

Final decision on WA Gas Networks Pty Ltd proposed revised access arrangement for the Mid-West and South-West Gas Distribution Systems

28 February 2011

Economic Regulation Authority



WESTERN AUSTRALIA

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FINAL 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 Authority issued its draft decision on WAGN's proposed access arrangement on 17 August 2010. The draft decision listed 74 Required Amendments to WAGN's proposed access arrangement.
3. On 8 October 2010, WAGN submitted an amended version of its proposed access arrangement for the WAGN GDS to the Authority as allowed by rule 60 of the National Gas Rules (**NGR**). The amended version of the proposed access arrangement addressed a number of the amendments required under the draft decision.
4. On 8 October 2010, WAGN also submitted an amended version of the access arrangement information and Template Haulage Contract to the Authority.
5. The Authority has considered WAGN's amended proposed access arrangement in conjunction with the amended access arrangement information, amended Template Haulage Contract, the draft decision and comments made in public submissions to the Authority on the draft decision, reports from the Authority's consultants and the requirements of the National Gas (South Australia) Law (**NGL**) and the NGR, as they apply in Western Australia by virtue of the NGA.
6. Pursuant to rule 62(2) of the NGR, an access arrangement final decision is a decision to approve, or to refuse to approve, an access arrangement proposal.
7. The final decision of the Authority in relation to the WAGN GDS is not to approve WAGN's amended proposed access arrangement.
8. The Authority's reasons for not approving WAGN's amended proposed access arrangement are set out in this final decision.
9. As a result of the Authority's decision not to approve WAGN's amended proposed access arrangement, the Authority is required, by rule 64 of the NGR, to propose revisions to the access arrangement for the WAGN GDS.
10. The Authority has indicated in this final decision the amendments to WAGN's proposed access arrangement that the Authority will adopt for the purposes of its proposed access arrangement revisions.
11. In the case of the access arrangement information, the Authority has indicated where it intends to amend WAGN's proposed access arrangement information for the purposes of its proposed access arrangement revisions.
12. The Authority will, in accordance with rule 64(4) of the NGR, give effect to its proposed access arrangement revisions within two (2) months of this final decision.

REASONS FOR THE FINAL DECISION

Background

13. The Authority refers to the background to the draft decision in relation to WAGN's proposed access arrangement revisions for the GDS set out in paragraphs 10 to 75 of the draft decision.
14. As noted in the draft decision, the Authority exercised its discretion under section 7.19 of the *National Third Party Access Code for Natural Gas Pipelines (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.
15. 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 NGA 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.
16. 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.
17. Copies of the abovementioned documents, other than any confidential information, are available from the Authority or may be downloaded from the Authority's website (www.erawa.com.au).

The Draft Decision

18. On 17 August 2010, the Authority issued its draft decision. Seventy four Required Amendments were required to WAGN's proposed access arrangement, as submitted on 29 January 2010.
19. Rule 59(5) of the NGR requires the Authority to invite written submissions from the public within a period of at least 20 business days commencing from the date a service provider is required to lodge its response to a draft decision (the revision period). The Authority initially provided WAGN until 1 October 2010 to lodge its response, however, this was extended until 8 October 2010 following an application for extension of time to the revised period by WAGN on 1 October 2010.
20. Rule 60(1) of the NGR provides that WAGN may, within the revision period, submit additions or other amendments to the access arrangement proposal to address matters raised in the access arrangement draft decision. Rule 60(2) of the NGR provides that the amendments must be limited to those necessary to address matters

raised in the access arrangement draft decision unless the Authority approves further amendments.

21. WAGN exercised the option to resubmit an amended proposed access arrangement to the Authority following issue of the draft decision. The amended proposed access arrangement was submitted on 8 October 2010. This final decision refers to WAGN's amended proposed access arrangement as submitted on 8 October 2010.
22. The Authority initially provided interested parties until 29 October 2010 to make submissions. Following the extension of time granted to WAGN, the Authority also extended the period for public submissions to 5 November 2010.
23. In accordance with rule 59(5) of the NGR, five public submissions were received in response to the Authority's draft decision, from:
 - Western Australian Council of Social Services (WACOSS) dated 10 November 2010;
 - the Australian Pipeline Trust and APT Investment Trust (APA Group) dated 1 November 2010;
 - Prime Infrastructure Employment Pty Ltd (Prime Infrastructure) dated 3 November 2010;
 - Alinta Pty Ltd (Alinta) dated 5 November 2010; and
 - Electricity Retail Corporation trading as Synergy (Synergy) dated 18 November 2010.
24. The Authority notes that the submission from Synergy was received after 5 November 2010. The Authority has considered this submission in making its final decision.
25. Rule 61 of the NGR provides that the Authority may, on its own initiative or on request by any person, hold a hearing about an access arrangement draft decision. The Authority advised, by written notice on 3 September 2010, that no requests for such a hearing were received and that the Authority would not be holding a public hearing on the draft decision.
26. On 30 November 2010, the Authority sought public comment on the methodology to measure the debt risk premium component of the rate of return on capital. Interested parties were invited to make submissions on the discussion paper 'Measuring the debt risk premium: A Bond-yield Approach' by 7 January 2011. The Authority received 13 submissions on the 7 January 2011 from the following entities:
 - Verve Energy;
 - Dampier to Bunbury Natural Gas Pipeline (DBP);
 - WA Gas Networks (WAGN);
 - Goldfields Gas Transmission (GGT);
 - Western Power;
 - BHP Billiton;
 - Brookfield;
 - WestNet Rail;

- Australian Rail Track Corporation (ARTC);
 - Horizon Power;
 - Alinta Gas;
 - Water Corporation; and
 - Western Australian Council of Social Services (WACOSS).
27. The Authority has considered the above submissions received in response to the discussion paper in making its final decision on WAGN's amended proposed access arrangement for the GDS.
28. Copies of the abovementioned documents, other than any confidential information, are available from the Authority's website (www.erawa.com.au).

Consultants used by the Authority

29. As noted in the draft decision, 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**). EnergySafety 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.
30. The Authority also again 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.
31. Copies of the consultants' reports, other than any confidential information, are available from the Authority's website (www.erawa.com.au).

Legislation Requirements

32. Rule 62 of the NGR provides:
- (1) After considering the submissions made in response to the access arrangement draft decision within the time allowed in the notice, and any other matters the [Authority] considers relevant, the [Authority] must make an access arrangement final decision.
 - (2) An access arrangement final decision is a decision to approve, or to refuse to approve, an access arrangement proposal.
 - (3) If an access arrangement proposal has been revised since its original submission, the access arrangement final decision relates to the proposal as revised.
 - (4) An access arrangement final decision must include a statement of the reasons for the decision.

- (5) When the [Authority] makes an access arrangement final 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.
33. Rule 64 of the NGR states:
- (1) If, in an access arrangement final decision, the [Authority] refuses to approve an access arrangement proposal (other than a variation proposal), the [Authority] must itself propose an access arrangement or revisions to the access arrangement (as the case requires) for the relevant pipeline.
 - (2) The [Authority's] proposal for an access arrangement or revisions is to be formulated with regard to:
 - (a) the matters that the Law requires an access arrangement to include;
 - (b) the service provider's access arrangement proposal; and
 - (c) the [Authority's] reasons for refusing to approve that proposal.
 - (3) The [Authority] may (but is not obliged to) consult on its proposal.
 - (4) The [Authority] must, within 2 months after the access arrangement final decision, make a decision giving effect to its proposal.
 - (5) Where the [Authority] makes a decision under this rule, 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.
 - (6) The access arrangement or the revisions to which the decision relates takes effect on a date fixed in the determination or, if no date is so fixed, 10 business days after the date of the decision.

Final Decision

34. The matters discussed in this final decision are as follows (and in the following order):
- Issues of general relevance (i.e. those not specific to one or other Required Amendment) including inflation, access arrangement information and the exclusion of commercial matters;
 - Pipeline services and access to pipeline services including draft decision Required Amendments 1 to 5;
 - Total revenue including Required Amendment 6;
 - Reference tariffs including Required Amendments 7 to 9;
 - Terms and Conditions of reference services including draft decision Required Amendments 10 to 68 and public submissions concerning non price matters that do not go to a particular Required Amendment; and
 - Other access arrangement provisions including Required Amendments 69 to 74.

35. The 74 Required Amendments are discussed in this final decision in the following manner:
- an outline of the amendments made by WAGN in response to the draft decision;
 - an outline of the submissions made by WAGN, other public submissions, and where applicable the consultants' reports, in relation to the amendments and the draft decision;
 - the Authority's assessment; and
 - the Authority's proposed access arrangement revisions.

General issues

Basis for dealing with inflation

Draft decision

36. In its draft decision, the Authority required WAGN's proposed revisions to adopt the use of Consumer Price Index (**CPI**) (All Groups, Eight Capital Cities) instead of the CPI (All Groups, Perth) WAGN proposed to use. The Authority also required that the effects of inflation be modelled at the end of each twelve month period, not the mid-point as proposed by WAGN.
37. The Authority also required WAGN to amend clause 9.1(b) of the proposed access arrangement so that each element set out in that clause is escalated at the rate of inflation as measured by the CPI (All Groups, Eight Capital Cities) (see paragraphs 784 to 786 of the draft decision).
38. The Authority further required that each of these elements be adjusted by the rate of inflation measured by CPI (All Groups, Eight Capital Cities) at the end point of modelling:
- Opening capital base (paragraphs 255 to 261 of the draft decision) ;
 - Past conforming capital expenditure (paragraphs 298 to 313 of the draft decision);
 - Capital contributions by users (paragraphs 323 to 328 of the draft decision);
 - Depreciation (paragraphs 347 to 350 of the draft decision);
 - Asset disposals (paragraphs 364 to 368 of the draft decision);
 - Incentive mechanise carryover (paragraphs 810 to 817 of the draft decision);
 - Forecast operating expenditure (paragraphs 845 to 872 of the draft decision); and
 - Tariff variation formula (paragraph 1014 of the draft decision).
39. Finally, the Authority required amendments to the Template Haulage Contract and the access arrangement where references were made to inflation. Specifically, the Authority required the following:
- The definition of 'inflation' in clause 22.12 be amended (Required Amendment 61; paragraphs 1807 and 1812 of the draft decision); and

- The definition of 'CPI' in clause 12 be amended (Required Amendment 72; paragraphs 2002 and 2005 of the draft decision).

Public submissions

WAGN's Submission

40. WAGN submitted on 8 October 2010 (at pages 8 to 14) that it has not amended its access arrangement as directed in paragraph 90 of the draft decision and that it has retained the CPI (All Groups, Perth) as the basis for dealing with inflation used in preparing the access arrangement proposal.
41. WAGN referred to the Authority's reasoning behind Amendment 6 in the draft decision (paragraphs 83, 84, 87 and 88) and noted that the Authority considered that a preferable alternative to CPI (All Groups, Perth) was CPI (All Groups, Eight Capital Cities), and modelled the effects of inflation using the index at the end of each twelve month period, not the mid-point.
42. WAGN stated that the Authority was incorrect in its application of rule 73 of the NGR and WAGN argued that rule 73 requires compliance; but does not address issues in respect of which there are alternative views, and on which discretion might be exercised. WAGN submitted that in its proposal, it stated that all financial information has been provided on a real basis, and has therefore complied with the requirements of rule 73 and that there is no scope under that rule for the exercise of discretion by the Authority.
43. WAGN stated that should it be incorrect with its view about rule 73, the Authority can only impose a preferred alternative if that alternative:
 - complies with the applicable requirements of the NGL and NGR; and
 - is consistent with applicable criteria (if any) prescribed in the NGL and NGR.
44. WAGN submitted that the Authority's reasons advanced for imposing its preferred alternative are:
 - consistency with the Authority's long-standing practice for all access arrangements; and
 - continuing standard regulatory practice.
45. WAGN submitted that none of these reasons are an applicable requirement of the NGL and NGR and referred to the Australian Energy Regulator's (**AER**) final decision on the proposed access arrangement for the Jemena Gas Networks, New South Wales, where a different approach was required. WAGN submitted that the three reasons listed by the Authority in the draft decision are not valid reasons for the Authority imposing on WAGN use of the Eight Capital Cities CPI and end of period escalation.
46. WAGN further submitted that the Authority offered no explanation of how the required basis for dealing with the effects of inflation satisfies the national gas objective, or is consistent with criteria which might be deduced from the objective.
47. WAGN stated that the capital expenditures which WAGN has incurred during the current access arrangement period, and which have been escalated so that all financial information is expressed in constant December 2009 prices, are

- expenditures incurred in Western Australia for the purpose of providing natural gas services to consumers of natural gas in Western Australia.
48. WAGN noted that during the period from 2005 to 2009, prices were rising more rapidly in Western Australia than they were nationally and that the Government of Western Australia, when enacting the NGA, wanted to ensure that the NGA was able to accommodate Western Australia's particular characteristics.
 49. WAGN submitted that if expenditures were to be expressed in constant December 2009 prices using CPI (All Groups, Eight Capital Cities), when the prices of materials and services purchased by WAGN were rising at a different rate – CPI (All Groups, Perth) – the reference tariffs for the next access arrangement period would, other things being equal, diverge from the costs which they were intended to cover.
 50. WAGN submitted that if reference tariffs for the next access arrangement period under-recover the costs which WAGN incurs, they would be an inducement for inefficient (inadequate) investment in the WAGN GDS and for inefficient (excessive) use of natural gas services by consumers of natural gas. WAGN stated that reference tariffs which under-recover or over-recover WAGN's costs would not promote economic efficiency and would be inconsistent with the requirement that the service provider be provided with effective incentives to promote economic efficiency.
 51. WAGN also made submissions with respect to the application of the index at the end of each twelve month period, rather than at the mid-point as required by the Authority. WAGN stated that the costs which have been escalated are costs which have been incurred by WAGN during 2005, 2006, 2007, 2008 and 2009. WAGN stated that those costs are not incurred at the end of each year, but rather are incurred progressively from the start of each year.
 52. WAGN submitted that assuming that costs are to be escalated from the end of the year in which they are incurred through to December 2009, does not take into account the effect of inflation on costs incurred during the year. The result is understatement of the amount expressed in constant December 2009 prices and modelling the effects of inflation, would have the effect of understating the capital base at 1 January 2010.
 53. Reference tariffs for the next access arrangement period which were determined using the understated capital base would under-cover WAGN's costs. WAGN submitted that this would be an inducement for inefficient (inadequate) investment in the WAGN GDS, and for inefficient (excessive) use of natural gas services by consumers. WAGN submitted that modelling the effects of inflation by applying a price index at the end of each twelve month period, instead of at the mid-point, would not be consistent with the national gas objective.
 54. In its amended access arrangement information (page 3), WAGN set out that financial information is provided on a real basis and expressed in constant prices at December 2009 by escalating, where necessary, at the rate of inflation measured by the CPI (All Groups, Perth). The values and forecasts for this CPI are contained in Table 2 (page 3). WAGN noted that for the period 2005 to 2009 values have been expressed in calendar years and the escalation has been based on the June CPI as this represents the mid-point of the calendar year. From 1 January 2010, data is reported in financial years and the escalation has been based on the December CPI as this represents the mid-point of the financial year.

Other submissions

55. Alinta submitted (pages 4-6) that WAGN's comments concerning the rate at which prices of materials and services purchased by WAGN are rising appear to relate only to historical capital and operating expenditure, and asset values, as WAGN indicated that it has derived its estimate of forecast inflation, used in establishing future asset values and the rate of return under rule 87(1) of the NGR, as the geometric mean of the Reserve Bank of Australia's inflation forecasts for the next ten years.
56. Alinta referred to its submission in April 2010 where it noted that the Reserve Bank of Australia's inflation forecasts are an Australian-wide forecast, and WAGN's proposed revisions would be internally inconsistent if it were to adopt CPI (All Groups, Perth). To the extent that the use of CPI (All Groups, Perth) instead of CPI (All Groups, Eight Capital Cities) creates an inconsistency, Alinta submitted that WAGN's proposal would not comply with rule 73(3) of the NGR, which requires all financial information to be provided, and all calculations made, consistently on the same basis.
57. Alinta noted that in any event, the actual nominal capital and operating expenditure incurred by WAGN is included in the opening capital base irrespective of which rate of inflation is used to convert nominal expenditure and asset values into real expenditure and asset values. To the extent that the actual nominal cost of materials and services purchased by WAGN did increase at a rate faster than implied by the CPI (All Groups, Eight Capital Cities), or for that matter CPI (All Groups, Perth), this would be appropriately reflected in the opening capital base.
58. Alinta further submitted that there appears to be no basis for believing that movements in the cost of gas distribution materials and services purchased by WAGN should be consistent with movements in the CPI. Alinta stated that whether changes in the unit cost of material and services purchased by WAGN are most accurately captured by movements in the CPI (All Groups, Perth), CPI (All Groups, Eight Capital Cities) or neither of these indices appears to be an entirely factual matter that the Authority could elect to examine.
59. Alinta submitted that it does not consider that the available evidence supports a view that reference tariffs for the next access arrangement period would diverge from the costs they were intended to recover if the CPI (All Groups, Eight Capital Cities) were used to express operating and capital expenditure, and asset values, in constant December 2009 prices rather than the CPI (All Groups, Perth). For these reasons, Alinta submitted that the Authority should continue to require that, in establishing the opening capital base for the WAGN GDS for the next access arrangement period, all nominal values are to be escalated, at the rate of inflation as measured by CPI (All Groups, Eight Capital Cities).
60. In relation to the Authority's requirement to model the effects of inflation using the CPI at the end-point of each twelve month period, Alinta submitted that it would appear to be reasonable to convert nominal values at the mid-point of each twelve month. Alinta considered this to be appropriate to the extent that there is no systematic bias when during a modelling period WAGN incurs costs (i.e. WAGN can demonstrate that costs have been incurred relatively equally throughout the year, and that this is anticipated to continue), Alinta considers that it would appear to be reasonable to convert nominal values to real values at the mid-point of each modelling period.

Authority's assessment

61. Rule 73 of the NGR contains specific requirements for the provision of financial information by the service provider. It states that financial information is to be provided on a nominal basis, a real basis or some other recognised basis for dealing with inflation. Rule 73 further provides that this basis must be stated in the access arrangement information and that there must be consistency in all financial information provided and calculations made.
62. The Authority is satisfied that the provision of financial data expressed in real values is consistent with the requirements of rule 73(1).
63. The Authority accepts WAGN's proposal set out in section 2 of the amended access arrangement to provide financial information in real terms with all values expressed in dollar values of December 2009. However, the Authority does not accept WAGN's proposal to calculate the real value financial information by applying escalation factors derived from the CPI (All Groups, Perth) at the mid-point of each twelve month period. The Authority notes that WAGN has not provided any substantive submissions justifying the change in the measurement of CPI nor the application of the escalation factor at the mid-point of the twelve month period.
64. The Authority notes Alinta's submission that, in order to comply with the consistency requirement of rule 73(3) of the NGR, WAGN should be required to calculate the opening capital base for the forthcoming access arrangement period by escalating all nominal values at the rate of inflation measured by CPI (All Groups, Eight Capital Cities). The Authority also notes Alinta's submission that the conversion of nominal values to real values at the mid-point of each twelve month period may be reasonable.
65. The Authority is not satisfied that WAGN has adopted a consistent approach to the treatment of inflation for its financial calculations. The use of escalation factors based on a measure of inflation for CPI (All Groups, Perth) is inconsistent with the rate of return applied in the calculation of total revenue. The rate of return is estimated using a forecast of inflation for the Australian economy. This is consistent with an implied assumption made in determining the rate of return of the WAGN GDS being financed by Australian investors.
66. The Authority does not accept WAGN's submission that the Authority's requirement for WAGN to apply the CPI (All Groups, Eight Capital Cities) and to use the index at the end of each twelve month period was inconsistent with the national gas objective. Rather, the Authority has ensured consistency in its modelling by applying the CPI (All Groups, Eight Capital Cities) both in its analysis of the Weighted Average Cost of Capital (**WACC**) and in its analysis of each of the building blocks in total revenue. This consistent approach ensures compliance 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.
67. The Authority considers that as return on capital is calculated in reference to the Australian financial market, the most appropriate escalation rate for all values related to capital is CPI (All Groups Eight Capital Cities). This ensures internal consistency in all modelling for capital expenditure and return on capital.
68. The Authority acknowledges that operational expenditure is more exposed to local factors that affect inflation in the region where that expenditure is incurred. The

Authority is aware that the Western Australian Department of Treasury and Finance is estimating that costs will continue to inflate significantly in Western Australia until at least 2013-2014¹. However, the Authority's analysis of inflation, when comparing CPI (All Groups, Eight Capital Cities) with CPI (All Groups, Perth), is that over the long term, there is no significant difference between the two indices.

69. Moreover, as the WAGN GDS is a capital-intensive industry, the Authority does not consider it necessary to provide for a different escalation rate for operational expenditure, which is a lesser component of total revenue, despite the possibility that operational expenditure may, in the short term, be affected by higher inflation in Western Australia. The Authority considers that, over the long term, WAGN will not be adversely affected by using CPI (All Groups, Eight Capital Cities) as the escalation rate for both capital and operational expenditure.
70. As the Authority noted in the draft decision, regulatory consistency is an important factor in complying with the national gas objective. For consistency over time, and to avoid service providers selecting the most favourable CPI rate that applies at the time of each access arrangement revision, the Authority considers that the preferable approach is to consistently adopt the CPI (All Groups, Eight Capital Cities) unless the service provider can establish a strong counter argument in favour of another escalation index. The Authority is not persuaded by WAGN's submission that there is reason to adopt CPI (All Groups, Perth) as the CPI index.
71. The Authority acknowledges Alinta's submission that it would appear reasonable to convert nominal values to real values at the mid-point of each twelve month period, as proposed by WAGN, rather than at the end-point, as required by the Authority. As set out at paragraph 72 below, the Authority's modelling assumes that all expenditure is made, and all revenue is received, on the last day of the twelve month period. As a consequence of this, the Authority considers that internal consistency is achieved within the model by applying the escalation rate at the end of the twelve month period.
72. In this final decision, the Authority has undertaken its calculations of total revenue in real terms with real values of financial information. This information is calculated by applying the escalation factors derived from the relevant quarter values of the CPI (All Groups, Eight Capital Cities). Where financial information has been given according to a calendar year, the December quarter values of the CPI (All Groups, Eight Capital Cities) has been applied as this is the end point of the twelve month period. Where financial information has been given according to a financial year, the June quarter values of the CPI (All Groups, Eight Capital Cities) has been applied as this is the end point of the twelve month period.
73. For consistency, the Authority has expressed all financial values in this final decision in dollar values of 31 December 2009, unless otherwise indicated.

Authority's proposal

The Authority will adopt CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period as the basis for modelling.

¹ http://www.dtf.wa.gov.au/cms/uploadedFiles/State_Budget/Budget_2010_11/07_2010-11_fact_sheet_economic_outlook.pdf?n=2613

Access arrangement information

74. As noted at paragraph 7, the Authority has not approved WAGN's amended proposed access arrangement. As a result, the Authority is required to propose its own access arrangement revisions and give effect to this access arrangement within two months. To the extent necessary and appropriate, the Authority will consider requiring WAGN, under rule 43(3) of the NGR, to amend the access arrangement information so that it is consistent with the access arrangement revisions as given effect by this final decision.

Commercial matters

Draft Decision

75. Rule 48(1)(d) of the NGR provides that a full access arrangement must specify for each reference service the other terms and conditions on which the reference services will be provided.
76. In the draft decision, the Authority found that certain clauses in the Template Haulage Contract went to commercial matters between the contracting parties and not matters relevant to the consistency of the proposed access arrangement provisions with the national gas objective. In these circumstances, the Authority required such clauses in the Template Haulage Contract to be amended or deleted.
77. In such cases, the Authority noted that WAGN and the user had the option to include such provisions, through commercial negotiation, in their contract by way of bilateral agreement, or failing agreement, following arbitration under the relevant provisions of the NGA.

Public submissions

WAGN's Submission

78. WAGN made submissions on this issue by reference to each of the clauses of the Template Haulage Contract in relation to which it arose. However, as the submission made in each case was the same, to avoid repetition it is appropriate to address the generality of the submission in advance of consideration of individual clauses.
79. In each of its submissions on this point, WAGN submitted that there is no basis under the NGL or NGR for the Authority's conclusion that a clause relates to commercial arrangements between contracting parties and not to matters that go to compliance of WAGN's proposed revisions with the national gas objective, it should not form part of the regulated contract. In forming this view WAGN submitted that the Authority has failed to apply the NGL and NGR as parliament intended as the Authority is required to consider the NGL and NGR as a whole.
80. Further, in considering any provisions of the Template Haulage Contract, WAGN submitted that the Authority is required to consider the competing interests of WAGN and the users in the context of the national gas objective. WAGN submitted that the Authority erred because it only had regard to WAGN's compliance with the national gas objective.

81. WAGN referred to rule 48(1)(d)(ii) which requires the terms and conditions on which the reference services will be provided to be referred to in the access arrangement. WAGN submitted that these clauses are terms and conditions on which the reference services will be provided and are not procedural matters but terms and conditions that provide certainty in respect to the party's rights and obligations thus being consistent with the national gas objective.
82. WAGN submitted that the suggestion of the Authority that the parties are free to agree such matters for themselves, in addition to not complying with rule 48(1)(d)(ii), is an agreement to agree and unenforceable at law. In the event that the parties do not agree then WAGN is bound to offer the reference services on the terms set out in the draft Template Haulage Contract.
83. WAGN also submitted that the deletion of the clauses in question will introduce ambiguity into the Template Haulage Contract leading to inefficiencies and increase the likelihood of a dispute thus being inconsistent with the national gas objective.

Other submissions

84. Alinta made a general submission on the exclusion of commercial matters from the access arrangement. Alinta submitted on 5 November 2010 (page 2) that the natural monopoly nature of the WAGN GDS, and the fact that the ongoing viability of gas retailers is highly dependent on access to the services provided by the GDS, means there appears to be little prospect for commercial matters being resolved by bilateral agreement as anticipated by the Authority where a default position is not determined in the access arrangement or the Template Haulage Contract.
85. Alinta noted its concern that the deletion of a number of clauses from the Template Haulage Contract on the basis that they relate to commercial matters between contracting parties rather than compliance with the NGL or NGR, are inconsistent with the national gas objective, specifically the 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.

Authority's assessment

86. The Authority makes the following observations in relation to the general arguments of the submitting parties.
87. The Authority maintains its position as set out in the draft decision that certain clauses in the Template Haulage Contract that relate to commercial matters should be left to the negotiating parties to agree, or failing agreement, to arbitration in accordance with the relevant provisions of the NGA.
88. The Authority confirms, contrary to WAGN's submissions, that in assessing WAGN's proposed revisions for the purposes of the draft decision and for this final decision, it has considered the competing interests of the service provider and users in the context of the national gas objective. The Authority notes that its position as regulator is to assess the proposed access arrangement as drafted and submitted to the Authority by the service provider, in this case WAGN, against the relevant criteria as set out in the regulatory framework. Contrary to WAGN's submission, the Authority in making its draft decision, did not assess WAGN's proposed revisions as a whole as regards compliance with the national gas objective, but considered each

proposed provision's consistency with the national gas objective, as required by rule 100 of the NGR.

89. The Authority notes WAGN's submission that the Authority's suggestion that the parties are free to negotiate such matters for themselves is an agreement to agree and therefore unenforceable at law. The Authority does not accept this submission. The Template Haulage Contract is not an agreement between two identifiable parties but rather the template of a contract that two parties may enter into at some point in time in the future.
90. No two parties have agreed to enter into an agreement at this stage; rather the purpose of the Authority approving the Template Haulage Contract is to ensure that the proposed access arrangement complies with the NGA and NGR.
91. The Authority notes that if the parties cannot agree as to the terms and conditions of service, the parties would be able to have that dispute determined by the WA arbitrator under the NGA. Under section 193 of the NGA, the WA arbitrator has a wide discretion over the matters it can arbitrate. Section 193 enables an access determination to deal with any matter relating to the provision of a pipeline service to a prospective user or user. This enables the arbitrator to assess any commercial terms which are in dispute and make a determination of that dispute, without being restricted to considering only the national gas objective.
92. The Authority's role is to determine whether the terms and conditions proposed by WAGN to be included in the access arrangement revisions (as opposed to negotiated terms and conditions of service) are consistent with all of the other terms and conditions in the access arrangement revisions and that they are consistent with the national gas objective.
93. In relation to some of the clauses of the Template Haulage Contract which the Authority determined by the draft decision were commercial matters, public submissions were received following the draft decision, which have persuaded the Authority that such provisions do relate to the terms and conditions of reference services rather than being-commercial matters. In these instances, the Authority is now satisfied that the inclusion of these terms and conditions in the access arrangement revisions is consistent with the national gas objective.

DRAFT DECISION REQUIRED AMENDMENTS 1 TO 74

Pipeline Services and Access to Pipeline Services

Draft Decision – Required Amendment 1

94. 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.

Public Submissions

WAGN's submissions

- 95. WAGN included clauses 4.7 to 4.11 (inclusive) in the amended proposed access arrangement revisions in accordance with Required Amendment 1.
- 96. WAGN submitted that it has elected to adopt the suggestion of the Authority referred to in Required Amendment 1 and accordingly the proposed access arrangement and Template Haulage Contract have been amended to include the Reference Services referred to in draft decision Required Amendment 1.

Other submissions

- 97. Alinta submitted that it concurs with the Authority's draft decision that deregistration services, meter lock services, disconnection and reconnection services are all pipeline services that will be sought by a significant part of the market during the period covered by the access arrangement. Consequently, Alinta agrees that these services should be specified as reference services in the access arrangement, and notes that this is the case in WAGN's October 2010 proposed access arrangement.

Authority's Assessment

- 98. The Authority accepts clauses 4.7 to 4.11 (inclusive) of WAGN's amended proposed access arrangement.
- 99. The Authority will adopt clauses 4.7 to 4.11 for the purposes of the Authority's proposed access arrangement revisions.

Draft Decision – Required Amendment 2

- 100. 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.*

Public Submissions

WAGN's submission

101. WAGN did not comply with Required Amendment 2 but did amend clause 5.2(a) to include that a request for a haulage service should be in writing as set out in Annexure F and incorporated a reasonableness requirement regarding prudential requirements and insurance requirements.
102. WAGN made, on 8 October 2010 (pages 69-72), the general comment that clause 5.2 has been amended in the amended proposed access arrangement to better identify the information that a prospective user must provide in order to commence an application process. The specific reasons submitted by WAGN for doing so are outlined below.
103. WAGN submitted that the NGL and the NGR create a framework for regulating the form of an access arrangement and as such are not intended to be prescriptive. WAGN submitted that Rule 100 only requires that an access arrangement must be consistent with the national gas objective, the NGR and the procedures defined in rule 135E and therefore there will be a number of different forms that might be appropriate in that they are consistent with the national gas objective, the NGR and rule 135E.
104. WAGN argued that the Authority, in requiring the terms of rule 112(2) to be inserted, has failed to have regard to the national gas objective. WAGN submitted that it is neither efficient nor safe and will give rise to issues of reliability of supply to leave the determination of the 'relevant technical details' (rule 112(2)(c)) to the prospective user. WAGN argues that the reference to the 'relevant technical details' can only be the relevant technical details specified by WAGN as WAGN is the entity licensed to construct, operate and maintain the gas distribution network under Licence GDL8, Version 5, 06 August 2010.
105. WAGN submitted that while some information will be common to all applications other relevant technical details will be particular to the specific/individual application. WAGN argued that prospective users are unlikely to comply with rule 112(2)(c) because they are unable to determine precisely the technical information required as they do not construct, operate or maintain the pipeline.
106. WAGN submitted that if the prospective user does not satisfy rule 112(2)(c) then there is no obligation on WAGN to respond to or to inform the prospective user as to how the application might be amended to comply with rule 112(2)(c) leading to inefficiency in the application process and increasing the likelihood of a dispute. WAGN also submitted that it is likely that a prospective user will not be compliant with rule 112(2)(c) if WAGN does not have the power to request information from such a user.
107. Therefore, WAGN argued, it is consistent with the national gas objective that WAGN has the power to request information from a prospective user in order to enhance the efficiency of the application process and decrease the likelihood of a dispute.
108. However, WAGN submitted that it accepts the application procedure would benefit from amendment to better articulate the type of information to be provided by a prospective user.

109. To this end WAGN submitted that in including proposed Annexure F in clause 5.2(a) it has adopted a 'materially similar' approach to the application procedure as that approved by the AER on 28 June 2010 the access arrangement for the Jemena GDS Network. WAGN submitted that the equivalent to its Annexure F in the Jemena access arrangement is Schedule 5, 'Request for Service'. WAGN argued that the approach is materially consistent in that it identifies certain required technical information that must be in an application and contemplates that the prospective user must meet some further requirements that will be identified by WAGN.

Other submissions

110. Alinta submitted on 5 November 2010 (page 2 of Attachment B) that it agrees with the Authority's assessment in the draft decision that clause 5.2 of the access arrangement as proposed by WAGN in January 2010 has the potential to create a barrier to entry. Alinta supports the inclusion of Annexure F in the access arrangement proposed in October 2010 on the grounds that it articulates the technical information that will be required by WAGN in an application. However, Alinta remains concerned that the subclauses requiring further information that WAGN may 'reasonably' specify in addition to information with respect to compliance with minimum prudential requirements and system pressure protection plan (5.2(b), (c) and (e)) would provide WAGN with very broad discretion with respect to information requirements in an application for a haulage service and that this may create a potential barrier to entry.
111. Alinta also submitted that if clause 5.2 does not specify all application information required by WAGN and if WAGN has broad discretion then this would create uncertainty for the prospective user and ultimately result in inefficiency in the application process. Alinta argues that even if the additional information required by WAGN under clause 5.2 were consistent with the NGL and the NGR, it would be possible for WAGN to claim that a prospective user has not submitted an application that met the requirements of clause 5.2 until such (as yet unspecified) information had been provided by the prospective user.
112. Alinta noted that WAGN has not included a provision that identifies its minimum prudential and insurance requirements and does not include a provision that these minimum requirements be reasonable. Alinta submitted that in the absence of minimum requirements being identified, an objective 'reasonableness' criterion must be included.

Authority's Assessment

113. The Authority stated in the draft decision that clause 5.2 of the proposed revised access arrangement imposed requirements in relation to the form and content of a request for access which were beyond those prescribed by rule 112(2) and which could limit a prospective user's access to a pipeline service and therefore be inconsistent with the national gas objective. The Authority also noted in the draft decision that 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) as well as being consistent with the national gas objective.
114. The Authority notes that in response to the draft decision, WAGN has amended clause 5.2 to include Annexure F, a more specific written information requirement. Annexure F does identify some required technical information and most of that information is consistent with rule 112(2), even though some of the information is

presented in a significantly different format to that listed in Jemena Schedule 5, and is additional to what is required as the minimum information requirements in rule 112(2).

115. The Authority's view is that the information requirements included in Annexure F complies with the NGR to the extent that they include all of the components of rule 112(2) (a) and (b).
116. The Authority's assessment of the individual/specific components of Annexure F is set out below.

Licence number and name of gas fitter

117. The Authority's view is that including the licence number and name of gas fitter as mandatory information under Annexure F is not necessary to comply with rules 112(2)(a), (b) or (c) and has the potential to unnecessarily delay lodgement and therefore consideration of an application as a request for service. This information to be included could be considered as being inconsistent with efficiency under the national gas objective.
118. The Authority's view is that it is reasonable to include this information only on an 'if known' basis in the schedule of information that is otherwise mandatory under Annexure F.

End User's name (and emergency contact)

119. The Authority's view is that requiring the end user's name and, in the case of a B1, A1 or A2 Service, emergency contact details, as mandatory information under Annexure F is not necessary to comply with rules 112(2)(a), (b) or (c) and has potential to unnecessarily delay lodgement and therefore consideration of an application as a request for service. Such an outcome would be inconsistent with the national gas objective.

Prospective User to provide all information listed under rule 112(2)

120. The Authority notes two items of information listed under rule 112(2) not included in Annexure F, these being the time when the pipeline will be required and the proposed gas specification.
121. The Authority's view is that an estimated commencement date for the pipeline service should be included in Annexure F.
122. The Authority notes that the GDS as a distribution system receives gas from transmission pipelines, which operate under gas specification constraints, and the prospective user cannot control the specification of the gas supplied from the transmission pipeline. In addition, there are separate regulatory arrangements in both cases governing the specification of gas that may be supplied to consumers. The relevant gas specification constraints are contained in Annexure A of the proposed access arrangement revisions.

Prospective User to provide information on compliance with minimum prudential and insurance requirements

123. The Authority notes that clause 5.2 (c) and (d) require the prospective user to provide information on compliance with minimum prudential and insurance requirements. The Authority's view is that information on minimum prudential and insurance requirements could not reasonably be considered to be relevant technical details under rule 112(2)(c) and is also not an essential item under rules 112(2)(a) and (b). Therefore, this information should not be included as part of the application information under clause 5.2 in the proposed access arrangement.
124. The Authority notes that there is no clear specification in the proposed revised access arrangement for both the minimum prudential requirement and insurance requirement and that Alinta has expressed concern about this issue. Furthermore, unlike the requirement for a system pressure protection plan there is no specific set of options for the prospective user to select to comply with those minimum requirements.
125. The Authority's view is that a commitment to compliance by the prospective user could reasonably be determined only following negotiation of relevant terms in the haulage contract and not by information provided by the prospective user in the application for a haulage service.

Prospective user to provide a system pressure protection plan

126. The Authority notes that clause 5.2(e) of the proposed access arrangement contains a requirement for the prospective user to lodge a System Pressure Protection Plan as part of the application information.
127. The Authority also notes that WAGN offers the prospective user 5 options for a system protection pressure plan as set out in Annexure D.
128. The Authority's view is that the five options presented in Annexure D are essentially commercial matters rather than relevant technical details for ensuring the safety and reliability of the supply of natural gas to, or from, the pipeline as required under rule 112(2)(c).
129. However, the Authority accepts that the choice of system pressure protection plan may have some technical consequences in terms of provision of operational information and/or of flow control devices.
130. The Authority's view is that including the choice of a System Pressure Protection Plan option as an additional item of information in the application information is acceptable, notwithstanding rule 112(2)(c), to the extent that such inclusion enhances the efficiency of the application process and is therefore consistent with the national gas objective.
131. The Authority would expect that WAGN would respond to the prospective user's choice with advice as to whether WAGN, as a reasonable and prudent operator, considers the chosen option as being satisfactory in the particular circumstances. Subsequent to provision of advice to the prospective user, WAGN and the prospective user would need to agree on a specific option in the haulage contract.

132. The Authority would expect Clause 5.2(a), including Annexure F, of the proposed access arrangement revisions should be consistent with rule 112(2) of the NGR in relation to the form and content of an application for a pipeline service in order to be consistent with the national gas objective.
133. The Authority's view is that Clause 5.2(b) of the proposed revised access arrangement should be consistent with the national gas objective.
134. Clause 5.2(c) of the proposed revised access arrangement should indicate to the prospective user that a system protection pressure plan should be selected from the options set out in Annexure D.

Authority's proposal

The Authority will adopt the following as clause 5.2 of its proposed access arrangement revisions:

5.2 Application Information

The information required for an Application is:

- (a) when a Haulage Service is requested, the information referred to in Annexure F (as relevant for the Haulage Service requested);
- (b) in addition to the information referred to at paragraph 5.2(a), such information that WAGN may reasonably specify in relation to the requested Pipeline Service (provided the request is consistent with the National Gas Access Law and the National Gas Rules); and
- (c) when a Haulage Service is requested, a proposed System Pressure Protection Plan that corresponds to one of the options referred to in Annexure D (as relevant for the Haulage Service requested).'

Authority's proposal

The Authority will adopt the following as Annexure F of its proposed access arrangement revisions:

INFORMATION REQUIRED FOR AN APPLICATION FOR A HAULAGE SERVICE

1. Service B3

- 1.1 the address where the Delivery Point will be located;
- 1.2 load details per hour expressed in MJ/h;
- 1.3 Meter pressure expressed in kPa;
- 1.4 the gas fitter's registration number (if known) that is undertaking the works downstream of the Delivery Point;
- 1.5 the gas fitter's name (if known) that is undertaking the works downstream of the Delivery Point;

- 1.6 the proposed commencement date and contract term for the Haulage Service in years;
- 1.7 the End User's name (if known); and
- 1.8 the Receipt Point.

2. Service B2

- 2.1 the address where the Delivery Point will be located;
- 2.2 load details per hour expressed in MJ/h;
- 2.3 Meter pressure expressed in kPa;
- 2.4 the gas fitter's registration number (if known) that is undertaking the works downstream of the Delivery Point;
- 2.5 the gas fitter's name (if known) that is undertaking the works downstream of the Delivery Point;
- 2.6 the proposed commencement date and contract term for the Haulage Service in years;
- 2.7 the End User's name (if known); and
- 2.8 the Receipt Point.

3. Service B1

- 3.1 the address where the Delivery Point will be located;
- 3.2 load details per hour expressed in MJ/h;
- 3.3 Meter pressure expressed in kPa;
- 3.4 the gas fitter's registration number (if known) that is undertaking the works downstream of the Delivery Point;
- 3.5 the gas fitter's name (if known) that is undertaking the works downstream of the Delivery Point;
- 3.6 the proposed commencement date and contract term for the Haulage Service in years;
- 3.7 the End User's name (if known);
- 3.8 the Receipt Point;
- 3.9 annual consumption quantity in MJ;
- 3.10 emergency contact details of the End User (if known); and
- 3.11 the operating profile of the load expressed as 5, 6 or 7 days week.

4. Service A2

- 4.1 the address where the Delivery Point will be located;
- 4.2 load details per hour expressed in MJ/h;
- 4.3 Meter pressure expressed in kPa;
- 4.4 the gas fitter's registration number (if known) that is undertaking the works downstream of the Delivery Point;

- 4.5 the gas fitter's name (if known) that is undertaking the works downstream of the Delivery Point;
- 4.6 the proposed commencement date and contract term for the Haulage Service in years;
- 4.7 the End User's name (if known);
- 4.8 the Receipt Point;
- 4.9 annual consumption quantity in MJ;
- 4.10 emergency contact details of the End User (if known); and
- 4.11 the operating profile of the load expressed as 5, 6 or 7 days week.

5. Service A1

- 5.1 the address where the Delivery Point will be located;
- 5.2 load details per hour expressed in MJ/h;
- 5.3 Meter pressure expressed in kPa;
- 5.4 the gas fitter's registration number (if known) that is undertaking the works downstream of the Delivery Point;
- 5.5 the gas fitter's name (if known) that is undertaking the works downstream of the Delivery Point;
- 5.6 the proposed commencement date and contract term for the Haulage Service in years;
- 5.7 the End User's name (if known);
- 5.8 the Receipt Point;
- 5.9 annual consumption quantity in MJ; and
- 5.10 emergency contact details of the End User (if known).'

Draft Decision – Required Amendment 3

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

Public Submissions

WAGN's submissions

136. WAGN did not comply with Required Amendment 3 as it did not delete sub clauses 5.3(a) and 5.3(c) to 5.3(h). WAGN amended clause 5.3(a) by including a requirement that a prospective user lodge a request for a pipeline service in writing. WAGN did not delete or amend subclauses 5.3(c) to 5.3(h).
137. WAGN submitted on 8 October 2010 (pages 72-73) that its proposed amendment to clause 5.3(a) (i.e. a written application), reflects its proposed amendment to clause 5.2(a) (i.e. the addition of Annexure F). WAGN submitted that these amendments address the Authority's concerns outlined in paragraphs 182 and 183 of the draft decision.

138. WAGN submitted that deleting paragraphs 5.3(c) to 5.3(h) would introduce ambiguity into the application process resulting in inefficiency and increased likelihood of an access dispute. This outcome would be inconsistent with the national gas objective.
139. WAGN argued that removing the time restriction on any prospective user's acceptance would have the effect of reserving capacity on the distribution system by this prospective user, acting as a barrier to entry for other prospective users and thereby increasing the chances of an access dispute arising.
140. WAGN reasoned that clauses 5.3(c) to 5.3(h) provide certainty with respect to the offer and acceptance process by regulating how a prospective user can accept an Investigation Proposal and Access Offer and for how long the respective offers are open. WAGN argued that this certainty in the offer and acceptance process is '...contemplated by National Gas Rule 112 and so is consistent with the national gas objective.'

Other submissions

141. Alinta submitted that although WAGN has amended clause 5.3(a) to specify a written application it has not included the application form to be used by prospective users.
142. Alinta noted the Authority's assessment of proposed clause 5.3(a) in the draft decision that it was unable to assess WAGN's compliance with the NGL and NGR as the content of the application form was not included.
143. Alinta submitted that it agrees with the Authority's assessment of proposed clause 5.3(a) in the draft decision and considers that WAGN should either include the application form to be used or otherwise specify the information to be provided by such a form.
144. Alinta submitted that it does not support the Authority's requirement for WAGN to delete clauses 5.3(c) to 5.3(h) and noted WAGN's claim that to do so would be likely to increase uncertainty and inefficiency.
145. In particular, Alinta agrees with WAGN's concerns that the absence of a specified period during which an applicant must respond to an offer would be likely to be seen by another prospective applicant as reserving capacity until the applicant has formally declined the access offer and the capacity described in the offer.
146. Alinta submitted that it does not object to WAGN's amended proposed access arrangement revisions including clauses 5.3(c) to (h) as drafted.

Authority's Assessment

Clause 5.3(a)

147. The Authority's concern in the draft decision was that the content of the application form was not included in clause 5.3(a) of the proposed access arrangement revisions submitted on 29 January 2010. The Authority was therefore not in a position to assess the compliance of the proposed form with the NGL, NGR and the national gas objective.
148. Furthermore, the Authority expressed concern that as WAGN's application form was 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 content prescribed in rules 112(1) and 112(2) of the NGR. The Authority concluded that clause 5.3(a) should be deleted as it was contrary to the requirements of rule 112(1) and 112(2) of the NGR.

149. The Authority's view is that while WAGN claims that its proposed amendment to clause 5.3(a) reflects the proposed amendment to clause 5.2(a), it does not do so adequately because it does not specify the addition of Annexure F in clause 5.3(a).

Clause 5.3(c) to (h)

150. The Authority notes that rule 103 of the NGR sets out the provisions for queuing requirements which provide a mechanism by which all prospective users of spare and/or developable capacity are treated on a fair and equal basis. This would require that the process be open and transparent so that all parties are equally informed about the selection criteria to allocate access. For example, the allocating mechanism could be based on time (first come first served) or on price via an auction. All prospective users of the relevant spare or developable capacity must be able to participate in the process and have the same information. It is for this reason that the application procedure, including the content and form of the application information, should be specific and clear. The establishment of such a queuing process should/would reduce uncertainty in the access application process and decrease the risk of prospective users being excluded from access to pipeline services. Therefore, such an effective queuing procedure would be consistent with the national gas objective.
151. The Authority also notes that an access arrangement for a gas distribution system must include queuing requirements only if the Authority notifies the service provider before the commencement of the first access arrangement to commence after the date of the notification.
152. The Authority has not notified WAGN that the revised access arrangement must contain queuing requirements. The proposed revised access arrangement does not contain queuing requirements.
153. The Authority notes Alinta's submission in favour of including WAGN's proposed clause 5.3(c) to (h).
154. The Authority's view is that the time limits provided by clause 5.3(c) to (h) are reasonable and would encourage efficiency in the consideration and granting of access, and that these provisions are therefore consistent with the national gas objective.
155. In the absence of an explicit queuing policy, the provisions in clause 5.3(c) to (h) go some way to ensuring that a prospective user makes a timely response to an investigation proposal or to an access offer. For this reason the Authority supports the inclusion in the access arrangement of clause 5.3(c) to (h) as proposed by WAGN on the basis that these provisions as to timeliness for a response by the prospective user are reasonable and that these provisions are likely to reduce the potential for access disputes and to increase efficiency in the granting of access to prospective users.
156. For the purposes of the Authority's proposed access arrangement revisions, the Authority will replace clause 5.3(a) of the amended access arrangement so that it is

consistent with clause 5.2(a) and remove the reference to a non-existent form specified by WAGN.

Authority's proposal

The Authority will adopt the following as clause 5.3(a) of its proposed access arrangement revisions.

5.3 Application Procedure for Prospective Users

- (a) A Prospective User may request WAGN to provide a Pipeline Service by lodging an Application in writing with WAGN that presents all the information required under paragraph 5.2 for the relevant category of Haulage Service.

Draft Decision – Required Amendment 4

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

Public Submissions

WAGN's submissions

158. WAGN has retained clause 5.5 of the proposed access arrangement with the addition of the words 'Subject to the National Gas Access Law and National Gas Rules' to clause 5.5(a).
159. WAGN referred to paragraph 203 of the draft decision and the Authority's comments that clause 5.5 of the proposed access arrangement cannot be assessed as it applies to pipeline services generally and not just reference services.
160. WAGN submitted on 8 October 2010 (pages 73-76) that the Authority appears to be confusing the terms and conditions that WAGN will provide the pipeline services on (in which case it is only the reference services that is relevant) and the matters that WAGN will have regard to prior to providing a pipeline service. Rule 112 of the NGR regulates requests for access and applies to pipeline services as a whole (ie not just pipeline services that are reference services). As such, WAGN submitted there is no basis under the NGL or NGR for the commentary of the Authority in relation to Required Amendment 4.
161. WAGN submitted that the intent of clause 5.5 of the proposed access arrangement is to set out the process that WAGN undertakes to determine if it should provide the pipeline services requested as contemplated by rule 112(3)(a) of the NGR. Such a process necessitates pre-conditions and restrictions that may result in a refusal to offer the pipeline services requested or an offer which may be subject to conditions.
162. WAGN referred to paragraph 206 of the draft decision and noted that sections 187 and 188 of the NGL are relevant in that they are indicative of when access will not be granted in the context of an access dispute and an arbitration so are also relevant to WAGN's decision to grant access (i.e. a prudent covered pipeline service provider would not grant access if the events or circumstances referred to in those sections were to occur if access was granted). WAGN submitted that clause 5.5 of the

proposed access arrangement is consistent with the framework concept and the national gas objective.

163. WAGN also referred to paragraph 207 of the draft decision and commented that the Authority has not identified the parts of clause 5.5 of the proposed access arrangement that relate specifically to a queuing policy. WAGN has reviewed clause 5.5 and considers that there are no provisions that relate solely to a queuing policy and notes that a queuing policy has not been included in the proposed access arrangement. WAGN submitted that there does not appear to be any basis for the commentary of the Authority at paragraph 207 of the draft decision.
164. WAGN confirmed that expressing the process under rule 112(3)(a) as a precondition is an approach that has been approved by the AER, referring to the Wagga Wagga GDS Network.
165. WAGN also confirmed that the use of the words 'preconditions to and restrictions on' in the context of determining an application from a prospective user is used at clause 46 of Part A of the current access arrangement.
166. WAGN submitted that the concept of the process that WAGN has to undertake to determine if it should provide a pipeline service under the NGR is materially consistent with the evaluation process under the Code.
167. WAGN stated that it has considered the concerns of the Authority referred to in the draft decision in regards to the application process and has made amendments to the clause inserting the word 'reasonable' where appropriate.

Other submissions

168. Alinta submitted on 5 November 2010 (page 2 of Attachment B) that it supports the Authority's decision to require the deletion of clause 5.5 of the proposed access arrangement and for any relevant provisions from that clause to be dealt with in clause 1.1 of the Template Haulage Contract. Alinta reiterated its submissions in relation to clause 1.1 of the Template Haulage Contract.

Authority's Assessment

169. The Authority notes that WAGN has, contrary to Required Amendment 4, retained clause 5.5 in the amended access arrangement.
170. The Authority refers to its reasoning at paragraphs 200 to 206 of the draft decision and maintains its position that there are no express provisions in the NGL or NGR that provides for an access arrangement to impose preconditions or restrictions on the right of access to non reference services. The Authority therefore, has no power under the NGL or NGR to consider approving such provisions.
171. The Authority notes WAGN's submission in relation to rule 112(3)(a) of the NGR. The Authority acknowledges that rule 112 enables the service provider to impose terms and conditions on a user for non reference services. The Authority does not accept WAGN's submission that this clause enables the Authority to regulate what these terms and conditions should be for such services and instead maintains this is a commercial matter for negotiation between contracting parties.
172. The Authority considers that rule 112 of the NGR sets out a process whereby the service provider and user can negotiate the terms and conditions on which the

service provider is prepared to provide the requested pipeline service, but notes that rule 112 is silent as to what those terms and conditions should be.

173. The Authority notes that if a dispute were to arise between the service provider and a prospective user regarding the preconditions for non reference services, then section 189 of the NGL requires an arbitrator to give effect to the applicable access arrangement. The arbitrator will be limited, when making an access determination, to those preconditions prescribed in the access arrangement. Therefore, the Authority considers that the inclusion of such preconditions in the access arrangement will negate the ability of the arbitrator to effectively and efficiently perform its functions and would not be consistent with the national gas objective.
174. The Authority notes the potential for efficiency by enabling a potential user to know in advance the preconditions that will apply to their request for access. The Authority does not consider that any efficiency which might arise from this will outweigh the potential detriment caused if the Authority were to exceed its powers as prescribed in the NGL and NGR.
175. The Authority notes WAGN's submission concerning clause 46 of Part A of the current access arrangement which is entitled 'Preconditions to and restrictions on provision of Services'. The question surrounding the Authority's ability to approve terms and conditions for non reference services arose when the access arrangement for the WAGN GDS was last revised in 2005. The Authority refers to paragraphs 786 to 792 of the final decision dated 12 July 2005 and especially paragraph 788 which provided:
- 'The Authority considers that under the provisions of the Code, if a matter is properly a matter relevant to the Queuing Policy it must relate to all Services, not only Reference Services. This is in contrast to terms and conditions of supply of a Service, in relation to which the Authority has concluded that only terms and conditions of Reference Services may be included in an access arrangement.'
176. In its final decision, the Authority was satisfied that the terms and conditions in question were properly the subject of the queuing policy and accepted WAGN's amended proposal to relocate the preconditions to the queuing policy.
177. The Authority notes WAGN's submission regarding the approach adopted by the AER in the Wagga Wagga GDS Network. The Authority considers that clause 5.2.1 of the Wagga Wagga access arrangement applies the preconditions to an 'Agreement' which is defined to mean an agreement for defined reference services of the Wagga Wagga GDS Network. The Authority therefore considers that its reasoning behind Required Amendment 4 is consistent with the approach adopted by the AER.
178. In light of the public submissions, the Authority considers that the best way to address the preconditions in the amended proposed access arrangement is to amend clause 5.5(a) so that it applies to reference services only. For the purposes of the Authority's proposed access arrangement, the Authority will delete all references to 'Pipeline Service' and insert 'Reference Service' at clause 5.5(a).
179. The Authority has considered each of the preconditions set out in clause 5.5(a) of the amended access arrangement and considers them to be consistent with the national gas objective. The Authority notes WAGN's submission on page 73 that the words

'Subject to the National Gas Access Law and National Gas Rules' have been included in clause 5.5(a). The Authority notes that the final amended proposed access arrangement does not include such wording. The Authority will adopt such an amendment for the purposes of its proposed access arrangement.

180. The Authority further notes that WAGN has amended several provisions in clause 5.5(a) so that WAGN is required to exercise its opinion reasonably when determining some of the preconditions and restrictions on the provision of pipeline services. The Authority accepts WAGN's amendments and will adopt those amendments for the purposes of its proposed access arrangement provisions.
181. In light of the Authority's amendment set out above, the Authority does not consider clause 5.5(b) of the amended proposed access arrangement to be consistent with the national gas objective. The Authority maintains its position that with respect to reference services, the proposed access arrangement must contain the terms and conditions of access. Therefore, a provision which enables the service provider to 'remove, add or to vary one or more of the pre-conditions' would be inconsistent with rule 48(d)(ii) of the NGR. The Authority will delete clause 5.5(b) in the Authority's proposed access arrangement revisions.
182. The Authority will retain clauses 5.5(c) of the amended proposed access arrangement, and will be renumbered clause 5.5(b) in the Authority's proposed access arrangement as this enables the service provider to waive one or more of the preconditions. The Authority considers this clause to be consistent with rule 48 of the NGR and the national gas objective.
183. The Authority considers that, for the purposes of the proposed access arrangement, the terms and conditions on which WAGN will provide non reference services should be limited to a reference to the process set out in rule 112 of the NGR. The Authority will adopt this amendment in a new clause 5.5(c) for the purposes of the Authority's proposed access arrangement.

Authority's proposal

The Authority will adopt clause 5.5 of the amended Template Haulage Contract subject to the following amendments:

The Authority will adopt clause 5.5(a) of WAGN's amended proposed access arrangement but will include the words 'Subject to the National Gas Access Law and National Gas Rules' as the opening words.

The Authority will also delete words 'Pipeline Service' and replace it with the words 'Reference Service' in clause 5.5.

The Authority will delete clause 5.5(b) of WAGN's amended proposed access arrangement.

The Authority will renumber clause 5.5(c) to clause 5.5(b).

Draft Decision – Required Amendment 5

184. 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.

Public Submissions

WAGN's submissions

185. WAGN has amended clause 5.7 of the proposed access arrangement and submitted on 8 October 2010 (page 76) that the amendment is materially consistent with the Authority's Required Amendment 5 in that it has reintroduced (via a new Annexure D) the different options for a prospective user to satisfy the requirement of a system pressure protection plan.
186. WAGN noted that consequential amendments have been made to the Template Haulage Contract at clause 5.10 to include the indemnity referred to as 'Option 3' at clause 29 of Part A of the current access arrangement. WAGN has also made reference to the relevant provisions of clause 7.2 and 7.4 of the Template Haulage Contract to reflect the circumstances that might arise in the event that Option 3 is selected.

Other submissions

187. Alinta submitted on 5 November 2010 (page 2 of Attachment B) that clause 5.7 and Annexure D of the proposed access arrangement are an appropriate approach to the requirement for a system pressure protection plan, provided clauses 1.1(a)(i) and 1.1(a)(ii)(A) of the Template Haulage Contract are deleted and clause 5.10(c) is amended to conform to Annexure D.
188. Alinta further submitted (page 6 of Attachment C) that clause 5.10(c) goes beyond what is contemplated and required under option 3 of Annexure D of the proposed access arrangement. The user should not release the service provider or indemnify the service provider under option 3 in circumstances where the contractual entitlements required under option 1 would not have prevented the direct damage or indirect damage.

Authority's Assessment

189. The Authority notes that WAGN has amended the definition of 'System Pressure Protection Plan' in clause 12 of the amended proposed access arrangement. This amended definition refers to Annexure D of the amended proposed access arrangement which sets out the requirements that the 'System Pressure Protection Plan' must comply with. The Authority considers that Annexure D of the amended access arrangement is materially the same as the provisions in the current access arrangement.
190. The Authority notes the error in clause 2(c) of Annexure D. The Authority considers that clause 2(c) should refer to clause 5.10(c) of the Template Haulage Contract, not clause 5.10(b).
191. The Authority considers that the introduction of Annexure D sufficiently addresses the Authority's concerns raised in the draft decision in relation to clause 5.7 of the proposed access arrangement. The Authority is satisfied that WAGN's amended proposed access arrangement addresses the risk of system de-pressurisation in a manner consistent with the national gas objective, for the reasons submitted by WAGN.
192. For the purposes of the Authority's access arrangement revisions, the Authority will adopt Annexure D and clause 5.7 of the amended proposed access arrangement.

193. The Authority notes Alinta's submission that clauses 1.1(a)(i) and 1.1(a)(ii)(A) of the amended Template Haulage Contract should be deleted. The Authority has considered this submission at paragraphs 924 to 929 of this final decision.
194. The Authority refers to Alinta's submission in relation to clause 5.10(c) of the Template Haulage Contract. The Authority accepts that the indemnity provision in clause 5.10(c) is materially the same as clause 29(c) of Part A of the current access arrangement. However, clause 5.10(c)(i) is a new provision not in the current access arrangement. Without sufficient justification for its inclusion, the Authority does not consider such a provision is consistent with the national gas objective. The Authority will not incorporate this clause 5.10(c)(i) which releases the service provider from all claims in its proposed access arrangement.
195. The Authority has further considered clauses 5.10(c)(ii)(A) and (C) of the amended Template Haulage Contract. The Authority accepts the amendments to clauses 5.10(c)(ii)(A) and (C) are consistent with the current access arrangement except to the extent that it refers to the 'Upstream Person'. The Authority refers to paragraphs 1335 to 1341 of this final decision regarding the indemnification of claims by the 'Upstream Person'. For the purposes of the Authority's proposed access arrangement provisions, the references to 'Upstream Person' in clauses 5.10(c)(ii)(A) and (C) of the Template Haulage Contract will not be adopted.

Authority's proposal

The Authority will adopt clause 5.7, Annexure D and the amended definition of 'System Pressure Protection Plan' in clause 12 of the proposed access arrangement.

The Authority will amend clause 2(c) of Annexure D so that it refers to clause 5.10(c) of the Template Haulage Contract.

The Authority will delete the references to 'Upstream Person' in clauses 5.10(c)(ii)(A) and (C) of the Template Haulage Contract.

The Authority will delete clause 5.10(c)(i) of the amended Template Haulage Contract.

Total Revenue (Reference Tariff Building Blocks)

Introduction

Requirements of the NGL and NGR

196. 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 return on the projected capital base for the year; and
 - depreciation on the projected capital base for the year; and
 - if applicable - the estimated cost of corporate income tax for the year; and

- increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency; and
 - a forecast of operating expenditure for the year.
197. 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).

Draft Decision

198. In the draft decision, the Authority considered each of the reference tariff building blocks that contribute to total revenue (paragraphs 242 to 1107). The Authority accepted WAGN's proposal in relation to the following:
- Speculative capital expenditure account (clause 10 of the proposed access arrangement; paragraphs 329 to 336 of the draft decision);
 - Re-use of redundant assets (paragraphs 337 to 342 of the draft decision);
 - Previous redundant assets (paragraphs 352 to 358 of the draft decision);
 - Forecast asset disposals (paragraphs 489 to 496 of the draft decision); and
 - Cost of corporate taxation (paragraphs 794 to 796 of the draft decision).
199. WAGN has not revised its proposal in relation to the above in its amended access arrangement revisions proposal. The Authority therefore accepts WAGN's proposal in relation to these matters and there is no need to discuss them further in this final decision. The Authority will adopt WAGN's proposal in relation to these matters in the Authority's proposed revised access arrangement.
200. In Required Amendment 8 of the draft decision the Authority required WAGN to amend Annexure A to reflect the haulage reference tariffs set out in Table 27 of the draft decision. The Required Amendment related to each of the building blocks of total revenue.
201. The Authority also required by Required Amendment 8 that WAGN amend sections 1 and 2 of Annexure B to WAGN's proposed access arrangement revisions in respect of inflation, regulatory operating costs, regulatory capital costs and real pre-tax rate of return. Required Amendment 8 is also relevant to the determination of reference tariffs and is thus set out in the context of the determination of reference tariffs at paragraph 825 below.
202. WAGN has, however, revised its proposal as regards elements of the other reference tariff building blocks. Each of these is discussed below.

Projected capital base

Opening capital base at commencement of current access arrangement period

Draft Decision

203. In the draft decision, the Authority did not approve WAGN's value for the opening capital base at the commencement of the current access arrangement period which it had submitted was \$788.188 million, expressed in December 2009 dollars. The Authority determined that the value of the opening capital base at the commencement of the current access arrangement period should be \$781.918 million, calculated in December 2009 dollars. This determination was reflected in Required Amendment 8 of the draft decision.

Public Submissions

WAGN's submission

204. The opening capital base information for the current access arrangement is provided on pages 6-10 of the amended access arrangement information, with Table 7 (page 7) showing the opening capital base for the current access arrangement at 1 January 2005 as \$779.962 million, expressed in December 2009 dollars. WAGN has therefore not complied with Required Amendment 8 in this regard and has adopted a value for the opening capital base in its amended access arrangement information which is higher than that adopted in its access arrangement information dated 29 January 2010.

Lives of assets created by 2000 to 2004 capital expenditure overstated by one year

205. WAGN submitted that the tariffs set out in Table 27 of the draft decision may have been determined using incorrect remaining economic lives for the assets created by capital expenditure from 2000 to 2004.

206. WAGN noted that in previous access arrangement decisions, capital expenditure for the period 2000 to 2004 was depreciated from the year in which the capital expenditure was incurred. WAGN submitted that the Authority's draft decision seems to indicate a change in procedure so that depreciation is charged from the beginning of the year following the year in which capital expenditure is incurred.

207. WAGN submitted that to bring capital expenditure from 2000 to 2004 into line with its current depreciation practice, the Authority has assumed the economic lives of the assets created by capital expenditure from 2000 to 2004 start in the year following expenditure. This has the effect of increasing the remaining asset lives by one year.

Incorrect negative asset balance adjustment at 1 January 2005

208. WAGN noted that in its modelling, the Authority has made two adjustments to the capital base, at the commencement of the current access arrangement period, to eliminate negative asset balances.

209. WAGN submitted that in order to correctly calculate depreciation and the capital base, capital expenditure must be disaggregated on a year by year basis to ensure

that correct remaining economic lives are applied to each asset category. WAGN stated that when assets are disaggregated on a year of expenditure basis, negative asset balances of \$0.244 million become apparent at 1 January 2005. WAGN submitted that these negative asset balances have been eliminated, but they were not taken into account in establishing the capital base at 1 January 2005. Therefore the capital base at 1 January 2005 no longer agrees with the capital base reported in the Authority's July 2005 final decision. WAGN stated that whilst the amount is small, it makes reconciliation of asset values difficult.

Combining asset categories

210. WAGN stated that capital expenditures for each of the three classes of pipeline assets were approved for the 2005 to 2009 period in the Authority's final decision for the WAGN GDS in July 2005. WAGN noted that the assets in all three classes have the same economic life of 60 years. WAGN submitted that for the purpose of calculating depreciation and establishing the capital base there is no need to separate capital expenditures into the three asset classes.
211. WAGN noted that during 2005 to 2009, actual capital expenditure for the three asset classes was recorded, by WAGN, under the one heading 'medium low pressure'.
212. WAGN submitted that the capital base at 1 January 2010 has been calculated by taking actual capital expenditures for 2005 to 2009 and subtracting, as depreciation, the depreciation for the period which was taken into account, by the Authority, for reference tariff determination in July 2005. WAGN noted that this may result in negative asset balances (at 1 January 2010) for the asset categories 'medium pressure' and 'low pressure' (for which no expenditure has been recorded for the period 2005 to 2009, but in respect of which depreciation has been subtracted).
213. WAGN submitted that combining the asset classes medium pressure, medium low pressure and low pressure into one – medium low pressure – avoids the problem of negative asset balances without affecting depreciation or the capital base.

