



Wesfarmers Kleenheat Gas Pty Ltd ABN 40 008 679 543 Campus Drive (off Murdoch Drive) Murdoch WA 6150  
PO Box 4184 Myaree Business Centre WA 6960 T (08) 9312 9333 F (08) 9312 9833 W [kleenheat.com.au](http://kleenheat.com.au)

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Assistant Director Gas Access;  
Level 4, Albert Facey House;  
469 Wellington Street  
Perth  
Western Australia 6000

Email: [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)

**Re: Kleenheat Gas submission on the Proposed Revisions to the Mid-West and South-West Gas Distribution System Access Arrangement.**

Dear Sir / Madam,

Wesfarmers Kleenheat Gas Pty Ltd ("Kleenheat") appreciates the opportunity to comment on the Proposed Revisions to the Mid-West and South-West Gas Distribution System ("MWSWDS") Access Arrangement ("AA4").

Since its launch into the retail natural gas market in 2013, Kleenheat is becoming an increasingly key user of the MWSWDS. As a user of this network its main focus is that the cost of accessing this regulated asset remains competitive whilst ensuring that the AA4 provides sufficient returns for the owner and operator of the regulated asset to provide an adequate level of service and undertake necessary investment.

Kleenheat's broad view of the proposal is concern over the significant increase in both capital and operational expenditure, leading to material increases for all its customers over the AA4 period. There are key elements of this proposals that appear to be minimising the risk profile for ATCO and transferring more of the risk onto customers through changes in tariff structure and volatility in tariffs.

Whilst Kleenheat does not underestimate the importance of adequate investment in the network to ensure its safe operation, we support a framework that suitably incentivises ATCO to maintain an efficient and competitive asset.

In response to this submission Kleenheat would like to make the following comments on specific areas of the proposal:

- 1. Rate of Return on the Regulatory Asset Base:** Kleenheat continues to broadly support the Economic Regulatory Authority (“ERA”) Rate of Return guidelines (“Guidelines”). A nominal WACC of 8.53% appears high when compared to these Guidelines and other recent regulatory decisions (i.e. APA GasNet on the East Coast of 7.22% nominal WACC). Whilst some of the models proposed by ATCO have academic grounding they are contrary to the most widely used and supported CAPM model. In regards to the Cost of Equity Kleenheat believes the Market Risk Premium is too high and does not believe the use of international Beta’s is appropriate given the Australian context of the AA4. Kleenheat considers the proposed Gamma is too conservative in assessing the value of dividend imputation credits in the Australian environment and therefore supports the Gamma presented in the Guidelines as a more comprehensive measure. In regards to the Cost of Debt we support ATCO’s submission that the annual reset of debt risk premium (“DRP”) introduces volatility in tariff prices. This creates a significant risk for Kleenheat and its customers as it creates a more challenging operating environment for capital budgeting and financing. Kleenheat supports a proposal that does not apply annual updates to the DRP.
- 2. Depreciation of the Capital Base:** Kleenheat is concerned about the significant short to medium term impact of the proposed transition from Current Cost Accounting to Historic Cost Accounting (“HCA”), based on regulatory accounting treatment rather than real world cost impacts. Higher tariffs in the short term as a result of this transition are likely to create a barrier to entry for some customers connecting to natural gas. Kleenheat considers this to be counterintuitive to promoting efficient growth in the natural gas market. If the ERA approves this transition, Kleenheat would recommend a much smoother and more gradual transition to minimise volatility.
- 3. Capital Base:** The proposed increase in capital base will have a significant impact on both current and future tariffs. Whilst we acknowledge the need for increased capital expenditure for IT, safety and network growth; Kleenheat has concerns with the magnitude of the capital expenditure relative to the existing capital base. The increase appears materially disproportionate to the growth of the network. There appears to be elements of the proposal that indicate under investment in prior access periods.
- 4. Operating Expenditure:** Kleenheat is concerned at the significant increase in operating expenditure. As per comments made above in relation to the Capital Base, there appears to be elements of the proposed expenditure that relate to under investment in prior access periods, particularly in relation to IT. Estimated marketing costs appear excessive for a monopoly network operator. While it is in the interest of all market participants to increase the demand for natural gas, it is in the interests of the retailers to drive this and the network operator to ensure its services are reliable and structured in a way to support retailers rather than through proposed advertising strategies. Based on our analysis of ATCO’s recent campaigns, the advertising appears to be heavily weighted towards ATCO brand awareness, rather than to encourage increases in gas usage; this has created significant confusion in the natural gas market, with the public perceiving that ATCO is a retailer of natural gas. Kleenheat does not believe that marketing to promote brand awareness is necessary to delivering efficient pipeline services; and such costs should not be included in AA4.
- 5. Reference Tariffs:** Kleenheat believes that the proposed increase to standing charges for B3 customers could be counterintuitive to promoting efficient growth in the natural gas market. In addition to this, Kleenheat notes that the effectiveness of price signalling by ATCO to B3 customers may be limited by the current regulated retail natural gas tariff structure.

## 6. Terms and Conditions:

- a. Change to clause 6.5, 6.7(b), 6.8(b) and 6.11(d) increase the scope of indemnity for the Service Provider and could significantly increase the risk to the User. Kleenheat would request that this proposed change be reviewed to ensure that risks borne by all parties of the haulage agreement are fair and reasonable;
- b. There appear to be inconsistencies between Clause 10.3 (b) (which implies that the user is barred from subsequently disputing an incorrect payment claim) and Clause 10.4 (which allows for an error to be corrected at a later date). It appears that 10.3 (b) creates ambiguity and should be reviewed;
- c. Clause 14.8 states that a Service Provider can novate its obligation by giving written notice to User. This provision is consistent with the current template haulage agreement but a novation involves a tripartite agreement between all parties and it is unclear how this clause could be legally effective;
- d. Clause 19.1 (c) appears to apply 'de minimis' limitations to any payment dispute, even ones arising under clause 10.3 (d)(ii) where a payment dispute notice has been issued within 10 business days after receiving the payment claim. If this is the case, Kleenheat does not believe this limitation to its right to dispute payments in this circumstance is acceptable and should be reviewed.

It is important to note that the comments above have been provided in good faith and reflect Kleenheat's broad view on ATCO's AA4 proposal. They are not intended to be used as expert technical advice; but to provide comments for consideration by the ERA in reviewing the proposal.

Should you wish to discuss any points raised in this submission please contact Colin York at [colin.york@kleenheat.com.au](mailto:colin.york@kleenheat.com.au).

Yours sincerely,

Colin York  
General Manager Natural Gas and Electricity  
Wesfarmers Kleenheat Gas Pty Ltd