imposing unanticipated and material costs on WAGN, the Authority is satisfied any such change will be dealt with adequately through the cost pass through mechanism approved in this draft decision.

#### **Draft decision**

2051. The Authority approves WAGN's proposal not to include a trigger event for the forthcoming access arrangement period.

# APPENDICES

**Appendix 1 – Reference Tariff Variation Mechanism  
– Alternative mechanism considered appropriate  
by the Authority in relation to sections 2.2 to 2.5 of  
Annexure B.**

**1. REFERENCE TARIFF VARIATION MECHANISM**

This Reference Tariff Variation Mechanism provides for the variation of a Haulage Tariff:

- a) in accordance with clause 2 of this Annexure B; and
- b) as a result of a cost pass through for a defined Through Event, under clause 3 of this Appendix 1.

**2. REFERENCE TARIFF VARIATION MECHANISM – VARIATION IN ACCORDANCE WITH FORMULA****2.1 Variation**

- (a) WAGN may vary any Haulage Tariff by varying one or more Tariff Components of that Haulage Tariff during a Variation Period in accordance with this clause 2.
- (b) Each Haulage Tariff varied under this clause 2 applies as varied on and from the first day of the applicable Variation Period.
- (c) Where, in this clause 2, reference is made to forecast Regulatory Operating Expenditure, that forecast is to be in real Dollars 2009.
- (d) Where, in this clause 2, reference is made to actual Regulatory Operating Expenditure, that actual is to be in nominal Dollars (Dollars of the day) as presented in the WAGN Financial Statement.

**2.2 Variation Period is the period from 1 January to 30 June 2011**

- (a) If the Variation Period is the period from 1 January 2011 to 30 June 2011, any variation of a Tariff Component under clause 2.1(a) must satisfy the following conditions:

$$P_{2011(I)}^{ij} \leq p_0^{ij} * \frac{CPI_{Sep2010}}{CPI_{Mar2009}}$$

where:

$P_{2011(I)}^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as varied on and from the first day of the variation period;

$p_0^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as set out in Annexure A of WAGN's proposed access arrangement;

$CPI_{Sep2010}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2010; and

$CPI_{Mar2009}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2009.

**2.2 Variation Period is the Year commencing 1 July 2011**

- (a) If the Variation Period is the year commencing 1 July 2011, any variation of a Tariff Component under clause 2.1(a) must satisfy the following conditions:

$$P_{2011/12}^{ij} \leq p_0^{ij} (1 + V_{2011/12}) * \frac{CPI_{Mar2011}}{CPI_{Sep2008}}$$

where:

$i, j$

$P_{2011/12}^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as varied on and from the first day of the variation period;

$p_0^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as set out in Annexure A of WAGN's proposed access arrangement;

$V_{2011/12}$  is calculated by applying the formula set out in paragraph (b) below;

$CPI_{Mar2011}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2011; and

$CPI_{Sep2008}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2008.

(b) For the purpose of paragraph (a),  $V_{2011/12}$  is calculated by applying the following formula:

$$V_{2011/12} = \frac{\Delta ROpex_{2010} * (1 + WACC)^{1.5} + \Delta ROpex_{2011(I)} * (1 + WACC)^1}{ExpRev_{2011/12}}$$

and

$$\Delta ROpex_{2010} = AROpex_{2010} * \frac{CPI_{Dec2009}}{CPI_{Dec2010}} - FROpex_{2010}$$

and

$$\Delta ROpex_{2011(I)} = AROpex_{2011(I)} * \frac{CPI_{Sep2009}}{CPI_{Mar2011}} - FROpex_{2011(I)}$$

where:

$AROpe_{x2010}$  is Actual Regulatory Operating Expenditure for the period from 1 January 2010 to 31 December 2010;

$FROpe_{x2010}$  is Forecast Operating Expenditure equal to \$6.620 million (3.914+5.411/2) (real \$ as at 31 December 2009);

$AROpe_{x2011(I)}$  is Actual Regulatory Operating Expenditure for the period from 1 January 2011 to 30 June 2011;

$FROpe_{x2011(I)}$  of \$2.706 million (5.411/2) (real \$ as at 31 December 2009);

$CPI_{Dec2009}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 December 2009;

$CPI_{Dec2010}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 December 2010;

$CPI_{Sep2009}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2009;

$CPI_{Mar2011}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2011:

$ExpRev_{2011/12}$  is Expected Revenue of \$141.197 million (real \$ as at 31 December 2009)

$WACC$  is 6.89% .