Average capital base and average customer numbers

214. WAGN stated that the tariffs set out in Table 27 of the draft decision have been determined using total revenue with a return component which has been calculated by applying the rate of return to the capital base in each year of the next access arrangement period.
215. WAGN submitted that this use of the capital base – and not the average capital base – for each year is inconsistent with the use of the average number of delivery points for each year for the calculation of tariff revenue. WAGN further submitted that it is inconsistent with rule 73(3) of the NGR which requires all financial information be provided, and all calculations made, consistently on the same basis.
216. In its submissions, WAGN stated that in the calculation of revised reference tariffs in the draft decision, the Authority assumed that revenue is earned from an average of the beginning of the year and end of the year numbers of customer connections for each year of the next access arrangement period. WAGN submitted that to be consistent, the average capital base for each year should then be used for determining forecast revenue.

Other submissions

217. There were no other submissions received in relation to the opening capital base.

Authority's Assessment

218. The Authority does not consider that WAGN's submissions raise any new arguments with respect to the opening capital base which were not raised before the draft decision and considered by the Authority in the context of the draft decision. In particular, the Authority confirms its position set out in paragraph 260 of the draft decision that its modelling approach does not permit assets to have a negative value at the commencement of an access arrangement period.

219. The Authority also notes that no other public submissions were received on this issue.

220. The Authority has full discretion with respect to the opening capital base. In its discretion, the Authority does not approve WAGN's value for the opening capital base set out in the amended access arrangement information. The Authority adopts the value for the opening capital base determined by the Authority in the draft decision in this final decision for the reasons set out in paragraphs 255 to 259 of the draft decision.

221. Table 1 below sets out the Authority's final decision values in relation to the opening capital base as at 1 January 2005. The table also reproduces for comparison WAGN's values from Table 7 of the amended access arrangement information.

Table 1 Opening Capital base at 1 January 2005 (\$ million, December 2009)

Asset Category	WAGN	Final Decision
High pressure mains	201.776	197.136
Medium pressure mains	257.304	251.387
Medium/low pressure mains	121.610	118.814
Low pressure mains	32.034	31.981
Regulators	11.450	11.187
Secondary gate stations	2.126	2.125
Buildings	1.928	1.883
Meters and service pipes	127.173	124.248
Equipment and vehicles	-3.423	2.886
Information technology	7.042	6.880
Full retail contestability	14.142	13.816
Land	6.801	6.645
Total	779.962	768.989

222. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt an opening capital base value of \$768.989 million as at 1 January 2005.

223. At paragraphs 61 to 73 above the Authority has set out its decision that the measure for the inflation rate is to be CPI (All Groups, Eight Capital Cities) and that this measure is to be applied at the end-point of the twelve month period. Therefore, the Authority does not approve WAGN's proposed escalation rate.
224. The Authority's financial model, released with this final decision (Appendix 2), contains details of the Authority's calculation of the opening capital base for the current access arrangement based on the Authority approved escalation rate.

Past conforming capital expenditure

Draft Decision

225. In the draft decision, the Authority did not approve WAGN's actual capital expenditure figures for the current access arrangement period to the extent that these figures were based on changes in CPI (All Groups, Perth) to the mid-point of the twelve month period. The Authority determined that the values should be those as set out in Table 3 of the draft decision based on changes in CPI (All Groups, Eight Capital Cities) at the end of the twelve month period.
226. The Authority also required WAGN to provide further information on the projects listed in EnergySafety's report requiring clarification before the final decision.

Public Submissions

WAGN's submission

227. The past conforming capital expenditure information for the current access arrangement period is provided in the amended access arrangement information, table 3 (page 4) showing capital expenditure by asset class for the period 2005 to 2009, expressed in December 2009 dollars. These figures have varied from those provided in the access arrangement information dated 29 January 2010, including a change in 2009 figures which are now actuals as opposed to estimates.
228. WAGN submitted that the tariffs set out in Table 27 of the draft decision appear to have been calculated using capital and operating expenditures which have not been corrected in the way proposed in the EnergySafety Report prepared for the Authority for the draft decision.
229. Annexure 1 of WAGN's submissions dated 25 September 2010 provided details of these corrections in an attempt to substantiate WAGN's historical and proposed network related capital expenditure.

Other submissions

230. Alinta submitted (at pages 6 to 8) that WAGN's actual and forecast capital expenditure cannot be added to its capital base unless the capital expenditure conforms with both rule 79(1)(a) and rule 79(2) of the NGR. The effect of these rules is that capital expenditure must be efficient (that is, 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 service) and must satisfy at least one of the tests set out in rule 79(2).

231. Alinta noted the Authority's references to the reports of *EnergySafety* and *Frontier*. Alinta requested that the Authority clarify whether *EnergySafety* evaluated all actual and forecast capital projects in order to assess whether all capital expenditure met the requirements of rule 79(1) of the NGR. Alinta submitted that this clarification was necessary as it appeared *EnergySafety* only considered, or commented on, whether actual or forecast capital projects claimed by WAGN (or suggested by *Frontier*) satisfied one of the requirements of rule 79(2)(c) and also met the requirements of rule 79(1)(a) of the NGR. Alinta submitted that this implied *EnergySafety* may not have considered whether actual or forecast capital expenditure which WAGN claimed (or *Frontier* suggested) met the requirements of either rule 79(2)(a), (b) or (d) also met the requirements of rule 79(1) of the NGR. Alinta argued that *EnergySafety*'s report failed to demonstrate that all actual and forecast capital expenditure met the requirements of rule 79(1) before considering which of the tests in rule 79(2) were satisfied in respect of each individual project.
232. Alinta submitted that it was unclear how *EnergySafety* assessed WAGN's actual and forecast capital expenditure in order to form the conclusion that those projects identified as NGR rule 79(2)(c) projects were reasonable for a prudent service provider acting efficiently and in accordance with accepted good practice. Alinta submitted that it did not appear that *EnergySafety* had considered whether WAGN's 'reasonable costs' were also consistent with the requirement of rule 79(1)(a) to achieve the lowest sustainable cost of providing service.
233. Finally, Alinta submitted that the *EnergySafety* report repeated project names but with different justifications. Alinta argued that it was therefore unclear whether the projects were simply repeated without affecting the aggregate amount of actual capital expenditure or whether an adjustment has been made to the amount of capital expenditure claimed by WAGN to be conforming capital expenditure.

Authority's Assessment

234. The Authority has considered Alinta's submission and can confirm that *EnergySafety* evaluated WAGN's capital expenditure against the new capital expenditure criteria set out in rules 79(1)(a) and 79(2) of the NGR.
235. With respect to rule 79(1)(a) of the NGR, the Authority did receive adequate information from WAGN in response to the projects listed in *EnergySafety*'s report.
236. Having received that further information, *EnergySafety* concluded that all of the projects detailed by WAGN met the criteria in rule 79(1)(a) for conforming capital expenditure in that the costs associated with the projects appeared to be reasonable for a prudent service provider acting efficiently and in accordance with accepted good industry practice.
237. With respect to rule 79(2)(c) of the NGR, *EnergySafety* was satisfied that, with one exception mentioned below, all of WAGN's capital expenditure was necessary to maintain the integrity of services, required for capacity, necessary to maintain capacity, necessary for regulatory compliance, necessary for emergency response or necessary for public safety.
238. Pursuant to section 18 of NGA the Authority can seek assistance from appropriate bodies to review technical aspects of an access arrangement proposal. The Authority is confident that *EnergySafety* has reviewed WAGN's capital expenditure appropriately within the context of a technical review and accepts its view that the

capital expenditure is compliant with the applicable criteria. The Authority does not accept Alinta's submissions that EnergySafety report is unclear.

239. The Authority is therefore satisfied that WAGN's capital expenditure conforms with the requirements of rule 79(1)(a) and 79(2).
240. The Authority confirms its assessment set out in paragraphs 304 to 312 of the draft decision as regards the other new capital expenditure criteria.
241. Pursuant to rule 79(6), the Authority's discretion with respect to the new capital expenditure criteria is limited. As such, the Authority has to be satisfied that WAGN's capital expenditure complies with the applicable requirements of the NGL and the NGR and complies with any applicable criteria prescribed by the NGL and the NGR. As noted above, the Authority is satisfied of this.
242. However, the Authority does not accept WAGN's proposal to adopt the use of CPI (All Groups, Perth) at the mid-point of the twelve month period (see paragraphs 61 to 73 above). The Authority requires that the actual capital expenditure for the 2005 to 2009 access arrangement period be inflated using the CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period.
243. Table 2 shows the capital expenditure approved in this final decision, with the Authority's CPI adjustment.

Table 2 Capital expenditure by asset class 2005-2009 – Adjusted by the Authority (\$ million, December 2009)

Asset class	2005	2006	2007	2008	2009
High pressure mains	0.520	1.547	1.608	3.310	10.367
Medium pressure mains	-	-	-	-	-
Medium/low pressure mains	7.891	8.932	13.164	11.612	8.623
Low pressure mains	-	-	-	-	-
Regulators	0.112	0.798	0.653	0.185	0.726
Secondary gate stations	-	-	-	0.013	1.657
Buildings	-	-	0.042	0.117	0.150
Meters and service pipes	18.589	21.890	19.392	17.669	19.026
Equipment and vehicles	-	-	-	-	-
Information technology	0.417	0.001	-	2.602	1.883
Full retail contestability	-	-	-	-	-
Land	-	-	-	-	-
Total	27.528	33.168	34.859	35.508	42.434

244. Based on the adjusted figures in Table 2 above, WAGN's actual capital expenditure for the current access arrangement period should total \$173.496 million, calculated in December 2009 dollars. The Authority's values have been amended from the draft decision as a result of minor changes being made to the allocation of capital expenditure, the effect of inflation and the effect of rounding. The change in past conforming capital expenditure between the draft decision and final decision models is negligible.

245. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figures set out in this final decision for past conforming capital expenditure.

Capital contributions by users

Draft Decision

246. In the draft decision the Authority did not approve WAGN's values in relation to user capital contributions for the current access arrangement period to the extent that they were based on CPI (All Groups, Perth) at the mid-point of the twelve month period and required WAGN to adopt CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period.

Public Submissions

WAGN's submission

247. WAGN's proposed values for capital contributions by users are set out on pages 7-8 of the amended access arrangement information, with Table 8 (page 7) showing user capital contributions for 2005-2009, expressed in December 2009 dollars. WAGN's values for the 2009 year are now less than those in the access arrangement information dated 29 January 2010, otherwise the values are the same.

Other submissions

248. There were no other submissions received with respect to capital contributions by users.

Authority's Assessment

249. The Authority confirms its assessment in paragraphs 323 to 327 of the draft decision. WAGN's amended access arrangement information contains audited figures for capital contributions by users. The Authority notes with approval WAGN's use of audited figures for this element of the reference tariff building blocks. This external verification of WAGN's data provides independent confirmation to the Authority upon which the Authority can rely in making its decision to accept WAGN's figures.
250. The Authority has full discretion with respect to capital contributions by users. In its discretion, the Authority accepts WAGN's audited figures for capital contributions by users.
251. However, the Authority does not approve WAGN's use of CPI (All Groups, Perth) at the mid-point of the twelve month period and requires the use of CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period (see paragraphs 61 to 73 above).
252. Table 3 below sets out values for the capital contributions by users proposed by WAGN and approved by the Authority in this final decision, adjusted by the Authority using the CPI (All Groups, Eight Capital Cities) rate for escalation.

Table 3 User capital contributions 2005-2009 - Adjusted by the Authority (\$ million, December 2009)

User capital contributions	2005	2006	2007	2008	2009
Allocated to specific projects	-	0.049	1.310	0.036	1.135
Not allocated to specific projects	0.235	2.670	1.329	1.273	0.095
Total	0.235	2.719	2.639	1.308	1.230

253. The values adopted by the Authority in this final decision are different from the values adopted by the Authority in the draft decision. In the draft decision, the Authority erroneously did not alter the values to reflect the CPI (All Groups, Eight Capital Cities) escalation.
254. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figures set out in Table 3 of this final decision for capital contributions by users.

Depreciation over the current access arrangement period

Draft Decision

255. In the draft decision, the Authority approved WAGN's proposed depreciation methodology for the current access arrangement period but did not approve depreciation values which were based on the use of CPI (All Groups, Perth) at the mid-point of the twelve month period. The Authority required WAGN to use CPI (All Groups, Eight Capital Cities) at the end of the twelve month period for the purpose of depreciation.

Public Submissions

WAGN's submissions

256. WAGN's amended access arrangement information sets out depreciation over the current access arrangement period with Table 9 (page 8) showing the values for depreciation over the current access arrangement period, expressed in December 2009 dollars.
257. The values set out in table 9 of the amended access arrangement are different from the values WAGN submitted for depreciation over the period 2005-2009 in its access arrangement information dated 29 January 2011. The values in the amended access arrangement have been increased by around 0.18 per cent for each year from 2005 to 2009.

Other submissions

258. No other public submissions were received with respect to depreciation over the current access arrangement period.

Authority's Assessment

259. The Authority confirms its assessment set out in paragraphs 347 to 349 of the draft decision but notes that the Authority has full discretion, under rule 77 of the NGR,

with respect to the opening capital base, of which depreciation over the current access arrangement period is a component (rule 77(2)(d)). However, pursuant to rule 89(3), the Authority's discretion with respect to the depreciation criteria is limited.

260. The Authority has reviewed the past depreciation component of the opening capital base and is satisfied that WAGN's actual depreciation for the previous access arrangement period complies with the applicable requirements and the applicable criteria prescribed by the NGL.
261. However, the Authority does not accept WAGN's use of CPI (All Groups, Perth) at the mid-point of the twelve month period and requires the use of CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period (see paragraphs 61 to 73 above). The Authority therefore does not accept WAGN's proposal as regards depreciation in the amended access arrangement information.
262. The Authority has used the same formula for calculating depreciation over the current access period for the purpose of this final decision and has maintained the same capital expenditure inputs. As a result, the depreciation values calculated by the Authority for the current access arrangement period set out in the draft decision do not differ from the values calculated by the Authority for the purpose of this final decision.
263. The Authority's final decision values for depreciation over the current access period are the same as those set out in Table 5 of the draft decision which is reproduced as Table 4 below.

Table 4 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	-	-	-	-	-
Total	28.661	30.486	32.171	33.540	35.291

264. The Authority's figures differ from those submitted by WAGN in its amended access arrangement information only by reason of WAGN's use of the CPI (All Groups, Perth) escalation rate at the mid-point of each twelve month period.

265. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figures set out in Table 4 of this final decision for depreciation.

Asset disposals

Draft Decision

266. In the draft decision, the Authority did not approve the values provided in Table 10 of the access arrangement information for asset disposals to the extent that the values were based on changes in CPI (All Groups, Perth) at the mid-point of the twelve month period and not changes in the CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period.

Public Submissions

WAGN's submission

267. Asset disposals are discussed on pages 8-9 of the amended access arrangement information, with Table 10 (page 9) showing the values of asset disposals over the current access arrangement period, expressed in December 2009 dollars. The total value for asset disposals in Table 10 is \$4.470 million, increased from \$4.462 million in the access arrangement information dated 29 January 2010. This is due to WAGN updating their figures since the draft decision.

Other submissions

268. No other public submissions were received with respect to asset disposals.

Authority's Assessment

269. The Authority confirms its assessment set out in paragraphs 364 to 367 of the draft decision.
270. WAGN has provided the Authority with updated figures for the assets to be disposed of. Pursuant to rule 77(1)(b)(iv) of the NGR, asset disposals are a component of opening capital base. The Authority has full discretion with respect to the opening capital base.
271. The Authority accepts the values ascribed by WAGN for asset disposals.
272. However, WAGN has not converted these values to take account of the half year CPI escalation. The Authority requires the values to be escalated by CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period (see paragraph 61 to 73 above).
273. The Authority's final decision values in relation to asset disposals are shown in Table 5 below.

Table 5 Asset disposals - Adjusted by the Authority (\$million, December 2009)

	2005	2006	2007	2008	2009
Land	-	-	-	-	3.832
Buildings	-	-	-	-	1.028
Total	-	-	-	-	4.409

274. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figures set out in Table 5 of this final decision for asset disposals.

Calculation of opening capital base

Draft Decision

275. The Authority did 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. The Authority required the opening value for the capital base for the forthcoming access arrangement period to be \$781.918 million, expressed in December 2009 dollars.

Public Submissions

WAGN's submission

276. Table 11 (page 10) of the amended access arrangement information shows WAGN's proposed opening capital base for the forthcoming access arrangement to be \$788.354 million, expressed in December 2009 dollars.

Other submissions

277. No other submissions were received with respect to the calculation of the opening capital base.

Authority's Assessment

278. The Authority's final decision in respect of the components of the opening capital base is set out above. The Authority does not approve WAGN's proposed opening capital base by reason of the Authority not approving WAGN's proposal in relation to any of the components of the opening capital base.

279. The Authority's values for the calculation of the opening capital base for the purpose of this final decision are set out in Table 6 below.

Table 6 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	766.507	768.231
Conforming Capital Expenditure	27.528	33.168	34.859	35.508	42.434
Vines Estate ²	-	-	-	-	0.580
Depreciation	-28.661	-30.486	-32.171	-33.540	-35.291
Adjustment for Over-depreciation					10.315
Asset Adjustment, Redundant Assets & Asset Disposal	-6.962	-	-	-	-4.409
Closing Asset Value	761.138	763.820	766.507	768.475	781.859

280. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figures set out in Table 6 of this final decision for the opening capital base.

Forecast conforming capital expenditure

Draft Decision

281. In the draft decision, the Authority was satisfied that WAGN's forecast capital expenditure for the forthcoming access arrangement was conforming capital expenditure for the purpose of rolling it into the capital base to the extent that the values were adjusted to reflect Table 9 of the draft decision.

282. The Authority also required WAGN to provide further information on the projects listed in EnergySafety's report.

Public Submissions

WAGN's submission

283. Forecast conforming capital expenditure is discussed on pages 11-12 of the amended access arrangement information, with Table 12 (page 12) showing the values for forecast conforming capital expenditure, expressed in December 2009 dollars. These values are different from the values set out in Table 12 of the access arrangement information dated 29 January 2010.

284. In correspondence to the Authority on 18 November 2010, WAGN confirmed that it made changes to its forecast capital expenditure in the amended access arrangement information. These amendments were made in accordance with findings of the report on WAGN's capital program prepared by EnergySafety for the Authority. Further, amendments were made as, during the time between the access arrangement information and the amended access arrangement information were submitted, 'actuals' for 2009 and for the first half of 2010 became available.

² Assets acquired in the Vines area of the outer Perth metropolitan region. The Vines Estate is a distinct section of the gas distribution system

Other submissions

285. In its submission, the Western Australian Council of Social Services (**WACOSS**) expressed concern about the lack of public information about capital expenditure (pages 14 to 16). In particular, WACOSS was concerned that both actual and forecast capital expenditure could not be evaluated against the criteria of the NGR because it was not presented with sufficient granularity by either project or sub-classification. WACOSS stated that the publicly available information was insufficient for stakeholders to assess WAGN's projects and the appropriateness of WAGN's capital overheads. WACOSS noted contradictions in the information that was publicly released. WACOSS submitted that this made it difficult for parties to comment on the appropriateness of the proposed capital expenditure.
286. WACOSS noted that, while some elements of the forecast capital expenditure were subject to market testing through a contracting out process, overhead allocation is not subject to market testing. It also noted that it was not clear whether WAGN's allocation should be the same where WAGN was delivering the capital expenditure projects in-house where overheads may be lower than contracted out projects.
287. WACOSS further noted that WAGN proposed projected capital expenditure that was significantly worse when compared with historical performance and urged the Authority to carefully scrutinise capital expenditure overhead performance.
288. WACOSS argued that the Authority's approach in the draft decision with respect to rule 79 of the NGR was erroneous. WACOSS expressed concern that by taking the view that it must base its decision on the level of capital expenditure based on how that expenditure is disaggregated by WAGN (and not requiring further disaggregation), constrained the Authority from rejecting individual capital expenditure projects that fail to meet the tests in rule 79. WACOSS noted that the report by Frontier on capital expenditure did not consider capital expenditure on a disaggregated basis and only found that the capital expenditure tests are met on the aggregated basis. WACOSS argued that this was at odds with the Authority's assertion that it has applied the rule 79 tests on a disaggregated basis.
289. WACOSS further submitted that the Authority's approach in considering capital expenditure on an aggregated basis did not accord with the approach adopted by other regulators. WACOSS expressed support for Frontier's suggestion that a threshold should be set for reviewing capital expenditure projects, with projects exceeding this threshold being subject to review on an individual basis.
290. Alinta's submission with respect to forecast capital expenditure is set out at paragraphs 230 to 233 above.

Authority's Assessment

291. The Authority has received the additional information required by the draft decision.
292. The Authority acknowledges the WACOSS submission but considers that the Authority and its consultants have properly evaluated WAGN's capital expenditure against the requirements of the NGL and NGR.
293. EnergySafety evaluated every item of forecast capital expenditure proposed by WAGN. Where EnergySafety did not consider itself qualified to evaluate the forecast capital expenditure, such as in the areas of information technology and depots, the

Authority evaluated the forecast capital expenditure and considered that either the materiality of the proposed expenditure was low or the expenditure was in keeping with accepted industry norms.

294. The Authority accepts EnergySafety's conclusion that overall, the projects detailed by WAGN meet the criteria for conforming capital expenditure in that all costs associated with the project appear to be reasonable for a prudent service provider acting efficiently and in accordance with accepted good industry practice.
295. Pursuant to section 18 of the NGA, the Authority can rely on a technical expert to evaluate technical aspects of a proposed access arrangement. In this instance, the Authority has consulted with EnergySafety to provide a report on WAGN's forecast capital expenditure and its compliance with the new capital expenditure criteria set out in the NGR.
296. In the period 2010/2011, WAGN will acquire assets from WestNet. These assets comprise of buildings, equipment and vehicles, and information technology. The Authority has considered this capital expenditure and considers that it meets the capital expenditure criteria set out in rule 79(2) of the NGR.
297. In its model, the Authority has included the value of the WestNet assets as a closing value in the 2010 (1 January to 30 June) period in order to earn a return in the 2010/2011 year. However, the acquisition of these assets occurred at 1 July 2010.
298. Pursuant to rule 79 of the NGR, the Authority has full discretion with respect to forecast capital expenditure. In its discretion, the Authority accepts WAGN's forecast capital expenditure under the forthcoming access arrangement as conforming capital expenditure for the purposes of rolling it into the capital base, based on the values in Table 7 of this final decision, subject to the WestNet asset acquisition being included in the modelling as a closing value in the 2010(1) period.
299. The Authority acknowledges WACOSS' submission with respect to the aggregation of capital expenditure. In evaluating capital expenditure against the criteria set out in rule 79 of the NGR, the Authority confirms that it applied the economic value test on an overall, or aggregated, basis. Further, the Authority confirms that its consultant, *EnergySafety*, conducted its analysis of projects against the criteria in rule 79 on an individual, or disaggregated, basis. By adopting this approach, the Authority considers that it has been able to evaluate all of WAGN's forecast capital expenditure against the criteria in rule 79.
300. The Authority's final decision values for the calculation of forecast capital expenditure are set out in Table 7 below.

Table 7 Forecast capital expenditure - Adjusted by the Authority (\$ million, December 2009)

	2010 ¹	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	5.426	11.544	12.114	12.058	12.665
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	9.115	21.524	24.440	24.321	25.140
Equipment and vehicles	-	0.649	-	-	0.637
Information technology	3.061	4.581	3.456	5.003	1.617
Full retail contestability	-	-	-	-	-
Land	-	-	-	-	-
Total	30.307	45.208	53.939	52.311	50.551

¹ 1 January 2010 to 30 June 2010 only

301. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figure set out in Table 7 of this final decision for forecast capital expenditure.

Forecast depreciation

Draft Decision

302. In its draft decision, the Authority did not approve WAGN's proposed values for forecast depreciation and required that the values for forecast depreciation reflect those stated in Table 10 of the draft decision.

Public Submissions

WAGN's submission

303. Forecast depreciation information is provided on pages 13-15 of the amended access arrangement information. Table 13 (page 13) sets out the asset lives for the derivation of forecast depreciation whilst Table 14 (page 14) shows the values of forecast depreciation, expressed in December 2009 dollars. The value for the 1 January 2010 to 30 June 2010 period rose from \$0.328 million in the access arrangement information dated 29 January 2010 to \$1.746 million in the amended access arrangement information. There was no substantial change to the values for the remaining periods.

Other submissions

304. WACOSS submitted (pages 19-20) that WAGN has over-depreciated its assets due to significant delays in capital expenditure in the current access arrangement period

compared with forecast capital expenditure. WACOSS noted that the Authority's draft decision proposed that this over-depreciation be accounted for as a cost of service adjustment rather than carried forward into the new access arrangement period. WACOSS argued that the draft decision restated the relevant asset lives at their actual asset life and depreciated value with the over-depreciation taken as a reduction to revenue requirements. WACOSS submitted that it could not be determined from the Authority's modelling whether the over-depreciation has been adjusted for appropriately as between the current and forthcoming access arrangement periods.

305. WACOSS noted that the Authority rejected WAGN's proposal to deal with over-depreciation by reducing the amount it would claim in the first half of 2010. WACOSS outlined the calculations for the Authority's approach to dealing with the over-depreciation before concluding that the Authority's approach favoured WAGN by \$0.546 million.
306. WACOSS then submitted that the Authority should consider what arrangements should apply to any future instances of over-depreciation. WACOSS argued that if over-depreciation was allowed to occur, a regulated service provider might choose to delay capital expenditure towards the end of an access arrangement period to earn excess depreciation at the beginning of the next access arrangement period. It may do this if it perceived it may earn a higher WACC in that future access arrangement period.
307. WACOSS argued that permitting over-depreciation could cause a level of pricing instability as a result of the impact of adjustments. The effect of this would be that customers in the earlier access arrangement will pay more than they should to the benefit of those customers of the later access arrangement. WACOSS submitted that the Authority should manage this by adjusting for variations between forecast and actual depreciation each year.

Authority's Assessment

308. The Authority notes that WAGN's values for forecast depreciation are set out in Table 14 of the amended access arrangement information and that, with the exception of the period 1 January 2010 to 31 June 2010, these values are substantially similar to the values in table 14 of the access arrangement information dated 29 January 2010. The value for the 1 January 2010 to 30 June 2010 rose from \$0.328 million in the access arrangement information to \$1.746 million in the amended access arrangement information. The Authority notes that this rise in forecast depreciation is attributable to a significant increase in the provision for forecast depreciation for medium pressure mains and low pressure mains. WAGN's value for the total depreciation for this 6 month period of \$1.746 million is less than the total value for that period set out in Table 10 of the draft decision of \$10.945 million.
309. The Authority notes that WAGN's total value for forecast depreciation for the remainder of the forthcoming access arrangement period set out in Table 14 of the amended access arrangement information is substantially similar to the values set out for the corresponding periods in table 10 of the draft decision.
310. The Authority confirms its assessment of forecast depreciation set out in paragraphs 475 to 485 of the draft decision. In short, the Authority noted WAGN's depreciation was forecast to decrease significantly over the six month period from 1 January 2010 to 30 June 2010 for two reasons. The first being meters and service pipes now being

fully depreciated. The second being WAGN proposing negative values for the depreciation of equipment, vehicles and information technology as a result of over-depreciating these items under the current access arrangement. The over-depreciation occurred because depreciation over the current access arrangement period is to be determined using forecast capital expenditure whereas actual capital expenditure was substantially less than forecast.

311. The Authority acknowledges the WACOSS submission but notes that WACOSS has misunderstood the Authority's approach to over-depreciation. The Authority's approach reflected in the draft decision, and which the Authority will also adopt for the purposes of this final decision, is more favourable to users as the amount for over-depreciation has been deducted from the cost of service. The Authority's modelling shows that when this over-depreciation, approximately \$10 million, is deducted from the cost of service, it results in a lower total revenue requirement and reduced tariffs for users.
312. The Authority has full discretion, under rule 78 of the NGR with respect to the projected capital base, of which depreciation over the forthcoming access arrangement period is a component (rule 77(2)(d)). However, pursuant to rule 89(3), the Authority's discretion with respect to the depreciation criteria is limited. As such, the Authority has to be satisfied that the depreciation complies with the applicable requirements of the NGL and complies with any applicable criteria prescribed by the NGL. The Authority has reviewed the forecast depreciation component of the opening capital base and is satisfied that WAGN's forecast depreciation complies with the applicable requirements and the applicable criteria prescribed by the NGL but does not accept WAGN's approach to over-depreciation.
313. Further, the Authority does not approve WAGN's use of CPI (All Groups, Perth) at the mid-point of the twelve month period and requires the use of CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period (see paragraphs 61 to 73 above).
314. Table 8 below shows the Authority's final decision values in relation to forecast depreciation.

Table 8 Forecast depreciation – Adjusted by the Authority - (\$ million, December 2009)

	2010 ¹	2010/11	2011/12	2012/13	2013/14
High pressure mains	1.057	2.193	2.228	2.286	2.375
Medium pressure mains	2.426	4.851	4.851	4.851	4.851
Medium/low pressure mains	2.391	4.873	5.066	5.268	5.469
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	0.076	0.201	0.212	0.212	0.212
Buildings	0.017	0.052	0.103	0.270	0.270
Meters and service pipes	3.703	7.771	8.632	9.610	10.583
Equipment and vehicles	-	0.585	0.650	0.650	0.650
Information technology	0.414	1.450	2.366	3.057	3.833
Full retail contestability	0.000	-	-	-	-
Land	-	-	-	-	-
Total	10.948	23.723	25.861	27.963	30.007

¹ 1 January 2010 to 30 June 2010 only

315. The Authority's modelling for forecast depreciation over the forthcoming access arrangement period has been amended. While the Authority has used the same formula to calculate forecast depreciation, some of the data inputs have been updated by WAGN. Further, the Authority has amended the draft decision model for the Vines Estate assets to correct a half year miscalculation in asset life.
316. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figure set out in Table 8 of this final decision in relation to forecast depreciation.

Calculation of projected capital base

Draft Decision

317. In the draft decision, the Authority did not approve WAGN's proposed projected capital base figures for the forthcoming access arrangement. The Authority instead required WAGN to adopt the values as set out in Table 11 of the draft decision.

Public Submissions

WAGN's submission

318. WAGN's projected capital base for the forthcoming access arrangement is set out on pages 15-16 of the amended access arrangement information, with Table 16 (page 16) showing the values for the projected capital base for 2010-2013/14.
319. The values set out in Table 16 of the amended access arrangement information are different from the values set out in Table 16 of WAGN's access arrangement information dated 29 January 2010. However, these variations are a necessary

consequence of WAGN's amendments to its values for conforming capital expenditure and depreciation.

Other submissions

320. No other public submissions were received with respect to the calculation of the projected capital base.

Authority's Assessment

321. The Authority's final decision in respect of the components of the calculation of the projected capital base is set out above. The Authority does not approve WAGN's calculation of the projected capital base by reason of the Authority not approving WAGN's proposal in relation to all of the components of that calculation.
322. The Authority's final decision values for the projected capital base are set out in Table 9 below. These values have been updated as a necessary consequence of the Authority's assessment in relation to conforming capital expenditure and forecast depreciation above.

Table 9 Modelled capital base for the forthcoming access arrangement period – Adjusted by the Authority (\$ million, December 2009)

	2010 ¹	2010/11	2011/12	2012/13	2013/14
Opening Asset Base	781.859	805.332	826.817	854.894	879.243
Conforming Capital Expenditure	30.307	45.208	53.939	52.311	50.551
West Net	4.113				
Depreciation	-10.498	-23.723	-25.861	-27.963	-30.007
Asset Adjustment, Redundant Assets & Asset Disposal	-	-	-	-	-
Closing Asset Value	805.332	826.817	854.894	879.243	899.786

¹ 1 January 2010 to 30 June 2010 only

323. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figure set out in Table 9 of this final decision for the projected capital base.

Return on Capital

324. Paragraphs 324 to 599 set out the Authority's consideration of the cost of capital (or rate of return) for WAGN for the forthcoming regulatory period, July 2011 to June 2014. The key issues considered in this chapter are the input parameters for the WACC, and matters raised in WAGN's revised submissions in response to the Authority's draft decision in August 2010, principally regarding the Debt Risk Premium (**DRP**), the Market Risk Premium (**MRP**), and the value of imputation credits (**Gamma**).

Requirements of the National Gas Law and the National Gas Rules

325. The Authority is required to determine the rate of return for regulated businesses in accordance with Rule 87 of the NGR.
326. Rule 87(1) of the NGR establishes a criterion for the setting of a rate of return. The rate of return to be used in determining total revenue and reference tariffs:
- ... is to be commensurate with prevailing conditions in the market for funds and the risks involved in providing the reference services.

Rule 87(2) requires that:

- the rate of return is to be established using a well accepted approach, such as a weighted average cost of capital (WACC), which incorporates the costs of equity and debt; and
- a well accepted financial model, such as the Capital Asset Pricing Model, is to be used.

Draft Decision

327. The WAGN initially proposed a real, pre-tax WACC of 11.1 per cent, based on an indicative averaging period. The proposed methods and/or values of the following WACC parameters were not consistent with the Authority's draft decision:
- the cost of equity;
 - the Market Risk Premium (MRP);
 - the value of imputation credits (Gamma);
 - the Debt Risk Premium (DRP); and
 - an allowance for debt raising cost.
328. For an estimate of the cost of equity, WAGN initially proposed that the standard Capital Asset Pricing Model (**CAPM**), known as the Sharp-Lintner CAPM, together with its derivations – namely Black's CAPM, the Fama and French Model, and Zero-beta Fama-French Model – should be used. The Authority was of the view that there is no evidence to depart from the current practice of Australian regulators with regard to the method used to estimate the cost of equity for regulated businesses. As a result, the Authority decided that the Sharp-Lintner CAPM should be used to determine the cost of equity for WAGN's proposed access arrangement.
329. For an estimate of the MRP, WAGN initially proposed using the Implied Volatility approach. This method was suggested by WAGN's consultant on this issue, the Value Adviser Associates (**VAA**), to estimate the MRP for its regulatory period. The Authority concluded that the approach of using historical data from the Australian financial market to calculate the MRP should be used as this is the current practice for Australian regulators.
330. For an estimate of Gamma, WAGN initially proposed using a range of 0 to 0.4 with a mid-point estimate of 0.2, which was advised by its consultant, the Strategic Finance Group Consulting (**SFG**), for the regulatory period. The Authority concluded that a

range of gamma of 0.37 to 0.81 was appropriate as an estimate of gamma for the WAGN's access arrangement.

331. For an estimate of the DRP, WAGN initially proposed using Bloomberg's estimates of the fair yield curves for 7-year and 5-year BBB/BBB+ Australian corporate bonds, which was advised by Second Opinion Financial Advisory (**SOFA**), to estimate the DRP for its regulatory period. The Authority concluded that CBASpectrum's estimate of a fair yield curve for 10-year BBB+ Australian corporate bonds should be used.
332. As also advised by SOFA, WAGN initially proposed the inclusion of a pre-finance cost of 16.3 basis points, in addition to the widely used allowance for debt raising cost of 12.5 basis points. The Authority decided against the inclusion of a pre-finance cost allowance, such that only 12.5 basis points, a widely adopted figure by Australian regulators, was allowed for debt raising cost.
333. In addition, the following two key WACC issues were concluded by the Authority in its draft decision:
334. First, the Authority decided that WAGN's method of ascertaining a Rate of Return using a real pre-tax WACC was appropriate and this proposal was also consistent with the Authority's preferences. The Authority was therefore satisfied that the proposed method of calculating the Rate of Return using a real pre-tax WACC formula meets the requirements of the NGL and the NGR.
335. Second, the Authority decided that WACC parameters should be estimated using data from the Australian financial market only.
336. In summary, Table 10 below sets out the WACC parameter values for the Authority's draft decision.

Table 10 Authority's draft decision on WACC parameters.

Parameter	WAGN's proposal as at 13 November 2009 (per cent)	Authority's draft decision as at 17 August 2010 (per cent)
Nominal risk free rate of return	5.59	5.16
MRP	8.0	6.0
Equity beta	0.8	0.8
Debt risk premium	4.50	3.293
Debt raising costs	0.288	0.125
Tax rate	30	30
Gamma (value of imputation credits)	20	60
Gearing: Debt to total value	60	60
Gearing: Equity to total value	40	40
Expected inflation	2.47	2.60
Real, pre-tax WACC	11.1	6.89

Source: The Authority's draft decision on WA Gas Networks Revision Proposal for the Access Arrangement for the Mid-West and South-West Gas Distribution Systems (tables 19 and 20, pages 136-7) and WA Gas Networks: Access Arrangement's Submission (tables 67, 68 and 69, pages 162-8).

WAGN's responses

337. In its response to the draft decision, WAGN argues that it is prepared to accept that the Sharp-Lintner CAPM is used to determine a rate of return on capital. However, WAGN is of the view that the outcome of this Sharp-Lintner CAPM does not reflect the current condition in the market for funds.
338. WAGN determined the real, pre-tax rate of return for the WAGN to be 9.6 per cent. This proposed real pre-tax WACC of 9.6 per cent was derived by the following steps:³
- First, WAGN submits that a proper application of the Sharp-Lintner CAPM produces a real, pre-tax WACC of 8.21 per cent under Rule 87(2).
 - Second, WAGN argues that approaches provided under Rule 87(2) must be used to determine the rate of return for the purposes of Rule 87. However, WAGN is of the view that Rule 87 does not prescribe that the rate of return produced by those approaches must be automatically adopted for the purposes of Rule 87. WAGN is of the view that a real pre-tax WACC of 8.21 per cent, calculated from the Sharpe-Lintner CAPM, does not take into account a number of risks, such as technological and regulatory risks, risks associated with the dynamics of investment behaviour and idiosyncratic risks.
 - Third, WAGN submits that the outcome of the approaches prescribed by Rule 87(2)(b) of the NGR must, if necessary, be adjusted to ensure that the rate of return determined under Rule 87 is commensurate with prevailing conditions in the market for funds and the risks involved in providing reference services. WAGN considers that the extent of the above additional risks may be estimated using other CAPM models such as the Black CAPM, Fama French CAPM, and zero-beta Fama French CAPM.
 - Fourth, WAGN states that the above additional risks justify an increase in a real, pre-tax WACC from 8.21 per cent to 9.6 per cent.
339. Value Advisor Associates (**VAA**) has been maintained as a consultant for WAGN on the issue of MRP. WAGN estimates that a forward looking MRP of 6.5 per cent will reflect 'average' current market expectations over the regulatory period.
340. WAGN maintains the advice by the SFG on an estimate of gamma. As such, WAGN's revised gamma is also 0.2, which is the same with its initial proposal.
341. For the estimate of DRP, WAGN's amended proposal is that Bloomberg's estimates of fair yield curves for 6-year BBB Australian corporate bonds should be used. This 6-year yield estimate is then extrapolated to a 10-year term using the change in the premium obtained from the Bloomberg AAA fair yield curves for 6 years and 10 years. The extrapolation yields an estimate of the debt risk premium of 4.10 per cent.⁴
342. On the advice of SOFA, WAGN proposes to include a component of pre-financing cost of 16.3 basis points in the cost of debt, together with a cost of debt issuance of 12.5 basis points.

³ WA Gas Networks: Proposed Revisions to the Access Arrangement for the WA Gas Networks Gas Distribution Systems: Responses to Draft Decision, pages 13-24.

⁴ WA Gas Networks: Proposed Revisions to the Access Arrangement for the WA Gas Networks Gas Distribution Systems: Responses to Draft Decision, pages 29-30.

343. The WACC parameter values that WAGN has applied in determining the Rate of Return are shown in Table 20 (page 29) of the Amended Access Arrangement Information. This table is reproduced in Table 11 of this final decision below.

Table 11 WAGN's Proposed Parameter Values for Determination of Rate of Return in response to the Authority's Draft Decision

Parameter	WAGN's amended proposal as at 8 October 2010 (per cent)
Nominal risk free rate of return	5.02
MRP	6.50
Equity beta	0.8
Debt risk premium	4.10
Debt raising costs	0.29
Tax rate	30
Gamma (value of imputation credits)	20
Gearing: Debt to total value	60
Gearing: Equity to total value	40
Expected inflation	2.60

Source: WA Gas Networks: Amended Access Arrangement Information for the WA Gas Networks Gas Distribution Systems (Table 20, page 29).

Other Submissions

344. In responses to the draft decision, the Authority received submissions regarding the return on capital from:

- Western Australian Council of Social Services (WACOSS);
- Alinta; and
- Prime Infrastructure.

345. Significant issues in each of the above public submissions will be considered in the relevant WACC parameter sections below.

Authority's Assessment

346. WAGN's methodologies and estimates for each of the WACC parameters in response to the Authority's draft decision are considered below.

Financial Structure (Gearing)

Draft Decision

347. The Authority agreed and approved 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.

Public Submissions*WAGN's Submissions*

348. WAGN has not made any response in relation to WAGN's debt to assets ratio.

Other Submissions

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

Authority's Assessment

350. The Authority maintains its draft decision 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**Draft Decision**

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

Public Submissions*WAGN Submissions*

352. WAGN's amended proposed access arrangement contained the same corporate tax rate of 30 per cent.

Other Submissions

353. WACOSS submitted on November 2010 (pages 20-22) that there is currently a proposal from the Commonwealth Government to reduce the corporate tax rate in 2013-2014 for large business from 30 per cent to 29 per cent (and then to 28 per cent in 2014-15) and that such a change would deliver a gain to WAGN if its proposal was to be approved by the Authority.

354. WACOSS argued that by the final decision, the Authority should build in the ability to adjust the assumed corporate tax rate if in fact the corporate tax rate is reduced in 2013-14 and beyond. The taxation rate to be applied is important as it influences the real pre-tax WACC through the derivation of the real pre-tax WACC from the nominal pre-tax WACC.

355. WACOSS submitted that the impact of the adjustment to the corporate tax rate from 30 per cent to 29 per cent in 2013-14 would be \$0.174 million.

356. WACOSS acknowledged that the reduction in the corporate tax rate may not occur but suggested that the Authority should recognise the potential for the reduction. WACOSS suggested that the Authority could make an adjustment to the total revenue for 2013-14 of \$0.174 million, provisional upon the tax reduction being made.

357. An alternative approach suggested by WACOSS, was for the Authority to make provision in the proposed access arrangement revisions to claw back any gain

resulting from a reduction in the corporate tax rate in 2013-14. WACOSS submitted that this approach of adjusting total revenue in out-years of the access arrangement for events that occur during those years would provide symmetry with the pass-through provisions in the proposed access arrangement revisions. The pass-through arrangements permit WAGN to either pass on the cost of particular events or submit a new access arrangement proposal to take account of the impact of those events.

Authority's Assessment

358. The Authority notes WACOSS' submission and the recent announcement from the Commonwealth Government that it may reduce the corporate tax rate in 2013-14. The Authority further notes that WACOSS conceded that this reduction in the corporate tax rate may not occur. The Authority does not consider it appropriate to make an adjustment to the total revenue provisional upon the corporate tax rate being reduced during the forthcoming access arrangement as the reduction of the corporate tax rate has not been introduced in the Parliament. It is therefore currently a speculative proposal on which it is inappropriate to form the basis of the Authority's consideration of the proposed access arrangement revisions.
359. As a consequence, the Authority is of the view that it is appropriate to adopt the corporate tax rate of 30 per cent for the entire period of this access arrangement.

Nominal Risk Free Rate of Return

Draft Decision

360. The Authority approved WAGN's proposed method for calculating the nominal risk free rate of return using the daily yield data for Commonwealth Government Securities with terms to maturity of 10 years.

Public Submissions

WAGN Submissions

361. WAGN has not made any responses to the method for calculating the nominal risk free rate of return. Using the daily yield data for the 10-year Commonwealth Government Securities for 20 trading days to 30 September 2010, WAGN calculated a nominal risk free rate of return of 5.02 per cent which was used in the calculations of the real, pre-tax WACC.

Other Submissions

362. The Authority has not received any public submissions in relation to the calculations for the nominal risk free rate.

Authority's Assessment

363. The Authority maintains its draft decision to approve WAGN's approach in relation to the calculation of the nominal risk free rate of return.
364. The Authority also approved WAGN's confidential request for a prior agreement on the averaging period for two inputs in the WACC, namely the nominal risk free rate and the debt risk premium. The Authority decided that the approved 20-day trading

period would be from Tuesday 23 November 2010 to Monday 20 December 2010 inclusive.

365. The Authority considers the estimated nominal risk free rate of return should be 5.61 per cent, for the period from 23 November 2010 to 20 December 2010.

Market Risk Premium (MRP)

Draft Decision

366. The Authority did not approve WAGN's proposed approach in relation to the method of using Implied Volatility to estimate the MRP.
367. The Authority considered that there is no persuasive evidence to depart from the previously adopted method of estimating the MRP using historical data on the equity risk premium for the purpose of the proposed access arrangement.

Public Submissions

WAGN Submissions

368. WAGN responded to the draft decision that the Authority, in making its decision, gave no consideration to the fact that:
- the MRP is not well understood. It remains a 'puzzle' some 25 years after being given that designation by Mehra and Prescott;⁵ and
 - there were major changes in global financial markets during 2007 and 2008 (Global Financial Crisis).
369. WAGN argued that the Authority's use of long-term historical averages of the equity premium in its draft decision on the MRP do not reflect current expectations and the way in which expectations adjusted during and after the Global Financial Crisis. WAGN is of the view that, in accordance with Weitzman's view,⁶ the adjustment of the MRP due to the Global Financial Crisis will not be obvious from past observations.⁷
370. WAGN submitted that evidence for the adjustment to the MRP is available from other (i.e. non-Australian) financial markets. WAGN also submits that other market evidence shows that the adjustment process is likely to be slow, in the order of 3.5 years⁸. Based on this evidence, WAGN is of the view that taking the long term historical average as an estimate of the MRP during the next access arrangement period while expectations are continuing to adjust to the effects of the Global Financial Crisis, cannot and does not lead to a rate of return which is commensurate with prevailing conditions in the market for funds.

⁵ Rajnish, Mehra and Edward C., Prescott (1985), 'The Equity Premium: A Puzzle', *Journal of Monetary Economics*, 15 145-161.

⁶ Martin L Weitzman (2007), "Subjective Expectations and Asset-Return Puzzles", *American Economic Review*, 97(4): 1102-1130.

⁷ WA Gas Networks: Proposed Revisions to the Access Arrangement for the WA Gas Networks Gas Distribution Systems: Responses to Draft Decision, page 28.

⁸ Carmen M Reinhart and Kenneth S Rogoff (2009), "The Aftermath of Financial Crises", *American Economic Review Papers and Proceedings*, 99(2): 466-472.

371. WAGN submitted that, in these circumstances, an alternative method of measuring the market risk premium is required. Such an alternative approach is known as the Implied Volatility Approach as proposed by WAGN's consultant VAA.
372. WAGN submitted that the estimate of the MRP of 6.5 per cent is indicative of current conditions in the market for funds.

Other Submissions

373. In its submission, Alinta notes that WAGN reduced its proposal from 8 per cent (in its first submission) to 6.5 per cent (in its second submission in response to the Authority's draft decision) without any further information provided to support this revised figure. Alinta also submitted that the current outlook for economic conditions and the capital market would see it revert back to the long-term historic MRP of 6.0 per cent.⁹

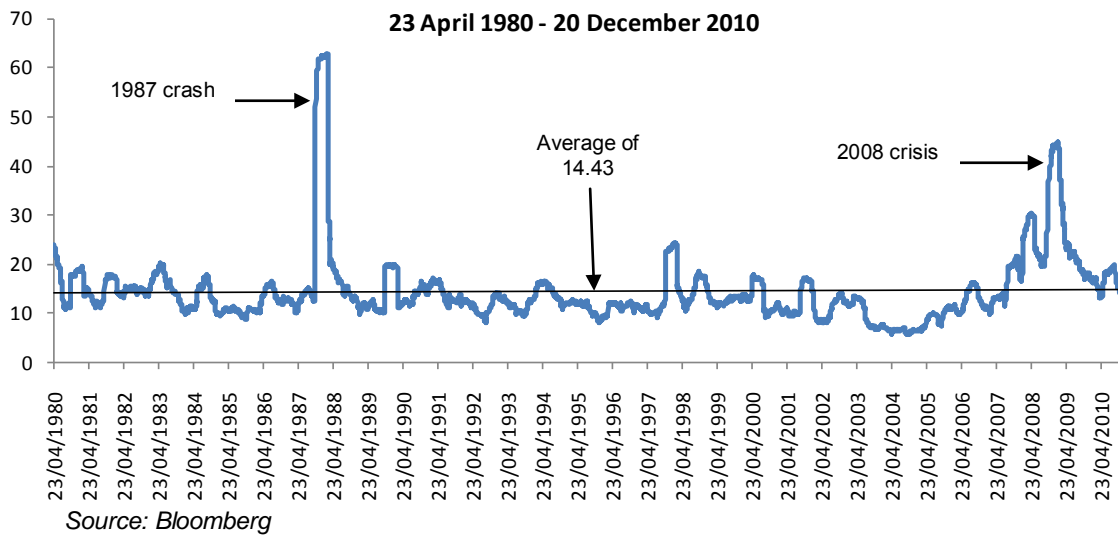
Authority's Assessment

374. The Authority notes that WAGN and its consultant VAA proposed the use of an Implied Volatility approach to estimate the MRP on two grounds:
- first, major changes due to the recent Global Financial Crisis; and
 - second, a limited understanding of the MRP.
375. Each of these will be discussed in turn below.

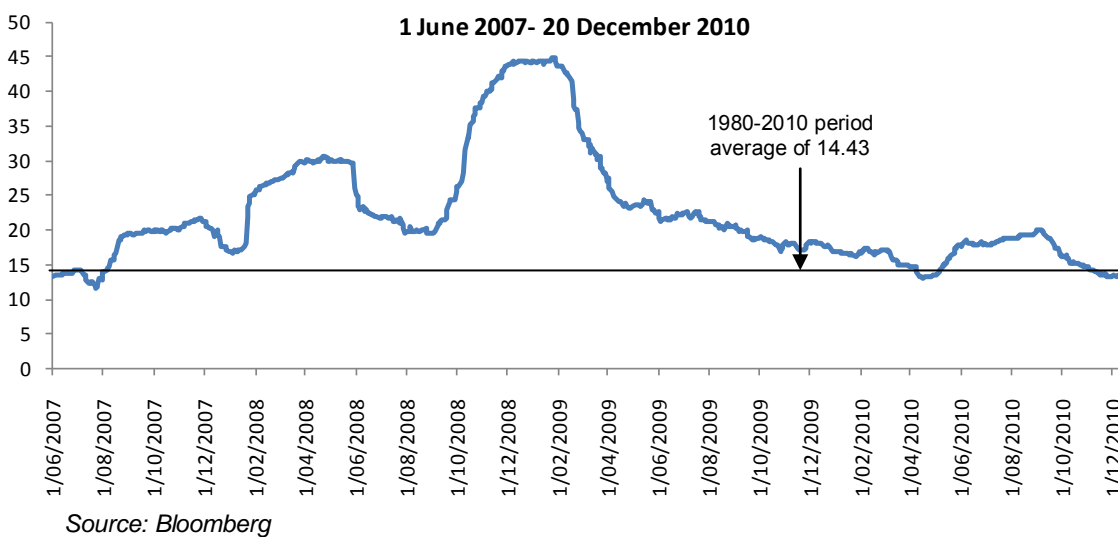
Have there been major changes in the Australian financial market due to the recent Global Financial Crisis?

376. From its draft decision, the Authority considered that the most significant issues causing the VAA, WAGN's consultant on the issue of estimate of the MRP, to propose a departure from the previously adopted method of using historical data on the MRP to derive a forward looking MRP were:
- the unusual economic circumstances, in the form of the global financial crisis; and
 - the substantive increase in risk spreads on debt for the regulatory period from 2010 to 2014.
377. In support of these arguments, the VAA used 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 maturity (1 month, 3 months, and 12 months) to illustrate what the VAA calls unusual economic circumstances for the period from 1980 to 30 November 2009.
378. The Authority has used the same approach but with the updated data set from Bloomberg until 20 December 2010. The Authority considers that risk cannot be solely measured by a level of volatility.

⁹ Alinta: WA Gas Networks: October 2010 Revised Access Arrangement for the Mid-West and South-West Gas Distribution Systems, pages 9-11.

Figure 1 90-Day Moving Average of All Ordinaries Accumulation Index

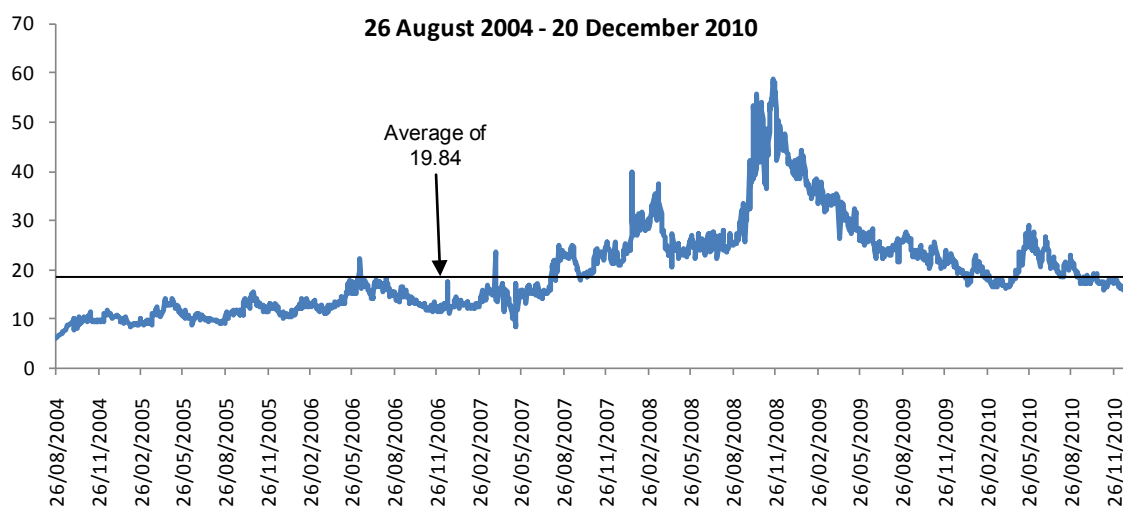
379. Figure 1 shows a 90-day moving average of the All Ordinary Accumulation Index for the period from 23 April 1980 to 8 December 2010. Current volatility in the equity market is currently lower than at the peak of the crisis level, and has almost returned to the pre-crisis level. This is consistent with the observation in the draft decision in August 2010.
380. The Authority is of the view that the argument by VAA that the equity market is experiencing an unusual period of high volatility is not justified. Figure 2 illustrates the 90-day moving average of the All Ordinaries Accumulation Index for the period before and after the crisis (1 June 2007 to 20 December 2010). In addition, the long term average of 14.43 for the 90-Day moving average slightly lies above the current level of volatility as shown in Figure 2. This is also consistent with the observation in the draft decision in August 2010 and also consistent with Alinta's view in its submission.

Figure 2 90-Day Moving Average of All Ordinaries Accumulation Index, pre-and post the 2008 Global Financial Crisis

381. The Authority agrees that a current view of market volatility can be derived from trades in options on the ASX 200 Index, although the Authority recognises that this is

only one of many approaches that could be employed. The data set from Bloomberg from 26 August 2004 to 20 December 2010 (the longest data set available from Bloomberg), rather than the data set used by VAA, for the period until September 2009, shows that the level of market risk has returned to around the average level. Figure 3 below supports the Authority's view that the market risk has returned to the pre-crisis level that market risk has returned to the pre-crisis level.

Figure 3 Implied Volatility from 3-month Call Option on ASX 200



Source: Bloomberg

Is the concept of Market Risk Premium well understood?

382. The importance of the MRP has arisen largely because of the increased use of the Capital Asset Pricing Model (**CAPM**). The difficulty in estimating the MRP arises from its ex-ante (forward looking) nature.
383. It is noted that the CAPM and MRP are ex-ante, as distinct from ex-post, models or variables. They are said to be ex-ante because the role of the CAPM is to forecast the return that is expected (or required) from the asset, $E(R_u)$. Similarly, the MRP is also ex-ante because it is a forecast of the expected (or required) premium or spread relative to the risk free return that is required to induce investors to hold stocks rather than riskless government bonds.
384. The ex-ante MRP is defined as:

$$MRP = E(R_{mt}) - R_{ft},$$

where: $E(R_{mt})$ is an *expected* market return at time t; and

R_{ft} is the government bond yield at time t

whereas the ex-post MRP is measured as:

$$MRP = R_{mt} - R_{ft}$$

where:

R_{mt} is an actual market return at time t

Simply, while the ex-ante MRP forecasts the *expected* return from the asset or stock, the ex-post MRP is the *observed* difference between the return on the market (R_m) and the yield on a government bond (R_f) over a particular time period, usually one year.

385. Australian economic regulators have consistently used historical data on the equity risk premium, which is the difference between the expected return on a market portfolio and the risk free rate, to derive the value of MRP.
386. Current practices in Australia reveal that the risk free rate is usually taken as a 10-year government bond yield, which implies a 10-year planning horizon. This choice is justified on the grounds that projects for which CAPM has been used as a means of estimating the required return on equity have been long term projects.
387. The pioneer work to systematically estimate the MRP in Australia can be traced back to the work by Officer in 1989.¹⁰ In his estimates of the MRP, Officer used an equity market index as a proxy for the market return. He described that:

‘Annual share returns were constructed from a share market accumulation index; such an index reflects both dividend returns plus capital gains. The index was constructed for the period 1882-1987 (106 years) inclusive from a variety of sources. The early period made use of data developed by Lamberton (1958) and this was linked to an accumulation index of fifty leading shares from the AGSM price file (1958-1974) and the AGSM Value Weighted Accumulation Index (1975-1987). The use of different indexes can present problems. There is always doubt as to compatibility when such a mix of indexes is used. A large number of checks were made for consistency and compatibility of indexes. All of the checks suggested movements in the above indexes were relatively closely and contemporaneously related.

There are also doubts as to the accuracy of the data in earlier parts of the period particularly for shares. The base data were monthly share price data from which annual indexes were constructed adding in dividends. Using annual data and the various relationships found, Officer (1985) dispels of the concern about incorrectly drawing inferences because of poor-quality data, at least on an annual basis.’

Source: Officer, 1989, p.211.

388. The estimate of Commonwealth government bond yields (or the risk free rate) is the yields on 10-year maturing Treasury Bonds. Officer described that:

‘The intention was to use long-term Commonwealth Bond yields to approximate the behaviour of interest rates. Under generally accepted theories of the term structure of interest rates, changes in these yields will reflect changes in yields generally across the term structure. Moreover, we would expect the yields on company debentures to be similarly affected. For the period 1882-1914, yields were taken from New South Wales government securities traded on the London capital market (Hall 1963). For the period 1915-1949 the yields were on Commonwealth Government Securities maturing in five years or more (see Reserve Bank bulletins). Finally, for the period 1950-1982, yields were taken from 10-year rebateable Commonwealth

¹⁰ Officer RR, 1989, ‘Rates of return to shares, bond yields and inflation rates: an historical perspective,’ in R Ball, P Brown, F Finn and RR Officer eds., *Share Markets and Portfolio Theory*, 2nd Edn, University of Queensland Press.

Government Bonds (see Reserve Bank 1982) and from 1982-1987 non-rebateables were used. The reason for switching between rebateables and non-rebateables was the lack of trading and/or availability of data on one or other of these security types — the typical difference between the yields of the two types is low, of the order of 5 per cent of the security's total yield, which implies the effective tax rate of traders in these securities is also low, approximately 5 per cent.'

Source: Officer, 1989, p.211.

389. After the study by Officer in 1989, many other studies have also been carried out with regard to an estimate of the MRP for Australia such as Brailsford, Handley, and Maheswaran,¹¹ Handley,¹² and many others.
390. In addition, MRP has been consistently used in the context of the widely adopted Sharpe-Litner CAPM in Australia by economic regulators, market practitioners and businesses. MRP is also widely used by market practitioners and businesses in Australia.¹³
391. As a result, the Authority is of the view that the 1985 Mehra and Prescott study, as referenced by WAGN and its advisor the VAA, is not directly relevant and that WAGN's view arising from the paper that the MRP is not well understood is not sustained. In addition, the Authority considers that the 1985 Mehra and Prescott study does not address the issue of whether the concept of the MRP is well understood or not. The Authority notes that the question addressed in the paper is whether the large differential in average yields, between historically observed average equity return and the average risk free return, can be accounted for by any economic models. As a result, the Authority considers that there is not a convincing argument for a departure from the method which has been widely adopted by Australian regulators.
392. Together with the above analyses, the Authority is also of the view that:
- a revised estimate of MRP of 6.5 per cent submitted by WAGN cannot be verified; and
 - current market conditions reveal that the Australian economy is reverting back to its pre-crisis level.
393. Each of these will be discussed in turn below.

Is WAGN's revised proposal for the MRP of a 6.5 per cent supported by available and transparent evidence?

394. The Authority notes that, in response to the Authority's draft decision, WAGN has used the same advice by the VAA, regarding the estimates of the MRP, as it did for its initial access arrangement proposal. In a previous submission, WAGN was of the view that a MRP of 8 per cent is appropriate. Without any justification and/or additional calculations and evidence, in response to the draft decision, WAGN now

¹¹ T. Brailsford, J.C.Handley, and K.Maheswaran, 'Re-examination of this historical equity risk premium in Australia', *Accounting and Finance*, Vol.48, 2008, p.92

¹² J. C. Handley, *Further comments on the historical market risk premium*, Report prepared for the AER, 14 April 2009, pp.6-9.

¹³ 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.

submits that the estimate of a MRP of 6.5 per cent is indicative of current conditions in the markets for funds.

395. It is noted that WAGN rejected the Authority's request to review the detailed calculations used by VAA to justify a MRP value of 8 per cent as outlined in WAGN's proposed access arrangement.

Economic outlook and market conditions

396. The Authority is of the view that there is now evidence to suggest that market conditions have stabilised. This view is supported by the reports released by the Reserve Bank of Australia (**RBA**), the International Monetary Fund (**IMF**), and the Organisation for Economic Cooperation and Development (**OECD**). In all these reports, it is widely agreed that the Australian economy has displayed strong resilience and robustness during and after the 2008 Global Financial Crisis.

397. The RBA was of the view that:

'Employment growth has been robust, business and consumer confidence is above average, the housing market has been strong, and there are signs that the period of business deleveraging is coming to an end. Collectively, these outcomes provide us with some confidence that the economy is now in a reasonably solid upswing.'¹⁴

and

'Our economy recovered relatively quickly from what was a shallow downturn following the global financial crisis, and over the past year has grown around its trend rate of 3¼ per cent. Domestic demand has grown substantially faster than this – about 5¼ per cent – due importantly to growth in public spending, though this is moderating now...

Business conditions are generally around average levels, although there are clear differences across sectors. Business investment is at a high level, particularly in the mining sector, and information published by the Australian Bureau of Statistics, as well as our own liaison with companies, suggests that it will pick up sharply further over the next couple of years'.¹⁵

and

"In November, the Reserve Bank Board increased the target for the cash rate from 4.50 per cent to 4.75 per cent, the first change to the target in six months. Money market yields suggest markets currently expect a further increase in the cash rate in the first half of 2011".¹⁶

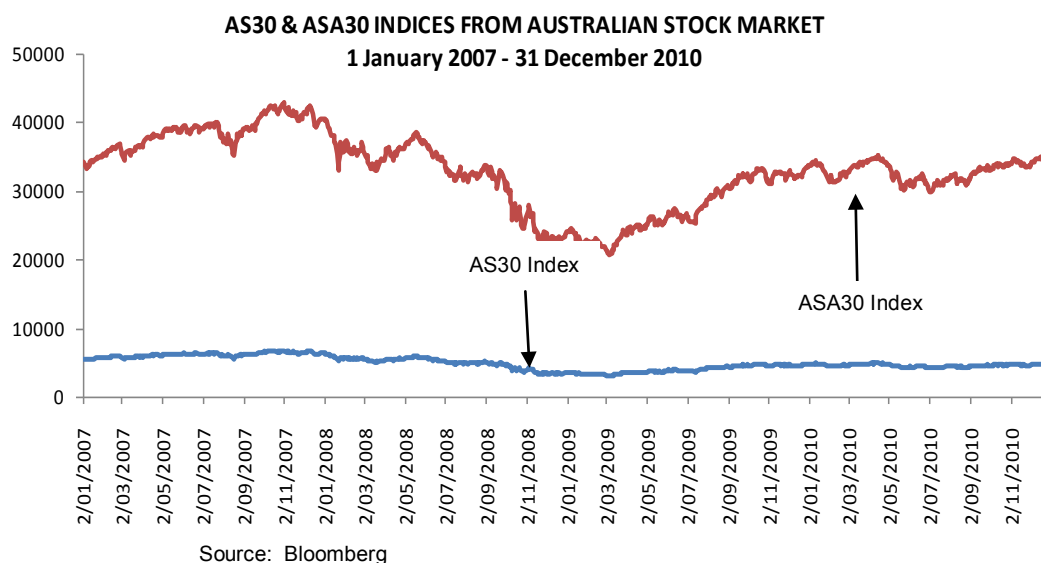
398. In addition, the Australian share markets significantly recovered from the crisis level. This view is illustrated in Figure 4 below.

¹⁴ The Reserve Bank of Australia, May 2010, 'Recent Developments in the Global and Australian Economies', available at <http://www.rba.gov.au/speeches/2010/sp-ag-250310.html> accessed on 8th December 2010.

¹⁵ The Reserve Bank of Australia, May 2010, 'Recent Developments in the Global and Australian Economies', available at <http://www.rba.gov.au/speeches/2010/sp-dg-181110.html> accessed on 8th December 2010.

¹⁶ The Reserve Bank of Australia, November 2010, "Statement on Monetary Policy", available at <http://www.rba.gov.au/publications/smp/2010/nov/html/index.html>, accessed on 8th December 2010.

Figure 4 Australian Stock Exchange All Ordinaries Index (AS30 Index) and ASX Accumulation All Ordinaries Index.



399. In November 2010, the OECD concluded that:

‘After weathering the crisis well in 2009, the Australian economy is projected to experience strong growth in 2010 and 2011, above its trend rate. Activity might expand by as much as 3¼ per cent and 3½ per cent in these two years, driven by booming exports and domestic demand. The unemployment rate is expected to fall below 5 per cent by the end of 2011, in a context of moderate inflation.’

‘The Australian economy, fuelled by the mining boom, should grow robustly in 2011 and 2012 at a rate of between 3½ per cent and 4 per cent. Strong growth, driven by terms of trade gains and dynamic investment, will reduce unemployment.’

The projected increase in demand is likely to require a further tightening of monetary conditions to ensure that a non-inflationary recovery remains on track. The current fiscal consolidation plan must be pursued, as assumed in the projections, to rebuild the margins for manoeuvre used during the crisis. Reforms are needed to strengthen supply capacities in the housing and infrastructure sectors to reduce bottlenecks, which the mining boom is likely to exacerbate.¹⁷

400. The IMF shared the views of the RBA and the OECD with regard to conditions for Australian economy. They state that:

The global downturn had a fairly small impact on the Australian economy, as real investment barely contracted in 2009 and the unemployment rate went up by less than 2 percentage points. Not surprisingly, Australia’s potential growth is estimated to have declined by just 1/3 per cent to 3.1 per cent in 2009.¹⁸

¹⁷ The OECD, November 2010 ‘Economic outlook for Australian economy’, available at http://www.oecd.org/document/15/0,3343,en_2649_34573_45268687_1_1_1_1.00.html accessed on 8th December 2010.

¹⁸ The Yan Sun, ‘Potential Growth of Australia and New Zealand in the Aftermath of the Global Crisis’, IMF Working Paper, WP/10/27, May 2010, pp. 19.

401. The Authority is aware that the AER adopted a MRP of 6 per cent in its most recent draft decision on Envestra's access arrangement proposal for the South Australian gas network released in February 2011.

Authority's Assessment

402. Given all available information from both domestic and international sources, the Authority is of the view that the market conditions in Australia have stabilised significantly since the Global Financial Crisis in 2008.
403. The Authority maintains its position from the draft decision that the Implied Volatility approach cannot be considered a reliable model to derive the MRP for WAGN's access arrangement. As such, the Authority considers there is no persuasive evidence to depart from the previously adopted method of estimating the MRP using historical data on the equity risk premium for the purpose of this access arrangement.
404. The Authority considers that a reasonable point estimate for the MRP is 6 per cent.

Value of Imputation Credits

Draft Decision

405. The Authority adopted the payout ratio of 1.0.
406. The Authority's draft decision was that a reasonable range for the value of theta is 0.37 (derived from dividend drop-off studies) to 0.81 (derived from a tax statistics study). This provided a reasonable mid-point value of theta of 0.60.
407. Based on a distribution rate of 1.0 and a theta of 0.60, the Authority concluded that a reasonable value of gamma for the draft decision is 0.60.

Public Submissions

WAGN Submissions

408. WAGN has maintained its estimate of 0.2 for gamma, which WAGN submits is within a reasonable range for gamma of between zero and 0.4 as evidenced by a study by National Economic Research Associates (**NERA**).¹⁹ WAGN argues that this value of gamma is commensurate with prevailing conditions in the market for funds.
409. WAGN submitted that:
- the Authority has relied on theoretical argument for a value of the payout ratio F of 1.0; and
 - the upper limit adopted for theta θ (0.81) was unreasonably high, which is consistent with the upward bias imparted by the Authority's method of estimation.

¹⁹ WAGN's proposed Access Arrangement: Supporting document from NERA, "The Value of Imputation Credits for a Regulated Gas Distribution Business", 8 September 2009.

Other submissions

410. The Authority has not received any public submissions in relation to the value of imputation credits.

Authority's assessment

411. It is widely accepted that the approach adopted by regulators across Australia to define the value of imputation credits, known as 'gamma'²⁰, is in accordance with the Monkhouse definition,²⁰ as discussed at length in the Authority's draft decision. There are two components of gamma:

- the payout ratio (F); and
- theta (θ).

412. In considering the value of imputation credits (gamma), the Authority has had regard to the detailed consideration given by available academic studies and evidence to this element of the WACC calculation.

Payout Ratio (F)

413. The Authority adopted a payout ratio (F) of 1.0 in the draft decision. This decision was based on advice that the assumption of the payout ratio of 1.0 is consistent with a standard assumption of valuation practice that all free cash flows are paid out to investors.²¹ In addition, the Authority is aware that the actual payout ratio is likely to be between 70 per cent and 100 per cent.²² Importantly, the assumption of a 100 per cent payout ratio simplifies the framework for estimating gamma, which is appropriate due to the difficulty in reliably estimating the value of retained imputation credits.

414. In the recent advice to the AER,²³ Handley advised that the Officer framework for estimating gamma is a theoretical simplification which only applies in a perpetuity setting. Handley also agreed that the alternative Monkhouse approach, which is briefly discussed below, provides a closer approximation to reality.

415. The Monkhouse approach (1996) relaxes the assumption of the payout ratio of imputation credits of 1.0. This approach incorporates the time value loss associated with the retention of imputation credits into the definition of gamma:

²⁰ 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.

²¹ Australian Energy Regulator, December 2008, *Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters*, p. 302.

²² See McKenzie and Partington, Report to the AER, *Evidence and submissions on gamma*, 25 March 2010, and Handley, Report prepared for the Australian Energy Regulator on *The estimation of gamma*, 19 March 2010.

²³ Handley, J., *Further Issues relating to the Estimation of Gamma*, a report prepared for the Australian Energy Regulator, October 2010, pages 3-6.

$$\gamma = F \times \theta + (1 - F) \times \psi$$

where F is the distribution or payout ratio;

θ (theta) is the per dollar value of a distributed credit;

γ (gamma) is the value of a dollar of imputation credits; and

ψ (psi) is the per dollar value of a retained imputation credit where $\psi < 0$ due to time value loss associated with retaining credits.

416. From the above Monkhouse approach, the value of imputation credits (gamma) may be interpreted as a weighted average of the value of a distributed credit and the value of a retained credit. The difference between the value of a distributed credit θ and the value of a retained credit ψ is time value loss only, which in turn depends on the expected retention period, τ (tau) and the appropriate discount rate, δ (delta).
417. However, Handley is of the view that using Monkhouse approach requires an estimate of the value of a retained imputation credit. He notes that it is unnecessary to adopt a more complicated (albeit more realistic) approach than the Officer framework, given the inherent imprecision in the value of theta.
418. The Authority notes that the 2004 Hathaway and Officer study concluded that the payout ratio was 71 per cent.²⁴ In a recent study by Hathaway,²⁵ the payout ratio of imputation credits was estimated to be 69 per cent. Based on these studies, the estimate of the payout ratio of the imputation credits of 70 per cent is considered relevant. This is also consistent with the AER's recent final decision on Victorian Electricity Distribution Network Service Providers in November 2010.²⁶
419. However, the above measure does not take into account the value of retained imputation credits. Some studies, such as the SFG's study, assumes that approximately 170 billion dollars in retained imputation credits,²⁷ as at November 2010, will never be paid out and are essentially without value. The Authority does not support the assumption that the retained imputation credits would never be distributed. This assumption is inconsistent with Handley's advice to the AER that retained imputation credits do have value indicating that a maximum payout ratio of 100 per cent is also considered relevant.
420. In summary, the Authority agrees that the actual payout ratio of imputation credits is around 70 per cent and that the retained imputation credits do have value. As such, the Authority is of the view that a payout ratio lies within the range of 70 per cent and 100 per cent.
421. Based on the above analyses, the Authority has decided to depart from its decision from the draft decision. The Authority considers that it is appropriate to assume that

²⁴ Hathaway, N., and R.R. Officer, 2004, *The Value of Imputation Tax Credits – Update 2004*, Capital Research Pty Ltd, 2 Melbourne, 2 November.3-6.

²⁵ Hathaway, N., 2010, *Imputation Credit Redemption: ATO data 1988 – 2008*, Capital Research Pty Ltd,

²⁶ The Australian Energy Regulator, November 2010, *Final Decision, Victorian Electricity Distribution Network Service Providers Determination, 2011 - 2015*, pages 534-7.

²⁷ Handley, J., *Further Issues relating to the Estimation of Gamma*, a report prepared for the Australian Energy Regulator, October 2010.

payout ratio ranges from 70 per cent to 100 per cent and has used this range for the final decision of this access arrangement.²⁸

Theta (θ)

422. The Authority maintains its position with regard to the estimate of theta from the draft decision:
423. First, the Authority relies on a recent study by SFG Consulting in 2009 using a dividend drop-off study.²⁹ This study used the same data as the 2006 Beggs and Skeels (which analysed data up to 10 May 2004) but analysed a further period of 28 months of data (up to 30 September 2006). The estimate of theta from this study is 0.37.
424. Second, the Authority has had regard to estimates of the utilisation rate from taxation statistics using the 2008 Handley and Maheswaran study. This study indicates a range of values of the utilisation rate, θ , from 0.67 (pre-2000) to 0.81 (post-2000).³⁰ The Authority adopted an estimate of 0.81 for the post-2000 data set because it is more relevant to the regulatory period for this final decision.
425. In summary, the Authority considers that the appropriate estimate of the value of theta is the range of 0.37 to 0.81.
426. Based on an appropriate estimate of the payout ratio of imputation credits of between 70 per cent and 100 per cent, together with an estimated appropriate range for theta of 0.37 and 0.81, the Authority concluded that a reasonable value of gamma, for the purposes of the Authority's proposed access arrangement revisions, is 0.53 (or 53 per cent).

Debt Risk Premium

Draft Decision

427. The Authority did not approve WAGN's proposal in relation to the credit rating for the WAGN of BBB/BBB+. The Authority considered that an appropriate credit rating for the WAGN is BBB+.
428. The Authority did not approve the WAGN's proposal of using Bloomberg's estimates of fair yield curves to derive the debt risk premium. The Authority considered that a reasonable debt risk premium should be estimated using the estimates of fair yield curves by CBASpectrum.
429. In its draft decision, the Authority also indicated that the Authority was investigating an alternative approach to estimate the debt risk premium for the final decision after Bloomberg ceased publishing its estimates of 10-year and 7-year AAA fair yield curves for Australian corporate bonds in July 2010.

²⁸ The Authority is aware that the AER adopted a payout ratio of 70 per cent in this most recent draft decision on Envestra's access arrangement proposal.

²⁹ SFG Consulting, 2009, The value of imputation credits as implied by the methodology of Beggs and Skeels (2006), page 3.

³⁰ 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.

Public Submissions

WAGN Submissions

430. WAGN notes that only a small number of BBB debt issues are available – and have been available – for “testing” the predictive accuracy of the Bloomberg’s fair value curves. WAGN indicated that the small number of BBB debt issues is not sufficient – nor has it previously been sufficient – to reject the use of Bloomberg’s estimates of fair yield curves. WAGN has estimated the current debt risk premium using information from the Bloomberg service.
431. The estimate is based primarily on the premium implied by the Bloomberg BBB band fair value curve for 6 years duration (the longest duration currently available). The BBB band curve has been extrapolated using the change in the premium obtained from the Bloomberg AAA fair value curves for 6 years and 10 years. The extrapolation yields an estimate of the debt risk premium of 4.10 per cent.³¹
432. However, in a confidential letter to the Authority dated 7 January 2011, WAGN submitted that the approach to the estimation of the cost of debt proposed in WAGN’s response to the draft decision does not satisfy the requirements of rule 87 of the NGR.³²
433. [Information in paragraphs 434 to 437 and Table 12 is confidential and is included in a confidential Appendix 5.]³³
434. [Information in paragraphs 434 to 437 and Table 12 is confidential and is included in a confidential Appendix 5.]³⁴
435. [Information in paragraphs 434 to 437 and Table 12 is confidential and is included in a confidential Appendix 5.]

³¹ WA Gas Networks: Proposed Revisions to the Access Arrangement for the WA Gas Networks Gas Distribution Systems: Responses to Draft Decision, pages 29-30.

³² WA Gas Networks: Cost Of Debt for WA Gas Networks Gas Distribution Systems, 7th January 2011, page 1.

Table 12 [Information in paragraphs 434 to 437 and Table 12 is confidential and is included in a confidential Appendix 5.]

Item	Australian Bank Market (per cent)
Margin plus upfront fees	
Debt advisory, legal and other transaction costs	
Total cost	
Lender' base rate (BBSW, 3 months)	
Estimated cost of debt	

Source: WAGN's confidential letter dated 7th January 2011 to the Authority.

436. [Information in paragraphs 434 to 437 and Table 12 is confidential and is included in a confidential Appendix 5.]

Other submissions

437. The Authority has not received any public submissions in response to the draft decision in relation to the estimate of debt risk premium.³⁵

Authority's assessment

438. In its previous decisions, the Authority relied on the estimates of 10-year fair yield curves derived by Bloomberg and CBASpectrum. However, Bloomberg has in recent times progressively shortened its estimates of fair yields across credit ratings for Australian corporate bonds. Additionally, in September 2010, CBASpectrum ceased publishing its estimates of the fair yield curves across all credit ratings for Australian corporate bonds. This means that the method of calculating the debt risk premium that was applied in the Authority's August draft decision on WAGN's proposed access arrangement, which used CBASpectrum data, is no longer available.
439. As indicated in the draft decision, an alternative approach to estimating the debt risk premium is needed. As a result, the Authority released a discussion paper on debt risk premium on the 1 December 2010 with regard to an intended approach, referred to as the Bond Yield approach, to seek comments from interested parties.
440. It is noted that the Authority's method for estimating the debt risk premium, as well as the nominal risk free rate, has in the past assumed the borrowing term is 10 years. A 10-year term has been consistently adopted by all Australian regulators in the energy sector since the Australian Competition Tribunal's (Tribunal) 2003 GasNet decision.³⁶

³⁵ It is noted that there are public submissions in response to the Authority's discussion paper to estimate the debt risk premium which will be discussed later.

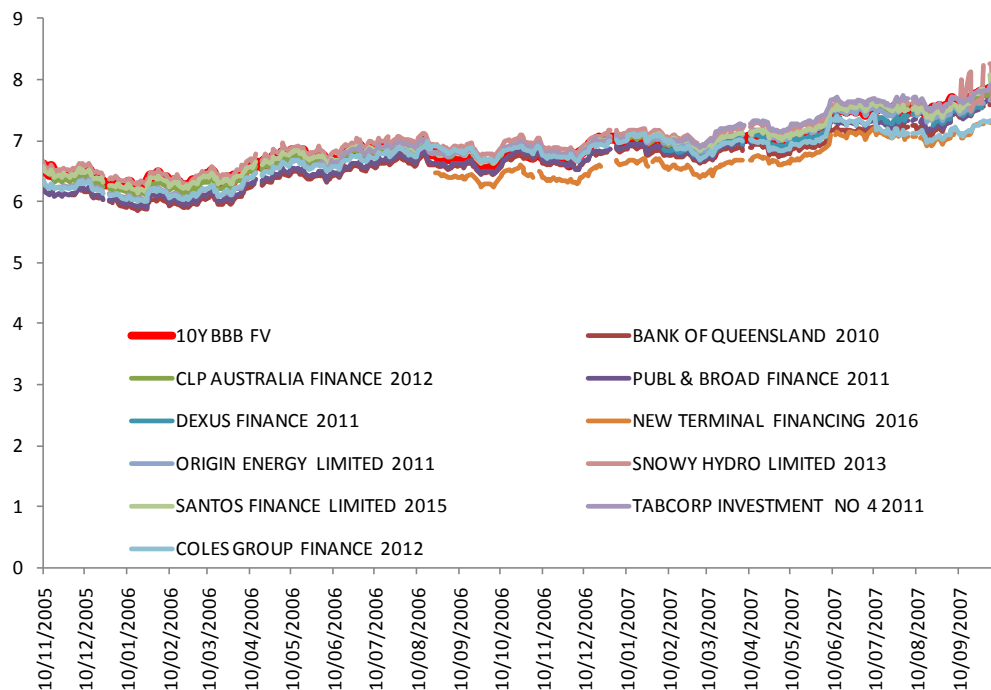
³⁶ Australian Competition Tribunal, *Application by GasNet Australia (Operations) Pty Ltd [2003] ACompT 6*, 23 December 2003, paragraph 48, page 18.

441. Since the draft decision in August 2010, there have also been developments in the Australian regulatory environment regarding the approach to estimating the debt risk premium.
- The Australian Competition Tribunal's decision in the ActewAGL appeal in September 2010;
 - The AER's final decision on the Victorian electricity Distribution Network Service Providers (**DNSPs**) in October 2010; and
 - The Independent Pricing and Regulatory Tribunal of New South Wales' (**IPART**) discussion paper on 'Developing the approach to estimating the debt margin' in November 2010.

The Estimates of Bloomberg's Fair Yield Curves

442. Australian regulators have historically had regard to Bloomberg's estimates of fair yield curves to estimate the debt risk premium for their regulatory decisions. Prior to the Global Financial Crisis, which started in 2008, an estimate of the fair yield curve for 10-year BBB Australian corporate bonds was consistent with observed yields for Australian corporate bonds (of the same rating) trading in the market at that time. This consistency is illustrated in Figure 5 below using estimates of the fair yield curve for 10-year BBB Australian corporate bonds from 10 November 2005 to 9 October 2007.

Figure 5 Bloomberg's 10-year BBB Fair Yield Curve and Observed yields for BBB/BBB+ Australian corporate bonds, 10 November 2005 – 9 October 2007 (Per cent)



Source: Bloomberg

443. Since the cessation of Bloomberg's estimate of the 10-year BBB fair yield curve on 9 October 2007, some Australian regulators, including the Authority and the AER, have extrapolated to a 10-year term from Bloomberg's estimate of the 8-year BBB

fair yield curve. The extrapolation was based on the assumption that the yield spreads between 10Y A and 8Y A is equal to that of 10Y BBB and 8Y BBB:

$$10Y\ BBB = 8Y\ BBB + (10Y\ A - 8Y\ A)$$

444. The above extrapolation was not possible after 18 August 2009 when Bloomberg ceased providing estimates of 8-year BBB fair yield curve, and 10-year and 8-year fair yield curves.
445. The Authority, as well as the AER, then analysed the appropriateness of using other fair yield curves from Bloomberg to extrapolate to a 10-year BBB fair yield curve. Both regulators came to the conclusion that the difference between the 10-year and 7-year AAA fair yields should be added to the 7-year BBB fair yield to gain an estimate of the 10-year BBB fair yield.

$$10Y\ BBB = 7Y\ BBB + (10Y\ AAA - 7Y\ AAA)$$

446. However, on 22 June 2010 Bloomberg again shortened its estimates of fair yield curves for Australian corporate bonds by ceasing to publish its estimates for both 10-year and 7-year AAA fair yield curves.
447. The duration of Bloomberg's fair yield curves are now well below the 10-year time period which Australian regulators have traditionally used for setting the debt risk premium and risk free rate.
448. It is understood that Bloomberg is currently deriving estimates of the fair yield curves for the credit ratings and terms to maturity shown in Figure 12 below. Bloomberg estimates the fair yield curves for 5-year terms across all credit ratings. For the credit ratings of A and BBB, Bloomberg also estimates the fair yield curves for 7-year terms to maturity, although there are no estimates for 6-year fair yield curves.

Table 13 List of fair yield curves from Bloomberg as at 18 November 2010

	Credit rating	Maturity (M=Month; Y=Year)
1	AUD Australia AAA ³⁷	3M, 6M, 1Y, 2Y, 3Y, 4Y, and 5Y
2	AUD Australia AA ³⁸	3M, 6M, 1Y, 2Y, 3Y, 4Y, and 5Y
3	AUD Australia A ³⁹	3M, 6M, 1Y, 2Y, 3Y, 4Y, 5Y, and 7Y
4	AUD Australia BBB ⁴⁰	3M, 6M, 1Y, 2Y, 3Y, 4Y, 5Y, and 7Y

Source: Bloomberg

449. A major concern is that, since the bond market is thinner⁴¹ than in the past, Bloomberg's estimate of the 7-year BBB fair yield curve is substantially different from

³⁷ Bloomberg ceased publishing its estimates of the fair yield curves for AAA 7Y, 8Y, 9Y, 10Y, and 15Y on 22 June 2010; and for AAA 20Y on the 30 June 2005.

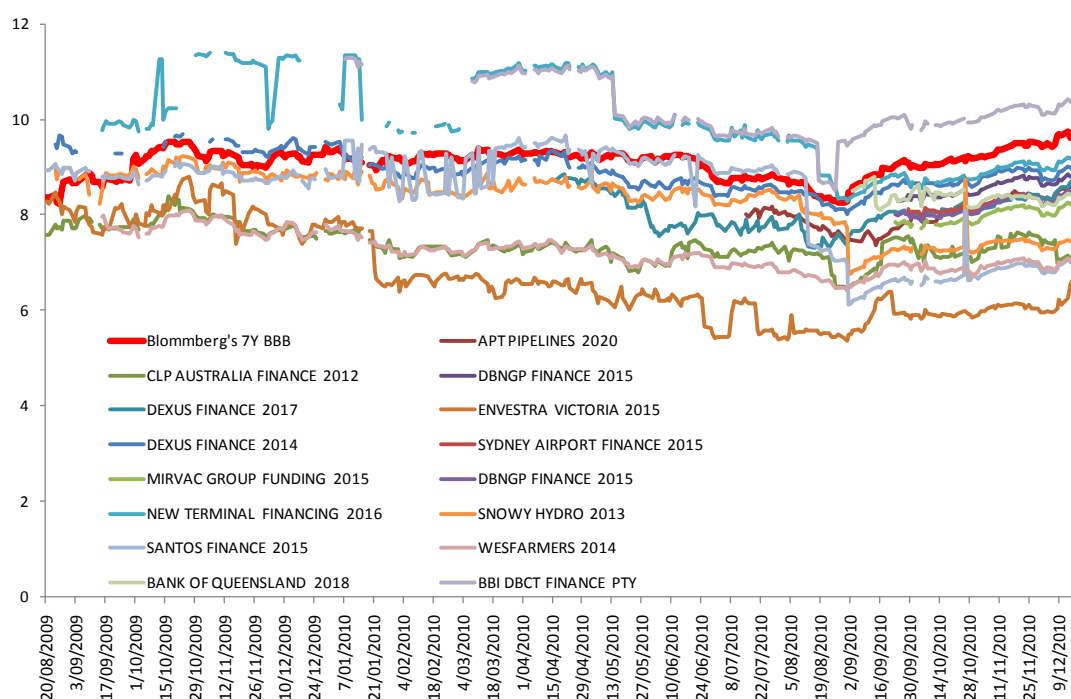
³⁸ Bloomberg ceased publishing its estimates of the fair yield curves for AA 7Y on 18 August 2009; and for AA 8Y on 19 June 2006.

³⁹ Bloomberg ceased publishing its estimates of the fair yield curves for A 8Y, 9Y, and 10Y on 18 August 2009.

⁴⁰ Bloomberg ceased publishing its estimates of the fair yield curves for BBB 8Y on 18 August 2009; for BBB 9Y, and 10Y on 9 October 2007; and for BBB 15Y on 14 March 2002.

the observed bond yields in the Australian bond market, as illustrated in Figure 6 below. This illustration is for the period when data on yield for the 7-year BBB is most recently available - after the cessation of the Bloomberg's estimate of 8-year BBB on 18 August 2009 until the end of October 2010. Since the method used by Bloomberg to derive its fair yield curves is not released to the public, the Authority is unable to understand and verify this difference.

Figure 6 Bloomberg's 7-year BBB Fair Yield Curve and Observed yields for BBB/BBB+ Australian corporate bonds, 19 August 2009 – 31 October 2010 (Per cent)



Source: Bloomberg

The Australian Competition Tribunal's Decision on the ActewAGL Matter in 2010

450. Regulators have historically used a 10-year term for estimation of the debt risk premium. However, the Authority notes that the Australian Competition Tribunal, in its recent decision for the ActewAGL gas network in September 2010, commented that:

'The reason a 10 year bond was originally chosen was because, in the past, many firms favoured long term debt, albeit that it came at a higher cost, because it reduced refinancing or roll-over risks. The high rate was then hedged via interest rate swaps. That may no longer be the position. If not, the AER may need to reconsider its approach in light of more current strategies of firms in the relevant regulated industry. Further, **there seems to be little point in attempting to estimate the yield on a bond which is not commonly issued**' [emphasis added].⁴²

451. The Authority notes that current bond market conditions are significantly different from those in the past. The Australian bond market is very illiquid for long-term bonds with terms to maturity of 5 years and above, with insufficient numbers of bonds

⁴¹ This means that the volumes traded in the market are lower than desirable for the derivation of average values.

⁴² Australian Competition Tribunal, *Application by ActewAGL Distribution [2010] ACompT 4*, 17 September 2010.

traded in the market to generate reliable industry-wide estimates. This is the reason why CBASpectrum decided to cease publishing its estimates of the fair yield curves for Australian corporate bonds.⁴³ Similarly, Bloomberg has shortened the duration of bonds in which their fair yield curves are derived across different credit ratings.

The AER's Method

452. In its recent final decision on the Victorian electricity distribution businesses in October 2010,⁴⁴ the AER adopted a new approach to estimating the debt risk premium. In this approach, the debt risk premium is derived as the weighted average of the Australian Pipeline Trust (**APT**) bond, which is assigned a 25 per cent weight, and an extrapolation of the Bloomberg 7-year BBB fair yield curve to 10-years, which is assigned a 75 per cent weight. The Bloomberg 7-year BBB fair yield curve is extrapolated to a 10-year BBB fair yield curve using the spread between 10-year AAA and 7-year AAA Australian corporate bonds in June 2010 – the last month Bloomberg produced these two AAA fair yield curves. The rationale for the AER's new approach is summarised below.
453. First, the AER considered the APT bond (APT is the financing arm of APA Group, a gas transmission and distribution network service provider). This 10-year BBB rated bond was issued by the APT in July 2010. The AER is of the view that, prima facie, the APT bond represents a useful benchmark corporate bond rate because it reflects a 10-year maturity, and provides an acceptable proxy for the BBB+ credit rating. The AER considered that the nature of the investments and markets by the APA Group provide a close match to those of electricity network service providers.
454. Second, the AER considered the reliability of independent estimates of fair yields by Bloomberg, together with the uncertainty surrounding the APT bond as a single observation. The AER is of the view that it is appropriate to use the yields derived from the Bloomberg 7-year BBB fair yield and the spread between the 10-year and 7-year AAA fair yields to extrapolate to a 10-year term. The AER considered that this 10-year fair yield estimate should be used together with the APT bond, to estimate the debt risk premium for its final decision on Victorian electricity DNSPs.
455. Third, the AER is of the view that more weight should be given to the Bloomberg's fair yield curve than the APT bond. The AER considers that Bloomberg accurately represents yields on shorter rated BBB bonds (e.g. 7 years). On the other hand, the yield on the APT bond reflects a directly observed yield for one specific 10-year BBB bond, notwithstanding that it may be reflective of the efficient cost of debt for regulated network service providers. Accordingly, the AER considered that a 75 per cent weighting for Bloomberg and a 25 per cent weighting for APT is appropriate to reflect a reasonable and practical approach in setting the debt risk premium.
456. The Authority notes that the AER has now adopted the equal weighting for APT bond and Bloomberg's estimate of the 10-year BBB bond in its most recent Draft Decision

⁴³ In its announcement, CBASpectrum states that: 'Sparse and heterogenic data have always made it difficult to produce a broad range of reliable credit curves in Australia. CBASpectrum has sought to overcome this problem in the past through the use of a number of econometric variables and assumptions that take account of additional information such as implied default rates, sector composition, historical relativities and spread performance of other rating bands. However, disparity of the data has increased and many of these relationships have changed over the past few years, meaning that reliability of the models designed to indicate where various credits should trade has receded. Users have also tended to confuse these fair value estimates with alternative models estimating where generic credit curves have actually traded and used the data for purposes other than relative value analysis'.

⁴⁴ Australian Energy Regulator, October 2010, Victorian electricity distribution network service providers: Distribution determination 2011 – 2015, pages 472-584.

on Envestra's Access Arrangement proposal for the South Australian gas network, released in February 2011

457. It should be noted that the 10-year and 7-year AAA fair yields are no longer provided by Bloomberg. The Authority notes the AER's recently revised approach in its final decision on Victorian electricity DNSPs, relying on the use of 10-year and 7-year AAA fair yield curves (which are no longer available), will be increasingly unrelated to the prevailing conditions in the market for funds.

IPART's Proposed Method

458. IPART recently released its discussion paper seeking comments from stakeholders on its proposed method for estimating the debt margin (or debt risk premium). Three key points from the IPART's paper are summarised below:
- the data source;
 - the statistical approach; and
 - the term to maturity.
459. In considering the data source, IPART is of the view that the Australian and US bond markets appear to be the most appropriate markets to access when making its regulatory decisions. In addition, IPART suggests that the Bloomberg fair yield curves may be suitable if used together with other data sources.
460. When discussing its statistical approach IPART is of the view that using the median of the sample of bonds tends to be more appropriate than using upper, lower and mid-point values, which was its previous approach.
461. In determining the appropriate term to maturity, IPART is considering shortening the term to maturity of bonds which are used to derive the debt risk premium, from 10 years to the term that matches the regulatory period.
462. IPART has not yet decided on the method to be used for calculating the debt risk premium for its future regulatory decisions. However, the above three factors appear to be the most important considerations for IPART.

The Authority's Intended Approach: A Bond Yield Approach

463. After careful consideration of the Tribunal's decision on the ActewAGL matter in September 2010, the most recent AER's final decision on Victorian electricity DNSPs in October 2010, and IPART's discussion paper on debt margin in November 2010, the Authority considered in its discussion paper that:
- extrapolation to a 10-year term based on estimates of the fair yield curves available from Bloomberg is problematic because it could add significant inaccuracy in and inconsistency across regulatory decisions;
 - the lack of observable bonds with terms to maturity of 10 years warrants a broader sample of bonds with varying terms for deriving the debt risk premium; and
 - the 10-year BBB APT bond is a relevant benchmark but should not be the only benchmark in determining a debt risk premium commensurate with the

prevailing conditions in the market for funds and the risks involved in providing reference services.

464. In the discussion paper, the Authority proposed to discontinue the previous practice of basing the debt risk premium on a 10-year corporate bond using Bloomberg's extrapolated data but rather to base the debt risk premium on a sample of bond yields of varying terms to maturity.
465. In the discussion paper, the Authority favoured the use of the bond-yield approach, which relies on bond yields observed directly from the Australian financial market. The Authority was not persuaded that bond markets in other countries should be used to inform this analysis. The Authority has consistently used data from the Australian financial market to estimate the WACC parameters. As such, foreign investors are only recognised to the extent that they invest in the domestic market. This means that the weighting given to foreign investors should be based on their domestic level of wealth and not on their global level of wealth. Under this framework, the aggregate amount of wealth is that amount invested in the domestic market portfolio. Wealth invested outside of the domestic market is outside the model and, as such, plays no role in the pricing of domestic assets.⁴⁵
466. Australian financial data has been consistently used by Australian regulators to estimate the debt risk premium as well as other WACC parameters. As such, the Authority indicated in its discussion paper that it did not intend to depart from this current practice.⁴⁶

Consistency versus Market Relevance

467. Given the current condition of the Australian bond market, the Authority notes that most Australian corporate bonds currently traded in the market have a maturity term well below 10 years. The Authority has considered the trade-off between:
- consistency between the debt risk premium and other WACC parameters, such as the nominal risk free rate and expected inflation, in terms of a 10-year term; and
 - how well the estimates of the debt risk premium are commensurate with prevailing conditions in the market for funds and the risks involved in providing reference services ('market relevance').
468. In the discussion paper, the Authority was of the view that the market relevance of the estimates of the debt risk premium should carry more weight than the requirement of consistency with other WACC parameters. The reasons for this are twofold.
469. First, attempting to maintain consistency with other WACC parameters is likely to have reduced the level of market relevance, and this relevance is likely to be further compromised in the future.
470. In this regard, there is an inherent instability in the process of extrapolating from Bloomberg's 7-year BBB to the 10-year BBB fair yield curve. The current approach

⁴⁵ Handley, J. April 2009, *Further comments on the valuation of imputation credits*, Report prepared for the AER, 15 April 2009, page 17.

⁴⁶ The Authority is aware that, in its recent Draft Decision on the approach to estimate the debt risk premium, IPART included bonds, issued by Australian companies in the US market, denominated in American dollars, in the sample of bonds to derive the debt risk premium for its regulated businesses.

by the AER is to use the spread between the 10-year AAA and 7-year AAA fair yields. It is noted that Bloomberg ceased publishing fair yield curves for both 10-year AAA and 7-year AAA fair yield curves on 22 June 2010. Additionally, the use of 10-year and 7-year AAA fair yield curves for Australian corporate bonds will become increasingly outdated if used for future regulatory decisions. In the current financial environment, the Authority considers that it is possible that Bloomberg will continue to shorten its estimates of fair yield curves. As such, errors from the extrapolation approach may become even larger in the future.

471. Second, moving away from the 10-year term provides for a larger sample of Australian corporate bonds to be considered, which should improve the estimate of the debt risk premium. This is because any measure that relies on a small sample of data points will be less reliable than one based on a larger sample.
472. This view is further supported by the fact that individual Australian corporate bonds are often not traded daily in the Australian financial market. The daily bond prices provided by Bloomberg do not necessarily reflect executed trades in the market on the day. For some days when there are not enough trades in the market, the daily bond pricing from Bloomberg is only an approximate market value of the bond.
473. As such, a large sample of data will provide a more reliable estimate of the debt risk premium for a benchmark firm. This is also consistent with the Tribunal's view, in its decision for the ActewAGL gas network in September 2010, that the current market does not have sufficient number of long term bonds to determine fair yields.⁴⁷
474. In summary, the Authority considered in the discussion paper that there were sufficient reasons to depart from the 10-year term adopted in previous regulatory decisions on the debt risk premium:
- First, there is a significant deviation between Bloomberg's estimate of the 7-year BBB fair yield curve and observed yields from Australian corporate bonds traded in the financial market;
 - Second, Bloomberg's estimation of 10-year and 7-year AAA fair yield curves for Australian corporate bonds ceased in June 2010. The use of 10-year and 7-year AAA fair yield curves for the Australian corporate bonds will become increasingly outdated if used for future regulatory decisions.
 - Third, Bloomberg has progressively shortened its estimates of the fair yield curves across credit ratings for Australian corporate bonds. The Authority considers that it is likely that Bloomberg will again shorten its estimates of fair yield curves in the future. Using the 7-year BBB fair yield curve in deriving the debt risk premium is problematic because this approach is subject to uncertain data being available from Bloomberg.
 - Fourth, Bloomberg's method to estimate the fair yield curves is not disclosed to the public. As such, its estimates cannot be replicated. Using estimates of Bloomberg's estimates of fair yield curves lacks transparency.
 - Fifth, CBASpectrum has recently decided to cease publishing its estimates of fair yield curves for Australian corporate bonds across all credit ratings.

⁴⁷ Australian Competition Tribunal, *Application by ActewAGL Distribution [2010] ACompT 4*, 17 September 2010, paragraph 72.

The Establishment of a Benchmark Sample of Australian Corporate Bonds

475. In the discussion paper, the Authority was of the view that each bond included in the sample of Australian corporate bonds used to derive the debt risk premium for regulated businesses should ideally satisfy three criteria. The security should ideally:

1. Criterion 1: have the same Standard and Poor's credit rating as the regulated businesses (BBB/BBB+ in this case because a credit rating of BBB+ is generally adopted by regulators for regulated businesses).

The Authority believes that it is currently appropriate to include all Australian corporate bonds within the BBB band credit rating in the sample. This also reflects a conservative approach taken by the Authority in selecting the bonds in the sample. The Authority is aware that Bloomberg has used all BBB-/BBB/BBB+, known as 'BBB band', to estimate the fair yield curve for the so-called BBB fair yield curve. As such, bonds with credit rating of BBB- are also included in the sample of the bonds. However, the inclusion of bonds with BBB- credit rating would need to be subject to review over time.

2. Criterion 2: be in the same industry (the regulated utility sector); and
3. Criterion 3: have a maturity of two years or longer to ensure that there are sufficient bonds in the sample for the analysis. This criterion has been used by the AER and IPART.

476. It would be ideal to derive a sample of Australian corporate bonds that meet all three of the desirable criteria above. However, given the current state of the Australian bond market, practical (i.e. less restrictive) criteria are necessary to select a sample of the Australian corporate bonds to estimate the debt risk premium.

477. In particular, the Authority noted that there are only five bonds issued by the Australian energy sector which are currently traded in the financial market. The Authority examined the actual term of debt portfolios of the energy businesses as shown in Table 14 below.

Table 14 List of Australian corporate bonds issued by the energy sector in December 2010⁴⁸

Name of business	S&P Credit rating	Maturity	Years to maturity as at 20 December 2010
APT	BBB	22 July 2022	9.59
Santos	BBB+	23 Sep 2015	4.76
Snowy Hydro	BBB+	25 Feb 2013	2.18
Envestra Victoria	BBB-	14 Oct 2015	4.82
DBNGP	BBB-	29 Sep 2015	4.78
Sample average years to maturity			5.23

Source: Bloomberg and Economic Regulation Authority's analysis

⁴⁸ In a current sample of Australian corporate bonds as at 20 December 2010, only 5 bonds were issued by the energy sector. However, the inclusion of both Santos and Snowy Hydro bonds in the regulated energy sector is questionable.

478. The lack of liquidity in the market for corporate bonds, particularly for bonds approaching 10 year terms, suggests that the method of estimating the debt risk premium using a 10-year term is increasingly problematic.
479. Accordingly, the Authority proposed to adopt the following approach to determine the sample of Australian corporate bonds to be used to estimate the debt risk premium, using the “search” function from Bloomberg:
- credit rating of BBB-/BBB/BBB+ by Standard & Poor’s;
 - time to maturity of 2 years or longer;
 - bonds issued in Australia by Australian entities and denominated in Australian dollars;
 - inclusion of both fixed bonds⁴⁹ and floating bonds,⁵⁰ and
 - inclusion of both Bullet and Callable/ Puttable redemptions.⁵¹
480. The Authority notes that bonds issued by individual companies change over time, as does the credit rating of the company. As a result, the sample of the Australian corporate bonds will be updated for future regulatory decisions. In addition, it is noted that only bonds in the sample which are currently traded (i.e. data on fair yields available from Bloomberg) in the averaging period are included in the sample of bonds used to derive the debt risk premium.

A Method to Estimate the Debt Risk Premium from a Benchmark Sample of Australian Corporate Bonds

481. Since bonds in the sample exhibit different characteristics, such as different industries and different terms until maturity, consideration needs to be given as to whether weights should be applied to each bond to reflect their relative importance in the sample. The weighting approaches that could be adopted are:
- a simple average (or equally weighted average);
 - a ‘number-of-years-until-maturity’ approach (in which bonds with more years to maturity are given greater weight than bonds with fewer years to maturity);
 - an ‘amount-issued’ approach (where more weight is given to bonds issued in greater amounts); and
 - an approach where the median⁵² of a sample is used. For a sample with an odd number of observations, the median value is the value of the single middle observation from the sample. If there is an even number of observations in the sample, then the median is calculated as the average of the two middle values.

⁴⁹ This is a long term bond that pays a fixed rate of interest (a coupon rate) over its life.

⁵⁰ This is a bond whose interest payment fluctuates in step with the market interest rates, or some other external measure. Price of floating rate bonds remains relatively stable because neither a capital gain nor capital loss occurs as market interest rates go up or down. Technically, the coupons are linked to the bank bill swap rate (BBSW) (it could also be linked to another index, such as LIBOR), but this is highly correlated with the RBA’s cash rate. As such, as interest rates rise, the bondholders in floaters will be compensated with a higher coupon rate.

⁵¹ A callable (puttable) bond includes a provision in a bond contract that give the issuer (the bondholder) the right to redeem the bonds under specified terms prior to the normal maturity date. This is in contrast to a standard bond that is not able to be redeemed prior to maturity. A callable (puttable) bond therefore has a higher (lower) yield relative to a standard bond, since there is a possibility that the bond will be redeemed by the issuer (bondholder) if market interest rates fall (rise).

⁵² The median of a sample of observations is the numeric value which separates the higher half of a sample from the lower half when observations from the sample are arranged from the lowest value to the highest value.

482. The weighted average of yields (WAY) is defined as:

$$\text{WAY} = \sum_{i=1}^n w_i \bar{Y}_i;$$

where:

- n is the number of bonds in the sample;
- w_i is the weight assigned to bond i in the sample $\left(w_i = \frac{K_i}{K} \right)$;
- K and K_i are the total value issued (or years to maturity) and value issued (or years to maturity) of each bond, respectively, to which the weight for each bond is calculated; and
- \bar{Y}_i is the average of the fair yields for bond i in the averaging period.

Table 15 BBB-/BBB/BBB+ Australian Corporate Bonds, December 2010

No.	Name of business	Bloomberg ticker	Coupon	Maturity	Main industry
1.	APT Pipelines	E1325336 Corp	7.75	22/07/2020	Electric transmission ⁵³
2.	Bank of Queensland Ltd	EH390789 Corp	10.75	4/06/2018	Commercial Banks Non-US
3.	Nexus Australia	EI204253 Corp	3.6	31/08/2017	Special Purpose entity
4.	Nexus Australia	EI204261 Corp	3.6	31/08/2019	Special Purpose entity
5.	DBNGP Finance Co Pty	EI414656 Corp	8.25	29/09/2015	Gas transportation
6.	Dexus Finance	EI223256 Corp	8.75	21/04/2017	Mortgage
7.	Envestra Victoria Pty Ltd	EC866427 Corp	6.25	14/10/2015	Gas distribution
8.	Leighton Finance	EH911249 Corp	9.5	28/07/2014	Diversified financial service
9.	Sydney Airport Finance	EI308853 Corp	8	6/07/2015	Finance-Other Services
10.	Mirvac Group Funding Ltd	EI195249 Corp	8.25	15/03/2015	Real Estate Oper/Development
11.	Mirvac Group Finance Ltd	EI414696 Corp	8	16/09/2016	Real Estate Oper/Development
12.	New Terminal Finance	EF641357 Corp	6.25	20/09/2016	Special Purpose entity
13.	BBI DBCT Finance Pty	EF461870 Corp	6.25	9/06/2016	Diversified Financial Services
14.	Snowy Hydro Ltd	EC870795 Corp	6.5	25/02/2013	Energy - alternate sources
15.	Santos Finance	EF102609 Corp	6.25	23/09/2015	Oil Comp-Exploration & Production
16.	Wesfarmers Ltd	EH964875 Corp	8.25	11/09/2014	Retail-Misc/Diversified
17.	Wesfarmers Ltd	EH964867 Corp	7.68	11/09/2014	Retail-Misc/Diversified

Source: Bloomberg

⁵³ This is a classification from Bloomberg. APT pipelines are generally classified as a business in a gas industry.

483. Given that the current market for bonds in Australia is relatively thin for the period from 23 November 2010 to 20 December 2010, as presented in Table 15 above, the Authority makes the following observations:
484. When the credit rating of BBB-/BBB/BBB+ is targeted, 17 bonds satisfy Criterion 1 (the same credit rating) and Criterion 3 (maturity of two years and longer), but not Criterion 2 (the same industry as the regulated business).
485. When the industry-based criterion is targeted, together with Criterion 3, only a few bonds are found (e.g. APT Pipelines, Snowy Hydro, and Santos).
486. Based on the above analyses, and to provide a broad sample, the Authority considered in the discussion paper that it is appropriate to include all bonds which satisfy Criteria 1 and 3 in the sample of bonds.

Public Submissions in response to discussion paper on debt risk premium

487. In response to the Authority's discussion paper on debt risk premium, 13 public submissions were received from the following organisations:
- Verve Energy;
 - Dampier to Bunbury Natural Gas Pipeline (**DBP**);
 - WAGN;
 - Goldfields Gas Transmission (**GGT**);
 - Western Power;
 - BHP Billiton;
 - Brookfield;
 - WestNet Rail;
 - Australian Rail Track Corporation (**ARTC**);
 - Horizon Power;
 - Alinta Gas;
 - Water Corporation; and
 - WACOSS.
488. Key issues raised in these public submissions are discussed below.

Selection criteria: which bonds should or should not be included in the benchmark sample?

489. In its submission, Verve Energy suggested that the Authority monitor the inclusion of BBB- Australian corporate bonds in the benchmark sample of bonds to derive the debt risk premium. Verve Energy suggests this is to ensure that the goal of widening the capture of referable corporate debts does not change the average rating of the included businesses from BBB/BBB+. Verve Energy submits the inclusion of BBB-bonds is likely to increase the resulting debt risk premium, inappropriately

advantaging the regulated business.⁵⁴ Verve Energy also submitted that the Authority may wish to estimate the premium included in callable bonds and make adjustment from their yields when those callable bonds are included in the benchmark sample.⁵⁵

490. In a similar manner, BHP Billiton submitted that the inclusion of BBB and BBB- bonds does not reflect the recognised credit ratings of regulated assets and so could be expected to result in an upwardly biased estimate of the debt risk premium for regulated businesses. BHP Billiton considers that such bonds with credit rating of BBB and BBB- should be excluded from a benchmark sample of bonds to derive the debt risk premium for regulated businesses. BHP Billiton suggests excluding callable bonds from the benchmark sample because these bonds could be expected to trade at higher yields than those without a callable redemption.⁵⁶
491. Western Power and its consultant, KPMG, submit that bonds issued by financial institutions should be removed from the benchmark sample because they have materially different capital structures to non-financial institutions. Western Power also propose that putable bonds, hybrid securities, subordinated bonds should also be excluded from the benchmark sample.⁵⁷

Selection criteria: cut-off point

492. Western Power and its consultant, KPMG, submitted that Australian infrastructure businesses tend to have a preference for, and tend to use, longer dated funding raised both in Australia (over the past 6 months) and offshore (over the past 12 months). Therefore, they argue that bond pricing observations of less than 5 years are irrelevant when determining the cost of debt for a benchmark business.⁵⁸ KPMG proposed that the Authority give consideration to varying the criteria for the bonds included in the Authority's benchmark sample by increasing the minimum term to maturity to 5 years.⁵⁹ KPMG argues that Australian infrastructure businesses such as Toll, Asciano, AGL, Energy Gas Partnerships, United Energy Distribution, Electranet and Envestra have all sourced 5-17 year funding from offshore US markets and this is indicative of the preference for, and use of, longer dated funding.⁶⁰
493. In its submission, Alinta is of the view that the absence of Australian corporate bonds with a longer term to maturity (excluding the APT bond) might be taken to indicate that the Authority's benchmark sample of corporate bonds with term to maturity less than 5 years is likely to better reflect the prevailing market conditions in the market

⁵⁴ Verve Energy, *Estimating Debt Risk Premium*, submission in response to the Authority's Discussion Paper on Debt Risk Premium, January 2011, page 1.

⁵⁵ Verve Energy, *Estimating Debt Risk Premium*, submission in response to the Authority's Discussion Paper on Debt Risk Premium, January 2011, page 2.

⁵⁶ BHP Billiton Nickel West, submission in response to the ERA's Discussion Paper on Debt Risk Premium, January 2011, page 6.

⁵⁷ Western Power, and KPMG's supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, pages 18-20.

⁵⁸ Western Power, and KPMG's supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, page 2.

⁵⁹ Western Power, and KPMG's supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, page 14.

⁶⁰ Western Power, and KPMG's supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, page 15.

for funds.⁶¹ However, Alinta was cautious that this approach may inadequately compensate investors. As such, Alinta proposed that the benchmark sample should exclude all corporate bonds with less-than-5-year term to maturity.⁶²

494. DBP, in its submission, argued that market realities, together with the requirements of the NGR, dictate a move away from the '10 years to maturity' assumption.⁶³

The proposed four weighting approaches

495. Verve Energy expressed its concern that the Authority's adoption of a conservative weighting approach, which produces the highest value of debt risk premium, would be in favour of the regulated businesses. Verve Energy proposed the Authority adopt the most neutral position in considering the weighting approach adopted.⁶⁴
496. BHP Billiton submitted that adopting the highest outcome of the proposed four approaches would be inconsistent with the requirement of the NGL. BHP Billiton proposed the selection of the most appropriate approach should be made by detailed reviews of all aspects of each approach, and not purely on taking a conservative approach.⁶⁵

Illiquidity of bonds in the Authority's benchmark sample

497. In its submission, Australian Rail Track Corporation (**ARTC**) submits that Bloomberg may not be including certain BBB bonds in the sample it uses to construct its fair value curves if the bonds are not well priced (i.e. illiquid). The ARTC also submits that the Authority has not considered why certain bonds in its benchmark sample are not referenced in Bloomberg's sample.⁶⁶ Brookfield expresses a similar concern about the lack of liquidity in the corporate bond market.⁶⁷
498. Goldfields Gas Transmission (**GGT**) and its consultant Synergies Economic Consulting (**Synergies**), submit that the Authority does not consider the liquidity characteristics of the bonds in its benchmark sample. Synergies argued that Bloomberg only includes liquid bonds to produce a reliable estimation of the fair value curves and that, to be well-priced, the bond must be liquid to ensure that the price is reliable.⁶⁸
499. GGT and Synergies also submit that the APT bond was excluded by Bloomberg in the sample used to construct its estimate of fair value curves as at 31 December

⁶¹ Alinta, *Measuring Debt Risk Premium*, submission in response to the Authority's Discussion Paper on Debt Risk Premium, January 2011, page 3.

⁶² Alinta, *Measuring Debt Risk Premium*, submission in response to the Authority's Discussion Paper on Debt Risk Premium, January 2011, page 4.

⁶³ DBP, submission in response to the Authority's Discussion Paper on Debt Risk Premium, January 2011, page 14.

⁶⁴ Verve Energy, *Estimating Debt Risk Premium*, submission in response to the Authority's Discussion Paper on Debt Risk Premium, January 2011, page 2.

⁶⁵ BHP Billiton Nickel West, submission in response to the ERA's Discussion Paper on Debt Risk Premium, January 2011, page 7.

⁶⁶ Australian Rail Track Corporation, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, pages 3-4.

⁶⁷ Brookfield, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, page 3.

⁶⁸ GGT, and Synergies' supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, January 2011, page 11.

2010. The reason for this exclusion is that the price of the APT bond is an indicative price and due to a lack of liquidity in the bond, the price is not considered to be a reliable price.⁶⁹

500. Horizon Power and its consultant, Economic Insight, submit that if bonds issued by a regulated entity are illiquid, then an illiquidity premium should be allowed in the cost of debt. In addition, they are of the view that an illiquidity premium needs to be derived separately and it is not useful to calculate an average of the debt risk premium based on a mix of liquid and illiquid bonds.⁷⁰

Inconsistency of 'terms to maturity'

501. Western Australian Gas Networks (**WAGN**) expressed its concern that it is unclear about the way in which the nominal risk free rate is to be determined. WAGN submitted that there is obvious inconsistency in that the debt risk premium is obtained as the difference between the weighted average yields of bonds, which is less-than-10-year term to maturity, and the nominal risk free rate over the same sampling period, which is 10-year term to maturity.⁷¹
502. Western Power and its consultant, KPMG, argue that there is an inconsistency issue with regard to terms to maturity. They submit that the bond yield approach proposed by the Authority involves subtracting the observed yield on the benchmark sample of Australian corporate bonds, which have less than 10 year term to maturity, from the 10 year Government bond rate published by the RBA. They are of the view that subtracting a shorter dated security from a longer dated risk free rate is expected to systematically understate the DRP, possibly by a material amount, depending on the shape of the underlying yield curve.⁷²

Retrospective analysis

503. BHP Billiton submitted that a retrospective analysis should be undertaken using historical data that compares the results from the Authority's intended approach with that from Bloomberg's estimate of the fair value curve for the same period of time with the purpose of providing insights into any deficiencies or biases of the intended approach.⁷³

Authority consideration

504. For the ease of the discussion, the Authority considers, in turn, each of the above issues raised in the public submissions in response to the Authority's discussion paper on debt risk premium in December 2010.

⁶⁹ GGT, and Synergies' supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, January 2011, page 16.

⁷⁰ Horizon Power and Economic Insight's supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, page 8.

⁷¹ Western Australian Gas Networks, response to the ERA's Discussion Paper on Debt Risk Premium, January 2011, page 8.

⁷² Western Power, and KPMG's supporting document, submission in response to the ERA's Discussion Paper on Debt Risk Premium, 7th January 2011, page 15.

⁷³ BHP Billiton Nickel West, submission in response to the ERA's Discussion Paper on Debt Risk Premium, January 2011, pages 4-5.

Selection criteria: which bonds should or should not be included in the benchmark sample?

505. The Authority agrees that inclusion of BBB and BBB- Australian corporate bonds in the benchmark sample used to derive the debt risk premium should be closely monitored. The benchmark credit rating for regulated businesses is generally BBB+ therefore inclusion of BBB- and BBB bonds may systematically overestimate the debt risk premium. However, given that the Australian bond market is currently very thin, the Authority is of the view that inclusion of all credit rating bonds within the BBB band is warranted to ensure there are sufficient bonds available for the benchmark sample.
506. In addition, the Authority is of the view that using a large, heterogeneous source of data is likely to provide a more reliable estimate of the debt risk premium. A sample size of data is also used to determine the confidence level of an estimate.
507. The Authority also notes that the AER has used a sample of Australian corporate bonds with terms to maturity of less than ten years to test whether estimates of fair yield curves from Bloomberg or CBASpectrum fit better with observed yields of the bonds in the sample.
508. The Authority is aware of the limitations of including in the benchmark sample bonds from different industries, of less than 10 years term to maturity and with callable/putable redemption. However, as previously discussed, the Authority is of the view that a large sample of bonds will likely result in a better estimate of the debt risk premium which is then applied to regulated businesses. In addition, the key strengths for the bond yield approach are its “market relevance”, simplicity, and transparency. As a result, putting too many constraints on the selection criteria will add unnecessary and arguable complexities into the approach.

Selection criteria: cut-off point

509. The Authority agrees that the average term to maturity for the benchmark sample should ideally be a 10-year term. However, given the very thin Australian bond market at the present time, the cut-off of terms to maturity of 2 years for individual bonds to be included in the sample seems reasonable to ensure that there are enough bonds included in the benchmark sample. Other Australian regulators including the AER and IPART used the cut-off of 2 years terms to maturity in their previous decisions as noted above. The average term to maturity of the 17 bonds in the benchmark sample is 5.42 years even though the cut-off term is 2 years.

The proposed four weighting approaches

510. The Authority notes that Verve Energy and BHP Billiton argue that adopting the highest estimate of the debt risk premium among four weighting approaches would be in favour of the regulated businesses. The Authority is of the view that it is appropriate to assume that bonds with longer term to maturity should be given greater weight than bonds with shorter term to maturity to derive a weighted average for the benchmark sample. This view is also consistent with the finance principle: a risk and return trade-off. As a result, the Authority considers that a weighted average approach using term to maturity of the bonds should be used.

Illiquidity of bonds in the benchmark sample

511. The Authority is aware that some of the bonds included in the benchmark sample used in the Economic Regulation Authority's bond yield approach are not referenced by Bloomberg to construct its fair value curves.

Table 16 BBB-/BBB/BBB+ Australian Corporate Bonds used by Bloomberg and by the Authority, December 2010

No	Bonds only in the Sample used by the ERA's Bond Yield Approach	Bonds in common in both samples	Bonds only in the Sample used by Bloomberg's Fair Yield Approach
1	Apt Pipelines Ltd (2020)	Leighton Finance Ltd	Publ & Broad Finance Ltd (2011)
2	Bank Of Queensland Ltd (2018)	Wesfarmers Ltd	Energy Partnership Gas (2011)
3	Nexus Australia Mgt (2017)	Mirvac Group Funding Ltd	Transurban Finance Cmpny (2011)
4	Nexus Australia Mgt (2019)	Sydney Airport Finance	Origin Energy Limited (2011)
5	Dexus Finance Pty Ltd (2017)	Santos Finance Limited	Tabcorp Investment No 4 (2011)
6	Envestra Victoria Pty Lt (2015)	DBNGP Finance Co Pty	CLP Australia Finance (2012)
7		BBI DBCT Finance Pty	Coles Group Finance (2012)
8		Mirvac Group Finance Ltd	Holcim Finance Australia (2012)
9		New Terminal Financing	Transurban Finance Co Pt (2014)
10		Snowy Hydro Limited	

Source: Bloomberg and Authority's analysis

512. The Authority notes that 9 bonds used by Bloomberg to construct its estimates of the fair value curves are not included in the Authority's benchmark sample. Out of these 9 bonds, 8 bonds are excluded because they have terms to maturity of less than the "a minimum of 2 years term to maturity" criteria stated in the Authority's bond yield approach. The bond issued by Transurban Finance was not in the result and the Authority believes that the main reason for this is that this company is assigned with a credit rating of A- by S&P. It is noted that, in terms of credit rating for the bonds, only Australian corporate bonds with S&P credit rating of BBB-/BBB/BBB+ are included in the benchmark sample.

513. The Authority notes that bond prices from Bloomberg's data terminal can be categorised into three different groups:

- Indicative prices
- Executable prices

- Traded prices
514. Indicative prices account for nearly 90 per cent of the bond prices available on the Bloomberg bond database. Since market makers have no obligation to execute trades at indicative prices, it is not unusual to find indicative prices being very different to actual market prices.⁷⁴
 515. Executable prices are available only for bonds traded on some electronic trading platforms. However, most electronic trading platforms only offer executable prices to non-competitors and the subscription costs of accessing executable prices could be very expensive. The Authority does not currently have an access to these electronic trading platforms.
 516. The Authority also notes that around 10,000 bonds out of 510,000 bonds on the Bloomberg database currently have Composite Bloomberg Bond Trader (**CBBT**) prices, which are Bloomberg Generic (**BGN**) prices based on executable prices.⁷⁵
 517. The Authority is aware that only bonds with BGN prices are included in the sample of bonds that is used in the Bloomberg's estimates of the fair value curves. BGN price is the simple average price of all kinds of prices, including indicative prices and executable prices, quoted by Bloomberg's price contributors over a specified time window. Bloomberg also states that the availability of the BGN price for a bond is an indication of good liquidity for that bond and in some cases, bond prices from a specific pricing source are used in lieu of BGN prices (e.g. fixing prices).
 518. The Authority notes that 11 out of 17 bonds have BGN pricing data in the Authority's benchmark sample of Australian corporate bonds for the period from 23 November 2010 to 20 December 2010. The six bonds that do not have BGN pricing data for the period considered include bonds issued by APT (mature in 2020); Nexus Australia (2017); Nexus Australia (2019); Dexus Finance (2017); Envestra Victoria (2015); and Wesfarmers (2014 Floating bond).
 519. If the Authority uses CBBT prices, which are the BGN prices based on executable prices, as the pricing source for the Authority's benchmark sample for the period from 23 November 2010 to 20 December 2010, then the Authority notes that none of 17 bonds have pricing data available.
 520. The Authority notes that, when the option of "CBBT Only" (i.e. include liquid bonds only) is selected from Bloomberg' search, together with all selection criteria stated in the discussion paper on debt risk premium, only three bonds have CBBT pricing data, including bonds issued by Mirvac Group Funding (2015); Mirvac Group Finance (2016); and Snowy Hydro (2013). These three bonds are all included in the Authority's benchmark sample.
 521. As the Australian corporate bond market is very thin and illiquid at the moment the Authority is of the view that indicative prices are the best estimates of the market values of bond prices.

⁷⁴ Lee, M. (2007), *Bloomberg Fair Value Market Curves*, presentation at International Bond Market Conference 2007, Taipei, available at www.taipeibond.gretai.org.tw, accessed on 21 November 2010 or search from www.google.com.au.

⁷⁵ Lee, M. (2007), *Bloomberg Fair Value Market Curves*, presentation at International Bond Market Conference 2007, Taipei, available at www.taipeibond.gretai.org.tw, accessed on 21 November 2010 or search from www.google.com.au.

Inconsistency of 'terms to maturity'

522. The Authority agrees that there is an inconsistency when the debt risk premium is calculated as the difference between bond yields with less-than-10-year term to maturity and the 10-year CGS as a risk free rate. As such, the Authority has decided to adjust the 10-year Commonwealth Government Securities (**CGS**) rates to be consistent with the term to maturity for each of the 17 bonds in the benchmark sample. The outcome is presented in Table 17 below.
523. As presented in paragraph 365, the Authority considers that the estimated nominal risk free rate of return should be 5.61 per cent, for the period from 23 November 2010 to 20 December 2010. This nominal risk free rate is estimated for a 10-year CGS. The same principle is applied to estimate the risk free rate for Australian corporate bonds with less-than-10 year term to maturity. The risk free rate for 10-year CGS must be adjusted to reflect the fact that bonds in the benchmark sample have shorter-than-10-year term to maturity.
524. For example, column (5) from Table 17 shows that the nominal risk free rate for the APT bond with 9.59 years to maturity is 5.596 per cent for the period from 23 November 2010 to 20 December 2010. By comparison, the nominal risk free rate for the APT bond, which will be used to estimate the debt risk premium for this bond, is lower than the risk free rate for a 10-year CGS. This is consistent with the finance principle of risk and return trade-off: for longer investments with higher risks, then higher returns are required.

Table 17 Observed Yields, adjusted Nominal Risk Free Rates, and Debt Risk Premium for BBB-/BBB/BBB+ Australian Corporate Bonds, for the period from 23 November 2010 to 20 December 2010 (Per cent)

	Name of business	Terms to maturity as at 20 Dec 2010 (years)	Observed Yields (per cent)	Risk Free Rates (per cent)	Debt Risk Premium (per cent)
1	APT Pipelines	9.59	8.449	5.596	2.853
2	Bank of Queensland Ltd	7.46	8.327	5.556	2.771
3	Nexus Australia	6.70	9.574	5.508	4.066
4	Nexus Australia	8.70	9.648	5.577	4.071
5	DBNGP Finance Co Pty	4.78	8.725	5.323	3.402
6	Dexus Finance	6.34	8.469	5.472	2.997
7	Envestra Victoria Pty Ltd	4.82	6.183	5.327	0.856
8	Leighton Finance	3.61	8.882	5.235	3.647
9	Sydney Airport Finance	4.54	8.365	5.301	3.064
10	Mirvac Group Funding Ltd	4.24	8.118	5.282	2.836
11	Mirvac Group Finance Ltd	5.74	8.363	5.414	2.949

	Name of business	Terms to maturity as at 20 Dec 2010 (years)	Observed Yields (per cent)	Risk Free Rates (per cent)	Debt Risk Premium (per cent)
12	New Terminal Fin	5.75	9.064	5.415	3.649
13	Bbi Dbct Finance Pty	5.47	10.255	5.388	4.867
14	Snowy Hydro Ltd	2.18	7.390	5.119	2.271
15	Santos Finance	4.76	6.916	5.321	1.595
16	Wesfarmers Ltd	3.73	6.979	5.254	1.725
17	Wesfarmers Ltd	3.73	7.190	5.254	1.936

Source: Authority's calculations

Retrospective analysis

525. The Authority has also carried out retrospective analysis (or a backdated test) of the bond yield approach for the period from November 2005 to October 2007 – the latest period for which Bloomberg estimate of its fair yield curve for 10-year BBB Australian corporate bonds was available.
526. By using all of the selection criteria stated in the bond yield approach and searching on the Bloomberg data terminal, 67 Australian corporate bonds were found. Of these, only 14 bonds have historical pricing data. Most of the 14 bonds only have pricing data for the period from 29 March 2007 to 13 September 2007. As a result, the Authority is of the view that the period where data was available for all 14 bonds should be used to conduct a backdated test.
527. Three floating bonds are Bendigo and Adelaide Bank; CLP Australia Finance; and Santos Finance Limited (mature in 2011). Their traded margins are converted into annualised fixed equivalent yield to maturity.
528. Australian corporate bonds that satisfy all the selection criteria for the bond yield approach are presented in Table 18 below.

Table 18 BBB-/BBB/BBB+ Corporate Bonds, March-September 2010

No.	Name of business	Bloomberg ticker	Coupon	Maturity
1.	Bendigo and Adelaide Bk	EG297494 Corp	5.3667	28/03/2012
2.	CLP Australia Finance	EF167972 Corp	5.57	16/11/2012
3.	CLP Australia Finance	EF167960 Corp	6.25	16/11/2012
4.	Publ & Broad Finance Ltd	ED928366 Corp	6.28	6/05/2011
5.	Energy Partnership Gas	ED554437 Corp	6.375	29/07/2011
6.	Dexus Finance Pty Ltd	EG150658 Corp	6.75	8/02/2011
7.	New Terminal Financing Co	EF641357 Corp	6.25	20/09/2016
8.	Origin Energy Limited	EF736322 Corp	6.5	6/10/2011
9.	BDI DBCT Finance Pty	EF461870 Corp	6.25	9/06/2016
10.	Snowy Hydro Limited	EC870795 Corp	6.5	25/02/2013
11.	Santos Finance Limited	EF100832 Corp	5.44	23/09/2011
12.	Santos Finance Limited	EF102609 Corp	6.25	23/09/2015
13.	Tabcorp Investment No 4	ED640649 Corp	6.5	13/10/2011
14.	Coles Group Finance	EF023185 Corp	6	25/07/2012

Source: Bloomberg

529. The result for the backdated test for the Authority's bond yield approach and Bloomberg's estimate of the fair yield curve for 10-year BBB Australian corporate bonds for the period from 29 March 2007 to 13 September 2007 can be summarised in Table 19 below.

Table 19 Backdated Test: Bond yield approach vs. Bloomberg's estimate of fair yield for 10-year BBB bonds, (per cent)

Bond Sample	Bond Yield Approach	Bloomberg's fair yield for 10-year BBB bonds	Difference
All 14 bonds	0.989	1.326	0.336
11 bonds (exclude 3 floating bonds)	1.192	1.326	0.133

Source: Authority's calculations

530. The Authority notes that the difference between the bond yield approach and Bloomberg's estimate of 10-year BBB fair yield for the period March-September 2007 is 0.336 per cent. In comparison, when the debt risk premium derived from the bond yield approach is compared with Bloomberg's estimate of 7-year BBB fair yield for the November-December 2010 period, the difference is more than one per cent.

531. In addition, for the backdated test, the difference is getting smaller, at only 13 basis points, when all three floating bonds, namely Bendigo and Adelaide Bank (2012); CLP Australia Finance (2012); and Santos Finance (2011) are excluded from the benchmark sample (Bloomberg does not include floating bonds in the sample to construct its fair value curves).
532. This backdated test provides further evidence on the robustness of the bond yield approach. As a result, the Authority is of the view that the bond yield approach should be used to estimate the debt risk premium for regulated businesses.

Authority's Assessment

533. The Authority considered four scenarios regarding the bond yield approach based on the public submissions received in response to the Authority's discussion paper on debt risk premium:
- A full sample of 17 Australian corporate bonds (Scenario 1);
 - A shortened sample excluding all bonds with BBB- credit rating (Scenario 2);
 - A shortened sample excluding all bonds with less-than-5-year term to maturity (Scenario 3);
 - A shortened sample excluding all bonds with BBB- credit rating and all bonds with less-than-5-year term to maturity (Scenario 4).
534. For each of the four scenarios above, the following four weighted average methods, which were previously discussed, are considered:
- a simple average;
 - a term-to-maturity weighted average approach;
 - an amount-issued weighted average approach; and
 - a median approach.
535. The debt risk premiums calculated under the different scenarios and different weighted average approach are summarised in Table 20 below.