### 2.3 Variation Period is the Year commencing 1 July 2012

- (a) If the Variation Period is the Year commencing 1 July 2012, any variation of a Tariff Component under clause 2.1(a) must satisfy the following conditions:

$$P_{2012/13}^{ij} \leq p_0^{ij} (1 + V_{2012/13}) * \frac{CPI_{Mar2012}}{CPI_{Sep2008}}$$

where:

$P_{2012/13}^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as varied on and from the first day of the variation period;

$p_0^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as set out in AnnexureA of WAGN's proposed access arrangement;'

$V_{2012/13}$  is calculated by applying the formula set out in paragraph (b);

$CPI_{Mar2012}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2012; and

$CPI_{Sep2008}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2008.

- (b) For the purpose of paragraph (a),  $V_{2012/13}$  is calculated by applying the following formula:

$$V_{2012/13} = \frac{\Delta ROpex_{2011/12} * (1 + WACC)^1}{ExpRev_{2012/13}}$$

and

$$\Delta ROpex_{2011/12} = AROpex_{2011/12} * \frac{CPI_{Sep2009}}{CPI_{Mar2012}} - FROpex_{2011/12}$$

where:

$AROpex_{2011/12}$  is Actual Regulatory Operating Expenditure for the period from 1 July 2011 to 30 June 2012;

$FROpex_{2011/12}$  is Forecast Operating Expenditure of \$5.403 million (real \$ as at 31 December 2009);

$CPI_{Sep2009}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2009;

$CPI_{Mar2012}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2012; and



$ExpRev_{2012/13}$  is Expected Revenue of \$145.150 million (real \$ as at 31 December 2009); and

$WACC$  is per cent 6.89%

## 2.4 Variation Period is the Year commencing 1 July 2013

- (a) If the Variation Period is the Year commencing 1 July 2013, any variation of a Tariff Component under clause 2.1(a) must satisfy the following conditions:

$$P_{2013/14}^{ij} \leq p_0^{ij} (1 + V_{2013/14}) * \frac{CPI_{Mar2013}}{CPI_{Sep2008}}$$

where:

$P_{2013/14}^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as varied on and from the first day of the variation period;

$p_0^{ij}$  is the value of Tariff Component  $j$  of haulage Tariff  $i$  as set out in Table 27 of this draft decision;

$V_{2013/14}$  is calculated by applying the formula set out in paragraph (b) below;

$CPI_{Mar2013}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2013; and

$CPI_{Sep2008}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2008.

- (b) For the purpose of paragraph (a),  $V_{2012/13}$  is calculated by applying the following formula:

$$V_{2013/14} = \frac{\Delta ROpex_{2012/13} * (1 + WACC)^1}{ExpRev_{2013/14}}$$

and

$$\Delta ROpex_{2012/13} = AROpex_{2012/13} * \frac{CPI_{Sep2009}}{CPI_{Mar2013}} - FROpex_{2012/13}$$

where:

$AROpex_{2012/13}$  is Actual Regulatory Operating Expenditure for the period from 1 July 2012 to 30 June 2013;

$FROpex_{2012/13}$  is Forecast Operating Expenditure of \$6.617 million (real \$ as at 31 December 2009);

$CPI_{Sep2009}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2009;

$CPI_{Mar2013}$  is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2013;

$ExpRev_{2013/14}$  is Expected Revenue of \$149.328 million (real \$ as at 31 December 2009) and

$WACC$  is 6.89 per cent.