Table 20 Debt Risk Premiums under various scenarios and weighted average approach, (per cent)

Weighted Average Method	Scenario 1 (17 bonds)	Scenario 2 (13 bonds)	Scenario 3 (8 bonds)	Scenario 4 (6 bonds)	Simple Average of all 4 scenarios
Simple Average	2.915	2.858	3.528	3.348	3.162
Term to Maturity Weighted Average	3.038	2.932	3.484	3.261	3.179
Amount Issued Weighted Average	2.987	2.829	3.458	3.241	3.129
Median	2.949	2.853	3.323	2.973	3.024

Source: Authority's calculations

536. As indicated in paragraph 510, the Authority is of the view that the most relevant estimate of the debt risk premium for WAGN is obtained using a term to maturity weighted average: bonds in the benchmark sample with longer term to maturity are assigned a higher weight, and as a result, account for more significance in the value of debt risk premium for the benchmark sample. This view is consistent with the finance principle that investment in the longer term is expected to be compensated with a higher return.
537. The Authority is of the view that a simple average of all four scenarios, when the term to maturity weighted average method is used, is likely to reflect the current conditions in the market for funds.
538. As a result, for the period from 23 November 2010 to 20 December 2010 for the final decision for WAGN, the Authority is of the view that the debt risk premium of 3.179 per cent is reasonable.
539. The adoption of the debt risk premium of 3.179 per cent would also reflect a conservative position. The Authority views this decision as conservative because:
- the sample of 17 bonds observed from the market includes bonds with the feature of "Callable" redemption which, in principle, require a higher yield to compensate bondholders. The bonds issued by the Bank of Queensland Ltd and BBI DBCT Finance Pty are callable bonds. There are no bonds issued with the feature of "Puttable" redemption. It is unlikely that there will be bonds with the feature of "Puttable" redemption issued in the Australian bond market in the foreseeable future;
 - the sample of Australian corporate bonds includes BBB and BBB- bonds which, in principle, have higher yields in comparison with BBB+ credit rating bonds for regulated business; and
 - the regulated businesses have access to bank finance which, currently, is likely to be a lower cost of borrowing in comparison with bond yields.

Allowance for Debt Raising Cost

Draft Decision

540. The Authority did not approve WAGN's proposal in relation to a pre-financing cost of 16.3 basis points.
541. The Authority considered that an allowance for debt raising costs of 0.125 per cent is appropriate and that this is the only component, together with debt risk premium, to determine the cost of debt for WAGN.

Public Submissions

WAGN's Submissions

542. WAGN has maintained an allowance of 16.3 basis points for pre-financing in its allowance for debt raising costs.
543. WAGN submitted that the Authority was not correct to reject its proposed pre-financing cost. WAGN is of the view that pre-financing now imposes a real cost on service providers. If that cost is not taken into account in the setting of reference tariffs, those tariffs will be artificially low. Artificially low reference tariffs will be an inducement for inefficient (inadequate) investment in the WAGN GDS, and for inefficient (excessive) use of natural gas services by consumers of natural gas. They will not be consistent with the requirement of the national gas objective for the promotion of efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas.
544. WAGN also submits that the pre-financing cost was not counted in the allowance for the debt raising cost of 12.5 basis points which were derived from the 2004 study by the Allen Consulting Group (**ACG**). WAGN notes that the 2004 ACG study was carried out before pre-financing costs became an issue.
545. WAGN considered that the NGL and NGR do not require consistency with recognised regulatory practice in terms of inclusion of pre-financing costs in the debt raising cost.

Other Submissions

546. In its submission, Western Australian Council of Social Service (**WACOSS**) submits that an allowance for debt raising cost of 8.5 basis points (not 12.5 basis points) would reflect the efficient debt raising cost of a benchmarked firm controlling an asset similar to the WAGN network.⁷⁶ Based on the 2004 Allen Consulting Group study on the allowance for debt raising cost, WACOSS notes that the allowance for debt raising cost varied based on the tenor or time to maturity of the debt issuance and the size of the debt, with this allowance for larger debts at longer tenors relatively lower than for smaller debts at shorter tenors. For debts between \$350 million and \$700 million, the allowance was in the range of 9.0 basis points to 8.2 basis points per year. As such, WACOSS is of the view that WAGN's benchmark debt is around \$500 million and an appropriate tenor is 10 years. This would suggest the allowance for debt raising cost at the lower end of the 9.0 basis points to 8.2 basis points per year range would be appropriate.

⁷⁶ Western Australian Council of Social Service (WACOSS): WACOSS Submission to the Economic Regulation Authority's Draft Decision on Mid-West and South-West Gas Distribution Systems Revised Access Arrangement, pages 10-11.

Authority's assessment

547. The Authority considers that WAGN has not provided any convincing evidence and/or information with regard to a pre-financing cost of 16.3 basis points. Evidence submitted in response to the draft decision on pre-financing cost is effectively the same as that previously submitted. The Authority already rejected the argument concerning this issue in an earlier submission and explained its reasoning in a lengthy discussion in its draft decision.
548. The Authority agrees with information from the 2004 Allen Consulting Group study on the allowance for debt raising cost cited by WACOSS and decided to take a conservative approach by allowing a higher allowance for debt raising cost compared with the figure provided by the study.
549. The Authority's decision is not only based on the ACG 2004 study, which provided the debt of raising cost of 12.5 basis points, but also on the evidence recently provided to the AER by Associate Professor Handley from the University of Melbourne in April 2010.⁷⁷ The Authority is also of the view that, in the absence of strong evidence to the contrary, an allowance of 12.5 basis points provides regulatory certainty given that this amount has been widely used in the past by Australian regulators.
550. The Authority concludes that it is appropriate to make an allowance for debt raising costs of 12.5 basis points, on the basis that such an allowance is ordinarily appropriate and provided for by Australian regulators.

Expected Inflation

Draft Decision

551. The Authority approved WAGN's proposed method to calculate the forecast rate of inflation. 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 inflation forecasts for the next ten years. The Authority's calculation of expected inflation for the draft decision was 2.60 per cent.

Public Submissions

WAGN's Submissions

552. WAGN has not made any response in relation to the method of estimating the expected rate of inflation.
553. In its amended access arrangement, WAGN adopted an expected rate of inflation of 2.60 per cent.

Other Submissions

554. The Authority has not received any public submissions in relation to the calculation for the expected inflation.

⁷⁷ Handley, J., April 2010, *A Note on the Completion Method*, Report prepared for the Australian Energy Regulator.

Authority's assessments

555. The Authority proposes to adopt the same approach for this final decision. The forecasts on which the Authority relies for its calculations are all from the Reserve Bank of Australia's November 2010 *Statement on Monetary Policy*:⁷⁸
- 2.75 per cent for the year to June 2011;
 - 2.75 per cent for the year to June 2012;
 - 3.00 per cent for the year to June 2013; and
 - 2.50 per cent (being a mid-point estimate of the Reserve Bank of Australia's long term inflation forecasts) for each year from June 2014.
556. Using the above forecasts, the Authority has calculated the forecast inflation rate for this final decision of 2.60 per cent.
557. Based on an estimated nominal risk free rate of return of 5.61 per cent and an expected inflation rate of 2.60 per cent, the Authority estimates a real risk free rate of 2.93 per cent.

The Cost of Equity

Draft Decision

558. The Authority did not approve WAGN's proposal that other versions of CAPM, namely Black CAPM, Fama-French CAPM, and Zero-beta Fama French CAPM, are well accepted models.
559. The Authority did 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.

Public Submissions

WAGN Submissions

560. WAGN has commissioned the Strategic Finance Group Consulting (**SFG**), together with NERA who advised in the initial submissions for the revised access arrangement, to provide expert advice in response to the Authority's draft decision on the issue of the estimate of the cost of equity.
561. The Authority notes that NERA has been retained as a consultant for WAGN on the issue of the estimate of the cost of equity. However, there is no update of calculations and/or information submitted in response to the draft decision, when compared with NERA's conclusions as outlined in WAGN's proposed access arrangement.
562. For convenience, NERA's estimates of the rate of return on equity for WAGN's initial submissions are reproduced in Table 21 below.

⁷⁸ Reserve Bank of Australia, November 2010, *Statement on Monetary Policy*, available at <http://www.rba.gov.au/publications/smp/2010/nov/pdf/1110.pdf> page 62.

Table 21 WAGN's Estimated Nominal Rates of Return on Equity⁷⁹

Method of Determining Cost of Equity	Value (per cent)
Sharp-Lintner CAPM	10.22
Black (zero beta) CAPM	11.52
Fama-French three factor CAPM	11.76
Fama-French (zero beta) three factor CAPM	14.03

Estimates of the cost of equity from SFG Consulting

563. SFG has adopted two different approaches to estimate the cost of equity. First, SFG uses broker research reports produced by major broker houses, an approach known as the Dividend Yield Technique. Second, SFG has used a dividend discount model, or the residual income model, which was detailed in the 2010 working paper by Fitzgerald et al.⁸⁰

The first approach: Dividend Yield Technique

564. SFG uses research reports from various brokers⁸¹ to estimate the cost of equity for a sample of energy infrastructure firms that are engaged in gas and electricity distribution, including APA Group (**APA**), Hastings Diversified Utilities Fund (**HDF**), Envestra (**ENV**), Spark Infrastructure (**SKI**), SP Ausnet (**SPN**), and DUET Group (**DUE**). SFG argues that these are the firms that investors are most likely to consider when assessing the opportunity cost of a capital investment in WAGN.

565. SFG submits that the expected return on equity available to investors has three possible components:

- dividends;
- capital gains; and
- dividend imputation franking credits.

566. First, the estimates of dividends for a sample of comparable firms are considered. SFG submits that the expected dividend yield on the set of comparable firms is approximately 10.5 per cent per annum. This estimate is derived from the forecasts reported in the equity analyses from major broking houses. SFG also notes that the set of comparable firms used in its analysis is the traditional set of firms used by regulators to estimate equity beta and credit ratings. SFG stated that forecasts are consistent across time (2010-2012), across firms, and across broking houses.

567. Second, the estimates of capital gains are considered. Capital gains (or price appreciations) are calculated by comparing the current stock price with the broker's 12-month price target. Capital gains vary significantly between the comparable firms,

⁷⁹ WA Gas Networks: Amended Access Arrangement for the WA Gas Networks Gas Distribution Systems: Responses to Draft Decision, pages 32-35, 8 October 2010.

⁸⁰ Fitzgerald Tristan, Stephen Gray, Jason Hall and Ravi Jeyaraj, 2010 'Unconstrained estimates of the equity risk premium,' Working paper, The University of Queensland, <http://ssrn.com/abstract=1551748>.

⁸¹ Broking houses include Macquarie Bank, UBS, Wilson HTM, Morgan Stanley, Credit Suisse, Ballieu Research, Goldman Sachs JBWere, JP Morgan, RBS Morgan, Merrill Lynch.

such as 1.8 per cent per year for SKI to 22.4 per cent per year for ENV.⁸² SFG submits that the forecast capital gain estimates are less reliable. As such, SFG adopted a range of 0-1 per cent per year for real stock price and considers that this is conservative. SFG submits that if stock prices are assumed to increase at a real rate of 0-1 per cent per annum, and if expected inflation is 2.5 per cent per annum (a mid-point of a target band adopted by the Reserve Bank of Australia), the combined return from dividends and capital gains would be in the range of 13 per cent to 14 per cent per year.

568. The SFG did not provide any information with regard to the estimates of the dividend imputation franking credits.

The second approach: the residual income model

569. Whilst acknowledging that the approach of using brokers' research reports provides the advantages of being:

- quite straightforward; and
- based directly on observable published forecasts from equity analysts.

570. SFG submits that the approach faces a short forecast horizon (three to four years for dividend yield forecasts and 12 months for capital gains forecasts). As a result, SFG submits that a more complete approach, known as the residual income model, which can be used to model dividends over a longer time horizon, is needed.

571. The residual income model, used by SFG in its submission, is as follows:

$$V_0 = BVPS_0 + \sum_{t=1}^T \frac{(ROE_t - r_e) \times BVPS_{t-1}}{(1 + r_e)^t} + \frac{(ROE_T - r_e) \times BVPS_{T-1} \times (1 + g)}{(r_e - g) \times (1 + r_e)^T}$$

where:

- V_0 is the estimated value per share;
 - $BVPS_0$ is the current book value per share;
 - $BVPS_t = BVPS_{t-1} + EPS_t - DPS_t$ where DPS_t is estimated as the historical dividend payout ratio multiplied by EPS_t ;
 - r_e is the cost of equity; and
 - g is the perpetual growth; T is the length of the forecast period.
572. SFG's approach was that three parameters in its model are simultaneously estimated, including a perpetual growth (g); the long-term return on book equity (ROE_T); and the cost of equity (r_e).

⁸² WAGN Revised Access Arrangement Proposal Submission: Responses to the Economic Regulation Authority's Draft Decision, Supporting document from SFG – The required return on equity commensurate with current conditions in the market for funds, Table 3, page 12.

573. SFG has applied the above model to the same set of comparable firms, as was used in the first approach. Two data sets are used to estimate the cost of equity: (i) analyst forecasts from the I/B/E/S database;⁸³ and (ii) brokers' research reports.
574. First, using the I/B/E/S data set for 12 quarters for 3 years from 2007 to 2009, SFG reports that the average implied return on equity for a set of comparable firms is 13.6 per cent. The SFG concludes that this estimate is consistent with the range of 13 to 14 per cent derived under the first approach, using brokers' research reports.
575. Second, using the brokers' research reports from 12 November 2009 to 25 February 2010, the average implied required return on equity is 14 per cent. The SFG also concludes that this estimate is consistent with the range of 13 to 14 per cent derived under the first approach, using brokers' research reports.
576. In conclusion, based on the analyses under both approaches, the SFG concludes that a range of 13 to 14 per cent return on equity is considered appropriate when determining the allowed return on equity which is commensurate with current market conditions for funds.

Other Submissions

577. In its submission, Western Australian Council of Social Service (**WACOSS**) submitted that there are four main problems with the SFG study.⁸⁴
- First, it is inappropriate to compare the return on equity of the firms (in the SFG sample), which own multiple assets including regulated and non-regulated assets, to the return on equity for a single asset such as the Mid-West and South-West Gas Distribution Systems.
 - Second, WACOSS is of the view that dividends may not represent a good proxy for expected return on equity for the firm. Using Telstra as an example, WACOSS submits that some Boards of Directors have kept dividends artificially high out of a concern that a cut in dividends would undermine market confidence and the share price.
 - Third, franking credit levels have declined in recent years for some of the companies in the SFG's sample. As such, it is more appropriate to compare dividend yields after adjusting for franking levels. However, WACOSS notes that the SFG report did not adjust for changes in the level of dividend franking.
 - Fourth, the SFG's approach is very sensitive with the selection of the period in which expected returns to equity are calculated. WACOSS argues that selection of another restricted period would likely result in a different outcome. An example is that the average dividend yield for the SFG's sample was 9.55 per cent as at 26 October 2010.
578. Another public submission on the estimate of the cost of equity comes from Prime Infrastructure. Prime Infrastructure is of the view that the draft decision does not recognise the market realities faced by investors. Four key points from this submission can be summarised as follows:

⁸³ The Institutional Brokers Estimate System (I/B/E/S) is a unique service which monitors the earnings estimates on companies of interest to institutional investors. The I/B/E/S database currently covers over 18,000 companies in 60 countries. It provides to a discriminating client base of 2,000 of the world's top institutional money managers. More than 850 firms contribute data to I/B/E/S, from the largest global houses to regional and local brokers, with US data back to 1976 and international data back to 1987.

⁸⁴ Western Australian Council of Social Service (WACOSS): WACOSS Submission to the Economic Regulation Authority's Draft Decision on Mid-West and South-West Gas Distribution Systems Revised Access Arrangement, pages 11-13.

- First, Prime Infrastructure submitted that the application of a formulaic approach by Australian regulators, including the Authority, consistently underestimates the real cost of capital faced by investors. Prime Infrastructure is of the view that the Authority should move beyond a single-model CAPM and adopt an approach that considers a broader range of market parameters.
- Second, Prime Infrastructure submitted that the application of a single model cannot provide a reliable estimate of the expected rate of return on equity which is commensurate with prevailing conditions in the market for funds. As such, Prime Infrastructure proposed a better estimate that would be obtained by using multiple models to determine a range of outcomes.
- Third, Prime Infrastructure argued that no single CAPM can take into account technological and regulatory risk faced by investors. As such, the use of multiple CAPM models is preferred.
- Fourth, Prime Infrastructure is of the view that market uncertainties continue. As such, the uplift should remain in place until there is clear evidence that the level of market uncertainty and volatility have permanently returned to 'normal' levels.

Authority's Assessment

579. The Authority notes that the main point from Prime Infrastructure's submission is that all versions of the CAPM models should be used for the estimate of the cost of equity. The Authority has discussed this issue in detail in the draft decision. As there is no new evidence and/or information available, the Authority maintains its decision from the draft decision that only the Sharp-Lintner CAPM should be used to estimate the cost of equity.
580. The next section sets out the evaluation of the approaches used by SFG, a consultant recently appointed by WAGN to provide advice on the estimate of the cost of equity.

SFG's first approach: Dividend Yield Technique

581. The Authority notes that the brokers' research reports used by SFG are based on forecasts from some particular agencies for dividend yields, inflation, capital gains, and economic growth. The Authority is of the view that all series used as inputs for the brokers' forecasts exhibit a relatively high degree of volatility.
582. However, while forecasters have been reluctant to evaluate their own performances, there exists enough evidence to conclude that the record of economic forecasting is not encouraging.⁸⁵ Additionally, the estimate of the cost of equity using the brokers'

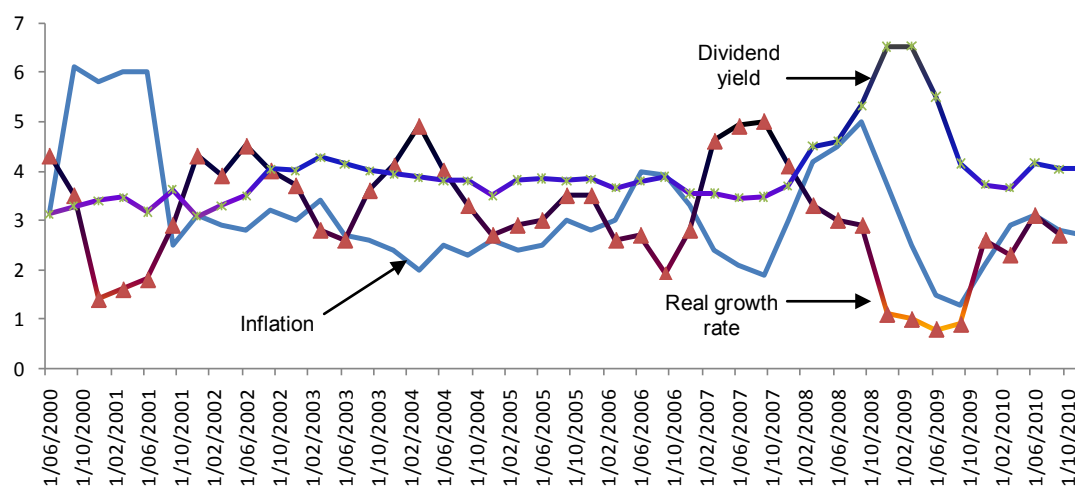
⁸⁵ For example, see Fildes, R. and Makridakis, S. (1995). The impact of empirical accuracy studies on time series analysis and forecasting, *International Statistical Review*, 63, 3, 289-308; and Hendry, D. and Clements, M. (2003). Economic forecasting: some lessons from recent research, *Economic Modelling*, 20, 301-329. For example, Clements and Hendry derive the following nine sources of forecast error as a comprehensive decomposition of deviations between announced forecasts and realised outcomes:

- shifts in the coefficients of deterministic terms;
- shifts in the coefficients of stochastic terms;
- mis-specification of deterministic terms;
- mis-specification of stochastic terms;
- mis-estimation of the coefficients of deterministic terms;
- mis-estimation of the coefficients of stochastic terms;
- mis-measurement of the data;
- changes in the variances of the errors; and

research reports involves at least three forecasts (dividend yield, inflation and GDP growth), so the error of these estimates compounds when estimating the cost of equity.

583. The Authority considers recent time series of inputs for the period from June 2000 to December 2010 (data from Bloomberg).

Figure 7 Quarterly Dividend Yield, Inflation and GDP Growth, June 2000 to December 2010 (Per cent)



584. Figure 7 reveals that all three series of dividend yields, inflation and GDP growth exhibit a relatively high degree of volatility. The Authority is of the view that, for any estimate, there is a degree of uncertainty involved that can be summarised in terms of a standard error: the higher the volatility, the higher the standard error. Standard deviations for dividend yield, inflation and GDP growth are 0.75, 1.16, and 1.12 respectively. A straight projection of these series is likely to be subject to large error.

585. Given the poor record of economic forecasting⁸⁶ on which the brokers' research reports are based, the Authority is of the view that it is inappropriate to use the brokers' research reports to derive an estimated cost of equity.

SFG's second approach: the residual income model

586. The Authority notes that the residual income model used by SFG to estimate the cost of equity for WAGN was set out in the 2010 working paper by Fitzgerald, Gray, Hall, and Jeyaraj from the University of Queensland. The Authority notes that working papers that have not been through peer review may be less reliable in comparison with a published academic paper.

587. However, regarding the second approach used in SFG's report, the Authority notes that there are some significant issues arising from its analysis, which can be summarised as follows.

• errors cumulating over the forecast horizon.

⁸⁶ See previous footnote.

588. First, there are five comparable firms in the sample, together with 12 quarters over the three-year period. If forecasts are all available, then 60 data-points are expected to be available for consideration. The study by SFG presents that there are only 21 data-points (or 35 per cent of total number of expected data-points) available for consideration. As such, the Authority is of the view that too many missing data-points in the SFG study will make the analysis more difficult and its findings become less convincing.
589. Second, there are no forecasts of the cost of equity for the above set of five comparable firms for the quarters ending on 20 June 2007, 30 June 2008 and 30 September 2009. Only two forecasts are available for a set of five comparable firms for the quarters ending on 31 December 2008 and 31 December 2009.
590. Third, using I/B/E/S data, the estimated cost of equity for the set of comparable firms varies significantly across: (i) quarters; and (ii) firms. For example, for the quarter ending on the 31 March 2007, only two forecasts are available for the firms APA and DUE with the cost of equity of 7.0 per cent and 16.0 per cent, respectively. These two significantly different forecasts are used to derive the average of the cost of equity for the entire set of five comparable firms of 11.5 per cent, being the average of 7.0 per cent and 16.0 per cent, for the quarter ending on 31 March 2007.
591. Fourth, some forecasts are implausible. For example, forecasts for DUE suggest that the cost of equity for this company is 20 per cent for the quarter ending on 30 June 2009. Three months later, the forecast cost of equity for this company decreases to 7.0 per cent, a reduction of more than 100 per cent within three months.
592. Fifth, comparing forecasts of the cost of equity for the set of five comparable firms using: (i) SFG's income residual estimates; and (ii) brokers' research reports reveals some unreliable findings as shown in Table 22 below.

Table 22 Estimates of the Cost of Equity

Authors	I/B/E/S Data	Analysts' reports	Difference
APA Group	10.2	14	-3.8
DUET Group	15.3	17	-1.7
Hastings Diversified Utilities Fund	17.5	17	0.5
Spark Infrastructure	13.3	4	9.3
SP Ausnet	11.0	18	-7.0
Average of the set	13.6	14	-0.4

Source: SFG, report on Return on equity commensurate with current conditions in the market for funds, Tables 5 and 6 and Authority's analysis.

593. From Table 22 above, the Authority is aware that the estimates using I/B/E/S data are for the period from 1 October 2006 to 31 December 2009, whereas the estimates of the cost of capital derived from analysts' reports are for the period from 12 November 2009 to 25 February 2010. However, there are significant differences in these two estimates for the same company such as APA Group and Spark Infrastructure 13.3 per cent per year, using I/B/E/S data, and only 4 per cent per

year, using analysts' reports – a difference of 9.3 per cent in these two estimates. The Authority notes that this significant difference results from the unreliable estimates produced by the two different approaches in estimating the cost of equity. As such, the Authority is of the view that these approaches should not be relied on in forming the Authority's decision on the cost of equity, to provide greater regulatory certainty.

594. The Authority notes that, even though WAGN and one of its consultants on the issue, NERA, present lengthy discussions on different versions of CAPM, namely the Black CAPM, the FFM CAPM and the zero-beta FFM CAPM, WAGN has effectively ignored the results of all four versions of CAPM and proposed the estimate of the cost of equity based on dividend yield forecasts prepared by SFG.
595. In conclusion, the Authority does not approve the use of brokers' research reports and the residual income model as proposed by SFG to estimate the cost of equity for WAGN. The Authority is of the view that WAGN and its consultants, NERA and SFG, do not provide any new and convincing evidence to depart from the widely adopted method, Sharpe-Lintner CAPM, used by Australian regulators to estimate the cost of equity for regulated businesses in Australia.

Authority's Assessment of Rate of Return: Summary

596. Based upon 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 23 Authority's Required Amendments to WAGN's Proposed Parameter Values for Determination of a Rate of Return (as at 20 December 2010)

Parameter	Value (per cent)
Nominal Risk Free Rate (R_f)	5.61
Real Risk Free Rate (R_f^r)	2.93
Inflation Rate π_e	2.60
Debt Proportion (D)	60
Equity Proportion (E)	40
Cost of Debt: Debt Risk Premium (DRP) (BBB+)	3.179
Cost of Debt: Debt Issuing Cost (DIC)	0.125
Cost of Debt: Risk Margin (RM)	3.304
Australian Market Risk Premium (MRP)	6
Equity Beta (β_e)	0.8
Corporate Tax Rate (T_c)	30
Franking Credit (γ)	53
Nominal Cost of Debt (R_d^n)	8.91
Real Cost of Debt (R_d^r)	6.15
Nominal Pre Tax Cost of Equity ($R_e^{n,pre-tax}$)	12.12
Real Pre Tax Cost of Equity ($R_e^{r,pre-tax}$)	9.28
Nominal After Tax Cost of Equity ($R_e^{n,post-tax}$)	10.41
Real After Tax Cost of Equity ($R_e^{r,post-tax}$)	7.61

Table 24 Estimates of WACC

WACC	Value (per cent)
Nominal Pre Tax WACC ($WACC_n^{\text{pre-tax}}$)	10.20
Real Pre Tax WACC ($WACC_r^{\text{pre-tax}}$)	7.40
Nominal After Tax WACC ($WACC_n^{\text{post-tax}}$)	9.51
Real After Tax WACC ($WACC_r^{\text{post-tax}}$)	6.74

597. The Authority does not approve WAGN's proposal in relation to the Rate of Return.
598. Table 20 of the access arrangement should be amended to reflect the values in Table 23 of this final decision.

Authority's proposal

In relation to Rate of Return, Table 20 of the access arrangement should be amended to reflect the values in Table 23 of this final decision

599. For the purpose of this final decision, the Authority adopts the point value, being a real pre-tax Rate of Return of 7.40 per cent.

Authority's proposal

WAGN's Proposed Revisions should be amended to adopt a real pre-tax Rate of Return of 7.40 per cent.

Working capital

Draft Decision

600. In the draft decision, the Authority did not approve WAGN's proposal for the inclusion of costs in relation to working capital and did not consider that the provision of an allowance for the costs of working capital to be appropriate for the GDS.

Public Submissions

WAGN's submission

601. WAGN has included an allowance for return on working capital as an element of total revenue in Table 28 (page 56) of the amended access arrangement information. These values are considerably less than those in Table 28 of the access arrangement information dated 29 January 2010. WAGN has not explained why the

values for return on working capital have been substantially reduced in the amended access arrangement information.

602. WAGN submitted that the requirement that no allowance be made for the cost of working capital is somewhat puzzling given the extensive discussion on the reasons for recognising that cost set out in the Authority's December 2009 final decision for Western Power's South West Interconnected Network and the Authority's May 2010 final decision on proposed revisions to the access arrangement for the Goldfields Gas Pipeline.
603. WAGN also noted that allowances for the cost of working capital have been approved by regulators in other jurisdictions, although not by the AER and the Australia Competition and Consumer Commission (**ACCC**).
604. WAGN stated that in not accepting the cost of working capital as a cost of operating the WAGN GDS, the Authority relied on the advice of the Allen Consulting Group which was provided to the ACCC. WAGN submitted that the Allen Consulting Group report was based on theoretical calculation, and neither the ACCC, nor the Authority in the context of assessing proposed revisions to the access arrangement for the WAGN GDS, gave consideration to the specific circumstances of the service provider.
605. WAGN submitted that when consideration is given to WAGN's specific circumstances, the requirement for working capital exceeds any working capital 'benefit' of the type identified by the Allen Consulting Group. WAGN submitted that this can be seen in Table 5 and Table 6, on pages 43 and 44 of WAGN's submission.
606. WAGN submitted that if the return on working capital were not included in the total revenue for the WAGN GDS, the reference tariffs determined using that total revenue would under-recover WAGN's costs. They would be inconsistent with the requirement of section 24(3) of the NGL that the service provider be provided with effective incentives to promote economic efficiency, and they would be inconsistent with the promotion of efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas. WAGN submitted that such reference tariffs would be inconsistent with the national gas objective.

Other submissions

607. No other submissions were received with respect to working capital.

Authority's Assessment

608. The Authority confirms its assessment set out in paragraphs 770 to 773 of the draft decision and maintains the view that the appropriate approach for dealing with the costs of working capital is that adopted by the AER. This approach is set out in paragraph 772 of the draft decision.
609. The Authority foreshadowed in its draft decision for the Goldfields Gas Pipeline (**GGP**)⁸⁷ that it was reconsidering its approach to return on working capital. In paragraph 341 of that decision, it noted that there are regulators, including the

⁸⁷ Draft Decision on GGT's Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline Submitted by Goldfields Gas Transmission Pty Ltd (9 October 2009).

- ACCC, Essential Services Commission (Victoria) and Independent Competition and Regulatory Commission of the Australian Capital Territory (**ICRC**) (ACT) which decline to allow a return on working capital as a component of total revenue.
610. Similarly, in the Authority's final decision on the South West Interconnected Network (**SWIN**)⁸⁸ the Authority noted that it was aware that regulators in other Australian jurisdictions have questioned whether an allowance for costs of working capital can reasonably be included in the determination of regulated revenues for utility businesses.
611. In the SWIN decision, the Authority advised that it intended to give this matter further consideration outside of the process of assessment of proposed revisions to the access arrangement for the SWIN.
612. The Authority has considered the issue of an allowance for a return on working capital within the context of the NGL and NGR. The regulatory approach set out in the NGL and NGR is a simple and transparent approach that assumes that the annual cash flow occurs at the end of the financial year. In effect, it assumes that cash inflow and cash outflow occur simultaneously on the last day of the financial year. Under this assumption, there is no need for a working capital allowance.
613. However, regulated businesses have argued that there is a timing difference between incurring expenses and receiving revenue and that this difference causes a net shortfall or net surplus in cash flow within a year. For this reason, such businesses request a working capital allowance to finance their net shortfall of cash within the year.
614. The Authority does not accept that WAGN requires a working capital allowance. As WAGN is a fixed-asset intensive business, it does not have the same issue with working capital as would an inventory intensive business. For established asset intensive businesses in a monopoly situation, it is likely that the business will experience working capital related cash flow problems only if the business is not efficiently managed.
615. The Authority notes that the general regulatory principle is to sufficiently recover cost only if that cost is efficient. WAGN's submission notes that the need for a working capital requirement is based on the delay between expenditure being incurred and revenue being received. The Authority does not consider that WAGN has provided sufficient evidence to demonstrate that it has taken steps, such as those suggested in paragraph 616 below to minimise any delay and to improve the efficiency of its working capital.
616. The Authority considers that, in a competitive market, a business could effectively manage its working capital by using a combination of policies and techniques. These include the use of debtor management to set appropriate credit policy, negotiating with upstream suppliers to obtain credits as to its short-term financing and setting appropriate payment terms with downstream customers. These actions all aim to reduce short-term cash fluctuations and to achieve effective working capital management.

⁸⁸ Final Decision on Proposed Revisions to the Access Arrangement for the South West Interconnected Network (4 December 2009).

617. WAGN's submission included a request for working capital funding for capital work in progress. The Authority's regulatory model uses capital expenditure data on an 'as incurred' basis, which means that capital expenditure is incurred and capitalised at the same time. There is no capital work in progress involved. An alternative approach is to undertake more detailed modelling, by incorporating into the model capital expenditure data on an 'as incurred' and 'as commissioned' basis. Under this alternative approach, the rate of return is applied to account for the time value of money between the time when the capital expenditure is incurred and when the project is commissioned. The amount that is added to the asset base is the amount of capital expenditure inclusive of the return on assets calculated over the period since the expenditure was incurred. Although this can be considered a more sophisticated modelling approach, it does not change the present value of the cost of service calculation (over the life of any particular asset).
618. WAGN's case for working capital is rendered less compelling by the proposed terms and conditions set out in clause 9.3 of Annexure C to the amended access arrangement revisions proposal (the Template Haulage Contract). Under this clause, delays in the payment of invoices by more than 10 business days attract interest penalties. Further, pursuant to clause 9.1(a) of the Template Haulage Contract, WAGN may give notice to the user that it will claim payment twice a month for each haulage charge or any other amount payable.
619. The Authority is not satisfied that, on the evidence presented by WAGN, there is a case for either working capital or return on working capital. The Authority's proposed access arrangement revisions will, therefore, not include provision for the costs of working capital.

Depreciation of rolling forward capital base

Draft Decision – Required Amendment 6

620. 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:*
- *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);*
 - *Conforming Capital Expenditure made, or to be made, during the Current Access Arrangement Period;*
 - *any amounts added to the Capital Base under rule 82, rule 84 and rule 86 of the National Gas Rules;*
 - *depreciation over the Current Access Arrangement Period (calculated in accordance with paragraph 9.1(a));*
 - *redundant assets identified during the course of the Current Access Arrangement Period; and*
 - *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).

Public Submissions

WAGN's submissions

621. WAGN submitted (pages 8-14) that a revised access arrangement proposal incorporating Amendment 6 would not comply or be consistent with the requirements of the NGL and the NGR. WAGN submitted that the measure of inflation which should be used for the purpose of expressing WAGN's expenditures in constant December 2009 prices is the CPI (All Groups, Perth) at the mid-point of each twelve month period. WAGN has elected not to amend its proposed revised access arrangement as required by Amendment 6.
622. WAGN stated that Amendment 6 requires that, where escalation is applied in the calculation of the opening capital base for the next access arrangement period, it is at the rate of inflation as measured by the CPI (All Groups, Eight Capital Cities) published by the ABS. WAGN referred to the access arrangement information whereby it advised that financial information is provided on a real basis, expressed in constant prices at December 2009 and escalating at the rate of inflation as measured by the CPI (All Groups, Perth) at the mid-point of the relevant year.

Other submissions

623. No other submissions were received with respect to depreciation of rolling forward the capital base.

Authority's Assessment

624. The Authority notes that the amended access arrangement revisions proposal provides in clause 9.1(b) that each of the factors in the calculation of the opening capital base for the next access arrangement period is to be escalated at the rate of inflation measured by the CPI (All Groups, Perth).
625. The Authority confirms its position set out in paragraph 784 of the draft decision. The Authority requires WAGN to measure the rate of inflation using CPI (All Groups, Eight Capital Cities) (also see paragraphs 61 to 73 above).
626. The Authority therefore does not accept clause 9.1(b) of the amended access arrangement revisions proposal. Consistent with this final decision, the Authority's proposed access arrangement revisions will measure the rate of inflation for the purpose of clause 9.1(b) using CPI (All Groups, Eight Capital Cities).

Cost of corporate taxation

Draft Decision

627. In the draft decision, the Authority approved WAGN's proposal to adopt a tax rate of 30 per cent in determining the rate of return for the WAGN GDS.

Public Submissions

WAGN's submission

628. Table 20 (page 29) of the amended access arrangement information shows that the tax rate WAGN used to calculate the real, pre-tax WACC is still 30 per cent.

Other submissions

629. The WACOSS submission in relation to corporate taxation is set out at paragraphs 353 to 357 above.

Authority's Assessment

630. The Authority confirms its assessment set out at paragraphs 358 to 359 above.
631. The Authority notes that the estimated cost of corporate income tax for the year is a building block that may be considered part of total revenue pursuant to rule 76(c) of the NGR.
632. With considerable uncertainty surrounding the proposed corporate tax rate reduction the Authority considers that the more appropriate method to deal with the potential for a change in taxation, as a component of total revenue, would be through the reference tariff variation mechanism where the reduction in the tax rate would be a cost pass through event.
633. Clause 3 of Annexure B of the amended proposed access arrangement revisions sets out WAGN's proposed cost pass through events and the procedure if such a variation occurs, giving rise to a variation on the reference tariff. Clause 3.1(iii) provides that a 'cost pass through event' includes where WAGN incurs conforming operating expenditure or conforming capital expenditure as a result of, among other things, a tax change. Clause 5 of Annexure B defines a tax change to include a change in the rate at which a relevant tax (itself defined to include any tax the effect of which was taken into account when setting the haulage tariffs which includes the company tax) is calculated.
634. The Authority is therefore satisfied that the amended proposed access arrangement revisions make provision for any future change in the rate of corporate tax to be incorporated into the reference tariff.
635. The Authority does not consider it necessary to amend clause 3(iii) to refer specifically to the possibility of a reduction in the corporate tax rate. The Authority considers that if there was a reduction in the corporate tax rate, the magnitude of the tariff impact is outweighed by the cost of any review process.
636. The Authority maintains its position in the draft decision to accept WAGN's proposal for a corporate tax rate of 30 per cent and will adopt this rate in the proposed access arrangements revisions to be drafted by the Authority.

Incentive mechanism carryover

Draft Decision

637. In the draft decision, the Authority did not approve WAGN's values for the carryover of increments for efficiency gains 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.

Public Submissions

WAGN's submission

638. Efficiency gains are discussed on pages 38-39 of the amended access arrangement information with Table 22 (page 39) setting out the efficiency gains achieved. These values for efficiency gains are substantially similar to the values set out in Table 22 of the access arrangement information dated 29 January 2010.
639. In its submission WAGN argued that the non-capital cost efficiency carryover mechanism which was in effect during the current access arrangement period allows WAGN to take account of any changes in the scope of the activities which were used in establishing the efficiency benchmarks of the mechanism. WAGN stated that during the current access arrangement period there has been a large real increase in the price of gas purchased to replace unaccounted for gas relative to the gas prices used to establish the efficiency benchmarks. This large real increase in gas price has been treated as a scope change for the purpose of applying the efficiency carryover mechanism.

Other submissions

640. No other submissions were received with respect to the incentive mechanism carryover.

Authority's Assessment

641. The Authority confirms its assessment set out in paragraphs 810 to 816 of the draft decision.
642. The Authority notes that WAGN has sought to apply the efficiency carryover mechanism on the basis that it has incurred an increase in the cost of unaccounted for gas compared with the gas price used to establish the efficiency benchmarks. WAGN sought to use this change in gas price as justification for a scope change for the purpose of applying the efficiency carryover mechanism. The Authority does not consider that the difference in gas price is justification for a scope change.
643. The Authority acknowledges that there has been a significant increase in unaccounted for gas and notes that WAGN has provided audited figures to support its submissions with respect to that issue. However, the Authority does not consider that this increase in the quantity and price paid for unaccounted for gas (UAFG), constitutes a scope change for the purposes of applying the incentive mechanism carryover pursuant to rule 76(d) of the NGR. The Authority's view is that the increase in the costs of UAFG should be dealt with as a component of forecast operating expenditure.

644. The Authority considers that the correct purpose of the incentive mechanism is a means by which a service provider can be rewarded for efficiently managing its operating expenditure. In this instance, WAGN is seeking reward for efficiency in operating expenditure by claiming that the increase in costs associated with UAFG is beyond its control and thus constitutes a shift in the efficiency benchmark; that is, a scope change for the purpose of calculating operating expenditure.
645. The Authority does not consider this to be a scope change or a proper application of the incentive mechanism and accordingly does not consider that WAGN has an entitlement, via the incentive mechanism, to claim an extra \$7.8 million in revenue measured in present value terms. This adjustment is shown in the Authority's model in Appendix 2 (input sheet, row 940).
646. The Authority has full discretion with respect to the building blocks of total revenue, including an efficiency carryover mechanism. In its discretion, the Authority does not accept WAGN's claim to an efficiency gain.
647. Further, the Authority does not approve WAGN's use of CPI (All Groups, Perth) at the mid-point of the twelve month period and requires the use of CPI (All Groups, Eight Capital Cities) at the end point of the twelve month period for escalating the value of the efficiency gains (see paragraphs 61 to 73 above).
648. The net effect of the Authority's decision with respect to the incentive mechanism carryover and efficiency gains is to reduce WAGN's total revenue by \$7.8 million measured in present value terms for the forthcoming access arrangement period.
649. The Authority's final decision values in relation to the efficiency gains component of total revenue are set out in Table 25 below.

Table 25 Efficiency gains – Adjusted by the Authority

	2005	2006	2007	2008
Non capital costs incentive				
Adjusted benchmark OPEX	43.867	43.394	42.615	41.806
Actual OPEX	39.300	40.791	40.712	37.608
Underspending	4.567	2.603	1.904	4.198
Efficiency gain/loss (-ve)	4.567	-1.964	-0.699	2.294
User initiated Capital Expenditure incentive				
Adjusted user initiated CAPEX benchmark	25.207	27.824	25.399	22.824
Adjusted user initiated CAPEX	26.331	31.286	28.252	22.978
Incremental gain	-1.124	-3.462	-2.853	-0.154
Financing gain/loss(-ve)	-0.076	-0.235	-0.193	-0.010

650. The Authority has recalculated the allowance for efficiency gains set out in Table 24 of the draft decision resulting in minor amendments to the values for efficiency gains over the period 2005 to 2008 in this final decision.

651. For the purposes of calculating total revenue in the Authority's proposed access arrangement revisions, the Authority will adopt the figure set out in Table 25 of this final decision for efficiency gains.

Forecast operating expenditure

Draft Decision

652. In the draft decision, the Authority did not approve the values of WAGN's proposed forecast operating expenditure and concluded that the appropriate values for forecast operating expenditures should be as stated in Table 22 of the draft decision.

Public Submissions

WAGN's submissions

653. Forecast operating expenditure is discussed at page 20 of the amended access arrangement information with Table 19 (page 20) showing the values of forecast operating expenditure over the forthcoming access arrangement period, expressed in December 2009 dollars.

Network costs

654. WAGN has elected not to remove the one off network costs incurred as a result of the delayed implementation of the NGL and NGR in Western Australia from the forecast of operating expenditure used to determine total revenue and the revised reference tariffs for the WAGN GDS (pages 39-41).
655. WAGN submitted that the haulage reference tariffs set out in Table 27 of the draft decision have been determined from total revenue calculated using a forecast of operating revenue which did not include estimates of certain costs which WAGN expected to incur as a result of delays in the implementation of the NGL and the NGR in Western Australia.
656. WAGN noted the Authority's position with respect to rule 91(1) of the NGR and that WAGN could have lodged its access arrangement revisions proposal without delay, at the end of the current access arrangement period.
657. WAGN submitted that faced with the very real prospect of a major change in regulatory regime and knowing that, once the change in regulatory regime had occurred, the new regime would govern key aspects of WAGN's business, WAGN decided to prepare and submit its access arrangement revisions under the scheme of the new regime.
658. WAGN stated that it commenced preparation of the revisions in early 2008, and set out the timeline of the introduction of the NGA into Western Australia. WAGN submitted that it proceeded cautiously and sought further time in which to submit its proposed revisions which the Authority approved. WAGN noted the unexpected delays which did not see the NGA receive assent until 1 September 2009 and the *National Gas Access (WA) (Local Provisions) Regulations 2009* published until 31 December 2009.

659. WAGN submitted that its decisions on whether to proceed under the new regime were made under uncertainty and that it sought advice from the Office of Energy and the Authority. WAGN submitted that reverting to preparation of the access arrangement revisions proposal under the regime of the Code would be a long and difficult process, with the risk that the change would be undone by the new regulatory regime becoming law in Western Australia before the revisions were submitted.
660. WAGN acknowledged that in retrospect, it should not have decided to prepare its access arrangement revisions proposal under the scheme of the NGL and the NGR as the costs which WAGN has incurred as a result of the delay appear imprudent. WAGN submitted, however, that a view in retrospect ignores the fact that decisions were made, over a period of time, in conditions of uncertainty. A more reasonable view, according to WAGN, would consider the circumstances, and the information which was available to WAGN, as it proceeded with the proposed revisions for the WAGN GDS.
661. WAGN submitted that, on this view, its decision making was sound. WAGN chose to adopt and work with the new regulatory regime, which had been implemented elsewhere in Australia, which would govern its future operations in Western Australia, and which was about to be implemented in Western Australia. WAGN stated that there were unexpected delays in the implementation of the new regime, and additional costs would, in consequence be incurred by WAGN which were, in the circumstances, not imprudent.
662. WAGN submitted that if such costs were ignored, they would lead to revised reference tariffs which under-recover WAGN's costs. These tariffs would be an inducement for inefficient (inadequate) investment in the WAGN GDS, and for inefficient (excessive) use of natural gas services by consumers of natural gas. They would not promote economic efficiency and would not be consistent with the national gas objective.

Unaccounted for gas

663. WAGN submitted that the tariffs set out in Table 27 of the draft decision have been determined assuming, among other things, that the forecast for unaccounted for gas (**UAFG**) included in the forecast operating expenditure, and in the total revenue, is to be calculated at a rate that does not reflect the real UAFG rate relating to the delivery of gas on the WAGN GDS. WAGN submitted that the actual UAFG rate is higher than that allowed for by the Authority when determining the tariffs set out in Table 27 of the draft decision.
664. WAGN noted that the Authority had seen the UAFG reported for 2008 as an anomalous result of the Varanus Island incident. WAGN argued that the Authority had failed to provide reasons for forming the view that the reported volume for 2008 UAFG was not anomalous nor had the Authority provided a reason for why a lower volume of gas haulage might lead to an anomalous level of UAFG.
665. WAGN submitted that the UAFG rate for both 2009 and 2010 was higher than the rate used in the draft decision. It further submitted that in 3 of the 5 years of the current access arrangement the actual rate of UAFG has been higher than that allowed for in the Authority's proposed forecast rate.
666. WAGN submitted that the method used by the Authority to calculate UAFG is erroneous and fails to provide an accurate measure of the rate of UAFG in any given

year. WAGN stated that the Authority used the annual quantity reported for the WAGN GDS for the period 12 months to 31 December of the preceding year then divided this quantity by total throughput to 30 June the following year. As the period over which UAFG is reported and the period over which throughput is measured are different, WAGN argued that the Authority's method of calculation is likely to understate the UAFG rate.

667. WAGN noted that the calculation of gas it must purchase to replace the UAFG is calculated by REMCo, an independent third party. However, in its Asset Management Plan, WAGN reported UAFG for the 2007/2008 financial year based on its internal data rather than REMCo data. As a result, the UAFG figure in the Asset Management Plan is not necessarily comparable to the REMCo data.
668. WAGN conceded that there had been a long term rise in UAFG but that the reasons for this rise were unclear. WAGN has not materially changed its construction and maintenance methods over the period of the current access arrangement. WAGN has discussed this issue with EnergySafety. The result of this discussion is a proposed independent study into the causal factors for UAFG which would take at least one year to complete. If the study revealed reasons for the rise in UAFG, WAGN could then plan and carry out appropriate corrective works. WAGN therefore submitted that it could not effect a change in the UAFG rate before July 2014. WAGN noted that it had not allowed for either the proposed study, or any remedial work, in the capital and operating expenditure for the period 2010 to 2013/2014.
669. WAGN submitted that if it were to adopt the forecast rate for UAFG proposed by the Authority and this rate was used by WAGN to calculate the cost of purchasing replacement gas, the reference tariffs would under-recover WAGN's costs. This would fail to promote economic efficiency and therefore be inconsistent with both section 24(3) of the NGL and the national gas objective.
670. On 24 December 2010, WAGN wrote to the Authority providing additional information with respect to UAFG. WAGN submitted that the actual rate of UAFG reported on a monthly basis has consistently tracked about the target benchmark. WAGN further submitted that the rate of UAFG has continued to rise. WAGN argued that the actual UAFG for the period January 2010 to November 2010 measured as a rolling 12 month average with 4 month lag, is higher than the rate allowed by the Authority in the draft decision and that this supported WAGN's view that there had been a long term rise in UAFG volumes. WAGN submitted that UAFG is calculated by an independent third party and that WAGN was unclear as to the reasons for the rise in UAFG given it has not materially changed the methods for maintaining and constructing the GDS. WAGN noted that it was investigating the rise in UAFG and was engaged in dialogue with EnergySafety on this topic.

Other submissions

671. WACOSS submitted (pages 16-18) that WAGN's forecast operating expenditure was worse than historical operating expenditure when compared against the three benchmarks of operating expenditure per kilometre of main, operating expenditure per GJ delivered and operating expenditure per customer connection. WACOSS expressed concern about this upward trend across all operating expenditure measures and suggested WAGN may be seeking more forecast operating expenditure than it actually requires. WACOSS conceded that WAGN had sought to justify the above trend operating expenditure proposal on the basis of higher UAFG (discussed below at paragraphs 675 to 678), higher regulatory costs, higher

corporate costs allocated to WAGN within its group of companies and higher labour costs.

672. WACOSS further submitted that WAGN should report its operating expenditure performance against a regulated asset base (**RAB**) benchmark as this provides a better benchmark than operating expenditure per GJ delivered and is an appropriate proxy for the size of the network. WACOSS noted that the RAB benchmark should not include UAFG as this is not comparable across networks. WACOSS provided a table setting out operating expenditure per RAB performance based on Table 22 of the Authority's draft decision, adjusted to remove UAFG and marketing costs. WACOSS argued that if the Authority's draft operating expenditure allowance is confirmed, its performance in the upcoming access arrangement period will be consistently worse, with a range of 5.9 to 5.5, than in the current access arrangement. WACOSS noted that Australian gas distribution networks typically deliver an adjusted operating expenditure per RAB in the range of 3 to 6, with an average of 4. WACOSS submitted that the operating expenditure allowance in the draft decision should therefore be more than is necessary for WAGN to perform its operating and maintenance activities.

Network costs

673. WACOSS submitted that WAGN had not presented reasons for why regulatory costs would be higher under the NGL and NGR than under the Code nor is it clear why this would be the case. WACOSS argued that the NGL and NGR are an evolution from the Code and not a radical change, and that regulatory costs under the NGL and NGR should gradually decrease as regulated firms become more familiar with economic access regulation.
674. WACOSS submitted that WAGN had not made it clear why it had been allocated a higher proportion of corporate costs following the restructure of its group of companies since the delivery of reference services is fundamentally the same. Ring-fencing provisions of both the Code and NGL/NGR oblige WAGN to maintain separate accounts from other activities and to allocate shared corporate costs appropriately between the different entities within the group. WACOSS noted that, as accounting practices should be consistent between periods, there should not be any increase in allocation of corporate costs to WAGN. WACOSS argued that any increase in allocation of corporate costs brought into question the effectiveness of WAGN's accounting and ring-fencing compliance.

Unaccounted for gas

675. WACOSS submitted (pages 18-19) that little information was provided by WAGN to determine whether the allowance for UAFG was appropriate. WACOSS noted that the only publicly available information was that the forecast cost for UAFG was based on a gas price received as a result of the tender process but conceded that the Authority may be privy to further information about the tender process. WACOSS argued that 'questions remained' for interested parties but that its belief was that the allowance for UAFG was possibly too high.
676. Firstly, WACOSS expressed concern about the tender process and the market competitiveness of the tender price. Secondly, WACOSS argued that if the duration of the tender did not match the duration of the access arrangement then the tender is not an appropriate measure for UAFG because shorter and longer term gas prices invariably differ. Thirdly, WACOSS expressed concern that the tender price should

be taken into account. WACOSS submitted that the tender price may only be theoretical and not reflect the price actually paid by WAGN. WACOSS noted that the UAFG forecast by WAGN in the October 2010 AAI was \$1.068m higher than in the AAI submitted in January 2010 and that WAGN has not explained this difference. WACOSS argued that WAGN should explain the variation in UAFG. Fourthly, WACOSS expressed concern that there may be a double counting of UAFG. If, as is the case for some distribution networks, shippers pay for or supply UAFG as part of their shipping contract, there should be no allowance for UAFG.

677. WACOSS submitted that it may be appropriate for the Authority to test the cost of UAFG because the recent high prices for gas may be an aberration as a result of the global financial crisis and the Varanus Island explosion. WACOSS noted that Verve is currently litigating against its suppliers on the basis that gas prices following the Varanus Island explosion were atypical and that prices will return to trend levels. WACOSS argued that heavy reliance on 2007 and 2008 prices to forecast UAFG may be dangerous.
678. WACOSS expressed concern that WAGN may not be applying full competitive rigour in minimising the price and amount of UAFG. This may mean the tender process itself was not competitively rigorous. WACOSS argued that the tender outcomes for UAFG should be tested against a second tender, particularly a second tender with the same tenor as the access arrangement. Further, WACOSS expressed concern that the incentives for WAGN to rigorously manage UAFG may not be sufficient and considered it appropriate for UAFG reduction targets to be set for the WAGN GDS. WACOSS argued that a targeted reduction of 1 to 2 per cent per annum would reflect the natural falls that would be expected as the network is renewed (in line with the capital expenditure WAGN has proposed in its amended access arrangement information) while also providing incentive for active management of UAFG. WACOSS noted that the AER has set UAFG targets for networks such as the ActewAGL network which are under those proposed by the regulated business.

Authority's Assessment

679. Pursuant to rule 76(e) of the NGR, the Authority has full discretion with respect to the total revenue, of which one building block is forecast operating expenditure. However, pursuant to rule 91(2), the Authority's discretion with respect to the criteria for operating expenditure is limited.

Network costs

680. The Authority considered future operating expenditure network costs at paragraphs 860 and 861 of the draft decision.
681. The Authority notes WAGN's submissions but maintains its position that these one-off network costs do not meet the criteria in rule 91(1) of the NGL. Further, the Authority maintains its view that any costs incurred by WAGN as a result of its request for 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.

Unaccounted for gas

682. In considering WAGN's submissions with respect to UAFG, the Authority must consider both the costs for UAFG and the percentage of UAFG used to forecast the cost of UAFG. The Authority notes the submission made by WACOSS but confirms its position set out in paragraph 851 of the draft decision that it is satisfied that the price WAGN proposed with respect to the cost of UAFG complies with the requirements of rule 91(1) of the NGR because a tender process was used by WAGN to determine that price. The Authority was made aware of the tender process prior to it being implemented. The Authority is satisfied with the outcome of the tender process and with the price that resulted from the tender process.
683. In the draft decision, the Authority determined a forecast rate for UAFG of 2.4 per cent, measured as unaccounted for gas as a percentage of total gas throughput. The reasoning for which is set out at paragraphs 852 to 859 of the draft decision. The Authority notes that actual UAFG rates reported by WAGN for the past 5 years have indicated a significant increase over that period. Further data provided by WAGN indicates another sustained, upward trend. The Authority further notes that WAGN is aware of this increase but cannot explain the significant upward trend in rates of UAFG.
684. The Authority has to consider whether WAGN is conducting itself as a reasonable and prudent operator in the way it is proposing to manage both the long term upward trend in the rate of UAFG and the current short term escalation of the reported rate. WAGN's proposed response is to enter into a discussion with EnergySafety about a proposed long term study into the causal factors of the upward trend and escalation of UAFG rates. WAGN has stated that this study will take at least 12 months to complete and that it is unlikely that any changes to the GDS will have an effect on the rate of UAFG over the course of the next access arrangement period.
685. The Authority is aware that UAFG is not just a matter of leaks and meter errors but is a complex issue that can be affected by a diverse range of factors including system architecture in general, and metering in particular, choice of materials, length of pipes and load factor. The Authority accepts that the cause of the rise in UAFG is unlikely to be a result of anything WAGN has done recently, nor that it is merely an increase in system leakage. However, the Authority is also aware that an independent technical study would enable improved accuracy in UAFG measurement and would contribute in determining the reasons for increases in UAFG as currently measured. The Authority's view is that this may facilitate WAGN's efficient operation of the GDS and to this extent the Authority would support reasonable and prudent expenditure that addresses and mitigates the rate of UAFG.
686. Since the draft decision was published and WAGN made submissions in response to that draft decision, including a submission with respect to UAFG, WAGN has provided additional information to the Authority which shows that recent 'actuals' for the volume of UAFG are, in fact, higher than WAGN's own percentages. The Authority considers that it should adopt a conservative approach to UAFG and accept the percentage and volume for UAFG submitted by WAGN in response to the draft decision. The Authority's approach in this regard is supported by the recommendations of EnergySafety. The Authority considers that there may be a commercial advantage to WAGN if it can address the percentage and volume of UAFG over the forthcoming access arrangement period and that this should act as an incentive for WAGN to ensure prudent and efficient operation of the WAGN GDS.

687. The Authority notes that EnergySafety is proposing a review of the appropriate measure for unaccounted for gas. This review may also address difficulties associated with the current well-recognised measure for UAFG.
688. As the Authority's discretion is limited, the Authority has to be satisfied that operating expenditure complies with the applicable requirements of the NGL and complies with any applicable criteria prescribed by the NGL. Whilst acknowledging that this is a different result from the Authority's draft decision, keeping in mind the matters raised above, the Authority is satisfied that WAGN's proposed operating expenditure in respect of UAFG meets those requirements because it is now supported by the independent third party, REMCo, and the Authority's technical consultant, EnergySafety.

Calculation of total revenue

Draft Decision

689. The Authority did not approve the values of WAGN's proposed forecast operating expenditure and concluded that the appropriate values for forecast operating expenditure should be as stated in Table 22 of the draft decision.

Public Submissions

WAGN's submissions

690. Total revenue is dealt with on pages 56-58 of the amended access arrangement information with Table 28 setting out the proposed values of total revenue for the forthcoming access arrangement period, expressed in December 2009 dollars.
691. Where WAGN has made a submission with respect to each component in the calculation of total revenue, the submission is set out in the relevant section above.

Other submissions

692. Where a party has made a submission with respect to each component in the calculation of total revenue, the submission is set out in the relevant section above.

Authority's Assessment

693. As a result of the Authority's final 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 for total revenue for the forthcoming access arrangement period.
694. Table 26 below shows the Authority's final decision values in relation to total revenue.

Table 26 Total revenue - Adjusted by the Authority - (\$ million, December 2009)

	2010 ¹	2010/11	2011/12	2012/13	2013/14	Present Value
OPEX	28.834	60.875	61.589	61.599	62.144	227.133
Efficiency Gain	1.842	1.438	0.292	1.837	1.142	5.573
AA2 Over Depreciation	-10.687	-	-	-	-	-10.315
Depreciation	10.948	23.723	25.861	27.963	30.007	97.074
Asset Disposal	-	-	-	-	-	-
Return on Asset	28.188	59.622	61.213	63.291	65.094	228.528
Return on Working Capital	-	-	-	-	-	-
Cost of Service	59.123	145.657	148.954	154.690	158.387	547.993

¹ 1 January 2010 to 30 June 2010 only

695. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt the values for total revenue set out in Table 26 of this final decision.⁸⁹

Reference Tariffs

Prudent discounts

Draft Decision

696. In the draft decision, the Authority approved WAGN's use of prudent discounts as proposed.

Public Submissions

WAGN's submissions

697. Prudent discounts are discussed at pages 57-58 of the amended access arrangement information, with Table 29 (page 58) showing the revenue expected to be received from users in respect of reference services provided at discounted reference tariffs.

698. This information has been revised by WAGN and is different from the revenue from reference services provided at discounted reference tariffs set out in the access arrangement information dated 29 January 2010.

Other submissions

699. No other submissions were received with respect to prudent discounts.

⁸⁹ Information from the Authority's financial model used to calculate Total Revenue and Reference Tariffs is provided in Appendix 2 of this Final Decision.

Authority's Assessment

700. The Authority confirms its assessment set out in paragraphs 903 to 908 of the draft decision.
701. In its draft decision, the Authority noted that it may approve an application by a service provider to provide a discount to a user, a particular class of users or prospective users if the conditions set out in rule 96(2) of the NGR are satisfied.
702. In making its draft decision, the Authority considered WAGN's proposed non-discriminatory policy with respect to discounted tariffs. The Authority also considered the public submissions and confidential information provided by WAGN. The Authority approved the prudent discounts on the basis, firstly, that they promoted efficiency and, secondly, they resulted in lower reference tariffs than may otherwise have been possible.
703. The Authority has considered the amended proposal from WAGN as regards prudent discounts and accepts the values set out in Table 29 of the amended access arrangement as the appropriate deduction from total revenue to be used in setting the reference tariffs for the current access arrangement period.
704. For the purposes of the Authority's proposed access arrangement revisions the Authority will adopt the values in Table 29 of the amended access arrangement information (page 58) for ease of reference this table is reproduced below.

Revenue form Reference Services provided at discounted Reference Tariffs (\$ million, December 2009)

	2010 ¹	2010/11	2011/12	2012/13	2013/14
Revenue	1.613	3.272	3.286	3.250	3.161

¹ 1 January 2010 to 30 June 2010 only

Revenue equalisation requirements

Demand forecasts

Draft Decision

705. In the draft decision, the Authority approved WAGN's forecast volumes of gas delivered to A1, A2, B1 and B2 customers, but did not approve WAGN's forecast volumes of gas delivered to B3 customers. For the purposes of the draft decision, the Authority assumed an average forecast volume of 18.5 GJ for each B3 customer.
706. Further, in the draft decision the Authority approved WAGN's forecast customer numbers by tariff class. The Authority did, however, require WAGN to provide updated information on forecast volumes and customer numbers following publication of the draft decision.

Public Submissions

WAGN's submissions

707. Forecast use of pipeline capacity is discussed on pages 17-19 of the amended access arrangement information with Table 17 (page 18) showing updated forecast volumes of gas delivered by tariff class and Table 18 (page 18) showing updated forecast customer numbers by tariff class.
708. On 24 December 2010, WAGN provided the Authority with additional information setting out the actual volumes for Tariff B3 customers compared with the January 2010 submission and the previous year for the period January 2010 to November 2010.
709. WAGN submitted (pages 49-54) that it has updated its customer numbers using actual data to 30 June 2010 and that this has resulted in an amended forecast customer base. Trends in consumption per customer to 30 June 2010 have been used to forecast total volume for B1, B2 and B3 customers resulting in a change of approach for B1 and B2 customers from the January 29 submission which was based on forecasts WAGN obtained from the National Institute of Economics and Industry Research (**NIEIR**). WAGN noted that the NIEIR forecast for B3 customers was close to the "actuals" for the period to 30 June 2010.
710. WAGN noted that A1 customer numbers have been adjusted to "actuals" at 30 June 2010 resulting in a reduction of 1 to 2 per year in forecast customer numbers. The total volume for the 6 months to 30 June 2010 was 3.2 per cent below NIEIR's forecast. As a result, WAGN has continued to rely on the forecast total volume set out in the April 2009 NIEIR report and not factor in the change in customer numbers.
711. With respect to A2 customers, WAGN submitted that A2 customers have exhibited a decline in average usage. WAGN stated that the total volume for the 6 months to 30 June 2010 was only 0.3 per cent above the NIEIR forecast so WAGN has continued to use that forecast.
712. WAGN submitted that it has connected between 30 and 50 new B1 customers annually over the past 2 years and that the forecast number of B1 connections set out in its proposed revised access arrangement submitted in January was lower than recent experience. For its amendments to the access arrangement, WAGN has forecast 40 new B1 customer connections annually, a rate in the upper limit of the range proposed by NIEIR in April 2009 but consistent with the new connection rate for B1 customers in the period January to June 2010. WAGN stated that it had therefore revised its forecasts connections capital expenditure to be consistent with these forecast figures.
713. WAGN submitted that the NIEIR April 2009 figures forecast for B1 customers were overstated as this customer class has been declining regardless of economic conditions. WAGN attributed the decline to end use customers adopting more energy efficient equipment. WAGN submitted that, in its amendments to the access arrangement proposal, it has assumed that B1 customer average use remains constant at the actual level for 2009/2010 for the period 2010 to 2013/2014 but conceded that this may be an overstatement as the actual B1 average for the period January to June 2010 was 1.7 per cent below forecast.

714. WAGN submitted that it connects about 500 new B2 customers annually. It further submitted that the number of B2 connections forecast in the access arrangement revisions proposal submitted in January 2010 was lower than recent experience hence in its amendments to the access arrangement proposal. WAGN has forecast 40 new B1 customer connections per year, consistent with the new connection rate for this tariff class in the period January to June 2010. WAGN noted that it had adjusted its forecast connections capital expenditure accordingly. WAGN further noted that average B2 usage has declined because the largest group of new B2 customers are at the low end of usage. WAGN stated that many of these customers were previously B3 customers but they now required larger meters due to the higher peak load of larger gas appliances. WAGN submitted that the NIEIR forecast average usage for the B2 tariff class had been reasonably accurate to 30 June 2010 so it has been retained for the amended access arrangement proposal.
715. With respect to the B3 tariff class, WAGN noted that the draft decision required it to use a forecast of 18.5GJ per B3 customer in the amended access arrangements revisions proposal. WAGN argued that the reasons given by the Authority for this forecast are inconsistent with the facts. WAGN submitted that average use by B3 customers has declined and is now below the forecast average submitted by WAGN in its January 2010 access arrangement revisions proposal. WAGN argued that there is no basis for assuming an average B3 customer usage of 18.5GJ per year so the forecast average provided by WAGN in its January 2010 submission is still the best estimate in the circumstances. WAGN stated that it had sought a revised forecast of residential customer connections from Economics Consulting Services and set out the revised forecast for customer connections in Table 14 (page 54) and for total volume in the B3 tariff class in Table 15 (page 54) of its submission dated 8 October 2010. WAGN noted that total B3 volume was 0.15 per cent above that forecast for the 6 months to 30 June 2010. WAGN stated that, while it has proposed to significantly increase its marketing budget, it does not expect that this will do anything more than limit the decline in average B3 usage to that forecast.
716. WAGN has provided the Authority with further confidential information regarding volumes for Tariff B3 customers which the Authority has accepted as a late submission.

Other submissions

717. WACOSS submitted (pages 23-27) that the demand forecast for B3 tariff customers adopted by the Authority of 18.5GJ per annum is too low. WACOSS submitted that it believed the average gas demand by B3 customers would grow steadily from the current level of 19.12 GJ to 19.5GJ per annum by 2013-14. WACOSS argued that the forecast 18.5GJ per annum will lead to higher than appropriate tariffs where actual B3 customer usage is higher than 18.5GJ because tariffs are based on a price cap approach. WACOSS noted that if average B3 usage was 19GJ per annum over the access arrangement period, the tariffs would be overstated by 2.6 per cent and overstated by 5.1 per cent if actual usage was 19.5GJ per annum. WACOSS argued that the Authority's own analysis seems to suggest an average of 19GJ per annum for B3 customers but the Authority's draft decision recommends a value of 18.5GJ without specifically providing for the adjustment.
718. WACOSS submitted that the lower forecast of 18.5GJ is significantly below historical usage levels and below the trend rate for the marginal decline in gas usage. WACOSS noted that there has been a declining trend in actual gas usage for B3 customers but that the trend down has never been more than 1 per cent and is

averaging 0.66 per cent. A drop from 19.12GJ per annum in 2009 to 18.5GJ in 2010-2011 is a one-step 3.24 per cent drop. WACOSS argued that if the historical trend continued, there would be a drop of less than 3 per cent by 2013-2014.

719. WACOSS submitted that there were strong reasons to believe that the historical downward trend would cease and reverse. One basis on which this would occur, WACOSS argued, was the relative impact of the change in electricity prices compared with gas prices. WACOSS cited Akmal and Stern (2001) to argue that gas and electricity are strong substitutes and that the demand for gas was more sensitive to electricity price variations than to gas price variations. WACOSS noted that in Western Australia residential electricity prices have been suppressed for long periods where residential gas prices have been steadily rising and this has suppressed gas demand. Since 2007-2008, electricity prices have started to rise but this has yet to impact on the gas demand seen over the 2005 to 2009 period, particularly as gas prices have also risen strongly since 2007-2008. WACOSS submitted that electricity prices will rise more strongly over the next access arrangement period, citing the Office of Energy recommendation of an increase of 52 per cent in electricity tariffs in 2009-2010 and a further 26 per cent in 2010-2011. WACOSS further noted that the Office of Energy's interim review of gas prices recommended an increase of 7 per cent in tariffs in July 2010 attributable to increased wholesale gas commodity prices. WACOSS submitted that if electricity prices continue to increase more strongly than gas prices, then an increased demand for gas could be expected for residential users over the next access arrangement period. WACOSS argued that this probability should be reflected in demand forecasts for gas use for B3 customers over the next access arrangement period.
720. WACOSS noted that the Global Financial Crisis (**GFC**) and Varanus Island explosion impacted on residential and small business gas usage and that the Authority relied on averaging 2007 and 2008 data rather than relying on 2008 data alone. WACOSS argued that this averaging may understate the impact of the explosion on B3 customer demand. WACOSS noted that if gas consumption over the 2005 to 2009 period is analysed, the reduction in demand in 2008 is greater than in any other year of the current access arrangement. Further, WACOSS noted that both WAGN and the Authority had touched on the impact of the GFC but that, as gas demand exhibits strong income elasticity effects, the reduction in gas demand as a result of the GFC is arguably small in comparison with other areas of consumer demand.
721. WACOSS submitted that the net effects of the Varanus Island explosion and the GFC have reduced gas demand in the 2007 to 2009 period but these effects are unlikely to significantly affect gas demand in the upcoming access arrangement period. WACOSS argued that it was more likely that the declining trend for gas demand by B3 customers was likely to reverse and start to increase.
722. Finally, WACOSS submitted that the demand forecast for B3 customers should rise to approximately 19.5GJ by 2013-2014 and that this would reduce tariffs by approximately 5.4 per cent in 2013-2014 from the tariffs calculated on an estimated usage of 18.5GJ per annum.
723. Alinta made a confidential submission to the Authority regarding historical consumption and forecasts for Tariff class B3 customers which the Authority has accepted as a late submission.

Consultant's Reports

724. In its report dated November 2010, Frontier Economics (pages 7-9) considered WAGN's response to the draft decision with respect to volume forecasts. WAGN stated that gas volumes per customer across most tariff forecasts are in sustained decline. Frontier Economics submitted that this implied that forecast incremental revenue had been overstated and that the approximate overstatements were 13 per cent for B1 tariff class customers, 12 per cent for B2 tariff class customers and 8 per cent for B3 tariff class customers. In its spreadsheet pursuant to Rule 79(2)(b), Frontier Economics revised per customer volumes for all B tariff class customers downwards by 10 per cent. Frontier Economics noted that the effect of this revision was to postpone by four years the date at which forecast capital expenditure satisfies the net incremental revenue test.

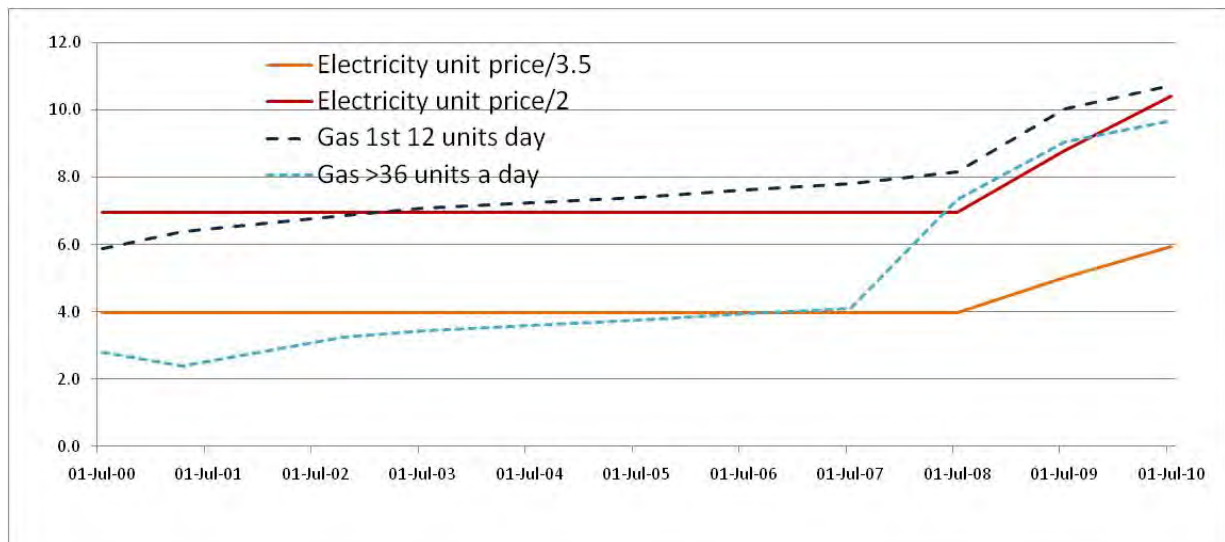
Authority's Assessment

725. The Authority notes WAGN's submission that there has been a change in the customer numbers and volumes for A1, A2, B1 and B2 tariff class customers. The Authority has also considered the confidential submissions from both WAGN and Alinta with respect to B3 tariff class customers.
726. As the Authority noted in paragraph 931 of the draft decision, demand forecasts affect both the calculation of total revenue, and therefore reference tariffs, and underpin the forecasts for capital and operating expenditure. New customers drive capital expenditure, and generate fixed charge revenue, whilst volume change to existing or new customers has little effect on capital or operating costs, yet new customers also generate volume based revenue. It is therefore necessary to separately consider customer number forecasts and volume forecasts.
727. The Authority is satisfied that WAGN has updated its forecast customer numbers for all classes including B3 which the Authority expressly required to be updated to meet the requirements of rule 74. In its updated forecasts, WAGN has increased by approximately 10,000 the forecast B3 customer numbers over the access arrangement period.
728. If volume forecasts are overstated the reference tariffs will be set too low to recover the total revenue over the access arrangement period, and vice versa. Further, overstated customer number forecasts are likely to result in overstated capital and operating expenditure forecasts because the service provider will plan for higher customer number growth on the network and the earlier replacement of assets, and vice versa.
729. Part of WAGN's proposed revised tariff structure is a reduction in the revenue impact of consumption where usage is above 10GJ per annum. If incorrect volume assumptions are made for B3 tariff customers (B3 customers generate over 75 per cent of revenue) the impact of this is reduced as the Authority's tariff for usage above 10GJ per annum is 43 per cent of that for usage below 10GJ per annum (\$11.74 per GJ for the first 10GJ versus \$5.07 per GJ for usage above 10GJ). Imperfect forecasts in the segment of greater than 10GJ per annum have less impact and therefore have less effect on retailers and end-use customers.
730. The Authority has also considered the effect of electricity tariffs on gas demand volumes. The relativity of gas and electricity retail tariffs affect gas demand as in many instances, electricity is a substitute for gas. Over the past 20 years there have

been significant changes to these relativities as electricity tariffs have remained static in nominal terms for most of that period, while gas tariffs have increased each year.

731. Gas retail prices have increased significantly over this 10 year period (and even prior to 2000), this increase is likely to have influenced the fuel choices many consumers have made. The difference in retail prices is most noticeable for use levels about 36 units per day in the period after 1 July 2008 when retail prices for 36 units per day and above units a day nearly doubled.⁹⁰
732. Figure 8 below reflects a conservative approximation of the marginal price for customers who have made, or who are about to make, purchasing decisions on gas versus electricity space heating. The operating costs are reflective of the fact that reverse-cycle air-conditioning puts out between 2kWh and 3.5kWh of heat for every 1kWh of electricity. Since 2008, the lowest cost of home heating for larger users of energy has been electricity. For those users with the most efficient reverse cycle air-conditioners, the cost is approximately halved if the customer chooses to use electricity for space heating, as represented in Figure 8 below⁹¹. A similar unit cost differential also occurs with the heat pump electric hot water systems.

Figure 8 Heating cost choice with Reverse cycle Air conditioning 2 to 3.5 times as efficient as gas



733. Electricity is now a lower cost option over gas, and for large energy users, electricity has been the lower cost option for many years. It is therefore understandable why gas usage has decreased. The Authority notes that future electricity retail price rises, as foreshadowed in the Western Australian Government's 2010 budget papers may result in a reversal in the downward trend in gas demand over time. However, the Authority considers that over the forthcoming access arrangement period gas volumes may, at least for space heating, continue to decline.

⁹⁰ Information on retail gas and electricity prices over the 10 year period is available from the Authority

⁹¹ Q: How can the capacity output of an airconditioner be greater than the power input?

A: For airconditioners, the measure of energy efficiency is the Energy Efficiency Ratio (EER) for cooling and the Coefficient of Performance (COP) for heating. The EER and COP are defined as the capacity output divided by the power input. Typically, the EER and COP are in the range 2.0 to 3.5 (meaning that the cooling or heating output is 2 to 3.5 times as great as the power input, or an efficiency of 200per cent to 350per cent). This is achieved by the use of a refrigeration heat pump which collects internal heat and moves it outside when in cooling mode, or collects ambient heat from outside and moves it inside when in heating mode. (<http://www.energyrating.gov.au/faq.html#>).

734. The Authority has also considered the effect on small business as business retail tariffs have been considerably different from domestic retail tariffs.
735. The decisions made by small businesses will also be affected by the tariff difference between electricity and gas. For example, where a small business requires heating and both electricity and gas heating options are available to the small business customer the marginal price of the heating option will play a considerable role in the decision being made.
736. The Authority is satisfied that WAGN's updated volume forecasts and customer numbers in relation to A1, A2, B1 and B2 customers meet the requirements of rule 74 of the NGR.
737. The Authority has reconsidered the value for the average volume of gas delivered to B3 customers to be assumed for the forthcoming access arrangement period. The Authority's view is that WAGN's proposal of 17.46 GJ per annum is a reasonable estimate for the forthcoming access arrangement period. It is below current observed values. Therefore, the Authority has accepted WAGN's forecast B3 volumes which decrease to an average of 17.16GJ of gas delivered for each year of the forthcoming access arrangement period.
738. Table 27 below shows the Authority's final decision values in relation to forecast volumes of gas delivered to B3 customers.

Table 27 Forecast total volume of gas (TJ) delivered to B3 customers per annum - adjusted by the Authority

	2010 ¹	2010/11	2011/12	2012/13	2013/14
Tariff Class B3 (draft decision)	4,842	11,296	11,568	11,871	12,206
Tariff Class B3 (final decision)	4,589	10,437	10,830	11,154	11,486

¹ 1 January 2010 to 30 June 2010 only

739. The Authority's proposed access arrangement revisions, will adopt WAGN's forecast volumes submitted in October 2010, for gas delivered to all tariffs classes A1, A2, B1, B2 and B3 customers. The Authority will also adopt WAGN's forecast customer numbers for all tariff classes as submitted in October 2010.

Allocation of total revenue and costs

Draft Decision

740. In the draft decision, the Authority accepted WAGN's proposal with respect to the allocation of total revenue to the reference services.
741. The Authority also concluded that the forecast operating expenditure incurred in providing the ancillary services must be included in the total costs of providing the reference services. The Authority considered that the forecast operating expenditure incurred for ancillary services should be allocated fully to those services and recovered through stand alone charges for each service as a component of reference tariffs.

Public Submissions

WAGN's submissions

742. WAGN did not make any submission with respect to the allocation of total revenue and costs.

Other submissions

743. No other public submissions were made with respect to the allocation of total revenue and costs.

Authority's Assessment

744. In Table 28 of its amended access arrangement information, WAGN has included revenue from ancillary reference services. The Authority considers that ancillary services have been correctly addressed by WAGN.

745. The values for ancillary services have also been updated by WAGN and the Authority is satisfied that there is no net effect on how reference tariffs are determined as a result of these updated figures.

746. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt WAGN's proposal with respect to the allocation of total revenue to the reference services.

Reference tariff variation in accordance with formula

Draft Decision

747. In the draft decision, the Authority did not approve WAGN's proposed tariff variation mechanism. The Authority required WAGN to amend its proposed tariff variation mechanism to conform with Required Amendment 7 and Required Amendment 8.

748. The proposed tariff variation mechanism must enable the service provider to recover the total regulated revenue approved by the regulator over the access arrangement period. It also includes a number of formulae and equations that prescribe how each reference tariff is permitted to vary each year over the course of the access arrangement period. The formulae are intended to ensure the full recovery of the approved total regulated revenue in present value terms, with provision for adjustments to the revenue to be recovered through reference tariffs. These adjustments encompass recovery of costs arising from specified events and adjustments arising from the effects of inflation. The tariff variation mechanism also provides for tariff components to be varied to achieve recovery of the total regulated revenue.

749. Further discussion relating to Required Amendment 7 is set out at paragraphs 776 to 824 below.

Public Submissions

WAGN's submissions

750. Annexure B of the amended access arrangement revisions proposal sets out the reference tariff variation mechanism for a variation in accordance with a formula.
751. With respect to inflation, WAGN submitted (pages 56-58) that if it were to submit an amendment to the access arrangement incorporating Required Amendment 8, the revised access arrangement would not comply or be consistent with the NGL and NGR. Required Amendment 8 requires that the formula for reference tariff variation that is set out in clause 2 of Annexure B of the proposed access arrangement provides for inflation adjustment using the CPI (All Groups, Eight Capital Cities) at the end of the twelve month period rather than the CPI (All Groups, Perth) as proposed by WAGN. WAGN argued that this requirement was inconsistent with the applicable requirements of the NGL and NGR and not consistent with the applicable criteria of the NGL and NGR.
752. With respect to regulatory operating costs, WAGN submitted that it has not deleted clause 2.3(c) from Annexure B of the proposed revised access arrangement as required by Required Amendment 8. WAGN argued that clause 2.3(c), which enables WAGN to recover unanticipated regulatory costs in 2009, should not be deleted because the 2009 regulatory operating costs, necessarily and prudently incurred, would be recoverable through the regulatory cost factor mechanism within the tariff variation mechanism of the current access arrangement if they had not been incurred in the last year of the current access arrangement period. WAGN stated that the Authority had included the regulatory costs factor in the tariff variation mechanism in 2005 in recognition that a service provider has limited ability to control regulatory costs incurred because of regulatory events outside the service provider's control. WAGN argued that, as there has been an interval delay, Rule 92(3)(b) can be taken into account to fix the reference tariffs for the next access arrangement period. WAGN then argued that it is open to the Authority to take into account the tariff variation that would have occurred if that tariff variation had been possible in the last year of the access arrangement period when fixing the reference tariffs for the new access arrangement period.
753. With respect to the regulatory capital costs, WAGN submitted that Required Amendment 8 required references to regulatory capital expenditure be deleted from the formula for reference tariff variation set out in clause 2 of Annexure B. WAGN submitted that the regulatory capital expenditure enabled it to recover unanticipated regulatory costs that are capital expenditure. WAGN argued that the Authority did not provide substantial reasons for this required deletion nor did it explain why the inclusion of regulatory costs in the tariff variation mechanism was inconsistent with the NGR and NGL. WAGN stated that it has not deleted the references to regulatory capital expenditure in clause 2 of Annexure B as there is no logical reason why WAGN should not allow for tariff variation for differences in regulatory capital expenditure provided that the tariff variation only recovers unanticipated return and depreciation. WAGN did concede that it should not be able to recover within one year the full amount of any unanticipated regulatory capital expenditure, as is possible under the tariff variation mechanism in the current access arrangement.
754. With respect to rate of return, WAGN submitted that the formulae of clause 2 of the reference tariff variation mechanism set out in Annexure B of the proposed revised access arrangement used a variable WACC, with the value assigned to WACC being

11.1 per cent. WAGN submitted that this was the proposed rate of return determined in accordance with rule 87 of the NGR. WAGN disputed the value of 6.89 per cent assigned to WACC in Required Amendment 8. WAGN submitted that, in response to the draft decision, it had amended the rate of return and value of variable WACC in clause 2 of Annexure B to 9.6 per cent (real, pre-tax). WAGN argued that if total revenue and reference tariffs were determined using a rate of return of 6.89 per cent as required by the Authority, rather than 9.6 per cent submitted by WAGN, the revised access arrangement would not comply or be consistent with the NGL and NGR.

Other submissions

755. There were no other submissions in relation to the proposed reference tariff variation in accordance with formula.

Authority's Assessment

756. The Authority disagrees with WAGN's October 2010 proposed tariff variation for the access arrangement period and addresses the relevant concerns below.

CPI

757. The Authority maintains its position that the inflation adjustment that is to be applied to the reference tariff variation mechanism is the CPI (All Groups, Eight Capital Cities) as set out in the draft decision at paragraph 1014.

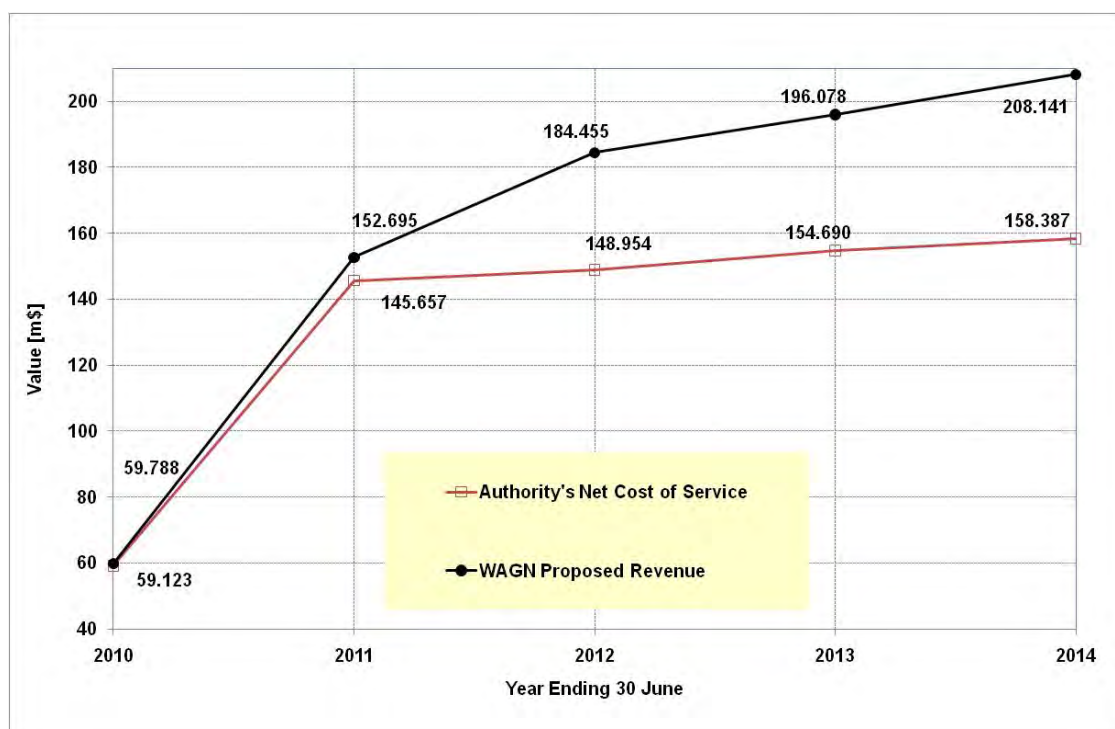
Commencement Date

758. The Authority notes that tariffs did not change on 1 January 2011 as forecast by WAGN. The Authority has completed its modelling on the basis that tariffs will change on 1 July 2011 even though the new access arrangement period will commence prior to that date. The Authority notes that it is impractical to change tariffs prior to 1 July 2011 as the monthly, or daily, load data is required, to calculate the appropriate revenue allocation for tariffs that would apply for part of a year. Without a precise date for the commencement of the new access arrangement period, the data for the calculations of the revised tariffs cannot be accurately established. The Authority also notes that the distribution load forecasts are not consistent throughout the year so a pro-rata rate on a time-only basis would not comply with Rule 92 of the NGR which requires revenue equalisation.

Tariff Path

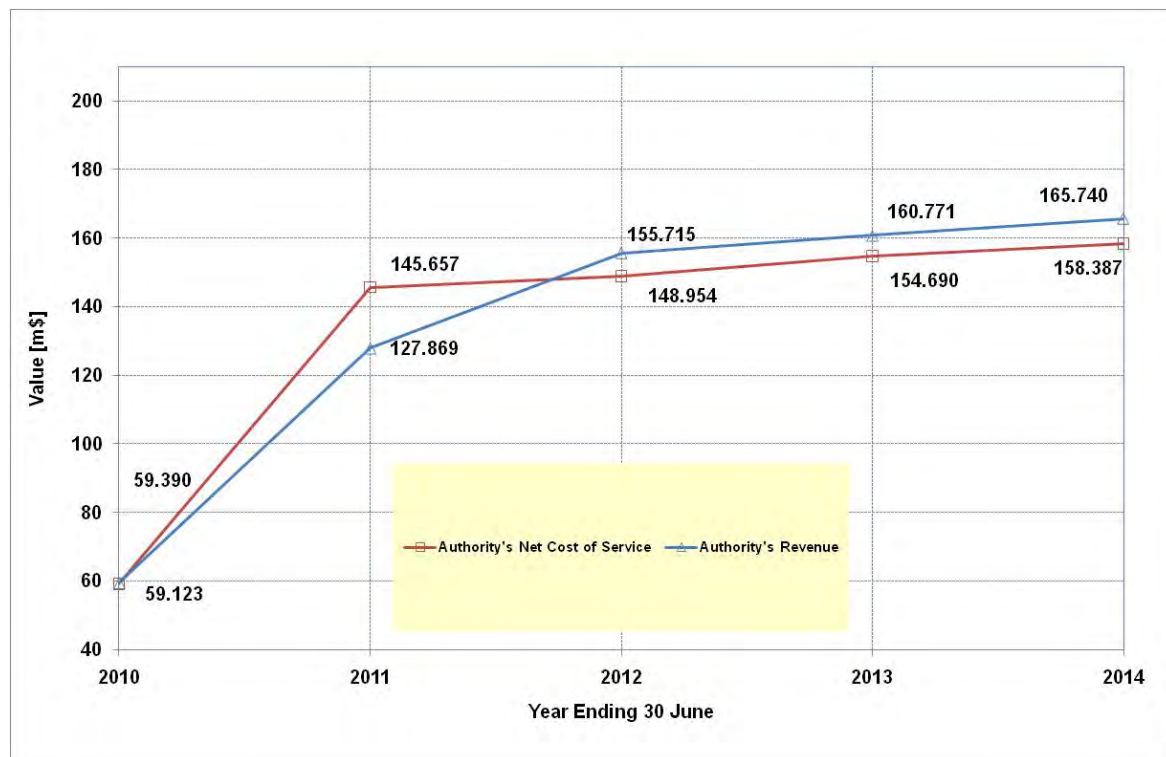
759. The Authority confirms its position set out in paragraph 1001 of the draft decision that it considers it preferable, wherever practicable, to determine reference tariffs with a smooth tariff path, including between access arrangements, rather than a tariff path which has significant and sudden changes in tariffs during and at the end of the access arrangement period.
760. Further, WAGN's proposed reference tariff revenue in the amended revised access arrangement exceeds the Authority's forecast cost of service in this final decision for each year of the forthcoming access arrangement period. 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)



761. The Authority confirms its position set out in paragraph 1001 of the draft decision that it 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.
762. The Authority has determined, based on its considerations in this final decision, an appropriate tariff price path based on an adjustment of reference tariffs on 1 July 2011. The reference tariffs will subsequently remain constant in real terms.
763. Figure 10 shows the Authority's reference tariff revenue and cost of service path over the forthcoming access arrangement period. The Authority's cost of service accords with the data illustrated in Figure 9. Further, the reference tariff revenue reflects the tariff path (set out in Table 27).

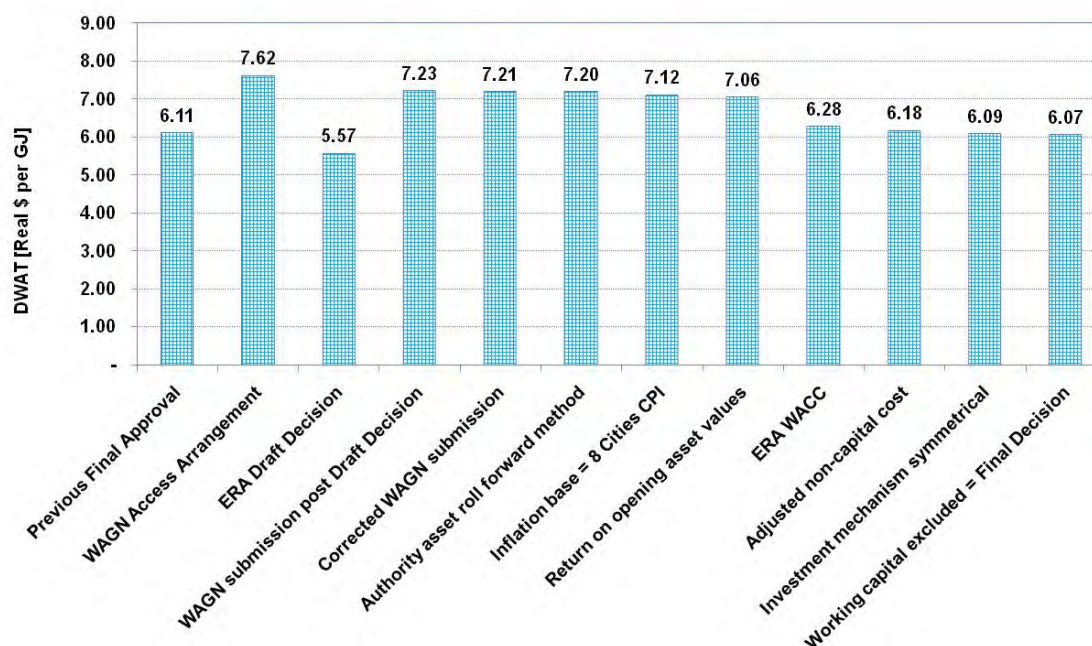
Figure 10 Authority's cost of service and reference tariff revenue (\$ million, real dollars as at December 2009)



764. A further effect of tariffs not changing until 1 July 2011 is that the tariffs applicable for 18 months of the 4½ year access arrangement will not change. As a consequence, the total revenue (cost of service) for this 18 month period will not be fully recovered by the reference tariffs which were last changed on 1 January 2009. The reference tariffs for the remaining 3 years of the access arrangement period will need to be commensurably higher to equalise revenue in present value terms, in keeping with the requirements of Rule 92 of the NGR.

DWAT

765. Figure 11 below sets out the changes the Authority has made to WAGN's proposal on the basis of the Discounted Weighted Average Tariff (**DWAT**) and includes the Authority's DWAT from the draft decision. DWAT is a measure of cost of energy transported through the distribution system paid by the users. It also enables a comparison of different costs over time.

Figure 11 Discounted weighted average tariff (\$ December 2009)

766. The Authority's adjustments to WAGN's response to the draft decision proposal based on the determinations for key tariff-related elements of this final decision are shown in Figure 11 above. 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; operating expenditure and volume.
767. In January 2010, WAGN proposed a DWAT of \$7.62/GJ and the Authority's draft decision DWAT was \$5.57/GJ. In October 2010, WAGN responded to the draft decision and proposed a DWAT of \$7.23/GJ. The Authority's calculations result in a final DWAT of \$6.07/GJ. Figure 11 shows that the determination with the most significant impact is the WACC, which the Authority has determined to be 7.40 per cent (real pre-tax) compared with WAGN's proposed WACC of 9.60 per cent (real pre-tax). This is the most significant factor in reducing the DWAT value and results in DWAT reducing from \$7.06/GJ to \$6.28/GJ.
768. The Authority's requirement to use the CPI (All Groups, Eight Capital Cities) to roll forward capital base rather than WAGN's proposal to use the CPI (All Groups Perth) results in a reduction in DWAT from \$7.20/GJ to \$7.12/GJ.
769. The Authority confirms its position set out in paragraphs 680 to 681 above that it does not accept WAGN's claim for one-off costs incurred in the period 1 January 2010 to 30 June 2010 as a result of the delayed implementation of the NGL and NGR in Western Australia and the consequential delay in the change in the level of reference tariffs. As a result of the Authority's position on operating expenditure, DWAT reduces from \$6.28/GJ to \$6.17/GJ.
770. Table 28 has set out the total revenue (cost of service (COS)) and reference service revenue for the new access arrangement period. This table further illustrates the

difference between the COS and reference service revenue proposed by WAGN with that modelled by the Authority adopting the Authority's approach in this final decision.

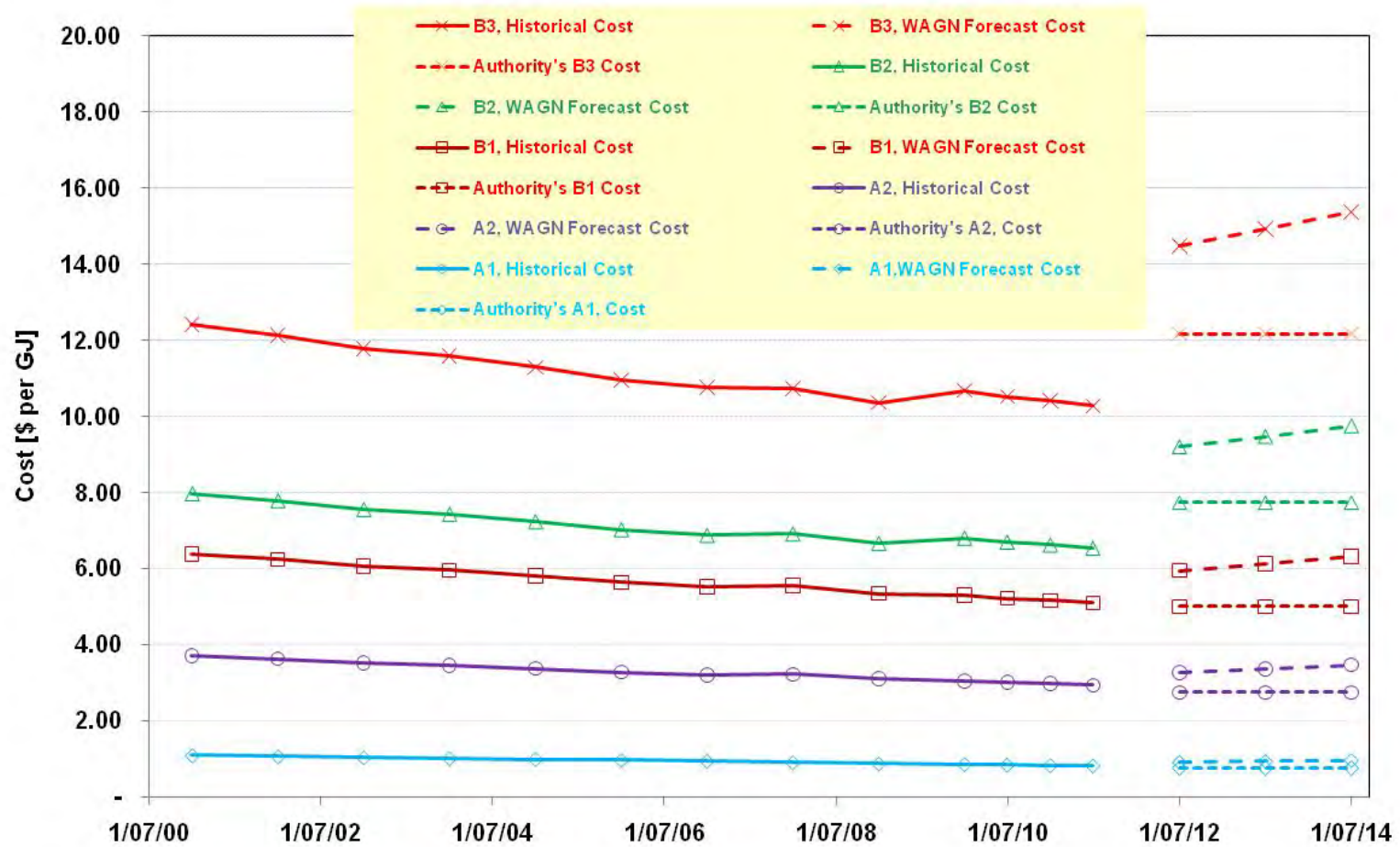
Table 28 WAGN and Authority Total Revenue (COS) by year and when that Total Revenue is recovered from users (\$ million December 2009)

	2010 ¹	2010/11	2011/12	2012/13	2013/14	PV	Sum
ERA Total Regulated Revenue (COS)	59.1	145.7	149.0	154.7	158.4	548.0	666.8
ERA Total Revenue	59.4	127.9	155.7	160.8	165.7	548.0	669.5
ERA Difference	0.3	-17.8	6.8	6.1	7.4	-	2.7
WAGN Total Regulated revenue (COS)	80.7	171.0	174.9	180.2	182.7	616.9	789.5
WAGN Total Revenue	59.8	152.7	184.5	196.1	208.1	616.9	801.2
WAGN difference	-20.9	-18.3	9.5	15.9	25.4	-	11.6
ERA less WAGN Total Revenue i.e. paid by users	-0.4	-24.8	-28.8	-35.3	-42.4	-68.9	-131.7

¹ 1 January 2010 to 30 June 2010 only

771. The above table highlights that although the present value of revenue received by WAGN as a result of the Authority's decision is lower than WAGN proposed, by \$68.9 million in present value terms, the sum of the difference paid by users (Total revenue) over the access arrangement period is \$131.7 million. This difference is attributable in large part to the discount rate (WACC) used to calculate the PV as mentioned in paragraph 767 above. The WACC used to derive WAGN's PV of revenue is 9.6 per cent whereas the WACC used to derive the Authority's PV of revenue is 7.4 per cent.
772. The Authority has set out in Figure 12 the historic and forecast cost per GJ for the average user in each tariff class. The forecast cost per GJ for the forthcoming access arrangement period 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

773. The variation mechanism which the Authority will adopt in its proposed revisions will reflect that reference tariffs will apply from 1 July 2011 and not the WAGN proposal of 1 January 2011.
774. As a consequence of the Authority's decision not to approve WAGN's amended access arrangement revisions proposal and the Authority's decision to draft its own access arrangement proposal, the Authority will adopt a reference tariff variation mechanism that conforms with the Authority's decision about reference tariffs set out at paragraphs 848 to 873 below. A significant difference is that there will be a once off change in real reference tariffs from 1 July 2011 with tariffs remaining constant in real terms thereafter (subject to some cost pass throughs if they occur and for actual CPI differing from forecast CPI).
775. In Appendix 1 of the draft decision, the Authority modified WAGN's proposed tariff variation mechanism which incorporated the changes required by the Authority in Required Amendment 8 of the draft decision. The Authority will adopt an amended tariff variation mechanism that addresses the matters set out in this final decision. A preliminary draft of the reference tariff variation mechanism to be included in the Authority's proposed amended access arrangement is provided at Appendix 3.

Reference tariff variation as a result of cost pass through

Draft Decision – Required Amendment 7

776. 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.

Public Submissions

WAGN's submissions

777. WAGN has not amended its amended proposed access arrangement revisions in accordance with Required Amendment 7 and has retained its cost pass through mechanism as the most appropriate way, within the scheme of the NGL and NGR, of dealing with short term economic inefficiency resulting from government introduction of an emissions trading scheme, or a fee, penalty or tax on greenhouse gas emissions.
778. WAGN submitted on 8 October 2010 (page 78) that it has not amended its access arrangement to comply with Required Amendment 7 because to do so would not be consistent with the NGL and the NGR. WAGN stated (pages 58-62) that in particular the inconsistency would be with the economic efficiency requirements of section 23 and section 24 of the NGL (that is, the national gas objective and the revenue and pricing principles).
779. WAGN addressed three components of Required Amendment 7 which can be categorised as cost pass through associated with environmental requirements, cost pass through associated with unaccounted for gas (**UAFG**) and the intended timing of the cost pass through tariff variation mechanism. These issues are discussed below.

Introduction of an Emissions Trading Scheme (ETS) or any fee, penalty, or tax on greenhouse emissions (clauses 3.1(iv)(A) and (B))

780. WAGN noted that the Authority's reason for requiring deletion of clauses 3.1(iv) (A) and (B) was the uncertainty surrounding the introduction of a scheme or tax to abate greenhouse gas emissions. Consequently the Authority decided it would be inappropriate to include such arrangements as a cost pass through event until the particulars of such a scheme have been clarified through legislation.
781. WAGN acknowledged that there is considerable uncertainty about the relevant legislation but argued that this uncertainty is not intrinsically different from other forecast operating and capital expenditure such as a connection of a new large end-user of gas to the network.
782. WAGN also argued that the inclusion of clauses 3.1(iv) (A) and (B) should be allowed under rule 97(1)(c) as this rule is intended to allow reference tariffs to be amended by an event that is yet to occur (or an event that might occur).
783. WAGN noted the Authority's comment in the draft decision that if regulatory requirements were introduced and costs incurred in the access arrangement period then WAGN could submit revisions to the access arrangement. WAGN argued that resubmitting a revised access arrangement in the event that ETS and other environmental legislation is enacted is inconsistent with the national gas objective because the cost of re-submitting is an inefficient use of resources when the issue can be dealt with via the current revisions process. WAGN submitted that rule 97(1)(c) provides a more efficient alternative to access arrangement revision. Furthermore, WAGN submitted that because the access arrangement revision process is likely to take two years, if the costs are incurred in the access arrangement period this would result in inefficient tariffs for the period of the delay.
784. WAGN referred to clause 12.5 of the Wagga Wagga Gas Distribution Network access arrangement and noted that the AER has approved a cost pass through event referring to a carbon emissions trading scheme.

Unanticipated increases in the cost of unaccounted for gas (UAFG) (Clause 3.1(v))

785. WAGN submitted that due to the possibility of price variation in the agreement with the gas supplier then, to the extent that the gas price increases faster than the rate of inflation - measured by changes in the CPI (All Groups, Perth) any increase in gas price above the inflation rate should be passed through to reference tariffs via clause 3.1(v).
786. WAGN observed that in the draft decision, the Authority commented on both the price and volume components of UAFG costs as a cost pass through event. The Authority considered: first, that price was already dealt with in WAGN's proposal based on tender price information submitted to the Authority in the access arrangement proposal; and second, that WAGN was best placed to manage the risk of UAFG volumes differing from forecast volumes.
787. With respect to volume WAGN agreed (page 62) that it is best placed to manage UAFG volumes but argued that the reasons given in the draft decision to delete clause 3.1(v) indicates that the Authority has misunderstood the intended operation of this clause.

788. WAGN submitted that the Authority interpreted clause 3.1(v) as allowing UAFG costs already included in operating expenditure and therefore total revenue.
789. WAGN argued that clause 3.1(v) does not allow pass through of UAFG costs where those costs have been included in the total revenue requirement used to determine reference tariffs. WAGN argued that clause 3.1(v) only allows pass through of the costs that are additional to the amount forecast for inclusion in the total revenue requirement for calculating reference tariffs. Therefore, WAGN argued the Authority's draft decision (paragraph 1036) that UAFG costs are dealt with in WAGN's proposal based on the Authority acceptance of WAGN's tender price for UAFG is incorrect.
790. WAGN claimed that the need to pass through these additional amounts is driven by provisions in the agreement resulting from WAGN's call for tenders to supply UAFG gas requirements. In particular, now that an agreement is in place, WAGN cannot manage the price at which it purchases gas as WAGN is 'locked in' to the pricing provisions of that agreement (which was the outcome of a competitive tender process).
791. WAGN argued that to the extent that UAFG price increases exceed the inflation rate the reference tariffs will under-recover the costs incurred by WAGN which will result in underinvestment in the GDS and over consumption of natural gas services. Consequently such an outcome would not be consistent with the national gas objective or the revenue and pricing principles of the NGL.
792. Intended timing of the cost pass through tariff variation mechanism (Clause 3.3)
793. WAGN claimed (page 64) that the Authority has made 'a significant error' in the interpretation of clause 3.3 of Annexure B of the proposed revised access arrangement.
794. WAGN noted (page 64) that in paragraph 1037 of the draft decision, the Authority's understanding was 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).
795. WAGN submitted that in its draft decision (paragraph 1039) the Authority approved Clause 3.1 of Annexure B if subclauses 3.1(iv)(A) and B and subclause 3.1(v) were deleted. This approval was based on the Authority's 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.
796. WAGN argued that if a cost pass through event were to occur, then it would expect to vary - at that time - one or more of its haulage tariffs to recover the costs incurred, or forecast to be incurred, in accordance with clause 3.2 of Annexure B of the proposed revised access arrangement.
797. WAGN illustrated the intended operation of clause 3.1, Annexure B, by providing an example where the costs for 'a defined event' are conforming capital expenditure. In this example, WAGN would not expect to be able to pass through a cost which was in the nature of capital expenditure via a reference tariff variation in a current access arrangement period but would expect to recover a return and depreciation on the

capital expenditure in that current access arrangement. However using the same example, WAGN would also, expect to add the capital expenditure to the opening capital base at the beginning of the next access arrangement period (2014-2019). WAGN submitted that clause 3.3(a) anticipates this by requiring that if the capital expenditure is added to the opening capital base then it is adjusted for return and depreciation already recovered in the access period in which the expenditure took place.

Other submissions

798. WACOSS included a section on the issue of UAFG but only as it relates to operating expenditure and the resulting total revenue requirement from which reference tariffs are determined by the Authority. WACOSS did not comment on the pass through in the tariff variation mechanism for UAFG price increases above inflation.

799. There were no other submissions received regarding Required Amendment 7.

Authority's Assessment

Introduction of ETS and/or penalty on greenhouse gas emissions (clauses 3.1(iv)(A) and (B))

800. In the draft decision, the Authority required the deletion of clauses 3.1(iv)(A) and (B) on the grounds that regulatory requirements with respect to an emissions trading scheme and a penalty on greenhouse emissions have yet to be finalised. The Authority accepted clause 3.1(i), (ii), (iii) and (iv)(C),(D) and (E) based on the understanding that the associated cost pass through would not affect the distribution tariffs until the access arrangement period following the forthcoming access arrangement, that is the period 2014-19.

801. The Authority is cognisant of WAGN's argument that clauses 3.1(iv) (A) and (B) should be included on the grounds that these events are not, in principle, different from other uncertain events. The Authority notes that WAGN cites the example of the opportunity to connect a new large end-user to the network where, although the potential requirement is known in advance, the details relating to timing and costs are uncertain until a contract has been negotiated.

802. However, the Authority considers that a more relevant example in this context is proposed clause 3.1 (iv)(C), relating to 'any renewable energy scheme', which the Authority accepted in the draft decision (albeit subject to the Authority's understanding of timing of the pass through). The Authority's current view is that cost pass through provisions for regulatory requirements with respect to an emissions trading scheme and a penalty on greenhouse emissions are, in principle, the same as proposed clause (iv)(C) as all three clauses relate to environmental regulatory requirements. Therefore, on the basis of consistency the Authority considers that clauses 3.1(iv)(A) and (B) are appropriate and acceptable as cost pass through events.

803. The Authority also emphasises that any approval that it may give to cost pass through events in principle is still subject to clause 3.4 in that each event must be reported to the Authority and approved by the Authority before any particular event can be a cost pass through.

Unanticipated increases in the cost of unaccounted for gas (UAFG) (Clause 3.1(v))

804. The Authority, in the draft decision, did not accept WAGN's proposal with respect to cost pass through of unanticipated increases in UAFG prices. The Authority has considered the arguments presented by WAGN and notes that WAGN entered an agreement with another party to supply UAFG following a tender process where WAGN had the ability to negotiate an outcome agreeable to both parties.
805. In particular, the Authority considers that WAGN had the option of negotiating in order to minimise the risk and uncertainty of unanticipated or above inflation increases in gas price namely by contracting a higher agreed price where the gas supplier could not increase the price above the inflation rate.
806. However, the Authority understands that if WAGN agreed to a higher price for UAFG with less variance any resulting or associated higher costs would be included in forecast operating expenditure resulting in a higher cost of service and revenue requirement, higher distribution reference tariffs for users and ultimately higher retail tariffs for end users and consumers. The Authority accepts that rather than have such an outcome it is preferable to allow WAGN to pass through the higher than forecast costs resulting from unanticipated increases in prices and therefore costs of UAFG.
807. The Authority's view is that increases in UAFG prices above the inflation rate should be included in the tariff variation mechanism as a cost pass through event. However, as stated at paragraphs 61 to 73 above, the rate of inflation is to be measured as changes in the CPI (All Groups, Eight Capital Cities) rather than changes in CPI (All Groups, Perth) as proposed by WAGN.

Intended timing of the cost pass through tariff variation mechanism (Clause 3.3)

808. The Authority agrees that WAGN is correct in its observation that the Authority has misinterpreted clause 3.3 of Annexure B.
809. The Authority considers that the confusion arose due to different uses of the terms 'current', 'forthcoming' and 'next' in referring to an access arrangement period. In the draft decision the Authority referred to the 2005-2009 access arrangement as 'current', the 2010-2014 period as 'forthcoming' and 2014-2019 as the 'next' access arrangement period. However, WAGN in the context of the proposed revised access arrangement, referred to 'current' as though the proposal for the 2010-2014 access arrangement were approved and was therefore current. It follows from this that in clause 3.3 entitled 'Next access arrangement Period' the next access arrangement period would be 2014-2019.
810. This is consistent with WAGN's proposal that cost pass throughs set out under clause 3.1 are intended to be passed straight through to reference tariffs via the variation mechanism in the period in which the costs are incurred. In the case of capital expenditure this would include depreciation in the period in which the expenditure occurs (e.g. if in 2010-2014 then passed through in this period) and similarly operating expenditure would be a straight pass through in 2010-2014 via the tariff variation mechanism without affecting the cost of service and total revenue requirement from which reference tariffs are derived.
811. Clause 3.3 describes how costs associated with 'relevant events' (clause 3.2(ii)) costs will be passed through in the next access arrangement (i.e. 2014-2019). In

particular, conforming capital expenditure will be added to the capital base for the next access arrangement period, after adjustment for any depreciation during the current access arrangement period; and conforming unforeseen regulatory operating expenditure incurred in the last year of the access arrangement (2014) will be included in the first year of the next access arrangement (2014-2019) as part of cost of service and revenue requirement for approval.

812. This provision allows WAGN to recoup unforeseen regulatory costs that are incurred in the last year of the access arrangement. In the 2005-09 access arrangement, WAGN was unable to recoup unforeseen regulatory costs incurred in 2009 via cost pass through, as the annual tariff variation mechanism, is lagged by one year.
813. The Authority accepts the content of proposed clause 3.1 of the access arrangement in principle subject to the inflation rate measured as changes in CPI (All Groups, Eight Capital Cities).

Corporate tax rate change

814. The Authority notes that it has considered the issue of a reduction in the corporate tax rate, which was raised in the WACOSS submission, as a cost pass through event. The Authority's assessment in this regard is set out at paragraphs 630 to 634 above.

Further considerations of the Authority Scope of costs included in pass through (Clause 3.1(ii) (iii) (iv) (D))

815. The Authority is concerned in general that the broad scope of the costs proposed to be associated with pass through events would make an objective assessment of compliance with the national gas objective difficult. It would also lead to difficulty in distinguishing pass through event costs from those already included in WAGN's proposed forecast expenditure. This is particularly the case for forecast operating costs.
816. In particular, the Authority considers that the references in clauses 3.1(ii) and (iii) to conforming capital or conforming operating expenditure being 'in connection with' or 'as a result of' a change in law, tax change or regulatory change is too broad and uncertain a reference. Similarly, the Authority considers that the reference in clause 3.1(iv) (D) to direct or 'indirect costs and expenditure associated with' the implementation of an emissions trading scheme to be inappropriately broad in scope.
817. The Authority's concerns in this regard also relate to the definitions in clause 5, of Annexure B, namely the references to, and definitions of, "Change in Law", "Regulatory Change" and "Regulatory Costs". The definition of Regulatory Costs refers to costs "connected to or associated with" the matters referred to in that definition. The Authority's concern is, again, with the scope of costs that potentially fall within the ambit of Regulatory Costs and any uncertainty arising from the definitions. It could arguably allow any variation to the forecast costs of the proposed access arrangement revisions to be passed through during the access arrangement period. This is not the intention of the cost pass through provisions and therefore the Authority proposes to modify the wording of this defined term to limit those costs to the costs that can be directly attributed to pass through events (where those costs have not been included in the approved forecast costs and could not have reasonably have been forecast).

818. Therefore the Authority considers that only costs that can be shown to be directly related to the specific pass through event and which while can be shown to have not already been included within WAGN's forecast expenditures should be allowed for pass through. For the purposes of the Authority's proposed access arrangement revisions the Authority will amend clauses 3.1(ii), (iii) and (iv)(D) to refer only to direct costs shown to have been incurred by WAGN as a direct result of the relevant pass through event.

Substance of a variation report

819. Clause 4 of Annexure B of the proposed access arrangement revisions requires WAGN to provide the Authority with a variation report, which is to be submitted at least 30 business days before the date on which the Haulage Tariff is to be varied. This clause prescribes the nature of the information that is to be included in the report. In particular, clause 4(b) of Annexure B specifies the following information:
- b) *if the Haulage Tariff is to be varied in accordance with clause 3 of Annexure B, a statement of reasons for the proposed variation, and supporting calculations, demonstrating consistency with the requirements of clause 3.*
820. The Authority considers that the variation report referred to in subclause 4(b), should also include a requirement for WAGN to provide all relevant information to the Authority to enable the Authority to substantiate the determination of the cost to be passed through under clause 3.1.
821. The Authority considers that the variation report referred to in subclause 4(b), should also include a requirement for WAGN to provide all relevant information to the Authority to enable the Authority to substantiate the determination of the cost to be passed through under clause 3.1.
822. In its proposed access arrangement revisions, the Authority will amend the provisions of Annexure B to ensure the above concerns are appropriately addressed.

Regulator's powers of approval over variation of the reference tariff

823. The Authority notes that rule 97(4) provides that a reference tariff variation mechanism must give the Authority adequate oversight or powers of approval over variation of the reference tariff.
824. The terms of WAGN's proposal as set out above do not give the Authority adequate oversight or powers of approval over the reference tariff variation. In its proposed access arrangement revisions, the Authority will therefore amend clauses 3 and 4 of Annexure B to incorporate an appropriate power of approval on the part of the Authority.

Authority's proposal

The Authority will make the amendments to clauses 3.1 described in the Authority's assessment above at paragraphs 800 to 824.

Clauses 3.2 and 4 will be amended to insert an appropriate power of approval by the Authority in respect of the proposed variation of the haulage charge as a result of a cost pass through event in accordance with rule 97(4).

The Authority will amend the definitions of Change in Law, Regulatory Change and Regulatory Costs in clause 5 to ensure the concerns regarding those definitions are addressed as discussed in paragraphs 815 to 818 above.

Determination of reference tariffs

Draft Decision

Draft Decision – Required Amendment 8

825. 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 of the draft decision.

Annexure B

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.

826. The Authority modelled the impact of the reference tariffs in Table 27 (reproduced below as Table 29) of the draft decision and (reproduced below) WAGN's proposed reference tariffs on a range of consumption levels for each tariff class and included these details in the Authority's financial model set out in Appendix 2 of the draft decision.
827. The Authority also confirmed it had complied with the requirements set out in the *National Gas Access (WA) (Local Provisions) Regulations 2009 (WA Local Regulations)*. This point was discussed more fully at paragraphs 1108 to 1148 of the draft decision.

Table 29 Authority's [Draft Decision] Reference Tariffs– (exclusive of GST\$ December 2009)

Tariff ¹	Charging parameter		1-Jan-10 ²	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 to the paragraph below for more detail.

Public Submissions

WAGN's submissions

828. WAGN argued that if it implemented the revised reference tariffs set out in Table 27 of the draft decision, it would recover a lower proportion of the total revenue through the standing (fixed) charge and recover a higher proportion through the usage (variable) charge relative to the tariffs proposed in Annexure A of the proposed revised access arrangement submitted in January 2010. WAGN further argued the structure of reference tariffs proposed in Table 27 increased the risk of WAGN not being able to recover its efficiently incurred costs because, even though it was expecting a decline in volume per customer connection, it could not be certain about the magnitude of the decline. WAGN submitted that the amended tariff structures for A2, B1 and B2 services allow for 2 usage blocks. WAGN argued that the 2 usage blocks would:

- enable a larger proportion of fixed cost recovery at lower volumes per customer connection by raising the usage charge for the first usage band;
- reduce the variability of revenues due to forecasting error or the impact of external factors; and
- allow a lower usage charge in the second block, more reflective of the marginal cost to provide additional usage services.

829. Table 23 from WAGN's Amended Access Arrangement Information (is reproduced below as Table 30) shows the reference services offered by WAGN, and the tariff classes, reference tariffs, service elements and charging parameters associated with each of the proposed reference services.

Table 30 WAGN GDS Reference Services, Tariff Classes, Reference Tariffs, service elements and charging parameters

Reference service Tariff Class Reference tariff	Service element	Charging parameter
A1	Use of distribution system capacity Haulage Haulage Provision of Service Pipe, regulators, metering and Telemetry	Standing Charge Demand Charge Usage Charge User specific Charge
A2	Use of distribution system capacity Haulage Provision of Service Pipe, regulators, metering and Telemetry	Standing Charge Usage Charge User specific Charge
B1	Use of distribution system capacity Haulage Provision of Service Pipe, regulators, and metering	Standing Charge Usage Charge User specific Charge
B2	Use of distribution system capacity Haulage	Standing Charge Usage Charge
B3	Use of distribution system capacity Haulage	Standing Charge Usage Charge

830. Clauses 1.1 to 1.5 of Annexure A of the amended access arrangement revisions proposal set out WAGN's proposed reference tariffs for all haulage services. Tariff for A1 customers consist of four charges – a standing charge, a demand charge, a usage charge and a daily user specific charge. Tariffs for A2 and B1 customers consist of three charges – a standing charge, a demand charge and a daily user specific charge. Tariffs for B2 and B3 customers consist only of a standing charge and a usage charge. Across all 5 tariff classes, the usage charge is divided into 2 tiers with the price for the second tier lower than for the first. The tariff structure for each tariff class is set out in Table 31 below.
831. The tariffs for all customer classes have been varied from the access arrangement revisions proposal dated 29 January 2010. WAGN has amended the proposed method in Annexure A of the access arrangement for calculating the user specific charge for tariffs A1, A2 and B1. WAAGN has proposed to use a weighted average cost of capital of 12.45 per cent (nominal pre-tax).
832. The standing charge has been decreased for A1 and A2 tariff customers but increased for B1, B2 and B3 customers. A1 tariff customers generally have a decreased demand charge rate and usage charge rate except for that demand charge for any part of the interconnection distance in excess of 10 kilometres which has increased. A2 tariff customers have a decreased standing charge with an increased usage charge for the first 10TJ per annum but the introduction of a lower second tier for usage above 10TJ per annum.
833. For all B tariff class customers, there is an increase in the standing charge. However, this is offset by a lower usage charge for the first tier of gas delivered and the introduction of a second tier charge which is, in all cases, lower than the first tier charge. The table below shows WAGN's proposed reference tariff structure.

Table 31 WAGN's proposed reference tariffs and structure

Tariff class	Standing charge (payable daily)	Demand charge	Usage charge	User specific charge
A1	\$45,000.00/365	\$189.68 for the first 10 kms of interconnection distance	\$0.04024 for the first 10 kms of interconnected distance	Amount per day reflecting costs to WAGN and may consist of: Value of user specific delivery facilities; Using nominal pre-tax WACC of 12.45 per cent; and Over the lesser of the duration of the economic life and the user specific delivery facilities and period during which the user is entitled to take delivery of gas at that delivery point
		\$99.84 for interconnection distance in excess of 10 kms	\$0.02011 for any part of interconnection distance in excess of 10 kms	
A2	\$24,912.07/365	N/A	\$2.40/GJ for the first 10 TJ of gas	Amount per day reflecting costs to WAGN and may consist of: Value of user specific delivery facilities; Using nominal pre-tax WACC of 12.45 per cent; and Over the lesser of the duration of the economic life and the user specific delivery facilities and period during which the user is entitled to take delivery of gas at that delivery point
			\$1.29/GJ for gas in excess of 10 TJ	
B1	\$1,250.00/365	N/A	\$4.80/GJ for the first 5 TJ of gas	Amount per day reflecting costs to WAGN and may consist of: Value of user specific delivery facilities; Using nominal pre-tax WACC of 12.45 per cent; and Over the lesser of the duration of the economic life and the user specific delivery facilities and period during which the user is entitled to take delivery of gas at that delivery point
			\$4.12 for gas in excess of 5 TJ	
B2	\$309.34/365	N/A	\$8.00/GJ for the first 100 GJ	N/A
			\$4.76/GJ for gas in excess of 100GJ	
B3	\$63.14/365	N/A	\$13.43/GJ for the first 10GJ	N/A
			\$5.80 for gas in excess of 10GJ	

834. 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.
835. WAGN detailed its approach to setting reference tariffs in accordance with rule 72(1)(j) of the NGR on pages 40 to 50 of the amended access arrangement information.
836. WAGN re-stated at page 41 of the access arrangement information that a reference service is proposed 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 submitted that there were about 609,000 customers provided with gas from the WAGN GDS.
837. WAGN included in its amended access arrangement information (pages 41 to 42) information about each tariff class. With the exception of an amendment to the number of A2 tariff customers from 90 to 100, this information is the same as WAGN's earlier submission, summarised in paragraph 1061 of the draft decision.

Charging parameters for each tariff class

838. 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 43) of the amended access arrangement information shows the reference services offered by WAGN, and the tariff class reference tariff, the service element and the charging parameter for each reference service.
839. WAGN stated that the existing structure of the reference tariffs for each reference service has been largely retained as the structure for the proposed reference tariff in each tariff class. The reference tariff for each tariff class will be constituted of a standing charge and a usage charge. For each tariff class, the usage charge has two blocks. Tariff classes A1, A2 and B1 also have an additional charging parameter (a user specific charge for the service element of the provision of service pipe, regulators, metering and telemetry) which varies between customers on a needs basis. A1 tariff class customers will also be charged a demand charge related to the distance from the nearest transmission pipeline which, WAGN submitted, is designed to avoid inefficient bypass of the WAGN GDS.

Reference tariff determination

840. The proposed reference tariffs for the WAGN GDS have been determined by applying the sequence of four steps set out on pages 43 to 46 of the amended access arrangement information.
841. WAGN repeated its submission that the structure of its proposed tariffs satisfy the requirements of rule 94(4) of the NGR based on the following:
- account is taken of long run marginal costs;
 - there are no significant transaction costs associated with each charging parameter; and
 - since each reference tariff comprises a standing charge and volume-related charges, 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

842. WAGN's submission with respect to the change required by rule 94, set out on pages 46 to 47 of the amended access arrangement information, repeated the submission made on pages 44 to 45 of the amended access arrangement information dated 29 January 2010.

First tariff estimates

843. Table 24 (page 47) of the amended access arrangement information shows the tariffs for the WAGN GDS when they are established using long run marginal costs of the reference services as the standing charge and a usage charge set to recover (approximately) the remainder of total revenue.
844. 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 48) 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.
845. In order to address these issues, WAGN has determined the reference tariffs for the WAGN GDS by adjusting these first tariff estimates so that:
- price shock is avoided, while allowing tariffs to partially adjust toward the first tariff estimates over the forthcoming access arrangement period;
 - 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
 - the present value of the expected revenue from the resulting reference tariffs is equal to the present value of total revenue.
846. Table 26 (page 49) of the access arrangement information shows the WAGN GDS reference tariffs exclusive of GST while Table 27 (page 50) 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.

Other submissions

847. WACOSS proposed an inclining block tariff to lessen impact on the lowest use B3 customers and also proposed a lower portion of costs allocated to B3 customers. WACOSS' submission is more fully set out at paragraphs 717 to 722 above.

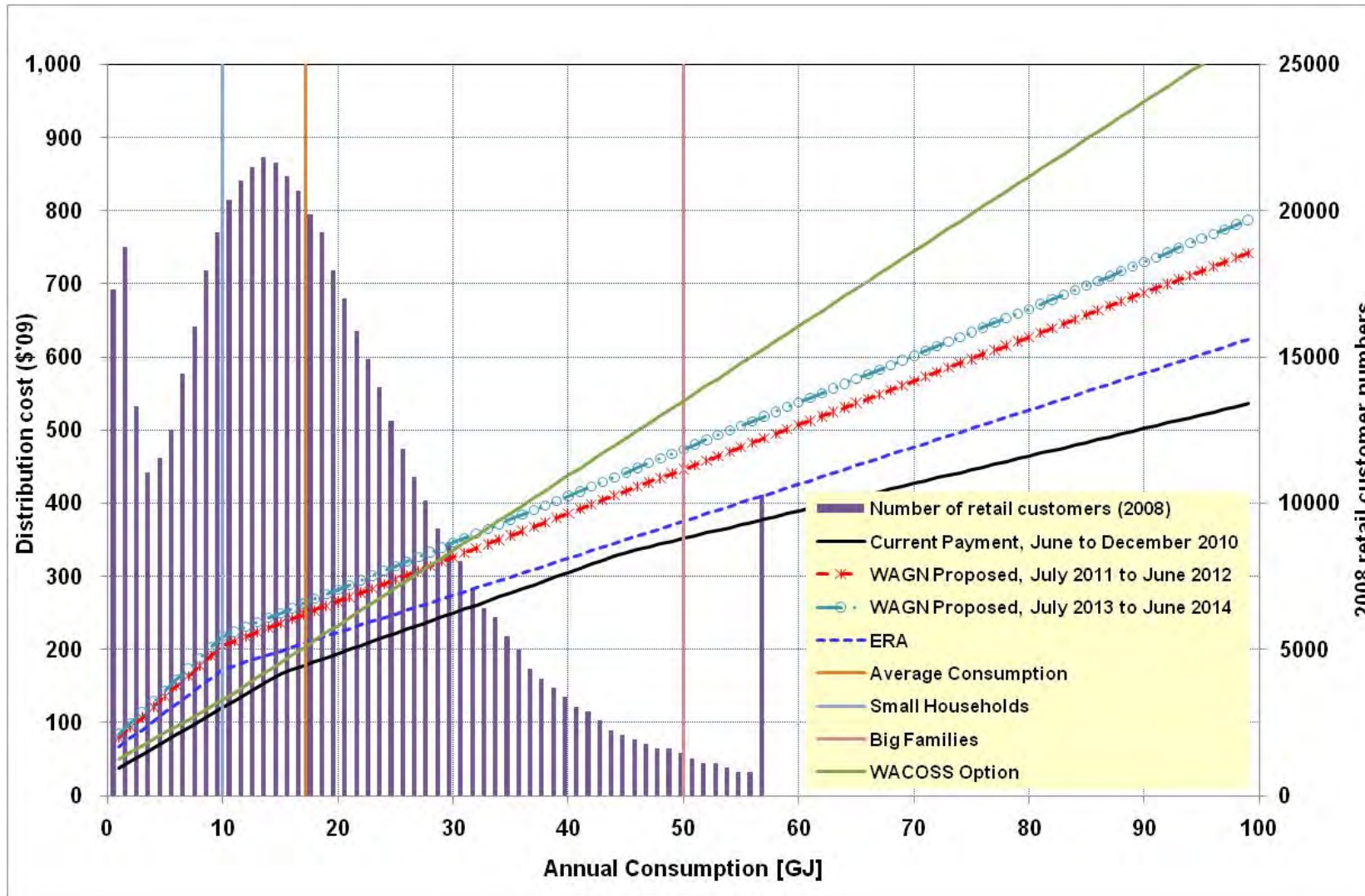
Authority's Assessment

848. The Authority's limited discretion under rule 94 is tempered with the Authority's requirements under the WA Local Regulations which require it to address the impact of tariffs on small use customers and retailers who supply small use customers. The WA Local Regulations also explicitly require that revenue be equalised over the access arrangement period prescribed in rule 92(2).⁹²
849. The Authority notes that in WAGN's initial proposed access arrangement revisions dated 29 January 2010 WAGN proposed a single tier usage charge for all tariff classes except A1, which had a two (2) tier usage charge. In its draft decision, the Authority required a two (2) tier declining block tariff for each class except A2 and B3 where the Authority required a three (3) tier declining block tariff structure.
850. In its amended access arrangements revisions proposal, WAGN proposed a two (2) tier declining block tariff for each tariff class, as set out in Table 31 above.
851. The Authority has considered the WACOSS submission regarding an alternative structure for tariff class B3 customers. The Authority notes that there is in place a State Government Energy Rebate Scheme (**Scheme**) to provide a rebate to pensioner concession card holders. The subsidy is intended to assist any energy use (including electricity, gas, fuel oil and wood) by concession card holders but is, for administrative simplicity, paid only as a rebate on electricity use. The subsidy is provided and paid through Synergy and Horizon Power as a rebate on some electricity costs to residential customers who hold eligible concession cards⁹³.
852. Figure 13 below, among other things, sets out the annual distribution costs associated with the WACOSS tariff structure if it were to be applied and compares this with the costs associated with the WAGN tariff structure and that of the Authority's determination in this final decision.
853. The figure seeks to illustrate how each of the proposed reference tariff structures would impact on the annual distribution cost (left hand axis of the chart) for B3 customers at different levels of annual gas consumption. The histogram (bell shaped cluster of columns, which is associated with the right hand axis on the chart) shows the approximate number of retail customers for each level of annual consumption, as at 2008. The annual distribution costs for different options, represented by the lines, overlay the histogram.

⁹² The NGR requires that an access arrangement contain reference tariff variation mechanism designed to equalise (in terms of present values): forecast revenue from reference services over the access arrangement period; and the portion of total revenue allocated to reference services for the access arrangement period.

⁹³ http://www.energy.wa.gov.au/3/3207/64/state_government_energy_rebate_scheme.pm.