## **Appendix 2 – Authority’s Reference Tariff Model (Public Version)**

## Appendix 3 - Glossary

Term	Definition
2005 draft decision	The Authority's draft decision, dated 28 February 2005, in relation to the current access arrangement.
Access arrangement information	The access arrangement information submitted by WAGN on 31 January 2010 with respect to the proposed revisions to the access arrangement for the GDS.
Authority	The Economic Regulatory Authority of Western Australia established pursuant to the <i>Economic Regulation Authority Act 2003</i> .
Capital expenditure	Expenditure on a Covered Pipeline and associated regulated assets that may be incorporated into the capital base of that pipeline.
Current access arrangement	AlintaGas's access arrangement for the Mid-West and South-West Gas Distributions Systems, as approved by the Economic Regulation Authority in Western Australia commencing from 25 August 2005.
Current access arrangement period	The period commencing 1 January 2005 and ending on 31 December 2009.
Deloitte	Deloitte Touche Tohmatsu.
Draft decision	This draft decision in relation to WAGN's proposed access arrangement.
Final decision	The Authority's final decision, dated 12 July 2005, in relation to the current access arrangement.
Forthcoming access arrangement period	The period commencing 1 January 2010 and ending 30 June 2014.
Frontier	Frontier Economics Pty Ltd Australia.
Full Retail Contestability	Contestability in all retail markets for gas within Western Australia, effected by the commencement on 31 May 2004 of the Retail Market Scheme, including the Retail Market Rules.
Gas Tariff Regulations	<i>Energy Coordination (Gas Tariffs) Regulations 2000</i> (WA).
Initial access arrangement	The period commencing 18 July 2000 and ending on 24 August 2005.
Marsden Jacob report	Marsden Jacob Associates, <i>Applying the new capital expenditure criteria to extensions and reinforcement of the WAGN GDS, a report prepared for WA Gas Networks</i> , April 2010.
National Gas Law	The National Gas Law as amended under the <i>National Gas Access (Western Australia) Act 2009</i> .
National Gas Rules	The National Gas Rules made under the <i>National Gas Access (Western Australia) Act 2009</i> .
Next access arrangement period	The access arrangement period following the forthcoming access arrangement period and commencing 1 July 2015.

Non Reference Service	A Service other than a Reference Service.
Retail Market Rules	The Retail Market Rules, established by the Retail Energy Market Company Limited (CAN 103 318 556), that govern the operation of the gas retail markets of South Australia and Western Australia, as amended from time to time.
Retail Market Scheme	The Retail Market Scheme, including the Retail Market Rules, approved under section 11ZOJ of the <i>Energy Coordination Act 1994</i> (WA) for the purposes of the WAGN's GDS as amended from time to time.
Proposed access arrangement	The proposed revision to the current access arrangement submitted by WAGN on 31 January 2010 in the form of a revised access arrangement.
Template Haulage Contract	Annexure C to WAGN's proposed access arrangement.
WA Local Regulations	<i>National Gas Access (WA) (Local Provisions) Regulations 2009</i>
WestNet Energy	WestNet Energy Services Pty Ltd

## Appendix 4 – Abbreviations

Abbreviation	For
AA	Access arrangement
AAI	Access arrangement Information
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
AER	Australian Energy Regulator
AGN	AlintaGas Networks Pty Ltd
ATO	Australian Taxation Office
bps	Basis points
Capex	Capital expenditure
CAPM	Capital Asset Pricing Model
Code	<i>National Third Party Access Code for Natural Gas Pipelines</i>
CPI	Consumer Price Index
DBNGP	Dampier to Bunbury Natural Gas Pipeline
DGM	Dividend growth model
DIC	Debt issuing cost
DRP	Debt risk premium
ESC	Essential Services Commission
FFN	Fama-French Model
FRC	Full Retail Contestability
GDS	Mid-West and South-West Gas Distribution Systems
GJ	Gigajoules (10 <sup>9</sup> joules)
HHV	Higher Heating Value
HML	High minus low
ICRC	Independent Competition and Regulatory Commission of the Australian Capital Territory
IPART	Independent Pricing and Regulatory Tribunal of New South Wales
Kpa	Kilopascal
Mpa	Megapascal
MRP	Market risk premium
N/A	Not Applicable
NECF	National Energy Customer Framework
NEM	National Electricity Market
NERA	NERA Economic Consulting



NGA	<i>National Gas Access (Western Australia) Act 2009 (WA)</i>
NGL	<i>National Gas (South Australia) Law</i>
NGR	National Gas Rules
NIEIR	National Institute of Economics and Industry Research
NPV	Net Present Value
Opex	Operating expenditure
PJ	Petajoules ( $10^{15}$ joules)
QCA	Queensland Competition Authority
RBA	Reserve Bank of Australia
RM	Risk margin
RMR	Retail Market Rules
RMS	Retail Market Scheme
SFG	Strategic Financial Group Consulting
SMB	Small minus big
SOFA	Second Opinion Financial Advisory
SWIN	The South West Network owned and operated by Western Power
TJ	Terajoules ( $10^{12}$ joules)
VAA	Value Advisor Associates
WA	Western Australia
WACC	Weighted Average Cost of Capital
WAGN	Western Australian Gas Networks Pty Ltd
WSSE	Weighted sum of square errors