Figure 13 Comparison of Annual Cost for B3 proposed distribution charges Overlaid with 2008 retail customers numbers



854. The graph shows that the WACOSS proposed structure would result in marginally lower annual distribution costs to small use customers who use below the average consumption level of just over 17 G J of gas per year. Distribution costs for customers using more than the average would be increasingly higher for higher levels of consumption. The Authority notes the negative impact that the WACOSS tariff structure (indicated by the straight green continuous line) would have on large families who consume in the order of 40 to 50GJ (indicated by the pink vertical line) per year. As the figure shows, these users will pay significantly more.
855. The Authority's proposed tariffs remain constant in real terms following the commencement of the new tariffs whereas the WAGN proposal has step changes for each year. Accordingly, the chart shows the annual distribution costs for WAGN's proposed tariff path when the new tariffs commence on 1 July 2011 and the last year of the access arrangement period.
856. The Authority notes that the current Government policy takes into account that if gas prices increased suddenly then gas users would be worse off unless the Government determined funding for the Scheme should be changed to reflect higher gas prices. The policy also takes into account that gas users will still benefit to the extent that the cost per GJ of energy delivered is lower when users have access to gas rather than electricity.
857. The Authority is aware that the Office of Energy is, in response to submissions by WACOSS, undertaking a Tariff and Concession Framework Review (**Review**). Under this Review, the Office of Energy will commission a large survey in early 2011 examining the relationships between various household characteristics and energy consumption. The survey will cover both metropolitan and regional Western Australia with public consultation an important part of the Review.
858. In light of the Scheme and Review, the Authority considers that existing Government policy and the review of this policy framework are the appropriate vehicles for addressing the social policy issues raised by WACOSS without creating price distortions that affect other users (including low income large families), which could have unintended social and economic issues.
859. The Authority confirms its assessment set out in paragraphs 1093 to 1094 of the draft decision which agreed with WAGN's proposed grouping of customers into appropriate tariff classes.
860. 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).
861. Table 32 below sets out WAGN's stand alone costs, avoidable costs, expected revenue from reference tariffs and total revenue, and also includes the Authority's expected revenue per service.

Table 32 Stand alone costs, avoidable costs, expected revenue from Reference Tariffs and Total Revenue

Tariff	Cost/Revenue	WAGN \$m	Test	ERA Expected Revenue per service
A1	Stand alone cost	239.32	Satisfied	252.282
	Avoidable cost	5.36	Satisfied	5.644
	Expected revenue	22.904		21.073
A2	Stand alone cost	350.13	Satisfied	369.025
	Avoidable cost	1.756	Satisfied	1.851
	Expected revenue	21.865		19.992
B1	Stand alone cost	419.61	Satisfied	442.199
	Avoidable cost	3.859	Satisfied	4.067
	Expected revenue	35.388		32.264
B2	Stand alone cost	431.03	Satisfied	454.410
	Avoidable cost	4.103	Satisfied	4.344
	Expected revenue	36.623		32.856
B3	Stand alone cost	571	Satisfied	602.266
	Avoidable cost	62.507	Satisfied	66.201
	Expected revenue	486.06		426.972
All Tariffs	Total revenue	602.84	Total revenue	533.157
	Expected revenue	602.84	recovered	533.157
Prudent Discount Revenue				12.072
Ancillary Services' Revenue				2.764

862. For completeness the Authority has remodelled the upper and lower bounds using the Authority's cost parameters. This analysis is included in the "Revenue" sheet in the spreadsheet financial model which is Appendix 2 of this final decision. This analysis concludes that there are no reference tariffs where the proposed revenue is approaching either the upper or lower bound costs modelled by WAGN or the Authority.
863. 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 resulting 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.
864. Table 33 below shows the Authority's reduced total revenue requirement whilst maintaining WAGN's proposed tariff structure for each tariff class adjusted as discussed above.

Table 33 Authority's expected revenue from reference tariffs - (\$ million, December 2009)

Tariff item	PV of forecast revenue	%
A1	21.073	3.8%
A2	19.992	3.6%
B1	32.264	5.9%
B2	32.856	6.0%
B3	426.972	77.9%
Total Tariff Revenue	533.157	97.3%
Discounts	12.072	2.2%
Ancillary Services' Revenue	2.764	0.5%
Total Forecast Revenue	547.993	100.0%

865. In relation to rule 94(4)(a) the Authority remains 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 is consistent with this rule.
866. The Authority is satisfied that WAGN's proposed replacement of the three part declining block tariffs in the current access arrangement with a two part declining block 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.
867. The Authority notes that the move away from three part declining block tariff structures for B2 and B3 tariff classes is consistent with the Energy Coordination (Gas Tariffs) Regulations 2000 (WA) (**Gas Tariff Regulations**)⁹⁴, which were amended on 1 July 2008 so as to remove the third level of declining block retail tariffs for domestic gas customers and retain two part declining block retail tariffs. The Authority also notes that the cut-off points no longer align with the domestic retail tariffs. The first cut-off point is now 10GJ per annum for distribution rather than approximately 15GJ per annum for retail domestic customers. The Authority notes it is a matter for Government to consider if and how quickly this change in distribution charges is to flow through to retail tariffs.
868. 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) that are limited in their ability to seek alternative retailers due to current contestability restrictions.
869. 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

⁹⁴ Office of Energy prepared Interim Report in 2008 – (http://www.energy.wa.gov.au/2/3248/64/gas_tariffs/rev.pm).

accordingly WAGN adjusted the proposed tariff structure to ensure recovery of its expected revenue. The Authority is satisfied that this adjustment is consistent with the requirements of rule 94(5).

870. Based on the above, the Authority has determined, as set out in Table 34 below, the reference tariffs applicable to each tariff class based on this final decision.
871. The Authority has modelled the impact of the reference tariffs in Table 34 and WAGN's proposed reference tariffs on all consumption levels for each tariff class. These details are included in the Authority's financial model, under Appendix 2 of this final decision.
872. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt the reference tariffs set out Table 34 below.
873. In determining the reference tariffs in Table 34, 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. This requirement, and the Authority's compliance, is dealt with in the following section.

Authority's proposal

For the purposes of the Authority's proposed access arrangement revisions, the Authority will:

Annexure A

Replace the haulage reference tariffs set out under Annexure A with the haulage reference tariffs set out in Table 26 of this final decision.

Annexure B

Inflation – tariffs will be set to account for inflation by adjusting the real tariffs modelled, using 31 December 2009 dollars, based in CPI (All Groups, Eight Capital Cities) at the end of the twelve month 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 will be deleted;

Regulatory capital costs – references to regulatory capital expenditure will be deleted; and

The real pre-tax rate of return will be 7.40 per cent.

Table 34 Authority's Reference Tariffs – (exclusive of GST, \$ December 2009)

Tariff	Charging parameter		1-Jan-10	1-Jul-10	1-Jan-11	1-Jul-11	1-Jul-12	1-Jul-13
A1	Standing Charge	\$/year	43,617.89	43,141.61	42,591.47	39,345.21	39,345.21	39,345.21
	Demand, First 10 km	\$/GJ km	180.10	178.13	175.86	165.85	165.85	165.85
	Demand, Distance > 10 km	\$/GJ km	90.05	89.07	87.93	87.29	87.29	87.29
	Usage, First 10 km	\$/GJ km	0.04393	0.04345	0.04289	0.03518	0.03518	0.03518
	Usage, Distance > 10 km	\$/GJ km	0.02196	0.02172	0.02145	0.01758	0.01758	0.01758
A2	Standing Charge	\$/year	547.73	541.75	534.84	21,781.57	21,781.57	21,781.57
	Usage Charge 1	\$/GJ	4.82	4.76	4.70	2.10	2.10	2.10
	Usage Charge 2	\$/GJ	4.53	4.48	4.42			
	Usage Charge 3	\$/GJ	1.19	1.18	1.16	1.13	1.13	1.13
B1	Standing Charge	\$/year	547.73	541.75	534.84	1,1092.92	1,1092.92	1,1092.92
	Usage Charge 1	\$/GJ	4.82	4.76	4.70	4.20	4.20	4.20
	Usage Charge 2	\$/GJ	4.53	4.48	4.42	3.60	3.60	3.60
B2	Standing Charge	\$/year	219.65	217.25	214.48	270.46	270.46	270.46
	Usage Charge 1	\$/GJ	5.57	5.51	5.44	6.99	6.99	6.99
	Usage Charge 2	\$/GJ	4.77	4.71	4.65	4.16	4.16	4.16
B3	Standing Charge	\$/year	28.16	27.85	27.50	55.21	55.21	55.21
	Usage Charge 1	\$/GJ	9.36	9.25	9.14	11.74	11.74	11.74
	Usage Charge 2	\$/GJ	5.60	5.54	5.47			
	Usage Charge 3	\$/GJ	3.80	3.76	3.71	5.07	5.07	5.07

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.

Impact on small use customers

Draft Decision

874. The Authority was not satisfied that WAGN's proposed tariff structure had been determined with due regard to rule 94(4)(b)(ii) of the NGR as it applies to small use customers and small users.
875. The Authority set out its reference tariffs in Table 27 of the draft decision and was satisfied that the impact on these customers was reasonable and consistent with the requirements of the NGR and WA Local Regulations.

Public Submissions

WAGN's submissions

876. WAGN's amended access arrangement revisions proposal includes reference tariffs for Services A1 and A2. These services are defined in a way such that the end users cannot be small users as defined by the WA Local Regulations. Services B1, B2 and B3 are defined such that the relevant end users could be, but are not necessarily, small use customers as defined in the WA Local Regulations.
877. WAGN's amended access arrangement revisions proposal does not contain reference tariffs specifically for users who deliver gas to small use customers, nor does it differentiate the pricing on the basis of geographical location.
878. 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.
879. WAGN has not made any further submissions with respect to small use customers. However, WAGN has proposed a change in the usage parameters for B3 tariff class customers. WAGN has proposed moving to a two (2) tiered system. It proposes that the first tier of pricing be applied to customer usage up to and including 10 GJ per annum. The second tier of pricing will be applied to usage of over 10GJ per annum.

Other submissions

880. WACOSS' submission with respect to small use customers in the B3 tariff class is set out at paragraphs 717 to 722 above.

Authority's Assessment

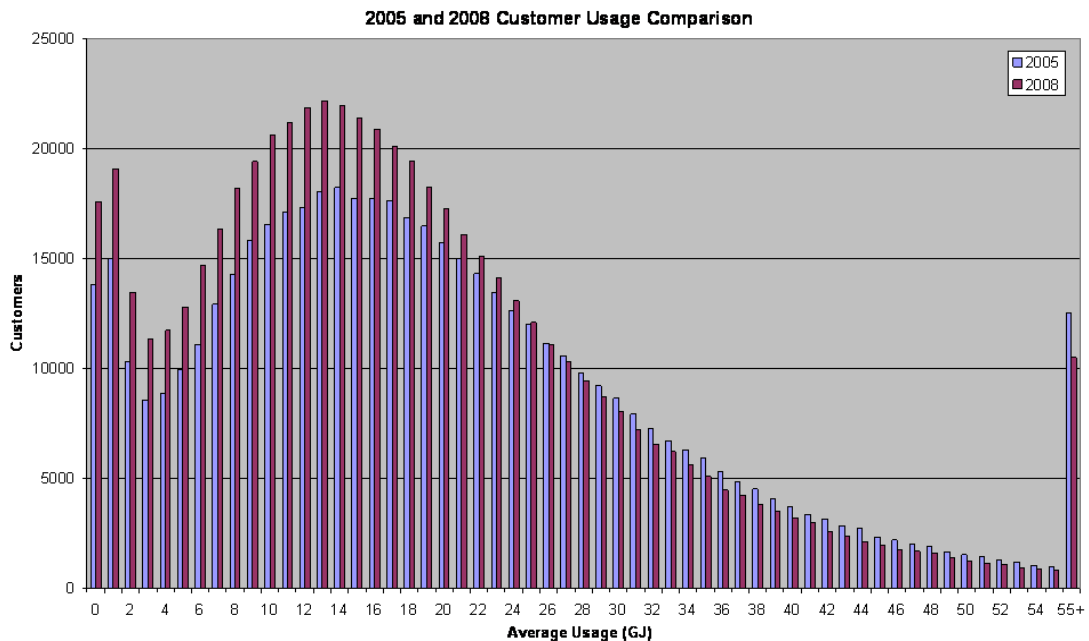
881. As well as addressing compliance with rule 94, reference tariffs proposed by WAGN also addressed the impact on small use customers. This is a critical aspect of the final decision and in the medium term is likely to affect around 600,000 small use customers. The Authority set out what the WA Local Regulations required of a regulator when exercising discretion in approving or making an access arrangement in paragraphs 1108 to 1112 of the draft decision. For ease of reference, these paragraphs are reproduced below.

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'.*

882. As discussed in the draft decision, the Authority sought information from WAGN regarding the number of reference service B1 end-users who are small use customers. WAGN has provided information to the Authority in confidence on this issue. In view of that confidential information, the Authority is satisfied that the B1 small use customers are limited in number and volume and are not material as regards the consideration of the WA Local Regulations or rule 94(4)(b) as it applies to small use customers. However, for completeness the effect on B1 tariff class customers has been modelled and is available in the financial model published with this final decision. The Authority advises that this part of the market is subject to active competition and the government-regulated tariffs will not be the tariffs negotiated by many of these end-use customers. The Authority's assessment below is therefore limited to Services B2 and B3, which are predominantly supplied to users who serve small use customers as defined in the WA Local Regulations.
883. The Authority confirms its assessment set out in paragraphs 1136 and 1137 of the draft decision.
884. In order to assess the impact of the reference tariffs on small use customers, the Authority has undertaken modelling of the retail tariffs for these customers based on two assumptions.
885. Firstly, the Authority has evaluated the usage of B2 and B3 customers for all levels of consumption for discussion and selected usage categories which reasonably reflect the annual usage for most of these customers. Accordingly, the Authority has selected the average use for B2 customers of 155GJ 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 was reproduced in Figure 15 under paragraph 1139 of the draft decision (again reproduced below as Figure 14).

Figure 14 WAGN's consumption profile for service B3

886. Secondly, the Authority assumed a full pass-through of the changes in WAGN's gas reference tariffs to the retail tariffs for B2 and B3 reference tariff categories. The Authority notes that full pass through of the changes in the relevant distribution tariffs is included in recommendation 5 of the 31 December 2010 Office of Energy *Draft Recommendations Report on the Gas Tariffs Review*⁹⁵. The Authority regards this as a reasonable assumption in the current retail commercial and regulatory environment.
887. Adopting these assumptions and reducing all WAGN's proposed tariff components by the same factor (15.9 per cent), the Authority's modelling showed that it is likely that the Authority's proposed reference tariffs would result in an increase in retail tariffs for small use customers in the B3 category. This impact is at a maximum of \$54 (ex GST) for 10 GJ per annum customers.
888. 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. 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 (see above analysis on B3 volume history and volume forecasts at paragraphs 725 to 739).
889. In its draft decision, the Authority noted that three submissions on WAGN's proposed revisions (Synergy, Alinta and the Office of Energy) expressed concern over WAGN's

⁹⁵ <http://www.energy.wa.gov.au/cproot/2318/2/Gas%20Tariffs%20Review.pdf> "A pass-through mechanism. Adjustments to the prices paid by consumers should be allowed during the regulatory period to account for cost movements associated with: changes in distribution charges resulting from regulatory reset, annual variations or network pass-through events.

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.

890. 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).
891. The Authority has considered alternatives to WAGN'S tariff structure. The economic efficiency requirements of rule 94 of the NGR means that as far as practicable reference tariffs should encourage or at least not detract from efficient use (or non use) of the distribution system and with the majority of distribution costs being of a fixed nature (i.e. they don't vary with usage) a relatively low and declining usage charge is indicated. The option to move revenue from the small use segment of B2 & B3 to larger use customers has also been considered and modelled. However, as over 80 per cent of revenue is recovered from this small use segment of the market any movement of revenue to other tariff classes has a disproportionate impact on those tariff classes. Reducing B3 tariffs by 1.9 per cent requires a corresponding increase of around 10 per cent in A1, A2 and B1 tariffs. The Authority examined a number of alternative tariff scenarios in its assessment of the WAGN proposal.
892. The Authority considered the option of a more gradual implementation of higher reference tariffs. The Authority considers the disadvantages to be too great to implement a more gradual change:
- It would delay recovery of revenue which must be achieved in PV terms (rule 92). This would mean users in total would pay more as cost recovery delayed is effectively inflated by the cost of capital (WACC) over the period of delay. For example, a two year delay would equate to a cost increase of approximately 15 per cent.
 - The last years' reference tariff revenue would be significantly higher than the corresponding total revenue (cost of service) for that year. Thus, if costs and volume assumptions for this year are accurate, the delayed recovery of costs could lead to a significant stepped change in tariffs in the subsequent (2014-2019) access arrangement period.
 - The impact on retail tariffs is affected by the Government's policy in setting retail tariff caps. Any government policy requirements regarding the smoothing of changes may be achieved through this mechanism.
 - The following two charts shows a comparison of the WAGN proposal for B2 and B3 tariffs, respectively over the current access arrangement reference tariffs and the Authority's proposed tariff path at all levels of consumption.

Figure 15 Distribution Tariffs for B2 customers – Average Annual Cost per GJ

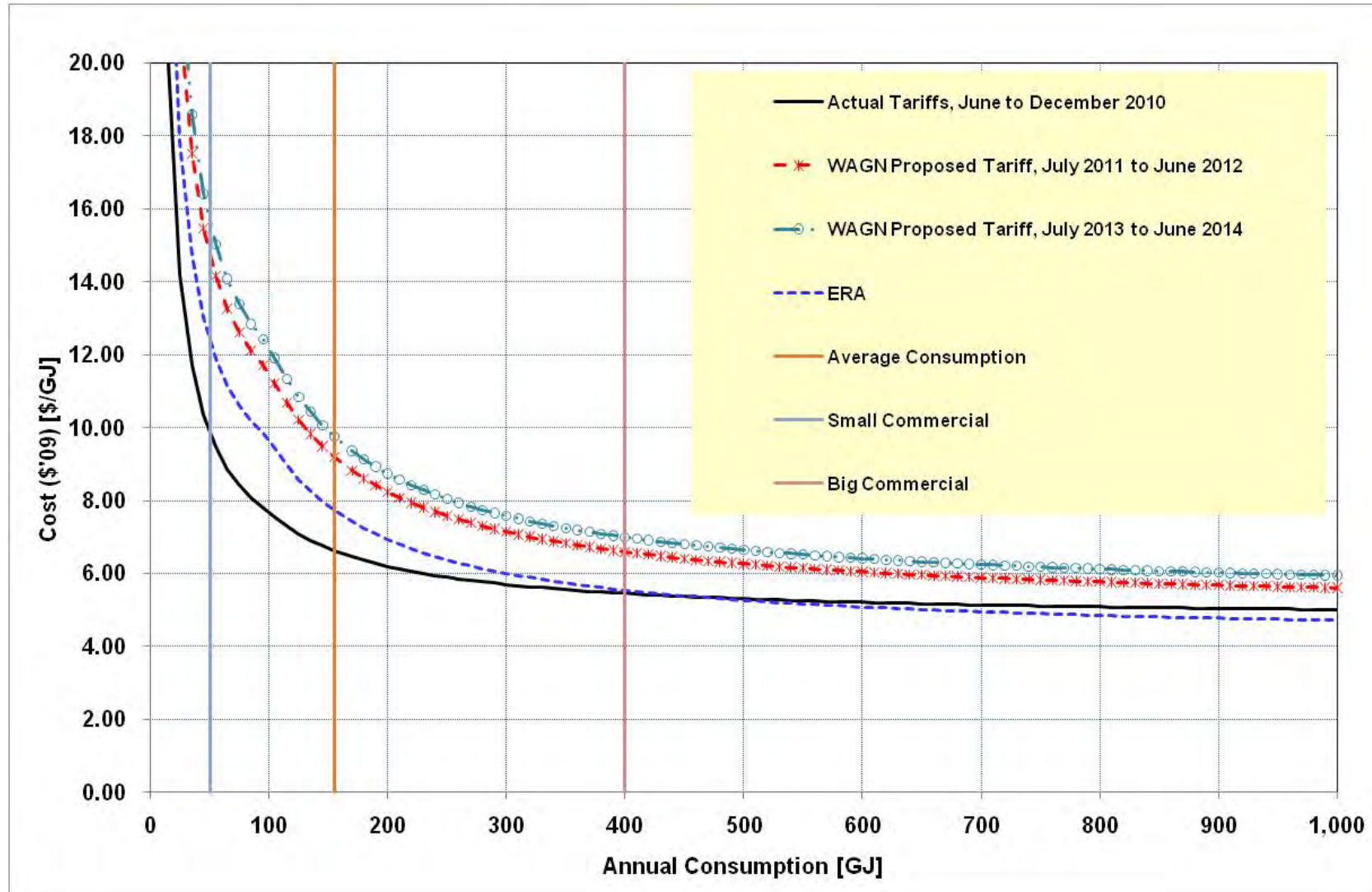
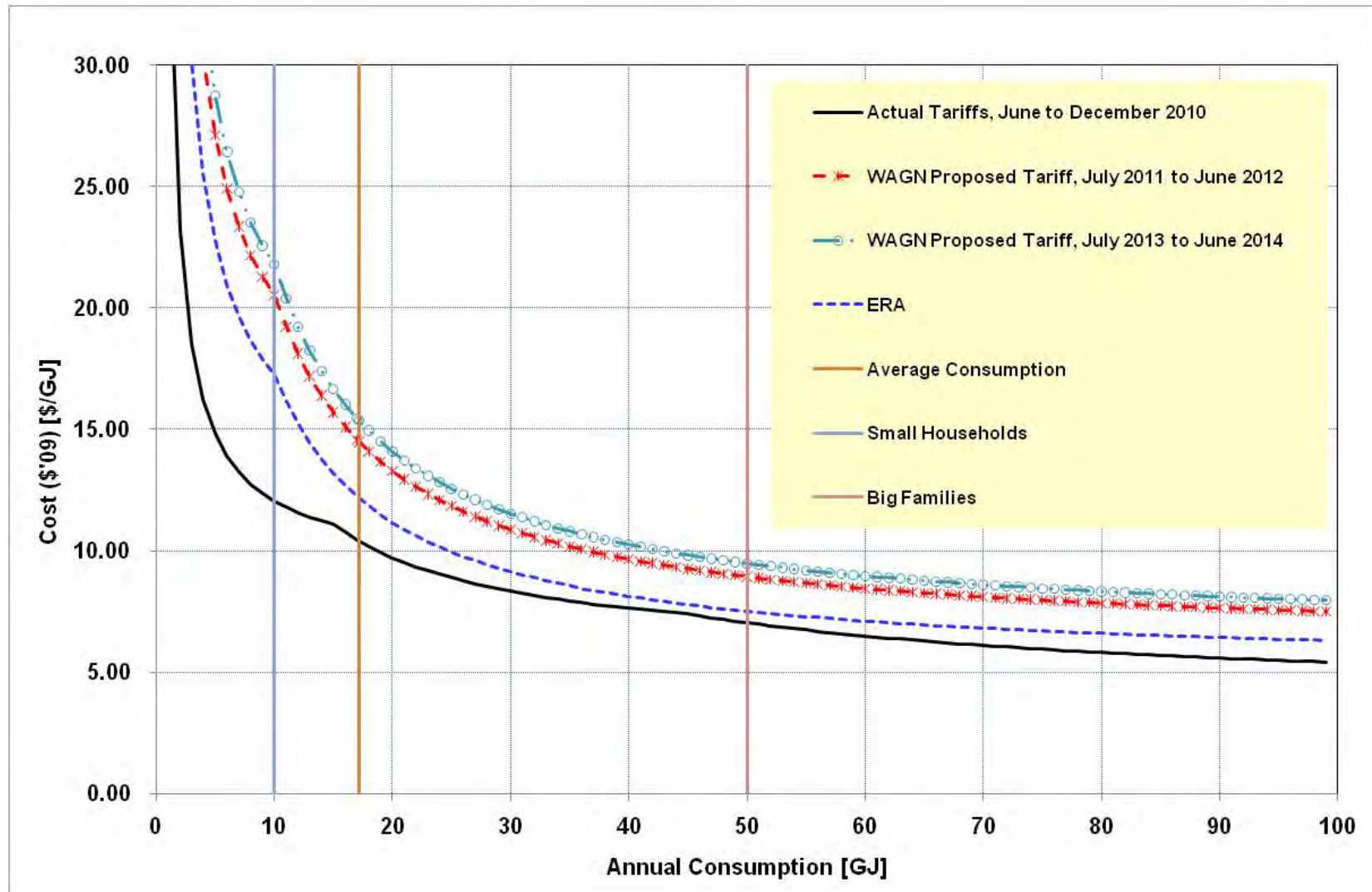


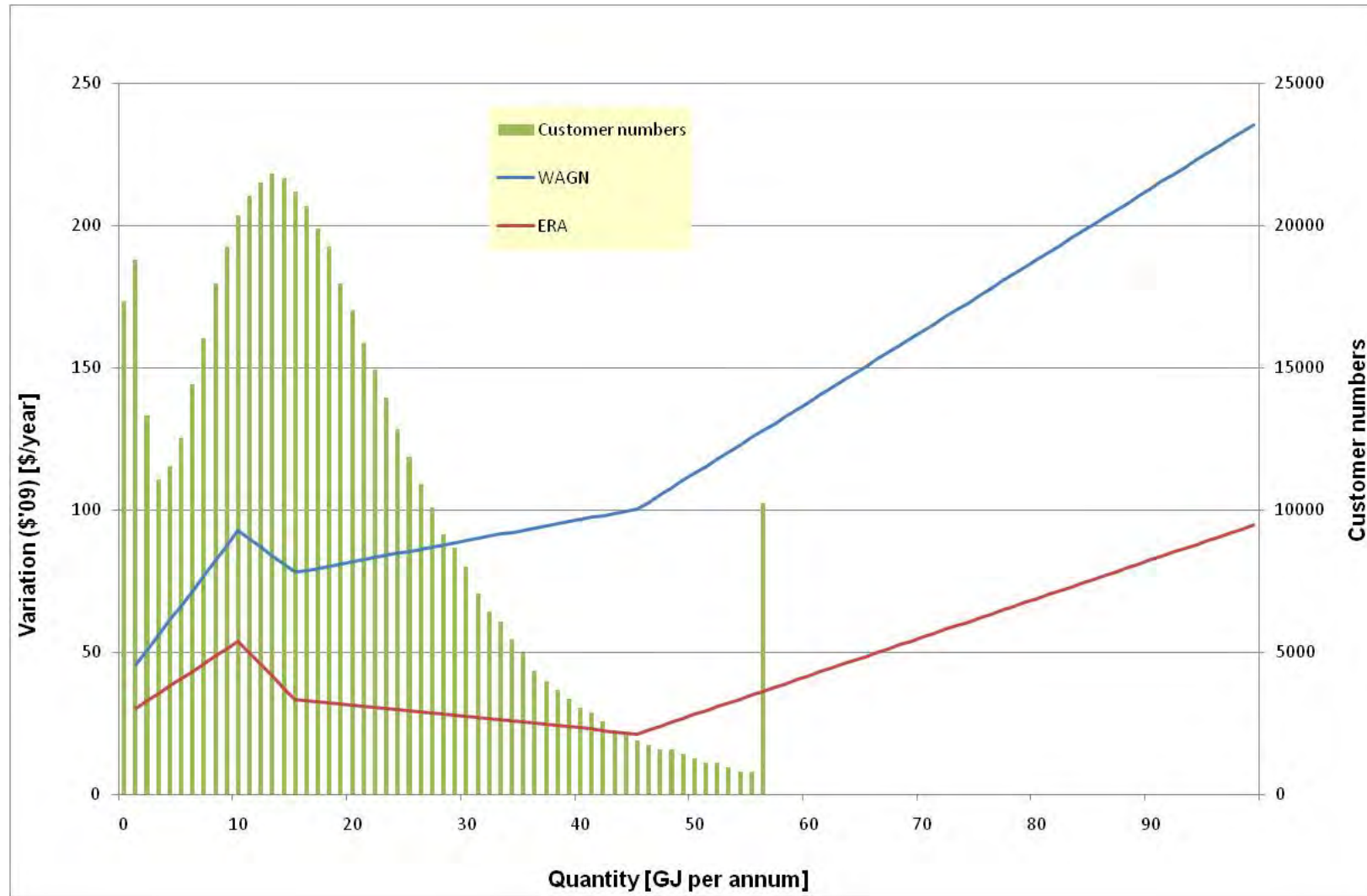
Figure 16 Distribution Tariffs for B3 customers – Average Annual Cost per GJ



893. The Authority's proposed distribution tariffs will result in increases of less than \$30 per annum or 65 cents per week for a typical large family (consuming around 50 GJ per year). This increase is less than that proposed by WAGN, which was approximately \$110 per annum.
894. Figure 17 below shows the annual average increase in distribution payments over the next three years and distinguishes the cost variation of the higher WAGN tariffs for the B3 reference tariff users from those of this final decision.⁹⁶

⁹⁶ Note the customer numbers of the histogram are retail customers (for the 2008 year) and are used as an approximation for assessing tariff impacts on small users of gas.

Figure 17 Average increase in distribution payments over the next 3 years B3 Customers



895. The Authority's decision is to scale the tariffs proposed by WAGN by a common factor and maintain the relativities inherent in the tariff structure proposed by WAGN to recover the allowable revenue.
896. In accepting the tariff path set out earlier in Table 34 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 34, the impact on the average B2 customer (155 GJ per annum) at retail level, assuming full pass through of changes in distribution tariffs to retail tariffs, would be 6.0 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 household retail level (exclusive of GST), assuming a full pass through of the changes in distribution tariffs to retail tariffs, would be \$41 per annum or 26 per cent (5 GJ), \$54 per annum, 21 per cent (10 GJ), \$32 per annum, 7 per cent (20 GJ), and \$24 per annum 3 per cent (40 GJ).
897. In the access arrangement to be proposed by the Authority, the Authority will adopt the WAGN two (2) tiered volume structure for B3 tariff class customers. However, the Authority's total revenue value, and therefore reference tariffs, will be lower than proposed by WAGN. The Authority's modelling shows that a small household (that is, using 10 GJ per annum, approximately half of average use) will be approximately \$54 (excluding GST) per annum worse off than under the current access arrangement. The Authority does not consider that a rise of around \$1 a week is an unsustainable tariff increase. It should be noted that distribution tariffs last changed on 1 January 2009.
898. Based on the above, the Authority considers that the impact on small use customers from the tariff path it will adopt in its access arrangement revisions proposal is reasonable and consistent with the requirements of the NGL, the NGR and the WA Local Regulations.

Revenue equalisation calculation

Public Submissions

899. No submissions were received with respect to the revenue equalisation calculation.

Authority's Assessment

Table 35 Revenue from reference services (\$ million, December 2009)

	2010 ¹	2010/11	2011/12	2012/13	2013/14	Present value
Total Tariff Revenue	57.409	123.842	151.790	156.886	161.948	533.401
Revenue from Prudent Discounts	1.613	3.272	3.286	3.250	3.161	12.072
Ancillary Services Revenue	0.368	0.755	0.739	0.739	0.739	2.764
Total Revenue	59.390	127.869	155.816	160.876	165.848	548.238

¹ 1 January 2010 to 30 June 2010 only

900. The Authority is satisfied that the present value of the approved reference service revenue as shown in Table 35 is equal to the present value of the total revenue as shown in Table 26 of this final decision in accordance with rule 92(2) of the NGR.

Reference tariff post approval matters

Incentive Mechanism

Draft Decision

901. In the draft decision, the Authority approved WAGN's proposal not to include an incentive mechanism in its revised access arrangement.

Public Submissions

902. At page 53 of the amended access arrangement information, WAGN maintains its proposal that there be no incentive mechanism for the forthcoming access arrangement period.

Authority's Assessment

903. The Authority accepts WAGN's proposal to not include an incentive mechanism in the access arrangement revisions for the forthcoming access arrangement period.
904. The Authority's proposed access arrangement revisions will not include an incentive mechanism.

Fixed principles

Draft Decision – Required Amendment 9

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

Public Submissions

WAGN's submissions

906. WAGN submitted (page 79) that it has elected to adopt the suggestion of the Authority referred to in Required Amendment 9 of the draft decision and has deleted clause 11.1(b)(i) from the amended proposed access arrangement revisions.

Other submissions

907. No other submissions were received with respect to Required Amendment 9.

Authority's Assessment

908. The Authority confirms its position as set out in paragraphs 1186 to 1200 of the draft decision. WAGN has complied with Required Amendment 9.
909. The Authority's proposed access arrangement revisions will incorporate Required Amendment 9.

Terms and Conditions of Reference Services

Draft Decision – Required Amendment 10

910. 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).*

Public Submissions

WAGN's submissions

911. WAGN has retained clauses 1.1(a)(i), 1.1(a)(ii)(A) and clauses 1.1(b) to (f) in the amended Template Haulage Contract, but has deleted clause 1.1(a)(ii)(D).
912. WAGN submitted on 8 October 2010 (pages 79-81) that the amendments made by WAGN in relation to the system pressure protection plan at Amendment 5, mean that clauses 1.1(a)(i) and 1.1(a)(ii)(A) accord materially with the suggested amendments of the Authority.
913. WAGN submitted that there is no basis under the NGA or NGR for the conclusion that clauses 1.1(b) to (f) are procedural and not matters that go to compliance of WAGN's proposed variations.
914. WAGN stated that in considering any provision of the Template Haulage Contract, the Authority is required to consider the competing interests of WAGN and the users in the context of the national gas objective and that it is insufficient for the Authority to have just had regard to WAGN's compliance with the national gas objective.
915. The deletion of clauses 1.1(b) to (f) is, according to WAGN, inconsistent with the national gas objective in that the amendment suggested by the Authority will introduce ambiguity into the Template Haulage Contract leading to inefficiencies and increase the likelihood of a dispute.
916. WAGN referred to rule 48(1)(d)(ii) of the NGR which requires the terms and conditions on which the reference services will be provided to be referred to in the access arrangement. WAGN submitted that clauses 1.1(b) to (f) are terms and conditions on which the reference services will be provided. The provisions reflect the law relevant to conditions precedent (i.e. they are intended to address the key areas of dispute that have arisen in the context of conditions precedent and the resulting judicial determinations). As such they are not procedural matters but terms and conditions that provide certainty in respect to the party's rights and obligations thus being consistent with the national gas objective.
917. WAGN stated that without clauses 1.1(b) to (f) there is no obligation on the prospective user to endeavour to satisfy the conditions precedent and no entitlement of WAGN to terminate in the event that they are not satisfied within a specific period. WAGN submitted that this means the prospective user has indefinitely reserved the capacity referred to in the Template Haulage Contract as WAGN will not be able to

offer that capacity to another prospective user creating a barrier for entry to those other prospective users.

918. WAGN submitted that the suggestion of the Authority that the parties are free to agree such matters for themselves is an agreement to agree so unenforceable at law. In the event that the parties do not agree, then WAGN is bound to offer the reference services on the terms set out in the draft Template Haulage Contract which will cause the reserve of capacity referred to above.

Other submissions

919. Alinta submitted on 5 November 2010 (page 1 of Attachment C) that clauses 1.1(a)(i) and 1.1(a)(ii)(A) of the amended Template Haulage Contract are not consistent with clause 5.7 of the amended proposed access arrangement, and to give proper effect to the Authority's required amendment, the clauses must be deleted.
920. Alinta submitted in relation to clause 1.1(d) that it agrees with WAGN's submission that clauses 1.1(b) to (f) are appropriate matters to be dealt with in the Template Haulage Contract but reiterates its submissions that it is the service provider that approves the satisfaction of the conditions precedent. It is misconstrued to require the user to notify the service provider of the satisfaction of the conditions precedent. Alinta submitted that clause 1.1(d) should be deleted or reworded to require the service provider to promptly advise the user of the satisfaction of each of the conditions precedent.
921. Alinta further submitted that a reasonableness qualification needs to be applied at clause 1.1(a)(ii) to the service provider's satisfaction as the current discretion is too broad.
922. Alinta noted that clause 5.2 of the amended proposed access arrangement has been amended to include a reasonableness requirement regarding information that the service provider can require as to a prospective user's compliance with WAGN's minimum prudential requirements. However, there is still no reasonableness requirement as to what may be required under the 'Access Offer' and WAGN's minimum prudential requirements are not identified. Alinta submitted that a 'reasonableness criteria' should be included in clause 1.1(a)(ii)(B).
923. In relation to clause 1.1(a)(ii)(E), now clause 1.1(a)(ii)(D) of the amended Template Haulage Contract, Alinta submitted on 5 November 2010 (page 2 of Attachment C) that the condition should relate to the status of user's ability to deliver gas at the time for satisfaction of the condition only. Including in the condition a requirement to presently demonstrate future compliance by the user throughout the duration of the Template Haulage Contract is so difficult to satisfy as to be misconceived, and should be deleted. Alinta submitted that alternatively, the words 'and will for the duration of this Haulage Contract be able to' should be deleted.

Authority's Assessment

924. The Authority accepts WAGN's deletion of clause 1.1(a)(ii)(D) in the amended Template Haulage Contract in accordance with Required Amendment 10.
925. The Authority notes that WAGN has retained 1.1(a)(i) and 1.1(a)(ii)(A) in the amended Template Haulage Contract contrary to Required Amendment 10. The Authority does not accept WAGN's submission that the amendments in clause 5 of the proposed access arrangement in relation to the System Pressure Protection Plan materially accord with Required Amendment 10.

926. The Authority maintains its position as set out in paragraphs 1241 and 1242 of the draft decision in relation to the conditions precedent. The Authority considers that in light of the amendments in relation to the System Pressure Protection Plan in the amended proposed access arrangement, this further supports its argument that clauses 1.1(a)(i) and 1.1(a)(ii)(A) should be replaced with clauses that require compliance with the proposed access arrangement. As stated in the draft decision, this amendment will ensure compliance with the relevant option the user chooses under Annexure D in the proposed access arrangement.
927. The Authority confirms that in assessing WAGN's proposed revisions for the purposes of the draft decision and for this final decision, it has considered the competing interests of the service provider and users in the context of the national gas objective. The Authority notes that its position as regulator is to assess the proposed access arrangement as drafted and submitted to the Authority by the service provider, in this case WAGN. Contrary to WAGN's submission, the Authority did not assess WAGN's compliance with the national gas objective, but considered each provision's consistency with the national gas objective, as required by rule 100 of the NGR.
928. In relation to clauses 1.1(b) to (f) of the amended Template Haulage Contract, the Authority has considered the submissions of both WAGN and Alinta who are in agreement that these clauses are appropriate matters to be dealt with in the Template Haulage Contract. The Authority accepts WAGN's submission that in the absence of clauses 1.1(b) to (f), a prospective user may indefinitely reserve capacity in the WAGN GDS which will limit WAGN's ability to offer that capacity to another prospective user. The Authority is satisfied that such a barrier to entry is inconsistent with the national gas objective and therefore accepts the inclusion of clauses 1.1(b) to (f) in the amended Template Haulage Contract.
929. Further, the Authority agrees with Alinta's submission regarding clause 1.1(d) and for the purposes of its proposed access arrangement revisions, will state that it is the service provider that is to promptly advise the user of the satisfaction of the conditions precedent, and not the user.
930. The Authority refers to Alinta's submission in relation to the need for a reasonableness qualification in clause 1.1(a)(ii) and clause 1.1(a)(ii)(B) of the amended Template Haulage Contract. The Authority notes that Alinta raised its concerns in relation to clause 1.1(a)(ii) and 1.1(a)(ii)(B) of the Template Haulage Contract in its April 2010 submissions which were summarised at paragraphs 1228 to 1230 of the draft decision.
931. The Authority notes its comments at paragraph 1243 of the draft decision that the sub-clauses in 1.1(a)(ii) have been included to protect WAGN's ability to continue to provide a service and that it is 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.
932. The Authority has further considered Alinta's submissions and accepts that a limitation for the service provider to be reasonably satisfied at clause 1.1(a)(ii) would ensure that the service provider does not abuse its power and unreasonably deny access to the WAGN GDS. The Authority also considers that a 'reasonableness criterion' in clause 1.1(a)(ii)(B) would be consistent with the national gas objective and prevent a barrier to entry. The Authority will adopt a requirement for

- reasonableness in clauses 1.1(a)(ii) and 1.1(a)(ii)(B) of the Authority's proposed access arrangement revisions.
933. The Authority notes Alinta's submissions in relation to clause 1.1(a)(ii)(D) of the amended Template Haulage Contract and the ability of a user's to presently demonstrate future compliance as a precondition. Alinta raised its concerns in relation to the former clause 1.1(a)(ii)(E) of the Template Haulage Contract in its April 2010 submissions which was summarised at paragraph 1232 of the draft decision.
934. At paragraph 1243 of the draft decision, the Authority accepted clause 1.1(a)(ii)(E) of the Template Haulage Contract without amendment.
935. The Authority has given further consideration to Alinta's submission and acknowledges the difficulty associated with a precondition for future compliance which could operate to unreasonably preclude access and operate inconsistently with the national gas objective. For the purposes of its proposed access arrangement revisions the Authority will delete the phrase 'and will for the duration of this Haulage Contract be able to'. The Authority does not consider the conditions precedent section of the Template Haulage Contract the appropriate place to set out the users warranty regarding its ability to deliver gas for the term of the contract.

Authority's proposal

The Authority will delete clauses 1.1(a)(i), 1.1(a)(ii)(A) and 1.1(a)(ii)(D) of the Template Haulage Contract in accordance with Required Amendment 10.

The Authority will adopt clauses 1.1(b) to (f) of the amended Template Haulage Contract.

The Authority will also adopt a requirement for reasonableness in clauses 1.1(a)(ii) and 1.1(a)(ii)(B) of the amended Template Haulage Contract.

The Authority will amend clause 1.1(d) of the amended Template Haulage Contract so that it is the service provider that is to promptly advise the user of the satisfaction of the conditions precedent.

The Authority will delete the phrase 'and will for the duration of this Haulage Contract be able to' from clause 1.1(a)(ii)(D) of the amended Template Haulage Contract (formerly clause 1.1(a)(ii)(E) of the Template Haulage Contract).

Draft Decision – Required Amendment 11

936. 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.

Public Submissions

WAGN's submissions

- 937. In its submission dated 8 October 2010, WAGN has elected to not amend clause 2(b) of the Template Haulage Contract in accordance with Required Amendment 11 of the draft decision.
- 938. WAGN submitted that Required Amendment 11 binds the service provider and the user to the rights and obligations that are created by a subsequent access decision.
- 939. WAGN has elected to amend clause 2(b) by making a reference to clause 12.5 of the haulage contract which provides that in the circumstances the haulage contract does not make provision for the termination of the haulage contract upon termination or expiry of the access arrangement then the service provider can terminate the haulage contract by giving 20 days notice to the user.

Other submissions

- 940. In its submission of 5 November 2010, Alinta submitted that it considers that clause 2(b), when read with clause 12.2, 12.3, 12.4 and 12.5 override the normal principles of a contract.
- 941. Alinta submitted that it should be entitled to enter into long term haulage contracts which continue on the agreed terms and conditions regardless of revisions to the access arrangement. Alinta submitted that users should be able to plan for the medium to long term and not have the whole basis to access contingent on access arrangement review every 5 years.
- 942. Alinta submitted that a user can bilaterally agree with the service provider to amend the Template Haulage Contract to address the varied access arrangement.

Authority's Assessment

- 943. In the draft decision the Authority interpreted the Template Haulage Contract as being a statutory obligation to provide reference services as the terms and conditions do not survive the variation or termination of the access arrangement. WAGN does not object to this interpretation.
- 944. WAGN argued, however, that given the NGL and NGR do not expressly provide for the view expressed by the Authority in the draft decision then it is appropriate that the template contract confirms that it is amended by the variation of the access arrangement.
- 945. WAGN has elected to amend clause 2(b) by making a cross reference to clause 12.5 of the haulage contract which provides that in the circumstances the haulage contract does not make provision for the termination of the haulage contract upon termination or expiry of the access arrangement then the service provider can terminate the haulage contract by giving 20 days notice to the user.

946. In the draft decision the Authority required that clause 12.7 of the Template Haulage Contract, which is clause 12.5 of the amended Template Haulage Contract be deleted. The Authority has maintained its position in relation to this provision for reasons set out in paragraphs 1219 to 1221 of this decision.
947. The Authority maintains its position as set out in paragraphs 1249 to 1253 of the draft decision regarding clause 2(b) of the access arrangement.
948. For the purposes of its proposed access arrangement revisions, the Authority will amend clause 2(b) of the amended Template Haulage Contract to address the expiry of the access arrangement in a manner that allows the user an option to agree to the continuation of the haulage contract on the terms and conditions of the access arrangement that will replace the current access arrangement at the end of the regulatory period.

Authority's proposal

The Authority will adopt Required Amendment 11 but will amend clause 2(b) of the amended Template Haulage Contract to address the expiry of the access arrangement in a manner that allows the user an option to agree to the continuation of the haulage contract on the terms and conditions of the access arrangement.

Draft Decision – Required Amendment 12

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

Public Submissions

WAGN's submissions

950. WAGN did not adopt Required Amendment 12 and made no changes to clause 4.2 of the amended Template Haulage Contract. WAGN stated in its submissions dated 8 October 2010 (pages 82-85) that contrary to the views expressed by the Authority at paragraph 1265 of the draft decision, clause 4.2(a)(ii) of the Template Haulage Contract is materially consistent with clause 3(2)(b) of Part C of the current access arrangement. WAGN submitted that there is therefore no basis for the conclusion that clause 4.2(a)(ii) should be deleted.
951. WAGN submitted that given the existence of clause 3(2)(b) of Part C of the current access arrangement, WAGN will be under a less favourable commercial position if clause 4.2(a)(ii) is deleted. The potential for additional costs arising from the less favourable commercial position is not reflected in the reference tariffs and so clause 4.2(a)(ii) must be retained.
952. WAGN stated that the addition of the reference to force majeure in clause 4.2(a)(iii) and 4.2(b)(v) was required to remove potential ambiguity in the wording of the current access arrangement. Clause 3(2)(b) of Part C in the current access arrangement contemplates that a tariff is still payable even though the requested service is not able to be provided or undertaken. In contrast, clause 37(3) of Part C of the current access arrangement contemplates that if WAGN claims force majeure the user is not required to pay the tariff. WAGN stated that the Authority has required an equivalent

provision to clause 37(3) of Part C of the current access arrangement to be included in the amended Template Haulage Contract.

953. WAGN submitted that the release from the obligation of a user to pay if WAGN relies on force majeure is inconsistent with the NGL and NGR.
954. WAGN submitted that by definition, force majeure relates to matters not within the control of WAGN but are risks that arise from the performance of the reference services. As such, any provision that denies WAGN the opportunity to be paid the reference tariffs during an event of force majeure is inconsistent with the revenue and pricing principles in section 24 of the NGL as WAGN will be required to incur the costs associated with force majeure and will not be able to recover those costs, or at least a part of the costs, by the reference tariffs.
955. In addition, WAGN submitted that denying them the opportunity to be paid the reference tariffs during an event of force majeure is inconsistent with the national gas objective.
956. WAGN commented that a GDS, by its nature, has a high ratio of fixed costs to total costs. Not allowing WAGN to recover some of those costs (in the event of a force majeure the costs able to be claimed would be the standing charges referred to in Annexure A of the proposed access arrangement) is inconsistent with the national gas objective in that it:
- prevents the fixed costs from being shared by all of the users (and ultimately the end users);
 - is likely to be a serious impediment to WAGN in obtaining finance or increase the cost of obtaining that finance;
 - discourages WAGN from investing in the GDS because of the financial risk associated with the event of force majeure.
957. WAGN has referred to the access arrangement for the Wagga Wagga GDS, approved by the AER on 23 April 2010 and compared the approval of a cost pass through event referring to 'Force Majeure' as similar circumstances under which the AER have approved the right to recover tariff payment notwithstanding an event of force majeure.
958. WAGN has also made reference to clause 26.5 and 26.6 of the service agreement in the Jemena gas distribution access arrangement and have noted that the AER have approved express obligations on the user to continue to pay for reference tariffs notwithstanding an event of force majeure.

Other submissions

959. Alinta submitted on 5 November 2010 (pages 3-4 of Attachment C) that it supports the Authority in insisting on the removal of clauses 4.2(a)(ii), 4.2(a)(iii) and 4.2(b)(v) and submitted that the Template Haulage Contract should contain provisions which make it clear that acts or omissions of the service provider and events of force majeure affecting on the service provider that result in the user being unable to use a haulage service should be express exceptions to the user's obligations to pay under this clause.

Authority's Assessment

960. The Authority accepts WAGN's submission that clause 4.2(a)(ii) of the amended Template Haulage Contract is materially consistent with clause 3(2)(b) of Part C of the current access arrangement. The Authority is satisfied that clause 4.2(a)(ii) will not place WAGN in a more favourable commercial position than what currently exists and therefore accepts that the clause is consistent with the national gas objective.
961. In its draft decision, the Authority noted that clause 4.2(a)(iii) and 4.2(b)(v) set out the rights of parties in events of force majeure, which is also set out in clause 11 of the Haulage Contract. The Authority considered it unnecessary to duplicate the provisions of clause 11 of the Haulage Contract as this only leads to the potential for inconsistency between in the application of the two provisions.
962. WAGN submitted that the purpose of these two clauses were to remove potential ambiguity. The Authority considers that clause 11 of the Template Haulage Contract does not give rise to any uncertainty or ambiguity as to when the user is required to pay the tariff in the event that WAGN claims force majeure. Instead, the Authority considers that duplicating the provisions in clause 4.2 and clause 11 of the Template Haulage Contract potentially has the effect of creating such inconsistency and ambiguity.
963. The Authority has addressed WAGN's submissions at paragraphs 1173 to 1184 of this final decision when discussing clause 11 of the Template Haulage Contract. The Authority considers that the provisions relating to force majeure are more appropriately dealt with, in their entirety, at clause 11 than also in clause 4.2 of the Template Haulage Contract.
964. The Authority maintains its position as set out in the draft decision in relation to clause 4.2 of the Template Haulage Contract and for the purposes of the Authority's proposed access arrangement provisions will delete clauses 4.2(a)(iii) and 4.2(b)(v) from WAGN's amended Template Haulage Contract.

Draft Decision – Required Amendment 13

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

Public Submissions

WAGN's submissions

966. In the amended Template Haulage Contract submitted 8 October 2010, WAGN has elected to comply with Required Amendment 13 of the draft decision.

Other submissions

967. No other submissions were received in response to this amendment.

Authority's Assessment

968. WAGN has accepted the Authority's position in the draft decision for the reasons given in the draft decision. WAGN's amendments to the amended Template Haulage Contract have addressed, to the satisfaction of the Authority, Required Amendment 13 of the draft decision.

Draft Decision – Required Amendment 14

969. 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.

Public Submissions

WAGN's submissions

970. In its submission of 8 October 2010, WAGN has elected not to amend clause 5.5(a) and 5.5(b)(i) in accordance with Required Amendment 14 of the draft decision.
971. WAGN argued that Required Amendment 14 contemplates that WAGN is obligated to treat applications for changes to delivery point peak rates and end dates differently for users who are already a party to an existing haulage contract. WAGN is of the view this differentiation between customers is inconsistent with the NGL and NGR which contemplates equal treatment for all users.
972. WAGN submitted that the differentiation contemplated by Required Amendment 14 could create a potential breach of contract for WAGN in circumstances where WAGN may be contractually bound to follow a different application process than contemplated in the access arrangement. WAGN further proposed that such an inconsistency creates uncertainty and inefficiency contrary to the national gas objective.
973. WAGN noted that the amendments made in relation to Required Amendment 4 of the draft decision deal with the application for service process. WAGN believes the concerns raised by the Authority at paragraph 1302 of the draft decision have been addressed by confirmation of Required Amendment 4 of the draft decision.

Other submissions

974. In its submission dated 5 November 2010, Alinta submitted that it supports the Authority's position in the draft decision to amend clause 5.5(a) and delete clause 5.5(b)(i) of the Template Haulage Contract.
975. Alinta notes WAGN's submission that differentiation between existing users and potential users in relation to delivery points is not permitted under the NGL. Alinta submitted that this interpretation is incorrect as the NGL does not explicitly prevent a service provider from minimising the administrative or technical requirements required of an existing user.

976. In relation to the service provider's discretion to refuse application to change delivery points, Alinta submitted that the service provider should also consistently refuse applications for capacity from potential users only on reasonable grounds, based on technical or commercial consideration.

Authority's Assessment

977. The Authority has considered both WAGN and Alinta's submissions in relation to Required Amendment 14 and maintains its position set out in paragraphs 1300 to 1302 of the draft decision in relation to new delivery points.

978. The Authority notes WAGN's submission at paragraph 971 above that the national gas objective and NGL require users and potential users to be treated equally and notes that clause 5.5 is only directed at existing users adding a delivery point to the existing contract or amending the contracted peak rate. This can be differentiated from the position of a prospective user under the application process.

979. The Authority maintains the position that the service provider should be obligated to add a new delivery point or increase contracted peak rates unless there are technical or commercial ground on which consent can be withheld. For the purposes of the Authority's proposed access arrangement, the Authority will adopt clause 5.5(a) as set out in Required Amendment 14.

980. The Authority refers to its decision in relation to Required Amendment 4 above at paragraphs 169 to 183. The Authority no longer considers it necessary to delete clause 5.5(b)(i) in the amended Template Haulage Contract. For the purposes of the Authority's proposed access arrangement, the Authority will delete the reference to 'Pipeline Services' and insert 'Reference Services' in clause 5.5(b)(i) of the Template Haulage Contract.

Authority's proposal

The Authority will adopt clause 5.5(a) as set out in Required Amendment 14 however, the Authority will delete the reference to 'Pipeline Services' in clause 5.5(b)(i) of the amended Template Haulage Contract and replace it with 'Reference Services'.

Draft Decision – Required Amendment 15

981. 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).*

Public Submissions

WAGN's submissions

982. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to substantially adopt the requirements of Amendment 15 of the draft decision.
983. WAGN has deleted clause 5.6(a) of the haulage contract in accordance with required amendment 15 and has replaced it with a clauses 5.6(a), 5.6(b)(i) and (b)(ii) and 5.6(c) that are substantially similar to that proposed by the Authority in Required Amendment 15 of the draft decision. The only notable difference being the express reference to the end date specified in the delivery point register.

Other submissions

984. No public submissions were received in response to this amendment.

Authority's Assessment

985. The Authority confirms its position set out in paragraph 1308 of the draft decision and accepts WAGN's amendments to clause 5.6 of the amended Template Haulage Contract.
986. The Authority is satisfied that the amended Template Haulage Contract substantially incorporates Required Amendment 15 of the draft decision.

Draft Decision – Required Amendment 16

987. 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.*

Public Submissions

WAGN's submissions

988. WAGN has elected to adopt, in part, the suggestion of the Authority in relation to Annexure A of the Template Haulage Contract. WAGN submitted on 8 October 2010 (pages 89-90) that it has not, however, adopted the suggestion of the Authority in its entirety because some of the components of the gas quality specification referred to by the Authority in Required Amendment 16 are not suitable for the Parmelia Pipeline.

Other submissions

989. APA Group submitted on 1 November 2010 that Required Amendment 16 stipulated the gas quality specification applicable to the WAGN GDS was more stringent than that of the Parmelia Pipeline specification and that this mismatch has the effect of excluding gas transported by the Parmelia Pipeline from entry into the WAGN GDS.

990. APA Group outlined the gas quality specification parameters that the Parmelia Pipeline would not be able to meet under typical operating circumstances together with those specification parameters which the Parmelia Pipeline may be able to meet under most operating circumstances, but not under all credible operating circumstances.
991. APA Group submitted that the aggregate impact of these two categories yields the result that Parmelia Pipeline gas is denied entry to the WAGN GDS under typical operating circumstances on a continuous basis.
992. APA Group submitted that if gas transported by the Parmelia Pipeline is denied entry to the WAGN GDS:
- the producers currently selling gas to end users serviced by the gas transport chain comprising the Parmelia Pipeline and the WAGN GDS will be denied access to that sector of the Western Australian gas market;
 - APA will be denied access to a sector of the gas transport market;
 - retailers may be denied access to competitive sources of natural gas;
 - the owners of the GDS may be denied the opportunity to provide transportation services offered by the GDS;
 - the market power of the Parmelia Pipeline's direct competitor will be increased.
993. APA Group stated that these outcomes are in direct conflict with the objectives of economic regulation of natural gas transport infrastructure, including the national gas objective.
994. Reduction of supply to end users and increased market power is in direct contradiction to the objective of the NGR. APA Group submitted that the gas quality specification applying to regulated services provided by the WAGN GDS should not reflect those stipulated in the draft decision.
995. APA Group noted that the gas quality specification proposed by WAGN in the amended access arrangement addresses the problems deriving from the draft decision and substantially lowers the barriers to entry of gas transported by the Parmelia Pipeline into the WAGN GDS.
996. APA Group recommended that the Authority reconsider the gas quality specification applying to inlets to the WAGN GDS to allow continued delivery of gas from the Parmelia Pipeline into the WAGN GDS.
997. Synergy submitted on 18 November 2010 that it shares APA Group's concerns and that Required Amendment 16 would result in a gas quality specification more stringent than that for the Parmelia Pipeline, with the effect that gas transported via the Parmelia Pipeline could be excluded from entry into the WAGN GDS.
998. Synergy submitted that there does not appear to be any technical or commercial reason for the more stringent specification. In the absence of any technical justification, Synergy noted its grave concern. Synergy has a number of gas supply contracts in place with Perth basin producers. Perth basin gas flows via the Parmelia Pipeline and into WAGN's Metro North sub-network, supplying Synergy customers in the Perth metropolitan area. Should the gas quality specification for the WAGN GDS be more rigorous than that for the Parmelia Pipeline, Synergy submitted that it could be excluded from supplying Perth basin gas to these customers. Synergy could be

forced to source its gas from the Carnarvon basin and transport it via the DBNGP, handing a monopoly position to the Carnarvon basin gas producers and to DBP.

999. Synergy stated that given the on-going difficulties that retailers and gas users face in obtaining sufficient quantities of gas at competitive prices it is imperative that, to the extent it is technically feasible, gas from all available supply sources is able to be used to supply a retailer's customer base. It is equally important that as many transportation options as possible be available to maintain competitive tension and give gas users flexibility.

Authority's Assessment

1000. The Authority has considered the submissions from WAGN, APA Group and Synergy in relation to Required Amendment 16 and the potential significant impacts that the Required Amendment would have on the Parmelia Pipeline.
1001. The Authority accepts that WAGN's amendments to Annexure A of the amended Template Haulage Contract sufficiently address the concerns of APA Group and Synergy and will ensure that gas from the Parmelia Pipeline is not denied entry into the WAGN GDS. The Authority considers that WAGN's proposal is consistent with the national gas objective and for the purposes of its access arrangement revisions, will adopt Annexure A of the amended access arrangement.

Draft Decision – Required Amendment 17

1002. Clauses 5.8(b) and 5.8(d)(iii) should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1003. In its amended Template Haulage Contract submitted 8 October 2010, WAGN has deleted clauses 5.8(b) and 5.8(d)(iii) in accordance with Required Amendment 17 of the draft decision.

Other submissions

1004. No public submissions were received in response to Required Amendment 17.
1005. However, Alinta submitted on 5 November 2010 (page 5 of Attachment C) that former clause 5.8(d)(i) of the Template Haulage Contract (now clause 5.8(c)(i) of the amended Template Haulage Contract) should be deleted, as it is not an acknowledgment which can or should be given by it or other users. The service provider may have no control over the quality of gas entering the WAGN GDS, but does have control over what happens to the quality of gas once in that system.

Authority's Assessment

1006. WAGN has accepted the Authority's position as set out in Required Amendment 17 in the draft decision for the reasons given in the draft decision.
1007. For the purposes of the Authority's proposed access arrangement, the Authority will adopt clause 5.8 of the amended Template Haulage Contract.
1008. The Authority notes that Alinta raised its concerns in relation to clause 5.8(d)(i) of the Template Haulage Contract in its April 2010 submissions which was summarised at

paragraph 1323 of the draft decision. The Authority does not accept Alinta's submission. The acknowledgement and agreement by the user in clause 5.8(c) (formerly clause 5.8(d) in the Template Haulage Contract) is consistent with and complementary to the user's obligations under clauses 5.8(a) and (b).

Draft Decision – Required Amendment 18

1009. 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.

Public Submissions

WAGN's submissions

1010. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to not amend clause 5.9(a) in accordance with Required Amendment 18 of the draft decision.

1011. WAGN has submitted that the amendments to clause 5.9(a) required by the draft decision are inconsistent with the national gas objective in that Required Amendment 18 is neither efficient nor safe.

1012. WAGN has submitted that the words 'good faith estimate' of the gas 'likely' to be withdrawn, required by the Authority in clause 5.9(a) of the haulage contract will allow for there to be a discrepancy between amounts injected into the GDS and the amounts withdrawn. WAGN submitted that such a discrepancy will result in depressurisation or over pressurisation of the system which is beyond the control of WAGN and they should be compensated for any damage.

1013. WAGN has also made reference to the AER decision to approve clause 7.6 of the service agreement for the Jemena Gas Distribution System, which prescribes an absolute obligation on the User to balance gas in and out of the distribution system.

Other submissions

1014. In its submission dated 5 November 2010, Alinta submitted that it supports the reasoning of the Authority that clause 5.9(a) of the Template Haulage Contract should provide a reasonable obligation in relation to gas balancing.

1015. Alinta reiterates its position in its previous submission of 19 April 2010, that clause 5.9(a) should include a provision that the service provider is liable to the extent it contributes to any loss or damage and that the user's liability under clause 5.9(d)(iv) should be limited to that relating to usage of the WAGN GDS and not conduct in general.

Authority's Assessment

1016. The Authority maintains its position at paragraphs 1334 to 1347 of the draft decision and rejects WAGN's submission that Required Amendment 18 of the draft decision is inconsistent with the national gas objective.

1017. The Authority notes that WAGN has not justified its view that it does not have the ability to manage a gas imbalance. The Authority is of the view that an absolute obligation as proposed by WAGN for users to ensure a zero imbalance over a Gas Day is impractical, even with third party overseeing the Gas Day balance.
1018. The Authority notes that even if a zero imbalance over every Gas Day was achievable through the actions of the user, shorter term imbalances might still give rise to risk of loss or damage. Moreover, WAGN as a reasonable and prudent network operator is expected to take actions that are within its control to mitigate any loss or damage that might arise from the occurrence of an imbalance whether the imbalance is over a Gas Day or any other time.
1019. The Authority notes the decision of the AER in relation to the Jemena GDS which prescribes an obligation on the User to balance gas in and out of the distribution system. The Authority, through Required Amendment 18, sought to reflect the practical situation in which a user instructs its supplier to inject in a Gas Day a certain quantity of gas to balance the expected withdrawals through the relevant delivery points. Contrary to WAGN's response, the obligation expressed in Required Amendment 18 does support efficient and safe operations. The question is rather whether the obligation in Required Amendment 18 goes far enough towards achieving a zero imbalance of actual gas flows into and out of the sub-network and in a manner than better supports efficient and safe operations.
1020. The Authority proposes that the concerns of WAGN in relation to safety, efficiency and reliability of supply can be addressed by amending the words of clause 5.9(a) of the Template Haulage Contract but not changing the substance of Required Amendment 18.
1021. The Authority proposes to clarify the risks that users need to manage responsibly. For the purposes of the Authority's proposed access arrangement revisions, the Authority will amend clause 5.9(a) in such a way as to place a reasonable but nevertheless explicit obligation on the user that would allow WAGN a remedy against users in certain circumstances such as the any imbalance between the amount of gas injected and the amount of gas withdrawn on a Gas Day. This would not only provide greater clarity as to the user's responsibility but it would also address the concerns raised by Alinta relating to liability for matters in relation to loss or damage caused by conduct in general.

Authority's proposal

The Authority adopt the following wording for clause 5.9(a) of the Template Haulage Contract:

For each Gas Day, <User> must ensure that it procures the injection of an amount of Gas into each Sub-network that is equal to the <User>'s good faith estimate, acting as a reasonable and prudent person, of the quantity of Gas that <User> is likely to withdraw from the Sub-network on that Gas Day and <User> agrees to indemnify and to keep indemnified <Service Provider> against any loss or damage arising from any imbalance between the actual amount of Gas injected into each Sub-network and the actual quantity of Gas that <User> withdrew from the Sub-network on that Gas Day except to the extent that such imbalance, loss or damage resulted from <Service Provider> acting in accord with some other provision of this Haulage Contract or under the Law, from negligence of <Service Provider>,

or from failure of <Service Provider> to act as a reasonable and prudent network operator to mitigate the occurrence of such an imbalance and/or mitigate any consequent loss or damage.

Draft Decision – Required Amendment 19

1022. Clause 5.10(a) of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1023. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected not to delete clause 5.10(a) of the Template Haulage Contract in accordance with Required Amendment 19 of the draft decision.

1024. In its submission of 8 October 2010, WAGN submitted that it does not agree with the Authority's position in the draft decision that there is an inconsistency between clause 5.10(a) and 5.9(d)(iii) of the Template Haulage Contract.

1025. WAGN has submitted however that in order to deal with the Authority's position it will delete clause 5.9(d)(iii) of the Template Haulage Contract and amend clause 5.10.

Other submissions

1026. In its submission dated 5 November 2010, Alinta submitted that it accepts the approach taken by WAGN in its response to Required Amendment 19 of the draft decision in relation to clause 5.10(a) of the Template Haulage Contract.

Authority's Assessment

1027. The Authority confirms its position at paragraph 1353 of the draft decision. The Authority notes that the amendments WAGN has made to clause 5.10 of the amended Template Haulage Contract have the effect of prescribing the user with an obligation to indemnify the service provider for any direct or indirect damage caused by the curtailment, interruption, cessation or restriction of gas deliveries into the WAGN GDS.

1028. The Authority has considered the amendments made by WAGN and is of the view that it has not accurately reflected the position of the old clause 5.9(d)(iii), now deleted, into the new clause 5.10(a). The outcome is that parties would under the new clause 5.10(a) be required by the user to comply, as the user is to comply with the User's approved System Pressure Protection Plan. Previously under the old clause 5.10(d)(iii) it was only the conduct of those other parties that the user was to ensure complied with the user's Approved System Pressure Protection Plan.

1029. The Authority notes that there is a difference between the two outcomes, the original not drawing the other parties into an obligation to comply as the user is obliged to comply, but only to exhibit conduct that complies. The Authority is of the view that this could be rectified by including the words the user must comply and ensure that 'the conduct' of its related shippers or swing service providers complies with the user's Approved Systems Pressure Protection Plan.

1030. For the purposes of the Authority's proposed access arrangement revisions, the Authority will amend clause 5.10(a) of the amended Template Haulage Contract to include a reference to the Related Shipper's conduct as discussed at paragraph 1029 of this decision.

Authority's proposal

The Authority will amend clause 5.10(a) of the Template Haulage Contract to include a reference to the Related Shipper's conduct.

Draft Decision – Required Amendment 20

1031. *The words 'be it direct or indirect' should be deleted from clause 5.11(d) of the Template Haulage Contract.*

Public Submissions

WAGN's submissions

1032. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to delete the words 'be it direct or indirect' from clause 5.11(d) in accordance with Required Amendment 20 of the draft decision.

Other submissions

1033. No public submissions were received in relation to this amendment.

Authority's Assessment

1034. The Authority confirms its position set out in paragraph 1364 of the draft decision and accepts that WAGN has adopted the Authority's position in the draft decision for the purpose of the amended Template Haulage Contract.

Draft Decision – Required Amendment 21

1035. 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.*

Public Submissions

WAGN's submissions

1036. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN elected to adopt Required Amendment 21 of the draft decision.

1037. WAGN has also proposed that the definition of 'Interconnection Event' also be re-considered in this context. WAGN proposed, as currently drafted, the definition of 'Interconnection Event' only addresses the circumstances in which the relevant

contract terminates and does not properly address the situation where either party to the interconnection agreement may have a right to curtail or refuse to accept gas.

1038. WAGN has suggested words in the definition of 'Interconnection Event' in clause 22.1 of the Template Haulage Contract that have the effect of providing for circumstances of curtailment or the right to refuse gas.

Other submissions

1039. In its submission dated 5 November 2010, Alinta submitted that the amending clause to make the right to disclose information subject to clause 20.2 does not provide sufficient protection of the user's information.
1040. Alinta submitted that the clause should be amended to require the service provider to obtain a confidentiality agreement from the operator of the interconnected pipeline before making any disclosure of the User's information, and disclosure should be strictly on the basis that the information is used only as required for the operation of the interconnection.
1041. Alinta further submitted on 5 November 2010 (pages 6-8 of Attachment C) that given the severity of the potential ramifications to the user under clause 6.6, it is unacceptable that the service provider not be required to act as a reasonable and prudent person in exercising its rights under clause 6.6(a)(ii) and when making a determination under clause 6.6(d). This represents a significant shift from the qualifications present under the current access arrangement and no justification is given for the removal of this qualification. Clauses 6.6(a)(ii) and 6.6(d) should be made subject to the requirement that the service provider act as a reasonable and prudent person.
1042. Alinta reiterated its earlier submissions that it is imperative that clause 6.6(b) reflects the fact that acts or omissions of the service provider may be responsible for an 'Interconnection Event' in many circumstances that do not amount to breach by the service provider or termination of the 'Interconnection Arrangements'. Alinta submitted that WAGN's amendment of the definition of 'Interconnection Event' highlights the fact that the service provider's right to refuse or curtail gas under clause 6.6(a)(ii) may arise for a number of other reasons. The user should not be liable for any damage it suffers as a result of the exercise of the service provider's rights under clause 6.6(a)(ii) to the extent they were caused or contributed to by the direct or indirect actions or omissions of the service provider.
1043. Contrary to WAGN's submissions, Alinta submitted that the expansion of the definition of 'Interconnection Event' does very much affect the rights of the user. It is the status of, or actions of the parties to, the 'Interconnection Arrangement' that triggers an 'Interconnection Event' and the service provider's ability to exercise its rights under clause 6.6(a)(ii). It is the liability for damage resulting from the exercise of those rights that clause 6.6(b) seeks to address.
1044. Clause 6.6(b) should be amended to provide that the service provider is liable for any direct or indirect damage suffered by the user as a result of an interruption or curtailment of gas delivery under clause 6.6(a)(ii) to the extent that it is caused or contributed by the direct or indirect acts or omissions of the service provider.

Authority's Assessment

1045. The Authority accepts that WAGN has adopted Required Amendment 21 which results in clause 6.6(e) being subject to the confidentiality provisions in clause 20.2.

The Authority refers to paragraphs 1404 to 1409 of this final decision where it has approved clause 20.2 of the Template Haulage Contract to remain in the Template Haulage Contract.

1046. The Authority notes that Alinta raised its concerns in relation to clause 6.6 of the Template Haulage Contract in its April 2010 submissions, which were summarised at paragraph 1386 of the draft decision. The Authority refers to its reasoning in relation to clause 6.6(e) of the Template Haulage Contract at paragraph 1392 of the draft decision.
1047. The Authority refers to Alinta's further submission that clause 20.2 does not go far enough to protect the user and that the Template Haulage Contract should require WAGN to obtain a confidentiality agreement from the operator of the interconnected pipeline before making any disclosure of the user's information.
1048. The Authority considers that such a requirement in the Template Haulage Contract would burden the service provider, and that if the user required additional protection to that afforded by clause 20.2, that would be a matter of commercial negotiation between the parties, and not a matter that goes to compliance of WAGN's proposed Template Haulage Contract with the national gas objective.
1049. In relation to the definition of 'Interconnection Event', the Authority notes WAGN has amended the definition of 'Interconnection Event' from the definition the Authority considered in the draft decision. WAGN's original definition of 'Interconnection Event' did not include curtailment events which the provisions in clause 6.6 contemplate. The Authority notes Alinta's disagreement in relation to the expansion of the definition, however, the Authority considers an extended definition of 'Interconnection Event' would be appropriate in the circumstances subject to amendments to clauses 6.6(a)(i)(A) and (B) to provide that the user is able to partly deliver gas into the WAGN GDS or partly take delivery of gas to the extent permitted by the service provider under partial curtailment.
1050. The Authority notes Alinta's suggestion that clause 6.6(b) be amended to provide that the service provider is liable for any direct or indirect damage suffered by the user under clause 6.6(a)(ii) to the extent that the Interconnection Event is caused or contributed to by the direct or indirect acts or omissions of the service provider. The Authority does not accept the argument put forward by Alinta in this regard. The effect of extending clause 6.6(b) in this way would be to make the service provider an insurer (i.e. strictly liable) for any damage which it can be shown is causally connected with the acts or omissions of the Service Provider. Alinta has not provided any reasons for extending liability beyond the current ambit of clause 6.6(b) which renders the service provider liable to the user in the usual circumstances where it is negligent or otherwise in default.
1051. The Authority refers to Alinta's submissions in relation to clauses 6.6(a)(ii) and 6.6(d) and accepts that clause 26 of Part A of the current access arrangement places an obligation on the service provider to act as a reasonable and prudent person. The Authority accepts Alinta's submission that no justification was provided by WAGN for the removal of such a requirement and considers such a qualification to be consistent with the national gas objective. For the purposes of the Authority's access arrangement revisions, the Authority will make clauses 6.6(a)(ii) and 6.6(d) subject to the requirement that the service provider act as a reasonable and prudent person.

Authority's proposal

The Authority will adopt clause 6.6 of the amended Template Haulage Contract but will amend clauses 6.6(a)(ii) and 6.6(d) so that they are subject to the requirement that the service provider act as a reasonable and prudent person.

Draft Decision – Required Amendment 22

1052. 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 of 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.*

Public Submissions

WAGN's submissions

1053. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected not to adopt Required Amendment 22 and instead revert back to the position in the current access arrangement in relation to delivery facilities installation, maintenance and operation.

1054. WAGN has submitted that Required Amendment 22 of the Template Haulage Contract as drafted by the Authority is inconsistent with the national gas objective as it gives rise to inefficiencies. WAGN has suggested that as drafted by the Authority, clause 6.7(b) of the Template Haulage Contract allows a situation where the service provider will have to obtain the user's consent to restore the land or premises in circumstances where the user does not have to act as a reasonable or prudent person or in line with any time frames.

1055. WAGN has reverted to the position in the current access arrangement where the service provider is obliged to restore the user's property where there has been damage or disturbance.

Other submissions

1056. Alinta submitted on 5 November 2010 (pages 8-9 of Attachment C), that it supports reverting to the position under the current access arrangement. To reflect the position under the current access arrangement, clauses 6.7(a) and 6.7(e) of the Template Haulage Contract should be amended to change the wording 'in the course of' back to the wording 'in the reasonable course of' as appears in the current access arrangement.

1057. Alinta further submitted that the user should not have to indemnify the service provider and the service provider should not be exempt from liability where it has not conducted itself in a reasonable and prudent manner.

Authority's Assessment

1058. The Authority notes that WAGN has elected not to adopt Required Amendment 22 and has instead amended clause 6.7 of the Template Haulage Contract to reflect the position in the current access arrangement.
1059. The Authority accepts WAGN's amendments to clause 6.7(b) in the amended Template Haulage Contract.
1060. The Authority also accepts Alinta's submission in relation to clauses 6.7(a) and (e) of the amended Template Haulage Contract and considers it appropriate to adopt the wording in the current access arrangement. For the purposes of the Authority's proposed access arrangement revisions, the Authority will use 'in the reasonable course of' where appropriate in clauses 6.7(a) and (e).
1061. The Authority notes Alinta's submission regarding clauses 6.7 (d), (e) and (f) of the amended Template Haulage Contract. The Authority considers that these provisions are materially the same as clause 62(6) of Part C of the current access arrangement and without substantiation to justify a change in the current position, the Authority considers that clause 6.7 is consistent with the national gas objective.

Authority's proposal

The Authority will adopt clause 6.7 of the amended Template Haulage Contract but will delete the phrase 'in the course of' in clauses 6.7(a) and (e) and will replace it with the phrase 'in the reasonable course of'.

Draft Decision – Required Amendment 23

1062. Clause 7.3(b) of the Template Haulage Contract should be amended to read
(b) *at any time at least ~~10~~ 30 days after giving <User> written notice,*

Public Submissions

WAGN's submissions

1063. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to adopt Required Amendment 23 of the draft decision to increase the notice period for the service provider to curtail gas from 10 days to 30 days.
1064. In its submission of 8 October 2010, WAGN has suggested additional words for clause 7.3 of the Template Haulage Contract in relation to the service provider's right to curtail gas under the Template Haulage Contract and any other rights to curtail gas that may arise under the NGL or NGR.
1065. WAGN has proposed that the additional words to clarify the position of the service provider in relation to the curtailment of gas.

Other submissions

1066. No public submissions were received in relation to Required Amendment 23 of the draft decision.

Authority's Assessment

1067. The Authority confirms its position set out in paragraph 1417 of the draft decision and notes that WAGN has accepted the Authority's position for the reasons given in the draft decision.

1068. The Authority has considered the suggested amendments to clause 7.3 of the Template Haulage Contract and agrees that the words suggested by WAGN clarify the service provider's rights to curtail gas under the Template Haulage Contract.

1069. For the purposes of the Authority's access arrangement revisions, the Authority will adopt clause 7.3 as set out in the amended Template Haulage Contract.

Draft Decision – Required Amendment 24

1070. Clause 7.4 of the Template Haulage Contract should be amended so that clause 7.4(i) is deleted.

Public Submissions

WAGN's submissions

1071. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN elected to delete clause 7.4 of the Template Haulage Contract in accordance with Required Amendment 24 of the draft decision.

Other submissions

1072. No public submissions were received in relation to this matter.

Authority's Assessment

1073. WAGN has accepted the Authority's position for the reasons given in the draft decision. The Authority is satisfied that WAGN has amended clause 7.4 of the amended Template Haulage Contract in accordance with Required Amendment 24.

Draft Decision – Required Amendment 25

1074. 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.*

Public Submissions

WAGN's submissions

1075. In its submission of 8 October 2010, WAGN submitted that the Authority has misunderstood the purpose of clause 7.5 of the Template Haulage Contract. WAGN has proposed that the intent of clause 7.5 is to give the service provider the right to use its ability under the contractual arrangements or under the *Energy Coordination Act 1994* to direct users to curtail gas, rather than provide the user with information about the curtailment of gas by the service provider.
1076. In its amended Template Haulage Contract WAGN has proposed that the words 'direct the user by issuing a notice' be inserted into clause 7.5 of the Template Haulage Contract to clarify the intent of the clause.

Other submissions

1077. In its submission dated 5 November 2010, Alinta submitted that it is critical that a user is provided with reasons for any curtailment of gas as required in Required Amendment 25 of the draft decision. Alinta submitted that such information is essential in circumstances where the service provider or a third party is liable for damage suffered by the user as a result of curtailment.
1078. Alinta is of the view the user should be provided with the same level of information regardless of whether the service provider effects a curtailment or requires the user to effect curtailment.

Authority's Assessment

1079. The Authority has considered WAGN's proposed changes to clause 7.5(a) of the Template Haulage Contract and accepts that the inclusions of the words 'direct the user to by issuing a notice' assists to clarify the intent of clause 7.5. The Authority accepts the changes WAGN has made as satisfying its concerns regarding clause 7.5. The Authority is satisfied the changes clarify WAGN's power to require the user to act under clause 7.5 in circumstances where the user is the party that effects curtailment and has retained WAGN's discretion to not require the user to do so where it is the service provider who will effect the curtailment.
1080. In relation to Alinta's submission at paragraphs 1077 to 1078, the Authority is of the view that clause 7.8(c) of the amended Template Haulage Contract addresses Alinta's concerns regarding reasons and ongoing information in relation to the curtailment and therefore a subclause requiring WAGN to give reasons for curtailment is not required under clause 7.5 of the Template Haulage Contract.
1081. The Authority is satisfied that WAGN's proposed changes to clause 7.5(a) of the amended Template Haulage Contract address the concerns raised in paragraph 1433 of the draft decision.

Draft Decision – Required Amendment 26

1082. 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.*

Public Submissions

WAGN's submissions

1083. As noted above at paragraph 1075, in its submission of 8 October 2010, WAGN has suggested that the Authority has also misunderstood the purpose of clause 7.6 of the Template Haulage Contract. WAGN submitted that the intent of clause 7.6 is to give the service provider the right to use its ability under the contractual arrangements or under the Energy Coordination Act 1994 to direct users to not accept gas, rather than provide the user with information about the non acceptance of gas by the service provider.

1084. In its amended Template Haulage Contract WAGN has proposed that the words 'direct the user by issuing a notice' be inserted into clause 7.6 to clarify the intent of the clause.

Other submissions

1085. In its submission dated 5 November 2010, Alinta submitted that its submission in relation to clause 7.5 of the amended Template Haulage Contract applies equally to clause 7.6 of the amended Template Haulage Contract.

Authority's Assessment

1086. The Authority notes its assessment of clause 7.5 of the Template Haulage Contract above at paragraphs 1079 to 1081 of this final decision. The Authority confirms that the application and reasoning of the changes made by WAGN to clause 7.5 of the Template Haulage Contract equally apply in relation to clause 7.6 of the Template Haulage Contract.

1087. The Authority confirms that the changes made by WAGN to clause 7.6 of the amended Template Haulage Contract clarify the purpose of clause 7.6 of the Template Haulage contract and satisfy the concerns raised at paragraph 1439 of the draft decision.

Draft Decision – Required Amendment 27

1088. 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.

Public Submissions

WAGN's submissions

1089. WAGN has elected to adopt the suggestion of the Authority referred to in Amendment 27 save that the term 'network operator' will be used.

Other submissions

Authority's Assessment

1090. The Authority notes that WAGN has adopted Required Amendment 27 except for the user of the term 'network operator' as opposed to 'service operator' and that the word 'acting' is missing for the amended Template Haulage Contract.

1091. The Authority does not see any material difference in the terms 'network operator' and 'service operator' and therefore accepts this amendment by WAGN to clause 7.8(a) of the amended Template Haulage Contract.

1092. For the purposes of the Authority's proposed access arrangement provisions, the Authority will include the word 'acting' as set out in Required Amendment 27 of the draft decision.

Authority's proposal

Clause 7.8(a) of the Template Haulage Contract is to read:

When exercising its rights under clauses 7.2, 7.3 or 7.4, <Service Provider> shall determine, acting as a reasonable and prudent network 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.

Draft Decision – Required Amendment 28

1093. 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).

Public Submissions

WAGN's submissions

1094. WAGN submitted on 8 October 2010 (pages 95-96) that the amendment suggested by the Authority is inconsistent with the national gas objective in that it might be

interpreted as a requirement to give a notice notwithstanding that the magnitude and expected duration of the curtailment is no different to that set out in the notice referred to at clause 7.8(c) of the Template Haulage Contract, so that the amendments suggested by the Authority will introduce ambiguity into the Template Haulage Contract leading to inefficiencies and increase the likelihood of a dispute.

1095. WAGN has elected to adopt the suggestion of the Authority in Required Amendment 28 save that the obligation to provide ongoing notice is only when the magnitude and expected duration is 'materially greater' than that described in clause 7.8(c) of the Template Haulage Contract.

Other submissions

1096. Alinta submitted on 5 November 2010 (page 11 of Attachment C) that clause 7.8(d) of the amended Template Haulage Contract should also be amended by changing the wording 'materially greater' to 'materially different' as a smaller or greater extent of the expected duration or magnitude could affect the operations and planned arrangements of the user.
1097. Alinta submitted (page 11 of Attachment C) that clause 7.8 of the amended Template Haulage Contract should be further amended or a new clause inserted requiring the service provider, when exercising its rights under clause 7.2, 7.3 or 7.4, to provide reasons for any curtailment or refusal to accept gas and the additional, relevant information.
1098. Alinta submitted that it is critical that the user is provided with reasons for any curtailment as the potential ramifications for the user are significant. It is also vital that the user has the right to be provided with such information as in certain circumstances the service provider is liable for damage suffered by the user as a result of a curtailment. The user may also have recourse against a third party responsible for a curtailment and the user should have the right to be provided with the reasons for the curtailment that would allow the user to make such an assessment.

Authority's Assessment

1099. The Authority notes that WAGN has adopted, in part, Required Amendment 28, but has suggested that the obligation on a service provider to provide ongoing notification be restricted to circumstances where the magnitude and duration of the curtailment is 'materially greater' than described in clause 7.8(c) of the Template Haulage Contract.
1100. The Authority has analysed the submissions made by WAGN and Alinta and has accepted Alinta's submission that clause 7.8(d) of the amended Template Haulage Contract should read 'materially different', as opposed to 'materially greater'. The Authority considers that any material change, be greater or smaller, should give rise to the service provider providing notification of the change. The Authority accepts that such an amendment is consistent with the national gas objective as a material change can significantly impact the operations of a user.
1101. The Authority has considered Alinta's submission to require the service provider to provide reasons for any curtailment or refusal to accept gas. The Authority considers that the provision under clause 7.8(c) of the amended Template Haulage Contract already sets out a provision whereby WAGN is to use reasonable endeavours to provide the user with the reasons for a curtailment. Alinta's submissions appears to assume that the obligation to provide reasons is only in circumstances where it is

reasonable to give an advance warning. However, the Authority considers that the obligation to use reasonable endeavours to provide reasons applies whether or not the curtailment has occurred, and is only qualified by it being 'practicable' to do so. Therefore, while there may be some delay before it is practicable for reasons to be given, ultimately such reasons would be required and the Authority is satisfied the clause provides an appropriate balance, having regard to the national gas objective.

1102. For the purposes of the Authority's access arrangement revisions, the Authority will incorporate clause 7.8(d) of the amended Template Haulage Contract but will refer to 'materially different'.

Authority's proposal

Clause 7.8(d) is to read:

In the event that the magnitude or expected duration is materially different to that described in the advance warning referred to at clause 7.8(c) then the <Service Provider> will, where practicable, use reasonable endeavours to provide <User> with reasonable ongoing notice of the likely magnitude and expected duration.

Draft Decision – Required Amendment 29

1103. 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.

Public Submissions

WAGN's submissions

1104. WAGN has elected not to adopt Required Amendment 29 and has retained clause 9.1 of the Template Haulage Contract without amendment.
1105. WAGN submitted on 8 October 2010 (pages 96-101) that rule 100(b) of the NGR requires the terms and conditions of the access arrangement to be consistent with the procedures (meaning the Retail Market Rules). WAGN submitted that some of the amendments requested by the Authority do not comply with the Retail Market Rules and so do not comply with the rule 100(b).
1106. WAGN has not incorporated the parts of Required Amendment 29 that do not accord with rule 100(b).
1107. WAGN states that in some circumstances, the Retail Market Rules do not regulate the circumstances contemplated by the Template Haulage Contract. In those circumstances, as required by rule 48(d)(ii) of the NGR, WAGN has included the applicable terms and conditions. WAGN submitted that it has attempted to reflect the Authority's Required Amendments in relation to clause 9 and, where appropriate and consistent with the Retail Market Rules, made minor amendments to the clauses.

1108. WAGN referred to clause 20.4 of the amended Template Haulage Contract which provides that any information provided under the Template Haulage Contract must be provided in accordance with the Retail Market Rules (to the extent that they apply). WAGN submitted that the provisions of clause 9.1 of the Template Haulage Contract have been drafted such that they are materially consistent with the Retail Market Rules (including the relevant B2B procedures and the current practice of users and WAGN in relation to payment claims).

Other submissions

1109. Alinta submitted on 5 November 2010 (page 12 of Attachment C) that it supports the Authority's decision to replace clause 9.1(c).

Authority's Assessment

1110. The Authority notes that WAGN has not adopted Required Amendment 29 in the amended Template Haulage Contract and has instead submitted that the provisions of clause 9.1 of the amended Template Haulage Contract are consistent with the Retail Market Rules, in particular the Full Retail Contestability (FRC) B2B System Interface Definitions (**Definitions**), version 3.2, dated 1 June 2005.

1111. The Definitions is a document that forms part of the REMCo Specification Pack referred to in the Retail Market Rules. As stated on page 13 of the Definitions, the purpose of the document is to define the behaviour of business and IT systems. The Authority also notes that the Network Billing transactions set out in the Definitions are used by network operators to provide users with the details to support 'Distribution Use of System (DUoS)' invoicing for basic and interval meters.

1112. The Authority notes the requirement under rule 100(b) of the NGR for the access arrangement to be consistent with 'the Procedures' and accepts WAGN's submission that the invoicing and payment procedures in the Template Haulage Contract must not be inconsistent with part 4.5 of the Definitions.

1113. The Authority considers that the requirement for 'consistency' under rule 100(b) of the NGR only invalidates provisions of an access arrangement where it is impossible for the service provider or user to comply concurrently with both the access arrangement and 'the Procedures'.

1114. The Authority notes WAGN's submission that Required Amendment 29 does not comply with the Retail Market Rules. The Authority maintains its view as set out in paragraphs 1476 to 1478 of the draft decision and, contrary to WAGN's submission, considers that the process as set out in the current access arrangement is consistent with the process set out in the Definitions and therefore rule 100(b).

1115. In particular, the Authority does not consider that WAGN's submission identifies any instance under the Authority's Required Amendment where either the service provider or a user could not concurrently comply with both the access arrangement and the 'Procedures'.

1116. The Authority notes that the Definitions forms part of a collective group of documents that can be, and most likely will be, revised or amended during the forthcoming coming access arrangement period. The Authority notes that rule 100(b) of the NGR provides that the access arrangement is to be consistent with the 'Procedures' as in force when the terms and conditions of the access arrangement are determined or revised. The Authority accepts that any amendments to the invoicing procedures set

out in the Definitions will not change the procedures set out on the forthcoming access arrangement.

1117. The Authority further notes that the current access arrangement has worked successfully alongside the Retail Market Rules, and the Definitions, for the current access arrangement period and in the absence of a substantial argument providing reasons to disturb the status quo, the Authority considers the service provider and users could continue to utilise the existing process.
1118. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt Required Amendment 29 by including an invoicing procedure consistent with clause 30(2) of Part C of the current access arrangement.

Draft Decision – Required Amendment 30

1119. 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.*

Public Submissions

WAGN's submissions

1120. WAGN has elected not to adopt Required Amendment 30 and has retained clause 9.2 of the Template Haulage Contract without amendment except for the deletion of clause 9.2(c)(iv).
1121. In addition to the submissions regarding clause 9 generally outlined above at paragraphs 1105 to 1108 of this final decision, WAGN submitted that the procedures set out clause 9.2(a) of the Template Haulage Contract are materially consistent with the Retail Market Rules B2B procedures which requires two separate notices to be provided.

1122. In addition, WAGN submitted that the procedures set out at clause 9.2(a) are consistent with the current practice. Prior to the FRC implementation, all of the participants in the market agreed that the bulk of the line items could be verified and the relevant notices issued within 3 business days of receipt of a payment claim. The participants also agreed that payment within 10 business days of a payment claim was appropriate.
1123. WAGN further submitted that the procedures set out in clause 9.2(b)(ii) are materially consistent with the Retail Market Rules B2B procedures which contemplates that there will be consultation between WAGN and the user in relation to any disputed item ('it is envisaged that email or phone will be utilised to resolve the billing dispute'). As a matter of practice this occurs between WAGN and the users and this process is used to confirm the reason for the decision and determine if the decision has been correctly made.
1124. WAGN stated that the 'Resolution Notification' referred to in clause 9.2(b) is the confirmation of WAGN's findings following the consultation process. Resolution of the dispute means that WAGN agrees or disagrees with the user. In the event that the user is not satisfied with WAGN's decision then it may dispute the issue further under clauses 9.4 or 18.
1125. WAGN submitted that the procedure set out in clause 9.2(c)(iii) is materially consistent with the current practice and the Retail Market Rules B2B procedures. Clause 9.2(c)(iii) operates in the event that the 'Resolution Notification' referred to in clause 9.2(b) confirms that WAGN does not agree that a line item in the payment claim was incorrect. In the event that the user is not satisfied with WAGN's decision then it may dispute the issue further under clauses 9.4 or 18.
1126. WAGN noted that clause 9.2(c)(iv) was inserted to clarify the process in the event that WAGN does not provide a 'Resolution Notice'. After further consideration of the intent of the payment process WAGN agrees it is a risk that WAGN can manage and does not object to the deletion of 9.2(c)(iv).
1127. WAGN further noted that clause 9.2(f) is not referred to in the Retail Market Rules B2B procedures. It operates in the event that WAGN has made a final payment claim but the subsequent process under clause 9.2 indicates there needs to be an adjustment of that payment claim. Given the parties have agreed a procedure to correct payment claims it is appropriate that the same procedure is followed (ie the payment claim process).

Other submissions

1128. Alinta submitted on 5 November 2010 (page 12 of Attachment C) that it supports the Authority's decision to align clause 9.2 with the matters in clauses 30 and 33 of Part C of the current access arrangement. Alinta stated that it can see no reason why WAGN could not comply with these requirements and the provisions of the Retail Market Rules which have co-existed for some time.

Authority's Assessment

1129. The Authority notes that WAGN has deleted clause 9.2(c)(iv) which forms only a small amendment in the context of Required Amendment 30. The Authority accepts this amendment but still maintains its decision at paragraphs 1488 to 1495 of the draft decision.

1130. The Authority refers to its decision and reasoning in relation to the FRC B2B System Interface Definitions (**Definitions**) at paragraphs 1110 to 1118 above.
1131. The Authority further notes that the Template Haulage Contract will contain the minimum terms and conditions for invoicing and payment. If the service provider and user wish to provide more specific or detailed provisions regarding the contents of invoicing and payments, the Authority considers that this is more appropriately dealt with by way of bilateral agreement and not in the Template Haulage Contract itself.
1132. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt Required Amendment 30.

Draft Decision – Required Amendment 31

1133. 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.

Public Submissions

WAGN's submissions

1134. WAGN has elected not to adopt Required Amendment 31 and has retained clause 9.4 of the Template Haulage Contract without amendment except for the deletion of clause 9.4(c).
1135. In addition to the submissions regarding clause 9 generally outlined above at paragraphs 1105 to 1108 of this final decision, WAGN submitted that clause 9.4(c) is not referred to in the Retail Market Rules B2B procedures and was inserted to clarify the process in the event that WAGN does not provide a 'Retrospective Resolution Notice'. After further consideration of the intent of the payment process WAGN agrees it is a risk that WAGN can manage and does not object to the deletion of clause 9.4(c).

Other submissions

1136. No other submissions were received in relation to Required Amendment 31.

Authority's Assessment

1137. The Authority notes that WAGN has deleted clause 9.4(c) in the amended Template Haulage Contract only and have retained the remaining provisions of clause 9.4. The Authority accepts this amendment but still maintains its decision at paragraphs 1501 to 1503 of the draft decision.
1138. The Authority refers to its decision and reasoning in relation to the FRC B2B System Interface Definitions (**Definitions**) at paragraphs 1110 to 1118 above.
1139. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt Required Amendment 31.

Draft Decision – Required Amendment 32

1140. 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.

Public Submissions

WAGN's submissions

1141. WAGN has elected not to adopt Required Amendment 32 and has retained clause 9.5 of the Template Haulage Contract without amendment.
1142. In addition to the submissions regarding clause 9 generally outlined above at paragraphs 1105 to 1108 of this final decision, WAGN noted that clause 9.5 is not referred to the Retail Market Rules B2B procedures. It operates in the event that WAGN determines there is an error in a payment claim (ie grants WAGN a similar right to that of the user under clause 9.4). In the event that the user is not satisfied with WAGN's decision under clause 9.5, then it may dispute the decision under clause 18.

Other submissions

1143. No other submissions were received in relation to Required Amendment 32.

Authority's Assessment

1144. The Authority notes that WAGN has elected not to adopt Required Amendment 32.
1145. WAGN submitted that whilst clause 9.5 is not referred to the Retail Market Rules B2B procedures, it operates in the event that WAGN determines there is an error in a payment claim.
1146. As discussed at paragraphs 86 to 93 of this final decision, the Authority maintains its position as set out in paragraphs 1507 and 1508 of the draft decision and considers that the process for accounting for errors after payment has been made should remain a commercial matter for bilateral agreement.
1147. The Authority will adopt Required Amendment 32 in its proposed access arrangement revisions.

Draft Decision – Required Amendment 33

1148. Clauses 9.6(a) and 9.6(b) of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1149. WAGN has elected to adopt Required Amendment 33 and has deleted clauses 9.6(a) and 9.6(b) from the amended Template Haulage Contract.

Other submissions

1150. No other submissions were received in relation to Required Amendment 33.

Authority's Assessment

1151. The Authority accepts that WAGN has adopted Required Amendment 33.

1152. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt clause 9.6 of the amended Template Haulage Contract.

Draft Decision – Required Amendment 34

1153. Clauses 10.1 and 10.2 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1154. WAGN has retained clauses 10.1 and 10.2 in the amended Template Haulage Contract. WAGN submitted on 8 October 2010 (pages 103-105) that contrary to the draft decision, the Authority is not being asked to determine matters relating to tax regulation.

1155. The clauses deal with contractual issues arising from legislative matters that parties undertaking arms length negotiations are required to agree upon. WAGN submitted that rule 48(1)(d)(ii) requires these to be included in the haulage contract and thus deletion of clause 10.1 and 10.2 are contrary to the NGR.

1156. The reference tariffs are expressed to be GST exclusive and are not exempt from GST as they are a taxable supply for the purposes of GST law.

1157. In the absence of clause 10.2 of the Template Haulage Contract, the reference tariffs will be deemed to be inclusive of GST. As such, the deletion of clause 10.2 is inconsistent with the revenue and pricing principles in section 24 of the NGL in that the Authority is denying WAGN the opportunity to recover the efficient cost of providing reference services (i.e. WAGN will be required to pay the GST on the reference tariffs without a right to claim that GST from the user).

1158. WAGN confirms that the AER has approved a GST clause when reference tariffs are expressed to be GST exclusive.

1159. WAGN submitted that the rationale for the inclusion of clause 10.1 is similar to that of 10.2 in that the basis for the calculation of the reference tariff is that it is on a tax free basis except those taxes that might arise by way of haulage. As such, the deletion of clause 10.1 is also inconsistent with the revenue and pricing principles in that the Authority is denying WAGN the opportunity to recover the efficient cost of providing the reference services.

1160. WAGN submitted that the Authority's suggestion that the parties are free to agree such matters for themselves is, in addition to not complying with rule 48(1)(d)(ii), an agreement to agree and unenforceable at law.

1161. WAGN referred to clause 11 of Part C of the current access arrangement and confirmed that the effect of the indemnity provided under clause 11(2)(b) is materially

similar to the approach taken by WAGN in relation to clauses 10.1 and 10.2 of the Template Haulage Contract.

Other submissions

1162. Alinta submitted on 5 November 2010 (page 12 of Annexure C) that supports the Authority's decision to require deletion of clause 10.1, but not necessarily clause 10.2. Alinta stated that clause 10.2 seems appropriate as the reference tariffs are GST exclusive.

Authority's Assessment

1163. The Authority notes that WAGN has retained clauses 10.1 and 10.2 in the amended Template Haulage Contract.

1164. The Authority has considered the submissions put forward by WAGN and Alinta. The Authority maintains its position as set out in paragraphs 1518 and 1519 of the draft decision that taxation is the subject of separate and distinct legal and regulatory system. The Authority does not consider it appropriate to regulate such matters as it would be going beyond its jurisdiction as an economic regulator.

1165. The Authority maintains its position that the taxation requirements of each party, and any agreement to adjust the incidence of taxation, is best dealt with by commercial negotiation after the parties have considered their respective legal and accounting positions.

1166. The Authority refers to WAGN's submissions at paragraph 1161 and does not consider the indemnity provision in clause 11(2) of the current access arrangement has the same effect as clause 10.1 in the amended proposed access arrangement. Clause 11(2) indemnifies WAGN in respect of certain tax claims whilst clause 10.1 provides for the user to pay all taxes arising under clause 10.1(a).

1167. The Authority notes WAGN's submission in relation to the suggestion that the parties are free to negotiate such matters for themselves is an agreement to agree and therefore unenforceable at law. The Authority refers to its comments at paragraphs 86 to 93 of this final decision.

1168. The Authority notes WAGN's comments regarding the revenue and pricing principles. The Authority refers to paragraph 1202 of the draft decision where it noted that the revenue and pricing principles do not have any application as the terms and conditions on which reference services will be provided, by definition, do not concern revenue or pricing.

1169. For the purposes of the Authority's proposed access arrangement provisions, the Authority will adopt Required Amendment 34.

Draft Decision – Required Amendment 35

1170. 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).

Public Submissions

WAGN's submissions

1171. WAGN has retained clause 11 of the Template Haulage Contract without amendment and referred to its reasoning for retaining Required Amendment 12 at paragraphs 950 to 958 above.

Other submissions

1172. Alinta submitted on 5 November 2010 (pages 12-13 of Attachment C) that it supports the Authority's decision to require a new clause 11(c) and to make clause 11(b) subject to clause 11(c).

Authority's Assessment

1173. This Required Amendment concerns the issue of liability of the user to pay charges (including but not limited to the reference tariffs), during events of force majeure.

1174. The Authority notes its decision in relation to clause 4.2 of the amended Template Haulage Contract above at paragraphs 950 to 958 where it found that the provisions of force majeure should be dealt in its entirety in clause 11 of the Template Haulage Contract.

1175. The Authority acknowledges, as submitted by WAGN, the potential ambiguity in the current access arrangement in relation to the force majeure clauses 3(2)(b) of Part C and 37(3) of Part C. However, as clause 3(2)(b) of Part C of the current access arrangement is no longer in the amended proposed access arrangement, there is no ambiguity as to when the user is obliged to pay as a result of force majeure.

1176. The Authority refers to Alinta's submissions at paragraph 1522 of the draft decision where it submitted 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. Alinta submitted, however, if the force majeure only prevents the user from using the haulage service, then the user should pay the haulage charge. The Authority has considered this submission but notes the considerable practical difficulties in applying this approach if (as is likely) a force majeure event was to prevent both WAGN from providing the haulage service and Alinta using the haulage service.

1177. The question is who should bear the risk and associated costs of a force majeure event having regard to the national gas objective. The Authority notes that the current balance (i.e. as set out in clauses 37(2) and 37(3) of Part C of the current access arrangement) has been in place for some considerable time and the parties (both the service provider and users and potential users) have made investments and put in place business plans (including plans to insure against risks of loss from force majeure events) based upon that current balance. In such circumstances, any alteration to the current balance such as the proposal by WAGN would require substantiation to establish that the balance is inconsistent with the national gas objective, because, for instance, the service provider could not obtain adequate insurance, or could not adequately fund self-insurance arrangements, and thus face a cost that it would be inefficient for the service provider to have to bear. The Authority notes that WAGN has not advanced any such substantiated evidence in its submissions to date, which would justify, in the Authority's opinion, the disturbance of the status quo.

1178. In relation to WAGN's submission regarding the revenue and pricing principles, the Authority refers to paragraph 1202 of the draft decision where it noted that the revenue and pricing principles do not have any application as the terms and conditions on which reference services will be provided, by definition, do not concern revenue or pricing.
1179. WAGN referred to the access arrangement for the Wagga Wagga GDS, noting the cost pass through event of force majeure. The Authority acknowledging that the AER's decision that a cost pass through event of force majeure may be an appropriate way to adjust tariffs. This would enable tariffs to be adjusted if there is an event of force majeure under the reference tariff variation mechanism approved in the access arrangement. The Authority notes, however, that WAGN has elected not to include an event of force majeure as a cost pass through event.
1180. WAGN has also made reference to the Jemena GDS access arrangement submitting that the AER has approved express obligations on the user to continue to pay for reference tariffs notwithstanding an event of force majeure.
1181. The Authority notes that clause 26.6 of the Jemena access arrangement is subject to clause 26.5 which does not relieve the user from any obligation to pay any amounts owing by the user to the service provider pursuant to this agreement. Clause 26.5 of the Jemena access arrangement provides that if a force majeure event affecting the service provider occurs within the network and prevents the service provider from performing its obligations to the user, the demand charge for any period during which the service provider is unable to deliver gas will be calculated by reference to the actual amount withdrawn each day at the delivery point. Therefore, the Jemena access arrangement does not accord with WAGN's proposal. The Authority considers that the approach of the AER in Jemena is one approach that may be appropriate on the material before the relevant regulator.
1182. On the material currently before the Authority, the Authority considers that no case has been made that it would be inconsistent with the national gas objective that the provisions in clause 37(2) and (3) of the current access arrangement continue, so the Authority maintains Required Amendment 35.

Draft Decision – Required Amendment 36

1183. 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'.

Public Submissions

WAGN's submissions

1184. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to adopt Required Amendment 36 of the draft decision.

Other submissions

1185. No other submissions were received in relation to Required Amendment 36.

Authority's Assessment

1186. WAGN has accepted the Authority's position for the reasons given in the draft decision at paragraphs 1533 to 1540.

1187. The Authority is satisfied that WAGN's amendments comply with Required Amendment 36.

Draft Decision – Required Amendment 37

1188. Clauses 12.2, 12.3, and 12.4 should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1189. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to adopt the requirements of Required Amendment 37 of the draft decision.
1190. WAGN noted the Authority's interpretation in the draft decision that the Template Haulage Contract is a statutory obligation to provide the reference services and that the terms and conditions do not survive the variation or termination of the access arrangement.
1191. WAGN submitted that it does not object to the Authority's interpretation at paragraph 1547 and 1548 of the draft decision. WAGN submitted however that there is nothing in the NGL or NGR that expressly confirms the Authority's view and therefore it is appropriate that the terms and conditions confirm that they are amended by the variation of an access arrangement.
1192. WAGN has acknowledged that notwithstanding its election not to delete clauses 12.2, 12.3 and 12.4 of the Template Haulage Contract that those clauses are complex and can be simplified by some minor amendments to the text including deletion of the onerous negotiation provisions in clause 12.2 and 12.3.

Other submissions

1193. In its submission dated 5 November 2010, Alinta submitted that it reiterates its submission in relation to clause 2(b) of the amended Template Haulage Contract discussed above at paragraphs 938 and 939 of this final decision.
1194. Alinta is of the view that the Template Haulage Contract should not compel a network user to have its haulage contract automatically reviewed or amended upon the occurrence of a regulatory event.

Authority's Assessment

1195. The Authority notes that WAGN has elected not to adopt Required Amendment 37 but has made amendments to clauses 12.2 and 12.3.
1196. The Authority refers to WAGN's acceptance of the Authority's interpretation in the draft decision and its submissions that there is nothing in the NGL or NGR that confirms the Authority's position that the provision of reference services, and the terms and conditions on which those reference services are provided, only operate for the term of the access arrangement.
1197. The Authority also refers to Alinta's submissions that it should be entitled to enter into long term haulage contracts which continue on the agreed terms and conditions regardless of revisions to the access arrangement and that it should not be

compelled to have its haulage contract automatically reviewed or amended upon the occurrence of a regulatory event.

1198. In paragraph 1550 of the draft decision, the Authority accepted that a service provider and a user can enter into long term haulage contracts extending beyond the forthcoming access arrangement period, regardless of the regulated terms set out in the Template Haulage Contract. The Template Haulage Contract, by contrast, provides a safety net of terms and conditions which a service provider is obliged to offer in respect of a reference service at the user's request.
1199. The Authority maintains its position that the Template Haulage Contract must be amended at each revision of the access arrangement so that it incorporates any changes or amendments to the reference services and the regulated terms and conditions of those reference services. The Authority has no power to approve regulated terms and conditions for a period beyond the forthcoming access arrangement period.
1200. The Authority notes that the parties remain free to negotiate commercial provisions of a haulage contract for a term agreed by the service provider and user exceeding the term of the access arrangement. Under such an arrangement the user would not be acquiring the haulage service under the right to take such service on regulated terms but rather on negotiated terms. These terms would not be affected by any change to the regulated terms of any subsequent access arrangement.
1201. Further, negotiated terms could provide for linkage to any varied regulated terms, or the maintenance of particular clauses despite change to regulated terms.
1202. The Authority therefore confirms its position set out in paragraph 1547 to 1549 of the draft decision. The Authority does not accept the proposed amendments to clause 12.2, 12.3 and 12.4 of the amended Template Haulage Contract as suggested by WAGN.

Draft Decision – Required Amendment 38

1203. Clause 12.5 should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1204. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to adopt Required Amendment 38 of the draft decision.

Other submissions

1205. No public submissions were received in relation to this matter.

Authority's Assessment

1206. The Authority confirms its position set out in paragraph 1554 to 1558 of the draft decision.
1207. The Authority accepts that WAGN's amendments to the amended Template Haulage Contract are consistent with Required Amendment 38.

Draft Decision – Required Amendment 39

1208. Clause 12.6 should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1209. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to adopt the requirements of Required Amendment 39 of the draft decision.

1210. WAGN submitted, as noted above at paragraphs 1190 to 1192, there is nothing in the NGL or NGR that expressly confirms the Authority's view and therefore it is appropriate that the terms and conditions confirm that they are amended by the variation of an access arrangement.

1211. WAGN has suggested some minor amendments to clause 12.6 of the Template Haulage Contract as set out in its amended Template Haulage Contract.

Other submissions

1212. In its submission dated 5 November 2010, Alinta reiterates its position as submitted in relation to clauses 12.2 to 12.4 of the Template Haulage Contract noted in paragraphs 940 to 942 above that a user should not be compelled to re-negotiate its contract or lose its haulage rights following each access arrangement revision.

Authority's Assessment

1213. The Authority notes its decision at paragraphs 1196 to 1202 above. The Authority confirms its position set out in paragraph 1562 of the draft decision.

1214. The Authority does not accept the proposed amendments to clause 12.6 of the Template Haulage Contract as suggested by WAGN in its amended Template Haulage Contract. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt Required Amendment 39.

Draft Decision – Required Amendment 40

1215. Clause 12.7 should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1216. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to delete clause 12.7 as required in Required Amendment 40 of the draft decision.

1217. WAGN has submitted that it has addressed the concerns raised by the Authority at paragraph 1568 to 1570 of its draft decision by amending clause 12.7 to include a reference to the circumstances where the access arrangement does not make provision for how the Template Haulage Contract will end.

Other submissions

1218. In its submission dated 5 November 2010, Alinta reiterates its position as submitted in relation to clause 12.2 and 12.4 of the Template Haulage Contract noted in paragraph 940 to 942 above that a user should not be compelled to re-negotiate its contract or lose its haulage rights following each access arrangement revision.

Authority's Assessment

1219. The Authority has considered the amendments to clause 12.7 as suggested by WAGN and is of the view that the amendments do not address the concerns raised by the Authority at paragraphs 1568 to 1570 of the draft decision. The Authority maintains the view that the user should have a right to extend a haulage contract past the date of the access arrangement on the basis of the haulage contract being varied to incorporate the terms and conditions of the subsequent access arrangement.
1220. This position is consistent with the view expressed earlier in this decision at paragraphs 943 and 948 in relation to clause 2(b) of the Template Haulage Contract. The Authority maintains the position that Required Amendment 11 will address the issues associated with the expiry of the access arrangement and the continuation of the Template Haulage Contract.
1221. The Authority maintains the position that clause 12.7 of the Template Haulage Contract should be deleted in accordance with Required Amendment 40 of the draft decision.

Draft Decision – Required Amendment 41

1222. Clause 12.8 should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1223. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to delete clause 12.8 of the Template Haulage Contract as required by Required Amendment 41 of the draft decision.
1224. WAGN has submitted that there is no basis for the conclusion of the Authority at paragraph 1575 to 1578 of the draft decision, that the terms of the Template Haulage Contract are unaffected by a change in law. WAGN submitted that in its draft decision the Authority has confused the concept of complying with a change in law, which a service provider and user must do and whether WAGN is entitled to a variation to the reference tariffs because of the change in law.
1225. WAGN submitted that the AER has approved a similar provision in clause 18.13 of the terms and condition of the WAGGA Wagga GDS access arrangement on 23 April 2010. WAGN are of the opinion that failure to include such a provision in the terms and conditions will lead to ambiguity in the Template Haulage Contract which will likely cause more disputes between parties. WAGN are of the view that such disputes will cause inefficiencies and thus be inconsistent with the national gas objectives.

Other submissions

1226. Alinta submitted on 8 November 2010 (page 14 of Attachment C), that it supports the authority's decision to require deletion of clause 12.8 of the Template Haulage Contract.

Authority's Assessment

1227. The Authority notes that WAGN has not adopted Required Amendment 41 of the draft decision.
1228. The Authority reiterates that the terms and conditions for the provision of reference services are set out in the Template Haulage contract and are statutorily regulated. If the laws were to change and the service provider wished to alter the terms and conditions on which the user will have access to the reference service as set out in the Template Haulage Contract, the service provider would be required to lodge an application under rule 65 of the NGR.
1229. WAGN and the user are not entitled, under any circumstances without the Authority's approval, to change the terms and conditions of reference services as set out in the approved access arrangement, which includes the Template Haulage Contract.
1230. The Authority notes WAGN's submission that 'WAGN is entitled to a variation to the reference tariffs because of the change in law.' WAGN may only vary a reference tariff as a result of a change in law in accordance with the reference tariff mechanism – cost pass through event as set out in Annexure B of the proposed access arrangement.
1231. The Authority does not see any merit in WAGN's submissions that would enable a service provider and user to agree on 'amendments to this Haulage Contract'.
1232. The Authority notes WAGN's submission in relation to a provision of the Wagga Wagga GDS access arrangement. The Authority notes that the relevant provision referred to by WAGN, clause 18.13, is subject to clause 18.4 which provides that 'Amendments to the Agreement can only be approved by the Regulator where the Regulator approves an amendment to the Terms and Conditions in response to a revision submitted.'
1233. The Authority confirms that the Template Haulage Contract is that part of the access arrangement which sets out the terms and conditions that the service provider will provide reference services to the user. The Authority maintains its position as set out in the draft decision and considers that the inclusion of clause 12.8 (now clause 12.6 in the amended Template Haulage Contract) would not only be inconsistent with the national gas objective but the NGL and NGR themselves.

Draft Decision – Required Amendment 42

1234. Clause 12.9 should be deleted from the Template Haulage Contract.

Public Submissions

WAGN's submissions

1235. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to adopt Required Amendment 32 of the draft decision.

Other submissions

1236. No other public submissions were received in relation to Required Amendment 42.

Authority's Assessment

1237. WAGN has accepted the Authority's position for the reasons given in paragraph 1583 of the draft decision.

1238. The Authority accepts that WAGN's amendments are in accordance with Required Amendment 42.

Draft Decision – Required Amendment 43

1239. 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;

Public Submissions

WAGN's submissions

1240. WAGN has retained clauses 13.3(c)(i) and 13.3(c)(ii) of the Template Haulage Contract without amended for the reasons as set out in Required Amendment 4 at paragraphs 159 to 167.

1241. WAGN further submitted that Required Amendment 43, being consequential of the amendments required at Required Amendment 4 of the draft decision is not necessary as the Authority incorrectly concluded at paragraph 201 of the draft decision that the terms and conditions for non-reference services are matters for commercial negotiation between the parties.

1242. WAGN is of the view that the pre-conditions set out in the section 5.5 of the access arrangement should apply to non-reference and Reference Services.

Other submissions

1243. Alinta submitted on 5 November 2010 (page 14 of Attachment A) that it supports the Authority's decision to require the amendment of clause 13.3(c)(i) and 13.3(c)(ii) of the Template Haulage Contract.

Authority's Assessment

1244. The Authority refers to its final decision regarding Required Amendment 4 in relation to clause 5.5 of the proposed access arrangement at paragraphs 169 to 183. The Authority notes that this final decision retains the preconditions set out in clause 5.5(a) of the proposed access arrangement, so that they apply to reference services only.

1245. In light of the Authority's decision in relation to clause 5.5(a) of the amended proposed access arrangement, the Authority no longer requires Required Amendment 43 as set out in the draft decision. Instead, for the purposes of the Authority's proposed access arrangement provisions, the Authority will delete the word 'Pipeline Services' in clause 13.3(c)(i) of the amended Template Haulage Contract and insert the word 'Reference Services'.
1246. The Authority also accepts clause 13.3(c)(ii) of the amended Template Haulage Contract.

Authority's proposal

The Authority will adopt clause 13.3 of the amended Template Haulage Contract but will delete the words 'Pipeline Services' in clause 13.3(c)(i) and will insert the words 'Reference Services'.

Draft Decision – Required Amendment 44

1247. 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.

Public Submissions

WAGN's submissions

1248. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to adopt Required Amendment 44 of the draft decision.

Other submissions

1249. No other public submissions were made in relation to Required Amendment 44.

Authority's Assessment

1250. The Authority confirms its position set out in paragraph 1604 of the draft decision. WAGN has accepted the Authority's position for the reasons given in the draft decision.

1251. The Authority is satisfied that WAGN's amendments are in accordance with Required Amendment 44.

Draft Decision – Required Amendment 45

1252. 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;*

Public Submissions

WAGN's submissions

1253. WAGN has elected to adopt Required Amendment 45 in relation to the addition of the words 'acting as a reasonable and prudent person' in clause 13.6(a). In relation to the amendment of clause 13.6(b), WAGN, in its submissions on 8 October 2010 (pages 113-114), relied on the same analysis as for Required Amendment 4 at paragraphs 158 to 167.
1254. WAGN has, however, elected not to amend clause 13.6(b)(i) of the Template Haulage Contract as required by Required Amendment 45 of the draft decision. In response to the amendments suggested by the Authority in relation to clause 13.6(b)(i) of the Template Haulage Contract WAGN has submitted that it relies on the same reasoning as it did in relation to Required Amendment 4 of the draft decision as set out at paragraphs 158 to 167 above.
1255. WAGN is of the view that the amendments to clause 13.6(b)(i) of the Template Haulage Contract are unnecessary as it does not agree with the Authority's reasoning in the draft decision regarding the deletion of the clause relating to pre-conditions from the access arrangement.

Other submissions

1256. Alinta submitted on 5 November 2010 (page 15 of Attachment C) in relation to clause 13.6(b) that it supports the Authority's decision to require deletion of clause 5.5 of the proposed access arrangement and to amend clause 13.6(b) as a consequence.
1257. In relation to clause 13.6(c), Alinta reiterated its original submission summarised at paragraph 1610 of the draft decision. Alinta submitted on 5 November 2010 (page 15 of Attachment C) that the unqualified right to novate may prejudice the interests of the user and the provision is unfair, unreasonable and lacks any balance. Alinta stated that put simply, the novation could be to a party which has no rights to control or operate the GDS and no capability to perform the haulage contract.

Authority's Assessment

1258. The Authority accepts that WAGN's amendment to clause 13.6(a) is in accordance with Required Amendment 45.
1259. In relation to clause 13.6(b)(i), the Authority notes that WAGN has not adopted the amendment as set out in Required Amendment 45 and has relied on its reasoning in relation to Required Amendment 4. The Authority refers to its final decision regarding Required Amendment 4 in relation to clause 5.5 of the proposed access arrangement at paragraphs 169 to 183. The Authority notes that this final decision retains the preconditions set out in clause 5.5(a) of the proposed access arrangement, so that they apply to reference services only.
1260. In light of this decision, the Authority no longer requires clause 13.6(b)(i) to refer to the 'Template Haulage Contract', however for the purposes of the Authority's

proposed access arrangement provisions, the Authority will delete the reference to 'Pipeline Services' and instead insert 'Reference Services' in clause 13.6(b)(i).

1261. In relation to clause 13.6(c) of the Template Haulage Contract, the Authority refers to its decision regarding Alinta's submission at paragraph 1616 of the draft decision. In the draft decision, the Authority concluded that a user's consent should not be required in the event that the service provider novates the contract.
1262. The Authority notes Alinta's further submissions in relation to clause 13.6(c) that the novation could be to a party which has no rights to control or operate the GDS and no capability to perform the haulage contract. The Authority considers that, in the unlikely event that such a situation arose, the user would be able to sue the new service provider for breach of contract for non performance.

Authority's proposal

The Authority will adopt clause 13.6 of the amended Template Haulage Contract but will delete the words 'Pipeline Services' in clause 13.b(i) and will replace it with the words 'Reference Services'.

Draft Decision – Required Amendment 46

1263. Clauses 13.7(b)(iii) and 13.7(c) should be deleted.

Public Submissions

WAGN's submissions

1264. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to delete clause 13.7(b)(iii) and 13.7(c) of the Template Haulage Contract as required by Required Amendment 46 of the draft decision.
1265. WAGN submitted that deleting clauses that require the user to comply with the application procedure when changing a receipt point or delivery point creates uncertainty and inefficiency in the sense that it is precisely the type of information WAGN may require from the user.
1266. WAGN is of the view that clause 13.7(b)(iii) and 13.7(c) are appropriate clauses for the Template Haulage Contract because requiring a user to make an application to change a receipt or delivery point means a single point of entry for all applications.
1267. WAGN also submitted that haulage contracts are long terms agreements and it is appropriate that WAGN be entitled to consider a user's ability to comply with the terms of the Template Haulage Contract whenever a further request for haulage services is made as the user's ability to perform its obligations in the past is not determinative of its future ability.

Other submissions

1268. In its submission of 5 November 2010, Alinta submitted that it considers the amendments WAGN has made to clause 13.7(b)(iii) of the amended Template Haulage Contract are appropriate even though they do not incorporate Required Amendment 46 of the draft decision.

1269. Alinta is of the view however that the Authority correctly required the deletion of clause 13.7(c) of the Template Haulage Contract in its draft decision.

Authority's Assessment

1270. In its amended Template Haulage Contract of 8 October 2010, WAGN deleted clause 13.7(c) in relation to delivery points however in its submission of 8 October 2010, WAGN stated it has retained clause 13.7(c) without change.

1271. The Authority notes that WAGN has instead incorporated former clause 13.7(c) of the Template Haulage Contract into clause 13.7(b)(iii) of the amended Template Haulage Contract and made the requirement for a user to comply with the application procedure limited to the extent that there are reasonable grounds based on technical or commercial considerations apply to both delivery points and receipt points. The Authority accepts that this amendment satisfies its concerns at paragraphs 1623 and 1624 of the draft decision.

1272. The Authority also notes that WAGN has not deleted the requirement for a user to comply with the application procedure as set out in the access arrangement as required by the Authority by Required Amendment 46.

1273. The Authority's reasons in the draft decision that required deletion of clauses 13.7(b)(iii) and 13.7(c) were based on the absence of any justification from WAGN that the imposition of such conditions to comply with the application procedure on a change of receipt or delivery point was necessary from the point of view of the national gas objective. The Authority also notes Alinta's submission supporting the amended clause 13.7(b)(iii). The Authority considers that WAGN has now provided sufficient justification for the proposal based on rule 106 of the NGR.

1274. The Authority refers to its final decision regarding Required Amendment 4 in relation to the preconditions in clause 5.5 of the proposed access arrangement at paragraphs 169 to 183. The Authority notes that this final decision retains the preconditions set out in clause 5.5(a) of the proposed access arrangement, so that they apply to reference services only. As a consequence of this amendment and for the purposes of the Authority's proposed access arrangement revisions, the Authority will delete the phrase 'Pipeline Services' in clause 13.7(b)(iii) and insert 'Reference Services'.

Authority's proposal

The Authority will adopt clause 13.7 of the amended Template Haulage Contract but will delete the words 'Pipeline Services' in clause 13.7(b)(iii) and replace them with the words 'Reference Services'.

Draft Decision – Required Amendment 47

1275. 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>;

Public Submissions

WAGN's submissions

1276. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to adopt Required Amendment 47 in the manner set out in the draft decision.
1277. WAGN submitted that Required Amendment 47 creates ambiguity and uncertainty as the term 'Haulage Contract' is defined in the definitions section of the Template Haulage Contract as 'this agreement'. WAGN propose the term 'Haulage Contract' replaced with the term 'other agreement ... under which, <Service Provider>, provides Pipeline Services to <User>.'

Other submissions

1278. No public submissions were received in relation to this matter.

Authority's Assessment

1279. The Authority confirms its position in paragraph 1631 to 1632 of the draft decision and confirms the changes proposed by WAGN to clause 14.2(b) of its amended Template Haulage Contract address the concerns raised in the draft decision.
1280. WAGN's amended Template Haulage Contract otherwise addresses to the satisfaction of the Authority, the requirements of Required Amendment 47 of the draft decision.

Draft Decision – Required Amendment 48

1281. 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.

Public Submissions

WAGN's submissions

1282. WAGN has retained clauses 15.2(c) to 15.2(k) of the Template Haulage Contract without amendment.
1283. WAGN submitted on 8 October 2010 (pages 117-119) that there is no basis under the NGL or NGR for the conclusion at paragraph 1654 of the draft decision to determine that clauses 15.2(c) to (k) relate to commercial arrangements between contracting parties and not to matters that go to compliance of WAGN's proposed revisions with the national gas objective. In forming this view the Authority has failed to apply the NGL and NGR as parliament intended as the Authority is required to consider the NGL and NGR as a whole.
1284. According to WAGN, the Authority has determined incorrectly that the detailed bank guarantee provisions are merely a matter of WAGN's compliance with the national gas objective (paragraph 1654 of the draft decision). In considering any provisions of the Template Haulage Contract, the Authority is required to consider the competing interests of WAGN and the users in the context of the national gas objective. WAGN submitted that it is insufficient for the Authority to have just had regard to WAGN's compliance with the national gas objective.

1285. WAGN referred to rule 48(1)(d)(ii) which requires the terms and conditions on which the reference services will be provided to be referred to in the access arrangement. WAGN submitted that clauses 15.2(c) to (k) are terms and conditions on which the reference services will be provided. The provisions reflect the law relevant to bank guarantees in that they address the key areas of dispute that have arisen in the context of bank guarantees and the resulting judicial determinations. As such, they are not procedural matters but terms and conditions that provide certainty in respect to the party's rights and obligations thus being consistent with the national gas objective.
1286. WAGN submitted that the suggestion of the Authority that the parties are free to agree such matters for themselves, in addition to not complying with rule 48(1)(d)(ii), is an agreement to agree and unenforceable at law. In the event that the parties do not agree then WAGN is bound to offer the reference services on the terms set out in the draft Template Haulage Contract meaning it will have an entitlement to request security but not to direct the form, when it is to be provided or how it is to be accessed.
1287. WAGN referred to section 28(2) of the NGL and submitted that such is the uncertainty created by the amendments suggested by the Authority stating that the Authority should have regard to the revenue and pricing principles in section 24 of the NGL. The intent of clauses 15.2(c) to (k) are to provide certainty in respect to WAGN's ability to recover the reference tariffs in the event that a user is unable, or elects not to, pay.
1288. WAGN submitted that the amendments required would present WAGN with material legal issues with regard to WAGN's ability to rely on the bank guarantees. As such, the Authority is denying WAGN the opportunity to recover the efficient costs of providing the reference services (drawing down on the bank guarantee being recovery of the efficient costs of providing the services).
1289. WAGN stated that as such it is contrary to the national gas objective for the Authority to approve a bank guarantee to be provided but not the form of bank guarantee, when it is to be provided or when WAGN may access the bank guarantee.
1290. The deletion of clauses 15.2(c) to (k) will introduce ambiguity into the Template Haulage Contract leading to inefficiencies and increase the likelihood of a dispute thus being inconsistent with the national gas objective.

Other submissions

1291. Alinta submitted on 5 November 2010 (page 16 of Attachment C) that it supports the Authority's decision to require the deletion of clauses 15.2(c) to (k).
1292. Alinta reiterated its earlier submissions regarding the bank guarantee expiring with the termination or expiry of the haulage contract. Alinta submitted on 5 November 2010 (page 16 of Attachment C) that the Authority, in its assessment of clause 15.2(b)(i) at paragraph 1652 of the draft decision, accepted Alinta's submission concerning the expiration of the bank guarantee and stated that clause 15.2(b)(i) should revert back to the position under the current access arrangement so that the bank guarantee applies only for the duration of the haulage contract.
1293. Alinta submitted that the Authority should require WAGN to amend the Template Haulage Contract in this respect.

Authority's Assessment

1294. The Authority notes that WAGN has elected not to amend clause 15.2 of the Template Haulage Contract as required. The Authority has considered WAGN's submission in relation to Required Amendment 48 however the Authority confirms its position as set out in paragraphs 1652 to 1654 of its draft decision.
1295. The Authority refers to its comments at paragraphs 86 to 93 of this final decision and confirms that in assessing WAGN's proposed revisions for the purposes of the draft decision and for this final decision, it has considered the competing interests of the service provider and users in the context of the national gas objective.
1296. The Authority does not consider that the detailed provisions contained in clauses 15.2(c) to (k) in the Template Haulage contract in relation to the provision of security for performance form part of the terms and conditions on which reference services will be provide as required by rule 48(1)(d)(ii) of the NGR. The Authority considers that such terms and conditions are provided for in clauses 15.2(a) and (b) which set out the provision of a bank guarantee to secure performance. The Authority regards clauses 15.2(c) to (k), contrary to WAGN's submission, as procedural matters in relation to the implementation of the security. The Authority considers that setting a form for the guarantee as provided in Annexure B goes too far in attempting to regulate the commercial relationship between contracting parties. The Authority maintains its position that this is a matter for commercial negotiation.
1297. The Authority notes WAGN's submission in relation to the suggestion that the parties are free to negotiate such matters for themselves is an agreement to agree and therefore unenforceable at law. The Authority notes that the Template Haulage Contract is not an agreement between two identifiable parties but rather the template of a contract that two parties may enter into at some point in time in the future. No two parties have agreed to enter into an agreement at this stage; rather the purpose of the Authority approving the Template Haulage Contract is to ensure that the proposed access arrangement complies with the NGA and NGR. The Authority notes that if the parties cannot agree, the parties would be able to have the dispute determined by the WA arbitrator under the NGA.
1298. The Authority notes that the provisions as required by the Authority do not deny WAGN the ability to require security from a user and therefore do not deny WAGN the ability to recover the reference tariffs in the event that the user does not pay.
1299. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt Required Amendment 48 as set out in the draft decision.
1300. The Authority notes that Alinta raised its concerns in relation to clause 15.2(b)(i) of the Template Haulage Contract in its April 2010 submissions and that the Authority considered Alinta's submission in the draft decision.
1301. In relation to clause 15.2(b)(i) of the Template Haulage Contract, the Authority notes its comments at paragraph 1652 of the draft decision and maintains its position that the clause should revert back to the provisions in the current access arrangement so that the bank guarantee applies for the duration of the haulage contract.
1302. The Authority notes that the requirement for this amendment was inadvertently omitted from Required Amendment 48. The Authority considers that in light of its comments at paragraph 1652 which state that 'clause 15.2(b)(i) should revert back the current access arrangement's provision that the bank guarantee applies for the

duration of the haulage contract', WAGN and the public were made aware of the Authority's position in relation to clause 15.2(b)(i) and were given an opportunity to make submissions in response.

1303. For the purposes of the Authority's proposed access arrangement revisions, the Authority will amend clause 15.2(b)(i) of the Template Haulage Contract as set out in paragraph 1652 of the draft decision so that the bank guarantee applies for the duration of the haulage contract.

Authority's proposal

The Authority will adopt Required Amendment 48 save that the Authority will amend clause 15.2(b)(i) of the amended Template Haulage Contract so that it applies 'for the duration of the Haulage Contract'.

Draft Decision – Required Amendment 49

1304. 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.

Public Submissions

WAGN's submissions

1305. WAGN has retained clause 15.3 in the amended Template Haulage Contract without amendment except for the reduction in the Standard & Poors rating from 'AA' to 'A'.
1306. WAGN submitted on 8 October 2010 (pages 119-123) that there is no basis under the NGL or NGR for the conclusion at paragraph 1663 of the draft decision to determine that clause 15.3 relates to commercial arrangements between contracting parties and not to matters that go to compliance requirements of WAGN with the national gas objective. In forming this view, the Authority has failed to apply the NGL and NGR as parliament intended, that being to consider the NGL and NGR as a whole.
1307. WAGN submitted that the Authority has determined incorrectly that the detailed insurance provisions go beyond WAGN's compliance with the national gas objective and in considering any provision of the Template Haulage Contract, the Authority is required to consider the competing interests of WAGN and the users in the context of the national gas objective.
1308. As submitted in relation to other required amendments, WAGN refers to rule 48(1)(d)(ii) and submitted that clause 15.3 sets out the terms and conditions on which the reference services will be provided. The provisions materially reflect insurance provisions that are commonly included in commercial agreements that have been subject to third party review (for example AS4000). The detailed provisions are intended to identify precisely what each of the parties obligations are in relation to insurance and so are not procedural matters but terms and conditions that provide certainty in respect of the party's rights and obligations. As such the inclusion of the clauses are consistent with the national gas objective and deletion inconsistent in that deletion will introduce ambiguity leading to inefficiencies and increase the likelihood of a dispute.

1309. In relation to the requirement that WAGN insert the current insurance provisions in clause 61 of Part C of the current access arrangement, WAGN submitted that the Authority has failed to have regard to the national gas objective. As stated above it is not just WAGN's compliance with the national gas objective that the Authority must consider. The insurance provisions as drafted regulate the users obligations appropriately with regard to the national gas objective because they:
- consider the financial standing of the insurer meaning there is a better chance of the insurances responding in the event of an incident;
 - they include a requirement to carry product liability (which the current access arrangement does not) which is the type of insurance that will respond in the event that the user does not comply with the gas quality specifications in the Template Haulage Contract;
 - includes a requirement for a cross liability clause to support the current requirement that WAGN's interests be noted on the policy; and
 - are materially consistent with the form required by other agreements that have been reviewed by a third party.
1310. WAGN further submitted that the suggestion of the Authority that the parties are free to agree such matters for themselves is, in addition to not complying with rule 48(1)(d)(ii), an agreement to agree and unenforceable at law.
1311. In the event that the parties do not agree, WAGN submitted that it is bound to offer the reference services on the terms set out in the draft Template Haulage Contract meaning there is, at best, uncertainty as to the matters referred to above and at worst no entitlement to require the matters to be appropriately addressed.
1312. WAGN referred to section 28(2) of the NGL and submitted that such is the uncertainty created by the amendments suggested by the Authority stating that the Authority should have regard to the revenue and pricing principles in section 24 of the NGL. The intent of clause 15.3 is to provide certainty in respect to WAGN's ability to rely on the insurance proceeds in the event of a claim by WAGN or a user.
1313. WAGN submitted that the amendments required by the Authority materially reduce the chance of the insurance proceeds being available. As such, the Authority is denying WAGN the opportunity to recover the efficient costs of providing the reference services (being compensated by the proceeds from the insurance provisions being the recovery of efficient cost of providing the reference services).
1314. Notwithstanding the above, WAGN has reconsidered the requirement for the insurer to have a Standard & Poors rating of 'AA' and considers that the rating is arguably higher than that required by the national gas objective and considers a reduction to 'A' is appropriate.

Other submissions

1315. Alinta submitted on 5 November 2010 (page 16 of Attachment C) that it supports the Authority's decision to require the deletion of clause 15.3.

Authority's Assessment

1316. The Authority notes that WAGN has not amended clause 15.3 as required by Required Amendment 49.

1317. In relation to the reduction in the Standard & Poors rating from 'AA' to 'A', the Authority accepts WAGN's proposal to require the insurer to have a rating of 'A' and considers that complies with the national gas objective.
1318. The Authority notes its reasoning set out in paragraphs 1662 to 1665 of the draft decision where the Authority concluded that detailed insurance and prudential obligations relate to commercial arrangements between contracting parties and go beyond consistency with the national gas objective.
1319. The Authority has considered WAGN's submissions in response to the draft decision relation to clause 15.3 in its entirety. The Authority considers that WAGN has now substantiated the inclusion of such insurance provisions in the amended Template Haulage Contract and accepts that such provisions form an integral part of the terms and conditions on which the reference services will be provided. In the absence of such provisions the Authority acknowledges that the risk placed on WAGN may have the potential to create inefficiencies in the operation of the WAGN GDS and conflict with the national gas objective.
1320. The Authority accepts WAGN's submissions that the insurance provisions regulate the users obligations with regard to the national gas objective and that the provisions enable WAGN to recover the efficient costs of providing reference services in the event that a claim is made. The Authority considers that the provisions proposed by WAGN reduce the chance of any shortfall in insurance proceeds being available if required and enable WAGN to sufficiently cover any risk associated with operating the WAGN GDS.
1321. The Authority accepts WAGN's justification for the inclusion of clause 15.3 of the Template Haulage Contract and no longer requires the amendments set out in Required Amendment 49. The Authority will adopt clause 15.3 in the amended Template Haulage Contract for the purposes of the Authority's proposed access arrangement revisions.

Draft Decision – Required Amendment 50

1322. 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>₁ 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>;*

Public Submissions

WAGN's submissions

1323. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to amend clause 16.1 of the Template Haulage Contract in accordance with Required Amendment 50 of the draft decision.
1324. WAGN submitted that it adopts the reasoning of the Authority in paragraphs 1674 to 1677 of the draft decision however proposes to add the words 'in accordance with the terms of this Haulage Contract' to clause 16.1(b)(i) of the amended Template Haulage Contract to add clarity to this provision.

Other submissions

1325. No other public submissions were received in relation to Required Amendment 50.

Authority's Assessment

1326. The Authority confirms its position in paragraphs 1674 to 1677 of the draft decision.

1327. The Authority has considered the minor amendment which WAGN has proposed in relation to clause 16.1(b)(i) and confirms that it accepts the proposed changes.

1328. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt clause 16.1 as drafted in the amended Template Haulage Contract.

Draft Decision – Required Amendment 51

1329. Clause 16.4 of the Template Haulage Contract should be amended to delete any reference to the 'Upstream Person'.

Public Submissions

WAGN's submissions

1330. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to delete the reference to 'Upstream Person' in clause 16.4 as required by Required Amendment 51 of the draft decision.

1331. WAGN has submitted that its election to adopt to retain the reference to 'Upstream Person' in clause 16.4 reflects the position that it should be protected from claims for damages or consequential loss from both upstream and downstream third parties. WAGN is of the view that as the Authority has accepted in the draft decision that a reference downstream person is consistent with the national gas objective then a reference to upstream person should also be consistent as there is no material difference between the two.

1332. WAGN submitted further that the inclusion of 'Upstream Person' is reflective of the operation of the gas market in Western Australia as the owner of the gas distribution system is not the same person as the retailers of gas. WAGN submitted that it does not have contractual relationship with the persons most likely to make a claim against it. WAGN is of the view that in these circumstances it appropriate that a user uses the contractual relationship it has with an upstream person and limit WAGN's liability.

1333. WAGN noted in its Template Haulage Contract submission that it has made a minor amendment to clause 16.3 of the amended Template Haulage Contract in relation to the extent of liability. WAGN proposed that the words 'including negligence' after the word 'tort' confirm that the exclusion of liability for indirect damage includes negligence.

Other submissions

1334. In its submission dated 5 November 2010, Alinta submitted that it supports the deletion of the reference to upstream person from clause 16.4 of the Template Haulage Contract.

Authority's Assessment

1335. The Authority notes that WAGN has elected not to adopt Required Amendment 51 of the draft decision which required deletion of the reference to the 'Upstream Person' in clause 16.4 of the Template Haulage Contract. The Authority reiterates that WAGN's proposal is a significant change to the current position and that such an amendment, if accepted, would significantly increase a user's liability.
1336. The Authority has considered WAGN's submissions with respect to the inclusion of the 'Upstream Person' in clause 16.4 of the Template Haulage Contract. However, the substantiation provided by WAGN does not support the conclusion that a user must indemnify WAGN against liability by claims made by an 'Upstream Person', instead the submissions only confirm the current position with respect to a 'Downstream Person' making a claim against the service provider.
1337. WAGN referred to the case of Esso Longford Fire as support for its proposed amendment that a service provider should be indemnified for potential claims made by an upstream person. The Authority notes however, that this case highlights the potential for claims by gas consumers from an interruption to the network. This case confirms that a pipeline operator may be exposed to liability from downstream persons despite there being no contractual relationship between the parties. The Authority considers that WAGN's submissions go no further than to state that there is equivalence between a downstream person and an upstream person for the purposes of a service provider's liability, without providing sufficient justification to support such a proposition.
1338. The Authority acknowledges that, unlike users, WAGN cannot manage risk through contractual arrangements. The Authority notes the potential for unlimited liability downstream and the significant insurance costs that the service provider would face if it were required to protect itself from such liability. The Authority accepts that the national gas objective justifies users and retailers, through contractual arrangements, to pass liability to consumers who would in turn take out the required insurances. This has the effect of spreading liability to numerous consumers, rather exposing the user, retailer and service provider to potential unlimited liability. It is this reasoning that provides the justification for a user to indemnify the service provider for potential claims from downstream persons.
1339. The Authority accepts the well recognised principles set out by WAGN in its submissions with respect to the downstream person. However, the Authority does not consider that WAGN has provided substantiated reasoning to support its proposal that a users liability should increase with respect to the upstream person, in particular WAGN has not:
- identified the potential 'Indirect Damage' claims that the upstream person would have against the service provider that would support an extended operation of such a provision; and
 - provided evidence to show that a user would have the bargaining power with an upstream person to limit liability in such a way as to create the situation whereby the upstream person's only option would be to seek remedies against the service provider, and not the user.
1340. The decision in this situation requires the Authority to balance the risk between the parties and to determine who should bear the insurance costs with respect to liability. The Authority considers that the national gas objective would require the status quo to remain as it currently stands. A service provider has always been liable to third parties upstream and WAGN has not provided any evidence or brought to the Authority's attention any recent case law to show that there has been a change in law

which has altered the understanding that the service provider or owner of a distribution pipeline should not be liable to the 'Upstream Person'. The Authority considers that the service provider should maintain the insurances it currently has to protect against such liability and that these insurance costs are a consequence of doing business.

1341. In the absence of further justification and evidence to show that the national gas objective demands a different situation, the Authority maintains the position as set out in the draft decision and requires the deletion of 'Upstream Person' in clause 16.4 of the Template Haulage Contract.

Draft Decision – Required Amendment 52

1342. Clause 16.8 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1343. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to delete clause 16.8 of the Template Haulage Contract in accordance with Required Amendment 52 of the draft decision.

Other submissions

1344. No public submissions were received in relation to this amendment.

Authority's Assessment

1345. The Authority confirms its position in paragraph 1690 of the draft decision.
1346. WAGN's amended Template Haulage Contract has addressed the Authority's position in the draft decision to the satisfaction of the Authority.

Draft Decision – Required Amendment 53

1347. 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.

Public Submissions

WAGN's submissions

1348. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to not delete clauses 17.1 and 17.3 in accordance with Required Amendment 53 of the draft decision.
1349. WAGN submitted that the Authority has incorrectly concluded at paragraph 1698 of the draft decision that warranty provisions cannot be included in the Template Haulage Contract as they are not matters which go to WAGN's compliance with the national gas objectives. WAGN is of the view that terms and conditions in relation to representations and warranties are necessary under rule 48(1)(d)(ii) of the NGR and the suggestion by the Authority at paragraph 1698 that terms and conditions in relation to representations and warranties are commercial matters for the parties to

agree to outside the access arrangement, is incorrect as it would lead to a situation where there is an agreement to agree.

1350. Required Amendment 53 of the draft decision requires that WAGN replace clause 17.1 and 17.3 with equivalent provisions to those in clause 60 Part C of the current access arrangement. WAGN has acknowledged that clauses 17.1 and 17.3 are more detailed than the representations and warranties clauses in clause 60 Part C of the current access arrangement but are of the view that none of the representation and warranties clauses in the proposed access arrangement are oppressive or inconsistent with the national gas objectives.

Other submissions

1351. In its submission dated 5 November 2010, Alinta submitted that it supports the Authority's decision to require clauses 17.1 to 17.3 to be replaced by equivalent provisions in clause 60 of Part C of the current access arrangement.
1352. Alinta made a more general submission regarding the exclusion of 'commercial matters' from the access arrangement discussed at paragraphs 84 to 85 above.

Authority's Assessment

1353. The Authority notes the submissions from WAGN and other interested parties with respect to provisions which the Authority has concluded in the draft decision to be matters of commercial negotiation and agreement between contracting parties. The Authority refers to its comments at paragraphs 86 to 93 of this final decision and maintains its approach that regulating such provisions concerning commercial matters goes beyond the Authority's consideration as to whether WAGN's proposal complies with the national gas objective.
1354. The Authority considers that the detailed representations and warranties listed in clause 17 of the Template Haulage Contract go beyond the Authority's consideration of WAGN's compliance with the national gas objective. The Authority refers to rule 100 of the NGR which states that the provisions of an access arrangement must be consistent with the national gas objective. The Authority considers that it is not in position to determine whether the representations and warranties contained in clause 17 promote efficient investment and operation in the WAGN GDS as the representations and warranties listed in clause 17 are promises made by contracting parties based on their commercial position at the time of entering into the Template Haulage Contract. The Authority cannot ensure that such representations and warranties are appropriate in every situation involving a user and service provider but rather considers such provisions to be dealt with by negotiation between the parties depending on their circumstances.
1355. The Authority notes Alinta's concern for the potential for WAGN to withhold gas distribution services if a default position is not determined in the access arrangement. The Authority considers that in the event that such a circumstance was to arise, a user or prospective user would be able to have the dispute determined by the WA arbitrator under the NGA.
1356. The Authority considers that under section 193 of the NGA, the WA arbitrator has a wide discretion over the matters in which it can arbitrate. Section 193 enables an access determination to deal with any matter relating to the provision of a pipeline service to a prospective user or user.

1357. Whilst the Authority must ensure the provisions of an access arrangement are consistent with the national gas objective as provided by rule 100, there is no guiding criterion for the WA arbitrator when making an access determination. Instead, section 68A of the NGA only provides that the arbitrator is to be guided by the national gas objective. The Authority consider that where the national gas objective has no bearing on the outcome of the access determination, the arbitrator is free to determine the dispute based on what is fair and reasonable in the circumstances. The Authority considers that if the arbitrator was to be limited in its access determination to the national gas objective, section 68A would have been expressed in the same way as rule 100.
1358. Finally, the Authority notes that approval of a Template Haulage Contract is a new concept for the WAGN GDS and also for regulation of gas distribution systems in Western Australia. As clause 60 of Part C of the current access arrangement only provided that the contract will specify the representations and warranties to be made by the user to the service provider and vice versa, the Authority does not consider that a parties rights and obligations are now more uncertain than what previously existed.
1359. The Authority therefore maintains its position as set out in the draft decision and requires clause 17 to be amended to revert back to more general provisions that state that the haulage contract will specify the representations and warranties to be made by the user and service provider.

Draft Decision – Required Amendment 54

1360. 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.

Public Submissions

WAGN's submissions

1361. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to substantially adopt Required Amendment 54 of the draft decision.
1362. WAGN has amended clause 18.1 of the Template Haulage Contract to include a reference to the interaction between the dispute resolution process under the Haulage Contract and other dispute resolution processes, including the National Gas Access Law and the Retail Market Scheme.
1363. WAGN submitted that amendments to clause 12.2 and 12.6 have been made as a consequence of the addition of the newly amended clause 18.1 of the Template Haulage Contract.

Other submissions

1364. Alinta submitted that it supports the Authority's decision to require the Template Haulage Contract to provide for the two (in fact three) alternatives for the parties to proceed to arbitration as set out in clause 56 of Part C of the current access arrangement, with appropriate amendments replacing the reference to the Code with the NGL.
1365. Alinta submitted that the amendments proposed by WAGN are ambiguous. It appears to put forward a mechanism for running jointly with the process under clause

18.2 and the dispute resolution process under the NGL or the Retail Market Rules, until the clause 18.2 process is unsuccessful and then reverting to the other process as applicable. This could lead to a conflict in the time periods applicable in the different processes. The definition of 'Alternative Process Dispute' is also unclear and could lead to uncertainty regarding when the processes under the Template Haulage Contract would apply.

1366. Alinta submitted that clause 18.1 and 18.2(a) should be replaced with wording similar to that approved by the AER in relation to the access arrangement for the Wagga Wagga gas distribution network for 1 July 2010 to 30 June 2015. An equivalent provision would provide wording to the following effect:

Clause 18.1(a)

To the extent that the National Gas Access Law or the Retail Market Scheme applies to a dispute under the Haulage Contract, the parties agree to apply the respective dispute resolution procedure to that dispute.

Clause 18.1(b)

Subject to clause 18.1(a) and clauses 9.2, 9.4 and 9.5 (regarding Disputed Invoices), any dispute or difference arising between the parties out of or in connection with the Haulage Contract must be resolved in accordance with clauses 18.2 to 18.4.

Clause 18.2(a)

If clause 18.1(b) applies to a dispute or difference, either Party may give written notice to the other Party specifying the details of the dispute.

1367. Alinta submitted that consequential amendments would be required to clauses 18.2(b) to 18.4. Clause 18.2(c) should also be amended by changing the words 'within 5 Business Days of the day referred to in clause 18.2(b)' to 'within 5 Business Days of the expiry of the period referred to in clause 18.2(b).'

Authority's Assessment

1368. WAGN has not adopted Required Amendment 54 as suggested by the Authority. Instead, WAGN has inserted clause 18.1 which sets out the interaction between the dispute resolution process under the Template Haulage Contract and 'other dispute resolution processes.'
1369. The Authority considers that WAGN's amendments do not have the desired effect to impose an obligation on the parties to first ensure that the dispute is not one that can be dealt with under the NGL, before the parties refer the dispute to arbitration under clause 18.
1370. The Authority agrees with Alinta's submissions regarding the ambiguous drafting of the new clause 18.1 of the Template Haulage Contract and considers that wording similar to that approved by the AER in relation to the Wagga Wagga access arrangement would be more appropriate. The Authority requires clear and precise drafting of clause 18 to ensure that the dispute is one that cannot be dealt with under the NGL, before the parties refer the dispute to arbitration under the Template Haulage Contract.
1371. The Authority notes that WAGN has made consequential amendments to clause 12.2 of the Template Haulage Contract as a result of the amendments made in clause 18. As set out in paragraph 1202 of this decision, the Authority maintains that clause

12.2 of the Template Haulage Contract should be deleted and therefore the cross reference to clause 18 in clause 12.2 will not apply.

1372. The Authority does not approve the amendments made by WAGN to clause 18.1 and 18.2 of the amended Template Haulage Contract and suggests that WAGN amend clause 18 of the Template Haulage Contract in line with the Wagga Wagga decision discussed above at paragraph 1366 of this decision.

Authority's proposal

Clause 18 of the Template Haulage Contract will read:

Clause 18.1(a)

To the extent that the National Gas Access Law or the Retail Market Scheme applies to a dispute under the Haulage Contract, the parties agree to apply the respective dispute resolution procedure to that dispute.

Clause 18.1(b)

Subject to clause 18.1(a) and clauses 9.2, 9.4 and 9.5 (regarding Disputed Invoices), any dispute or difference arising between the parties out of or in connection with the Haulage Contract must be resolved in accordance with clauses 18.2 to 18.4.

Clause 18.2(a)

If clause 18.1(b) applies to a dispute or difference, either Party may give written notice to the other Party specifying the details of the dispute.

As a consequence, the Authority will amend clauses 18.2(b) to 18.4 of the Template Haulage Contract.

Draft Decision – Required Amendment 55

1373. Clause 18.3(f) of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1374. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected not to delete clause 18.3(f) of the Template Haulage Contract as required by Required Amendment 55 of the draft decision.
1375. WAGN submitted that it does not believe there is a basis for the proposition by the Authority at paragraph 1728 of the draft decision that the Template Haulage Contract should not have fundamental changes to the NGL procedure. WAGN submitted that the dispute resolution process under the Template Haulage Contract and the NGL can be different as they deal with different subject matters and are intended to be exclusive of each other.

1376. WAGN submitted as drafted clause 18.3(f) allows parties to agree whether the rules of evidence apply or not and in the absence of agreement the arbitrator is empowered to make the decision.

Other submissions

1377. Alinta submitted that it supports the Authority's decision to require that clause 18.3(f) be deleted.

Authority's Assessment

1378. The Authority has considered WAGN's submission and maintains its position in paragraph 1728 of the draft decision that clause 18.3(f) of the Template Haulage Contract should be deleted. The Authority maintains the view that it is not appropriate for the Template Haulage Contract to contain fundamental changes to the NGL procedures for dispute resolution.

1379. The Authority notes that section 198 of the NGL provides that in a dispute hearing the arbitrator is not bound by the rules of evidence. If the Authority were to approve clause 18.4(f) of the amended Template Haulage Contract, with the requirement that parties must be given the opportunity to make submissions regarding whether the rules of evidence apply, the Template Haulage Contract may be void as it is inconsistent with the NGL.

1380. When approving the Template Haulage Contract the Authority is of the view that it should not fetter the Arbitrator's role as prescribed in the NGL. To allow the parties the right to make submissions regarding evidence and to prescribe that the Arbitrator must abide by those submissions when making its decision regarding the rules of evidence to apply to it process, denies the Arbitrator its right to make a decision.

1381. The Authority considers that the national gas objective would support a consistent approach to the dispute resolution procedures, irrespective of whether it is set out in the NGL or in the Template Haulage Contract. To have the rules of evidence potentially applying in one dispute, but not in another dispute between the parties would create inefficiencies as resources will be required to ensure compliance depending on whether the resolution process was under the NGL or under the Template Haulage Contract.

1382. Without substantive justification to support a change in the NGL procedure, the Authority considers that a consistent approach is required to ensure an efficient and effective dispute resolution procedure is adopted and requires clause 18.3(f) of the Template Haulage Contract to be deleted.

1383. The Authority maintains its position in Required Amendment 54 of the draft decision that clause 18.3(f) of the Template Haulage Contract should be deleted.

Draft Decision – Required Amendment 56

1384. Clause 20.1 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1385. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to delete clause 20.1 in accordance with Required Amendment 56 of the draft decision.
1386. WAGN submitted that the Authority has incorrectly considered intellectual property rights by reference solely to the national gas objective.
1387. WAGN submitted that the Authority's implicit reasoning at paragraph 1744 of the draft decision that the parties are free to agree such matters for themselves, is an agreement to agree so unenforceable at law. WAGN submitted that in the event that parties do not agree then WAGN is bound to offer the Reference Services on the terms set out in the Template Haulage Contract.
1388. WAGN submitted that in considering any provision of the Template Haulage Contract the Authority is required to consider competing interests of WAGN and the users in the context of the national gas objective. WAGN submitted that clause 20.1 regulates the ownership of intellectual property rights and thus provide certainty in respect to the party's rights and obligations and therefore consistent with the national gas objective.
1389. WAGN submitted that the Authority's suggested approach is inconsistent with the approach taken by the Authority in relation to other property rights (i.e. provisions that confirm WAGN owns the Standard Delivery Services and the User Specific Delivery Services).
1390. WAGN further submitted that clause 20.1(b) of the Template Haulage Contract reflects the operation of the gas market in Western Australia in that the operation of the gas distribution system and the retail arrangements are undertaken by separate entities and under different licence regimes. As such WAGN submitted that it is not a matter that can be left for the parties to endeavour to agree on as WAGN requires ownership in all documents evidencing the location, dimensions and specifications of the WAGN GDS as WAGN is responsible under the licence for the construction, operation and maintenance of the system.

Other submissions

1391. Alinta submitted on 5 November 2010 (pages 19-20 of Attachment C) that it supports the decision to require that clause 20.1 be deleted.
1392. Alinta submitted that if the Authority is moved by WAGN's submission that the ownership of intellectual property is a matter which goes to the compliance of WAGN's proposed Template Haulage Contract with the national gas objective, then Alinta reiterates that the competing interests of WAGN and the user require a provision that all documents, tools, software, reports etc created by the user are owned by the user, even if they are created under or for the purposes of the haulage contract.

Authority's Assessment

1393. The Authority confirms that in assessing WAGN's proposed revisions for the purposes of the draft decision and for this final decision, it has considered the competing interests of the service provider and users in the context of the national

gas objective. The Authority notes that its position as regulator is to assess the proposed access arrangement as drafted and submitted to the Authority by the service provider, in this case WAGN. The Authority did not assess WAGN's compliance with the national gas objective, but considered each provision's consistency with the national gas objective.

1394. The Authority notes WAGN's submission in relation to the suggestion that the parties are free to negotiate such matters for themselves is an agreement to agree and therefore unenforceable at law. The Authority notes its comments at paragraphs 86 to 93.
1395. The Authority maintains its position as set out in paragraphs 1743 to 1744 of the draft decision and considers that intellectual property is a matter relating to the commercial arrangements between the service provider and the user and not a matter that goes to consistency with the national gas objective.
1396. The Authority notes WAGN's submission in response to the draft decision, in particular, WAGN's reference to the operation of the gas market in Western Australia and the associated licensing system. The Authority has not been persuaded by WAGN's submissions that the licensing system in Western Australia requires clauses in the Template Haulage Contract to regulate the intellectual property rights of the service provider and the user. WAGN have not provided substantiated reasoning in their submissions that would support a change in the status quo as provided for in the current access arrangement.
1397. Further, the Authority notes that the AER has not seen it necessary to regulate in relation to intellectual property rights. The recently revised GDS access arrangements for the Wagga Wagga, Jemena and ACT, Queanbeyan and Palerang do not mention the ownership of intellectual property rights of the service provider or user.
1398. For the purposes of the Authority's proposed access arrangement, the Authority will adopt Required Amendment 56 and delete clause 20.1 from the amended Template Haulage Contract.

Authority's proposal

The Authority will maintain the position of Required Amendment 56 of the Draft Decision and will delete Clause 20.1 of the Template Haulage Contract.

Draft Decision – Required Amendment 57

1399. Clause 20.2 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1400. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected not to delete clause 20.2 in accordance with Required Amendment 57 of the draft decision.

1401. WAGN submitted that the basis for Required Amendment 57 is ambiguous and conflicts with Required Amendment 21 of the draft decision. WAGN submitted that paragraph 1749 of the draft decision refers just to clause 20.2(c) and confirms it is not in the current access arrangement. Paragraph 1751 of the draft decision then determines that clause 20.2 of the Template Haulage Contract is not approved despite a similar provision in clause 66 of Part C of the current access arrangement.
1402. WAGN submitted that Required Amendment 21 makes an express reference to clause 20.2 of the Template Haulage Contract.

Other submissions

1403. Alinta submitted that clause 20.2 does not relate to intellectual property, and should be retained as providing reasonable prohibition against the disclosure of confidential information.

Authority's Assessment

1404. The Authority notes its approach in the draft decision that 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.
1405. On review, the Authority has closely considered clause 20.2 distinct from other commercial clauses in the Template Haulage Contract and in this instance considers that the protection of confidential information afforded to users, in particular, by clause 20.2 may impact on the competitive process if no satisfactory regime of handling confidential information is provided for in the Template Haulage Contract.
1406. The Authority appreciates the concern of both WAGN and users such as Alinta regarding the potential impact on competition if confidential information is disclosed. The Authority considers that confidentiality, or lack thereof, may deter entry into the Template Haulage Contract due to fears of a user's competitive position being compromised.
1407. The Authority considers that the national gas objective supports a regime that minimises the risk of any confidential information being released to competitors. Unless appropriate protection is provided for, the Authority considers that the potential risk for leakage of such confidential information may actually act as a disincentive to the operation of the WAGN GDS and hinder a competitive environment that would otherwise exist.
1408. The Authority has distinguished this approach from that concerning intellectual property in clause 20.1. The Authority considers that the ownership rights of intellectual property and the potential for any changes in those ownership rights 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.
1409. For the purposes of the Authority's proposed access arrangement, the Authority will adopt clause 20.2 of the amended Template Haulage Contract.

Draft Decision – Required Amendment 58

1410. 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.

Public Submissions

WAGN's submissions

1411. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to amend clause 20.4(b) as required by Required Amendment 58 of the draft decision.

Other submissions

1412. No public submissions were received in relation to Required Amendment 58.

Authority's Assessment

1413. The Authority notes its reasoning in paragraph 1760 to 1761 of the draft decision and maintains its position in relation to clause 20.4(b) of the Template Haulage Contract.

1414. The Authority confirms that WAGN has satisfied Required Amendment 58 of the draft decision.

Draft Decision – Required Amendment 59

1415. Clause 20.5 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1416. In its amended Template Haulage Contract of 8 October 2010, WAGN has elected to delete clause 20.5 as required by Required Amendment 59 of the draft decision.

Other submissions

1417. No public submissions were received in relation to Required Amendment 59.

Authority's Assessment

1418. The Authority notes its reasoning in paragraph 1766 of the draft decision and maintains its position in relation to clause 20.5 of the Template Haulage Contract.

1419. The Authority confirms WAGN has satisfied Required Amendment 59 of the draft decision.

Draft Decision – Required Amendment 60

1420. Clause 21.4 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN's submissions

1421. WAGN has retained clause 21.4 of the Template Haulage Contract without amendment. WAGN submitted on 8 October 2010 (pages 133-134) that the clauses deal with contractual matters arising from legislative matters that parties undertaking arms length negotiations are required to agree upon. Rule 48(1)(d)(ii) requires these to be included in the haulage contract and thus deletion of clause 21.4 is contrary to the NGR.
1422. WAGN submitted that the reference tariffs have been calculated on a basis that they are exclusive of any stamp duty that may be payable on the Template Haulage Contract and that each party pay its own legal costs.
1423. According to WAGN, the deletion of clause 21.4 is inconsistent with the revenue and pricing principles in section 24 of the NGL in that the Authority is denying WAGN the opportunity to recover the efficient cost of providing the reference services (in the event a duty arises or a claim that WAGN ought to pay the other party's costs).
1424. The suggestion of the Authority at paragraph 1786 of the draft decision that the parties are free to agree such matters for themselves is, according to WAGN, an agreement to agree and unenforceable at law.
1425. WAGN submitted that in the event that the parties do not agree then WAGN is bound to offer the reference services on the same terms set out in the Template Haulage Contract meaning the reference tariffs are offered without agreement on the duty that may be payable or how the parties costs are to be managed.
1426. WAGN has stated that it is for these reasons that clause 21.4 of the Template Haulage Contract is consistent with the NGL and NGR.

Other submissions

1427. No other public submissions were received in relation to Required Amendment 60.

Authority's Assessment

1428. The Authority notes that WAGN has not deleted clause 21.4 from the amended Template Haulage Contract. The Authority maintains its position as set out in paragraph 1786 of the draft decision and notes its comments at paragraphs 86 to 93 of this final decision. The Authority confirms 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.
1429. The Authority does not accept WAGN's submission that stamp duty and legal costs are 'other terms and conditions on which the reference service will be provided' as required by rule 48(1)(d)(ii) of the NGR. The Authority maintains its position that the potential liability for stamp duty is a matter for commercial negotiation between the parties and not for the Authority to regulate.
1430. In relation to WAGN's submission regarding the revenue and pricing principles, the Authority refers to paragraph 1202 of the draft decision where it noted that the revenue and pricing principles do not have any application as the terms and conditions on which reference services will be provided, by definition, do not concern revenue or pricing.

Draft Decision – Required Amendment 61

1431. 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.*

Public Submissions

WAGN’s submissions

1432. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to adopt all of the amendments required by Required Amendment 61 of the draft decision.
1433. In its submission in relation to the Template Haulage Contract, submitted on 8 October 2010 WAGN has provided a summary of its response in relation to each definition which Required Amendment 61. WAGN submitted that where it has elected not to adopt the suggestion by the Authority in the draft decision it has done so because it is of the view that the amendment suggested by the Authority is

inconsistent with the national gas objective in that the suggested amendment will introduce ambiguity into the Template Haulage Contract leading to inefficiencies and increase the likelihood of a dispute.

1434. In order to deal with each definition completely WAGN's response to each individual definition in Required Amendment 61 is set out below under its respective heading.

'CPI'

1435. WAGN has elected not to adopt the amendments suggested by the Authority in Required Amendment 61 of the draft decision. WAGN submitted relied on its analysis submitted in relation to Amendment 6 of the draft decision at paragraphs 621 and 622 of this final decision.

'Access Arrangement'

1436. WAGN has elected not to adopt the Authority's suggestion at Required Amendment 61 that the definition of 'access arrangement' should read the same in the Template Haulage Contract as the corresponding definition in the NGL and NGR. WAGN submitted that the reference to 'access arrangement' in the NGL is a generic description. WAGN submitted that the intent of the definition of 'access arrangement' in the Template Haulage Contract is to cross reference it to the WAGN access arrangement and therefore it is correct to retain the definition in this format.

'Delivery Point'

1437. WAGN has elected not to adopt the Authority's suggestion at Required Amendment 61 that the definition of 'Delivery Point' should read the same in the Template Haulage Contract as the corresponding definition in the NGL and NGR. WAGN submitted that the reference to 'Delivery Point' in the National Gas Rules encompasses two concepts, delivery point and receipt point and is generic. WAGN is of the view that the definition of 'Delivery Point' in the proposed Template Haulage Contract is more appropriate as it deals with the delivery point and receipt points separately and is specific the WAGN GDS. This is of importance when read in light of the definition of Delivery Point Register, which refers to delivery points which are only a part of the WAGN GDS.

1438. WAGN has cited the approval of a similar approach in the Wagga Wagga distribution access arrangement by the AER and relies on this approach.

'End User'

1439. WAGN has elected not to adopt the Authority's suggestion at Required Amendment 61 that the definition of 'End User' should read the same in the Template Haulage Contract as the corresponding definition in the NGL and NGR. WAGN submitted that the definition in the NGL is too broad and should be confined to WAGN GDS users only for the purposes of the Template Haulage Contract.

'National Gas Rules'

1440. WAGN has elected to adopt the definition of National Gas Rules as provided for in the NGL.

'Receipt Point'

1441. WAGN has elected not to adopt the Authority's suggestion at Required Amendment 61 that the definition of 'Receipt Point' should read the same in the Template Haulage Contract as the corresponding definition in the NGL and NGR. WAGN

submitted that the reference to 'Receipt Point' in the National Gas Rules encompasses two concepts, delivery point and receipt point and is generic, as mentioned above at paragraph 1437 of this final decision. WAGN is of the view that the definition of 'Receipt Point' in the proposed Template Haulage Contract is more appropriate as it deals with the delivery point and receipt points separately and is specific to the WAGN GDS. This definition contemplates that WAGN will designate a receipt point for a sub-network.

1442. WAGN cited the approval of a similar approach in the Wagga Wagga distribution access arrangement by the AER on 23 April 2010 and relies on this approach.

'Regulator'

1443. WAGN has elected to adopt the suggestion of the Authority referred to in Required Amendment 61 of the draft decision.

'User'

1444. WAGN has elected not to adopt the suggestion of the Authority in Required Amendment 61 of the draft decision. WAGN submitted that the definition of 'User' in the Template Haulage Contract already refers to the NGL and therefore does not need to be amended.

'REMCo'

1445. WAGN has elected not to adopt the suggestion of the Authority at Required Amendment 61 of the draft decision as it is of the view that the words 'retail energy market' are broader than the gas retail market that REMCo regulates.

'REMCo Registry'

1446. WAGN has elected not to adopt the suggestion of the Authority at Required Amendment 61 of the draft decision as it is of the view that the words 'as amended from time to time' is inconsistent with the requirement under Required Amendment 62 of the draft decision which requires the deletion of clause 22.2(b) of the Template Haulage Contract which has the same effect.

1447. WAGN submitted further that the words 'or any other rules applying to the retail energy market' suggested by the Authority in Required Amendment 61 are not appropriate as they broaden the definition beyond the gas retail market that the Retail Market Rules regulate.

'Retail Market Rules'

1448. WAGN has elected not to adopt the suggestion of the Authority at Required Amendment 61 of the draft decision in relation to the definition of 'Retail Market Rules'. WAGN submitted that the inclusion of the words 'as amended from time to time' are not appropriate for the same reasons as submitted at paragraph 1446 above.

1449. WAGN submitted the words 'or any other rules applying to the retail energy market' suggested by the Authority in Required Amendment 61 are not appropriate as they broaden the definition beyond the gas retail market that the Retail Market Rules regulate.

‘Retail Market Scheme’

1450. WAGN has elected not to adopt the suggestion of the Authority at Required Amendment 61 of the draft decision in relation to the definition of ‘Retail Market Rules’. WAGN submitted that the inclusion of the words ‘as amended from time to time’ are not appropriate for the same reasons as submitted at paragraph 1446 above.

1451. WAGN submitted the words ‘or any other rules applying to the retail energy market’ suggested by the Authority in Required Amendment 61 are not appropriate as they broaden the definition beyond the gas retail market that the Retail Market Rules regulate.

‘Service Provider’ and ‘Covered Pipeline Service Provider’

1452. WAGN has elected to substantially adopt the amendments required in Required Amendment 61 in relation to ‘Service Provider’ and ‘Covered Pipeline Service Provider’. WAGN submitted that it has elected to incorporate the concept of ‘Service Provider’ in addition to ‘Covered Pipeline Service Provider’.

Other submissions

1453. Alinta submitted (page 20 of Attachment C) that it supports the Authority’s decision to require the definition of ‘CPI’ to be amended in the manner required by the Authority.

Authority’s Assessment

‘CPI’

1454. For the reasons set out in paragraphs 61 to 73 above the Authority will adopt the definition of ‘CPI’ in the draft decision to refer to ‘CPI (All Groups, Eight Capital Cities)’.

‘Regulator’ and ‘National Gas Rules’

1455. The Authority accepts that WAGN has amended the definitions of ‘Regulator’ and ‘National Gas Rules’ in accordance with Required Amendment 61.

‘Access Arrangement’, ‘End User’ and ‘User’

1456. The Authority notes that WAGN has elected not to adopt the corresponding definitions of ‘access arrangement’, ‘End User’ and ‘User’ as defined in the NGL and NGR. The Authority considers that for convenience of drafting and referring to the terms in an agreement such as the Template Haulage Contract, the defined terms ‘access arrangement’, ‘End User’ and ‘User’, whilst materially meaning the same as in the NGL and NGR, can refer specifically to the WAGN GDS access arrangement.

‘Delivery Point’ and ‘Receipt Point’

1457. The Authority notes WAGN’s has not amended the definitions of ‘Delivery Point’ and ‘Receipt Point’ to correspond with the wording in the NGL and NGR. The Authority accepts WAGN’s submission that it is not practical in the Template Haulage Contract to encompass both terms together and that for ease of reference the terms can be dealt with separately.

‘REMCo’, ‘REMCo Registry’, ‘Retail Market Rules’ and ‘Retail Market Scheme’

1458. The Authority notes that WAGN has elected not to amend as required the definitions of ‘REMCo’, ‘REMCo Registry’, ‘Retail Market Rules’ and ‘Retail Market Scheme’ in the Template Haulage Contract as required by Required Amendment 61. The Authority required the definition of ‘REMCo’ to be amended should the functions of REMCo change or move to another regulatory body. As a result of this amendment, the Authority required consequential amendments to ‘REMCo Registry’, ‘Retail Market Rules’ and ‘Retail Market Scheme’.

1459. The Authority requires these definitions to be amended as set out in the draft decision.

‘Service Provider’ and ‘Covered Pipeline Service Provider’

1460. The Authority notes that WAGN has amended the definition of ‘Service Provider’ in the Template Haulage Contract to state that ‘WAGN is a Service Provider for the WAGN GDS and also the Covered Pipeline Service Provider for the WAGN GDS.’ The Authority considers a covered pipeline service provider to be a sub-category of service provider and therefore approves the definition of ‘Service Provider’ as amended by WAGN.

1461. The Authority notes that WAGN has, by referring to the definition in the NGL, adopted the definition of ‘Covered Pipeline Service Provider’ as required by the Authority.

Draft Decision – Required Amendment 62

1462. Clause 22.2 of the Template Haulage Contract should be deleted.

Public Submissions

WAGN’s submissions

1463. WAGN has retained clause 22.2 of the Template Haulage Contract without amendment.

1464. WAGN submitted on 8 October 2010 (pages 141-144) that there is no basis under the NGL or NGR for the conclusion at paragraph 1818 of the draft decision to determine that clause 22.2 relates to commercial arrangements between contracting parties and not to matters that go to compliance with the national gas objective. In forming this view, WAGN stated that the Authority has failed to apply the NGL and NGR as parliament intended as the Authority is required to consider the NGL and NGR as a whole.

1465. WAGN submitted that in considering any provisions of the Template Haulage Contract the Authority is required to consider the competing interests of WAGN and the users in the context of the national gas objective, not just WAGN’s compliance with the national gas objective.

1466. According to WAGN, clause 22.2 sets out the terms and conditions on which the reference services will be provided as required by rule 48(1)(d)(ii) of the NGR.

1467. WAGN submitted that clause 22.2 deals with common interpretation issues that commercial arrangements regulate. In the absence of such a clause there is

uncertainty as to how the terms of the haulage contract will be interpreted. This means an increased possibility of disputes arising.

1468. WAGN stated that the provisions of clause 22.2 reflect the law relevant to the interpretation issues (i.e. they are intended to address the key areas of dispute that have arisen in the context of interpretation issues). As such they are not procedural matters but terms and conditions that provide certainty in respect to the party's rights and obligations thus being consistent with the national gas objective.
1469. The suggestion by the Authority at paragraph 1618 of the draft decision that the parties are free to agree such matters for themselves is, according to WAGN, an agreement to agree and unenforceable at law. In the event that the parties do not agree, then WAGN is bound to offer the reference services on the terms set out in the draft Template Haulage Contract meaning that WAGN will have to offer the reference services without certainty provided by the inclusion of clause 22.2.
1470. WAGN further submitted that the statement at paragraph 1818 of the draft decision that the Template Haulage Contract is not a complete document is wholly inconsistent with the intent of the Template Haulage Contract in the access arrangement.
1471. WAGN submitted that clause 22.2 is materially consistent with Schedule 1 of Part A of the current access arrangement and also confirms that the AER has approved an interpretation clause in an agreement to provide reference services, referring to the Wagga Wagga and Jemena Gas Networks.

Other submissions

1472. Alinta submitted on 5 November 2010 (page 20 of Attachment C) that it supports the retention of clause 22.2 in the Template Haulage Contract.

Authority's Assessment

1473. The Authority has considered WAGN and Alinta's submissions in relation to clause 22.2 of the amended Template Haulage Contract.
1474. The Authority accepts WAGN's submission that clause 22.2 provides certainty in the interpretation of the Template Haulage Contract and reduces the possibility of disputes arising in relation to the terms and conditions on which the reference services will be provided. The Authority considers that clause 22.2 forms an integral part of the terms and conditions set out in the Template Haulage Contract and accepts that its exclusion may lead to uncertainty as to how the terms of the haulage contract may be interpreted.
1475. The Authority has reviewed the Wagga Wagga and Jemena decisions by the AER and considers that an interpretation clause in an agreement to provide reference services is consistent with the national gas objective.
1476. For the purposes of the Authority's amended access arrangement revisions, the Authority will adopt clause 22.2 in the amended Template Haulage Contract.

Draft Decision – Required Amendment 63

1477. 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.

Public Submissions

WAGN's submissions

1478. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to retain without amendment clause 2(c) of Schedule 1 and 2; clause 2(d) of Schedule 3; and clauses 2(b) of Schedule 4 and 5 of the Template Haulage Contract.
1479. WAGN submitted that Required Amendment 63 of the Template Haulage Contract is inconsistent with the national gas objectives as it prevents WAGN from modifying its property without consulting third party users, who WAGN submitted do not have a proprietary interest in the asset. WAGN submitted that this may affect their ability to make modifications in situation that are required for safety or operational matters which the third party user is not qualified to comment.
1480. WAGN further submitted that the user has contractual rights in the event that the modification causes the haulage of gas to be interrupted. Under clause 7 of the Template Haulage Contract WAGN are obliged to notify the user in the event modifications result in a need to curtail gas. WAGN submitted that it is inefficient to introduce additional procedural requirements into this process which deal with the same issue.

Other submissions

1481. In its submission dated 5 November 2010, Alinta submitted that it supports the Authority's decision to require the service provider to consult with the user under the provision set out in Required Amendment 63.

Authority's Assessment

1482. The Authority has considered WAGN's submission in relation to the User specific delivery facilities. The Authority is of the view that WAGN's argument that it is not appropriate to consult with the user on the modification of user specific delivery services because the user is not the owner, is not a sufficient reason to reject taking the user's reasonable requirements into account.
1483. The Authority suggests that as WAGN has agreed to have regard to the user's reasonable requirements when designing and constructing user specific delivery facilities in clause 2(b) that it should have equal regard to the user's requirements when making modifications. The Authority does not accept WAGN's election to retain clauses 2(c) of schedule 1 and 2, clause 2(d) of schedule 3 and clauses 2(b) of schedule 4 and 5 of the Template Haulage Contract.
1484. The Authority is of the view that the underlying principle of Required Amendment 63 of the draft decision, that the user be consulted is reflected in the words 'reasonable requirements' as it is used for example in clause 2(b) of schedule 1 and 2 and that WAGN has not raised concerns regarding the expression.

Draft Decision – Required Amendment 64

1485. 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.*

Public Submissions

WAGN's submissions

1486. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to delete the clauses referred to in Required Amendment 64 of the draft decision.

1487. WAGN submitted that Required Amendment 64 is inconsistent with the national gas objective in that clause 8.3(a) of the Template Haulage Contract contains acknowledgements that WAGN's ability to provide the reference service relies on a user providing unfettered access but does not expressly grant unfettered access.

1488. WAGN submitted that without the relevant entitlements in the clauses referred to in Required Amendment 64 there is not express obligation on the user to provide unfettered access.

Other submissions

1489. In its submission dated 5 November 2010, Alinta submitted that it supports the Authority's decision to require the deletions suggested in Required Amendment 64 of the draft decision.

Authority's Assessment

1490. The Authority has considered WAGN's submission in relation to Required Amendment 64. The Authority acknowledges that the obligation for unfettered access that WAGN seeks to impose on the user is important to the provision of reference services under the Template Haulage Contract. The Authority acknowledges in particular clause 8.3 of the Template Haulage Contract which provides that the user acknowledges that the service provider's ability to provide a haulage service to the user's 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 are to be installed.

1491. The Authority proposes that the principal difficulty that arises in relation to the provisions set out in the schedules in relation to unfettered access is the means of expressing the obligation as an absolute requirement to ensure unfettered access.

The Authority submits that the practical difficulty of a user performing the absolute obligation to ensure unfettered access is reflected in clause 8.3(b) and 8.3(c) of the Template Haulage Contract and in various provisions of the schedules where these provisions address circumstances where unfettered access is not provided.

1492. The Authority submits that a more practical approach would therefore be to express the obligation on the user as an obligation to use reasonable endeavours to secure in a timely manner the unfettered access to the service provider.
1493. The Authority proposes, and will adopt for the purposes of the Authority's proposed access arrangement revisions, that in the interests of providing clarity and simplicity to the Template Haulage Contract the clauses specified in Required Amendment 64 of the draft decision are deleted and address the concerns in relation to unfettered access by inserting a sub-clause in 8.3 which states that the user acknowledges that it has an obligation to use reasonable endeavours to provide or procure in a timely manner the unfettered access for the service provider and its agent, officers, employees and contractors.

Authority's proposal

The Authority will adopt Required Amendment 64 but will insert a sub-clause into clause 8.3 of the Template Haulage Contract which states that the user acknowledges that it has an obligation to use reasonable endeavours to provide or procure in a timely manner the unfettered access for the service provider and its agent, officers, employees and contractors.

Draft Decision – Required Amendment 65

1494. 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.*

Public Submissions

WAGN's submissions

1495. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected not to adopt the suggested of the Authority at Required Amendment 65 of the draft decision.
1496. WAGN submitted that the purpose of clause 4(b) of schedule 1 and 3 of the Template Haulage Contract was to allow WAGN to amend the relevant minimal nominal operating pressure in the event that it was required for operating or maintenance purposes or because of unforeseen system issues. WAGN submitted that as drafted Required Amendment 65 of the draft decision requires WAGN and the user to agree on the nominal operating pressure which is an agreement to agree and unenforceable at law.

1497. WAGN further submitted that an agreement to agree on the minimum nominal operating pressure may place WAGN in breach of its obligations under its Licence in circumstances where there is a gas leak classified as a Class 1 incident and WAGN is required under the licence to immediately commence action to investigate and repair the leak. In these circumstances it will not be possible to consult with the user prior to modification.
1498. WAGN submitted that it has considered the concerns of the Authority paragraph 1840 of the draft decision and has inserted the words as a 'reasonable and prudent network operator' to satisfy those concerns without encroaching on the requirements of the Licence.

Other submissions

1499. Alinta submitted on 8 November 2010 (pages 21-22 of Attachment C) that it supports the Authority's decision to require an amendment to clause 4(b) of Schedules 1, 2 and 3 of the Template Haulage Contract. Alinta also stated that it reassures WAGN that it has the technical ability partake in relevant discussions and to reach agreement on a sensible amended pressure.

Authority's Assessment

1500. The Authority has considered WAGN's submission in relation to minimum nominal operating pressure and accepts WAGN has strict compliance obligations under the distribution Licence.
1501. The Authority has considered the alternative wording suggested by WAGN in its submission and accepts that this wording satisfies its concerns at paragraph 1840 of the draft decision.
1502. The Authority notes WAGN's submission in relation to the suggestion that the parties are free to negotiate such matters for themselves is an agreement to agree and therefore unenforceable at law. The Authority refers to its comments at paragraphs 86 to 93 above.
1503. The Authority accepts the proposed changes to clauses 4(b) of Schedule 1 to 3 of the amended Template Haulage Contract.

Draft Decision – Required Amendment 66

1504. 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.~~

Public Submissions

WAGN's submissions

1505. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to adopt Required Amendment 66 of the draft decision.

Other submissions

1506. No other public submissions were received in relation to Required Amendment 66.

Authority's Assessment

1507. The Authority confirms its reasoning at paragraphs 1844 to 1846 of the draft decision and notes that WAGN has amended clause 5(b) of schedule 1 and 2 of the Template Haulage Contract as required by Required Amendment 66 of the draft decision.

Draft Decision – Required Amendment 67

1508. 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.

Public Submissions

WAGN's submissions

1509. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to adopt Required Amendment 67 of the draft decision.

Other submissions

1510. No other public submissions were received in relation to Required Amendment 67.

Authority's Assessment

1511. The Authority confirms its reasoning at paragraphs 1851 to 1855 of the draft decision and notes that WAGN has amended clause 8(c) of schedule 1 of the Template Haulage Contract as required by Required Amendment 67 of the draft decision.

Draft Decision – Required Amendment 68

1512. 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*

Public Submissions

WAGN's submissions

1513. In its amended Template Haulage Contract submitted on 8 October 2010, WAGN has elected to substantially adopt the changes required by Required Amendment 68 of the draft decision.

1514. WAGN submitted that Required Amendment 68 of the draft decision is ambiguous as the commentary at paragraph 1856 of the draft decision appears to refer to certain sub-sections of the clauses referred to in Required Amendment 68 of the draft decision in relation the claim for loss or damages if there is a failure to permanently deregister a delivery point and Required Amendment 68 requires the deletion of the whole clause.

1515. WAGN has elected to adopt the suggestions in relation to the relevant sub-section of clause 9 of Schedules 1 and 2, clause 8 of Schedule 3 and clause 7 of Schedules 4 and 5 of Required Amendment 68 of the draft decision.

Other submissions

1516. In its submission dated 5 November 2010, Alinta submitted that it does not support the deletions required in Required Amendment 68 of the draft decision.
1517. Alinta submitted that the deletions required by Required Amendment 68 of the draft decision would result in the subject of deregistration of delivery points to be dealt with only by clause 5.6 of the Template Haulage Contract and removes the reference to the user being able to request the service provider to deregister a delivery point.
1518. Alinta submitted that there are also procedural aspects of these clauses that ought to be retained in the Template Haulage Contract, in particular the requirement for the service provider to deregister a delivery point when it receives a request to do so from the user and the requirement of the service provider to notify the user once a delivery point is deregistered.
1519. Alinta submitted that it considers that it is only the provision that seeks to exculpate WAGN from liability that should be removed from the clauses referred to in Required Amendment 68 of the draft decision. Alinta submitted that issues of liability should be exclusively dealt with in clause 16 of the Template Haulage Contract.

Authority's Assessment

1520. The Authority confirms its position at paragraphs 1856 to 1862 of the draft decision and confirms that Required Amendment 68 of the draft decision should in fact refer to 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.
1521. The Authority accepts the amendments made by WAGN in its amended Template Haulage Contract to clause 9 of Schedules 1 and 2, clause 8 of Schedule 3 and clause 7 of Schedules 4 and 5 for the purposes of its proposed access arrangement revisions.

Public submissions not concerning a Required Amendment

Clause 6.2 of the Template Haulage Contract

Public Submissions

WAGN's submissions

1522. WAGN made no amendments to clause 6.2 of the Template Haulage Contract.

Other submissions

1523. Alinta submitted on 5 November 2010 (page 6 of Attachment C) that regardless of the content of clause 12 in Part C of the current access arrangement, it is inappropriate to provide that the user receives gas (clause 6.2(a)) and that possession of the gas passes to the user (clause 6.2(b)) at the delivery point. This is manifestly untrue and providing it in the haulage contract will not make it true. The provisions should be deleted in the case of clause 6.2(a) and amended to remove the reference to 'possession' in the case of clause 6.2(b).

Authority's Assessment

1524. The Authority approved clause 6.2 of the Template Haulage Contract in the draft decision. The Authority refers to Alinta's submission in April 2010 which was summarised at paragraph 1374 of the draft decision.
1525. The Authority does not accept Alinta's submissions in relation to clause 6.2 of the amended Template Haulage Contract. The haulage contract is a contract between the service provider and the user for the provision of pipeline services for the WAGN GDS. Whilst an end user may ultimately be entitled to receive gas, it is the user who is to receive gas at the receipt point. WAGN has no contractual relationship with the end user and therefore cannot be expected to consider such a third party for the purposes of the haulage contract. The haulage contract has no bearing on what happens to the gas after delivery pursuant to any agreement between the user and the end user.
1526. The Authority considers that requiring a contract between the service provider and the user to consider a third party end user is not consistent with the national gas objective.
1527. The Authority refers to its final decision for the current access arrangement dated 12 July 2005, in particular paragraphs 944 to 946. The Authority notes that for the purposes of the current access arrangement, it required reference to 'possession' of gas in order to avoid uncertainty as to exactly which circumstances gave rise to WAGN's obligation to replace unaccounted for gas.
1528. The Authority maintains this reasoning and for the purposes of the Authority's proposed access arrangement, will adopt clause 6.2(a) and (b) of the amended Template Haulage Contract.

Clause 7.2 of the Template Haulage Contract

Public Submissions

WAGN's submissions

1529. WAGN did not amend clause 7.2 of the Template Haulage Contract.

Other submissions

1530. Alinta expressed its concern that the Authority has approved clause 7.2 of the Template Haulage Contract primarily because it is consistent with the provisions of the current access arrangement. Alinta submitted on 5 November 2010 (pages 9-10 of Attachment C) this cannot be the criteria that the Authority applies as it results in access arrangement reviews which are a one way valve: users have no rights to submit changes on matters which are not working for them while the service provider can revise the access arrangement at large. Alinta stated that it is better for the Authority to be ultimately right than consistently wrong.
1531. Alinta further submitted that clause 7.2 should be amended to prevent users being unfairly treated by curtailments. The point is that there is no required nexus between the delivery point being curtailed and the interconnected pipeline. Alinta submitted that clause 7.2 be amended so that WAGN may only curtail if the event relates to or derives from an interconnected pipeline which is connected to the sub-network to which the delivery point belongs.

Authority's Assessment

1532. The Authority approved clause 7.2 of the Template Haulage Contract in the draft decision. The Authority notes Alinta's submissions at paragraphs 1406 of the draft decision in relation to clause 7.2 of the Template Haulage Contract.
1533. The Authority refers to its comments at paragraph 1410 of the draft decision that without substantive submissions justifying how the current access arrangement is inefficient or adversely affecting users, the Authority will consider the provisions of the current access arrangement to be consistent with the national gas objective. The Authority does not agree with Alinta's submission that reviews of an access arrangement are 'a one way valve'. The Authority does, and will always as long as the legislation permits, consider the proposals and submissions of the service provider and the users. However, the Authority requires such proposals and submissions to be justified, substantiated and consistent with the NGA and NGR.
1534. The Authority notes Alinta's further submissions in relation to clause 7.2 of the Template Haulage Contract. The Authority does not accept that it is necessary for clause 7.2 to specify a nexus between the curtailment event and the right to curtail such as the event relating to or deriving from an interconnected pipeline which is connected to the sub-network to which the delivery point belongs. The evident intent of the conferral of the right to curtail is that it only will arise in circumstances where the relevant event interferes with the ability of the service provider to deliver gas to the contracted delivery point or points.

Clause 8.2 of the Template Haulage Contract

Public Submissions

WAGN's submissions

1535. WAGN made no amendments to clause 8.2 in the amended Template Haulage Contract.

Other submissions

1536. Alinta submitted on 5 November 2010 (pages 11-12 of Attachment C) that it reiterates its submission that gas quality data should only be used across locations in the same sub-network. The reason for this is that there is a significantly greater likelihood that gas quality will be uniform across a sub-network.

Authority's Assessment

1537. In the draft decision, the Authority approved clause 8.2 of the Template Haulage Contract.
1538. The Authority notes that Alinta raised its concern regarding clause 8.2 of the Template Haulage Contract for the purposes for the draft decision. At paragraph 1459 of the draft decision, Alinta submitted that clause 8.2 should be amended to specify the limitation whereby data from equipment located in one sub-network should only be used to estimate gas quality at other locations in that sub-network.
1539. The Authority refers its response to Alinta's submission at paragraph 1461 of the draft decision. The Authority noted that Alinta's submission did 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.

1540. The Authority determined in the draft decision that it did not consider it necessary to limit clause 8.2 as suggested by Alinta.
1541. For the purposes of the Authority's final decision, Alinta has again raised the same argument further submitting that there is a significantly greater likelihood that gas quality will be uniform across a sub-network.
1542. The Authority maintains its decision as set out in the draft decision. The Authority does not consider the Alinta has provided sufficient justification to necessitate an amendment to clause 8.2 of the Template Haulage Contract. The Authority notes that clause 8.2 excludes the service provider's right to use data from other sub-networks in cases of manifest error which is a means of addressing any inefficiency contrary to the national gas objective.

Clause 15.1 of the Template Haulage Contract

Public Submissions

WAGN's submissions

1543. WAGN made no amendments to clause 15.1 of the Template Haulage Contract.

Other submissions

1544. Alinta reiterated on 5 November 2010 (pages 15-16 of Attachment C) that clause 15.1(c) be deleted for the reasons previously submitted. Alinta submitted that it will not be in a position to provide that evidence while WAGN will have that information available to it from several sources.

Authority's Assessment

1545. The Authority approved clause 15.1 of the Template Haulage Contract in the draft decision.
1546. The Authority notes that Alinta made similar submissions in relation to clause 15.1(c), summarised at paragraph 1637 of the draft decision. The Authority maintains its decision at paragraphs 1643 and 1644 of the draft decision.

Other Access Arrangement Provisions

Draft Decision – Required Amendment 69

1547. Clause 6.4(a)(ii) of the proposed access arrangement should be deleted.

Public Submissions

WAGN's submissions

1548. WAGN has retained clause 6.4(a)(ii) of the proposed access arrangement relying on the same analysis for Required Amendment 4 at paragraphs 158 to 167 of this final decision.

Other submissions

1549. Alinta submitted on 5 November 2010 (page 3) that it supports the Authority's decision to require the deletion of clause 6.4(a)(ii) which is consistent with the requirement to delete clause 5.5 of the proposed access arrangement. Alinta's submissions on the amendments to clause 1.1 of the Template Haulage Contract are also relevant for this amendment and were outlined in paragraphs 919 to 920 of this final decision.

Authority's Assessment

1550. The Authority notes that WAGN has retained clause 6.4(a)(ii) contrary to Required Amendment 69.

1551. The Authority refers to its final decision regarding Required Amendment 4 in relation to clause 5.5 of the proposed access arrangement at paragraphs 169 to 183. The Authority notes that this final decision retains the preconditions set out in clause 5.5(a) of the proposed access arrangement, so that they apply to reference services only.

1552. In light of its decision in relation to Required Amendment 4, the Authority no longer requires clause 6.4(a)(ii) to be deleted from the Template Haulage Contract. The Authority considers it acceptable for WAGN to make it a condition of its consent that the third party satisfies one or more of the preconditions in clause 5.5 of the proposed access arrangement which is now only applicable to reference services.

Draft Decision – Required Amendment 70

1553. 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.

Public Submissions

WAGN's submissions

1554. In its amended proposed access arrangement submitted on 8 October 2010, WAGN elected not to adopt the suggestions in Required Amendment 70 of the draft decision.
1555. WAGN submitted that there is no basis to amend clause 7.1, 7.2 and 7.3 of the access arrangement as suggested by the Authority at Required Amendment 70 of the draft decision. WAGN submitted that Required Amendment 70 is inconsistent with the national gas objective as it is ambiguous, requires inefficiencies and increases the likelihood of disputes.
1556. Specifically, WAGN referred to clause 7.1 of Required Amendment 70 and submitted that 'high pressure pipeline extensions' is not defined in the access arrangement leading to inefficiencies and ambiguities.
1557. Further, WAGN submitted that the requirement that extensions under 7.1(v) will not affect reference tariffs does not appear in clause 7.2 of Required Amendment 70 and introduces ambiguities regarding the effect of extensions on reference tariffs in relation to medium and low pressure pipeline.
1558. WAGN also submitted clause 7.1(iii) fails to provide a time period in which the Authority must make a decision, clause 7.2(ii) requests information already provided to the Authority under a different process in the access arrangement both of which lead to inefficiencies.

Other submissions

1559. In its submission dated 5 November 2010, Alinta submitted that it supports the Authority's decision to require the deletion of clause 7.1, 7.2 and 7.3 as proposed by WAGN and replace them with the clauses suggested in Required Amendment 70 of the draft decision.

Authority's Assessment

1560. The Authority confirms its position expressed in paragraph 1961 of the draft decision in relation to the provision of a mechanism for determining whether the applicable access arrangement will apply to incremental service pursuant to rule 104(1) of the NGR. The Authority maintains a provision similar to that expressed in Required Amendment 70 of the draft decision is necessary to satisfy rule 104(1) of the NGR, taking into account incremental service and the Authority's role in determining whether an extension or expansion should be covered by the access arrangement. .
1561. The Authority however has considered WAGN's submission in relation to the term 'high pressure pipeline extensions'. The Authority is of the view that the term 'high pressure pipeline' may be ambiguous and proposes to define this term with the following definition:
- “For the purposes of the Template Haulage Contract, a **“high pressure pipeline extension”** is an extension to WAGN's Covered Pipeline with a direct connection to a transmission pipeline that provides reticulated gas to a new development or an existing development not serviced with reticulated gas.”*
1562. The Authority notes WAGN's submission in relation to clause 7.1(iii) of Required Amendment 70 that the Authority be required to make its decision within a reasonable time. The Authority intends to address this matter by including a reference to 'within a reasonable time' when drafting the proposed access arrangement revisions.
1563. The Authority notes WAGN's submission in relation to clause 7.2 and notes that clause 7.2(iv) states that an expansion under clause 7.2 will not affect reference tariffs and therefore does not lead to any ambiguity or inefficiency as suggested by WAGN.
1564. The Authority confirms its position set out in paragraphs 1959 to 1967 of the draft decision and for the purposes of the Authority's proposed access arrangement revisions will adopt Required Amendment 70 of the draft decision, and making the suggestions set out above at paragraphs 1561 and 1562.

Authority's proposal

The Authority will adopt Required Amendment 70 but will define 'High Pressure Pipeline Extensions' in clause 12 of the proposed access arrangement as follows:

"For the purposes of the Template Haulage Contract, a "high pressure pipeline extension" is an extension to WAGN's Covered Pipeline with a direct connection to a transmission pipeline that provides reticulated gas to a new development or an existing development not serviced with reticulated gas."

The Authority will also amend clause 7.1(iii) set out in Required Amendment 70 so that the Authority is required to make its decision 'within a reasonable time'

Draft Decision – Required Amendment 71

1565. 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.

Public Submissions

WAGN's submissions

1566. In its amended proposed access arrangement submitted on 8 October 2010, WAGN has elected to adopt the analysis of the Authority at paragraph 1993 of the draft decision and amend the reference clauses 5.3 and 5.4 of the Template Haulage Contract to clause 13.7 of the Template Haulage Contract.

Other submissions

1567. No other public submissions were received in relation to Required Amendment 71.

Authority's Assessment

1568. The Authority notes that WAGN has not adopted Required Amendment 71 as set out in the draft decision.

1569. WAGN has adopted the Authority's suggestion at paragraph 1993 of the draft decision and has amended the second sentence in clause 8.1(a) to refer to clause 13.7 of the Template Haulage Contract. The Authority is satisfied that clause 13.7 of the amended Template Haulage Contract adequately sets out the terms in clause 8.2 of the amended proposed access arrangement.

1570. The Authority notes that Required Amendment 71 required WAGN to delete clause 8.1(a)(iv) of the proposed access arrangement which makes it a condition of its consent that the user satisfies the preconditions set out in clause 5.5 of the proposed access arrangement.

1571. The Authority refers to its final decision regarding Required Amendment 4 in relation to clause 5.5 of the proposed access arrangement at paragraphs 169 to 183. The Authority notes that this final decision retains the preconditions set out in clause 5.5(a) of the proposed access arrangement, so that they apply to reference services only.
1572. In light of its decision in relation to Required Amendment 4, the Authority no longer requires clause 8.2(a)(iv) to be deleted from the amended proposed access arrangement.
1573. The Authority will adopt clause 8 of the amended proposed access arrangement for the purposes of the Authority's proposed access arrangement provisions.

Draft Decision – Required Amendment 72

1574. The definition of CPI in clause 12 of the proposed access arrangement should be amended to CPI All Groups, Eight Capital Cities.

Public Submissions

WAGN's submissions

1575. In the amended proposed access arrangement submitted on 8 October 2010, WAGN has elected to retain the definition of CPI.
1576. WAGN submitted that it has relied on the same reasoning in relation to this issue as it relied on in relation to Required Amendment 6 of the draft decision at paragraphs 621 to 622 of this decision.

Other submissions

1577. Alinta referred to its submissions in relation to clause 22.1 of the Template Haulage Contract which supported the Authority's decision to require the definition of 'CPI' to be amended to refer to 'CPI All Groups, Eight Capital Cities'.

Authority's Assessment

1578. The Authority refers to its decision at paragraphs 61 to 73 above and the adoption of CPI (All Groups, Eight Capital Cities).
1579. The Authority will adopt the definition of CPI (All Groups, Eight Capital Cities) in clause 12 of the proposed access arrangement.

Draft Decision – Required Amendment 73

1580. 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*.

Public Submissions

WAGN's submissions

1581. WAGN has adopted some of the amendments set out in Required Amendment 73. WAGN has submitted on 8 October 2010 (pages 151-153) that where it has elected not to adopt the suggestion of the Authority, it has done so because the amendments would be inconsistent with the national gas objective in that it would introduce ambiguity into the Template Haulage Contract leading to inefficiencies and increase the likelihood of dispute.

1582. WAGN submitted that the definitions in the NGL are generic and does not take into account the manner in which the NGL was enacted in Western Australia. The definition of NGL refers to section 7 of the NGA which calls up the modified text of the relevant South Australian legislation.

'National Gas Regulations', 'National Gas Rules' and 'Reference Tariff Variation Mechanism'

1583. WAGN elected to adopt the suggestion of the Authority referred to in Required Amendment 37 and has amended the definitions of 'National Gas Regulations', 'National Gas Rules' and 'Reference Tariff Variation Mechanism' materially as required.

'Delivery Point' and 'Receipt Point'

1584. WAGN referred to their submissions in relation to Required Amendment 61 at paragraphs 1437, 1438, 1441 and 1442 of this final decision in relation to the definitions of 'Delivery Point' and 'Receipt Point'.

'National Gas Access (WA) Legislation'

1585. In relation to 'National Gas Access (WA) Legislation' WAGN submitted that this defined term does not appear in this form in either the NGL or NGR.

'User'

1586. In relation to 'User' WAGN submitted that there is no basis for the request by the Authority as the definition of 'User' in the proposed access arrangement already refers to the NGL.

Other submissions

1587. Alinta referred to its submission in relation to clause 22.1 of the Template Haulage Contract which supported the Authority's decision to require the definition of 'CPI' to be amended.

Authority's Assessment

'National Gas Regulations', 'National Gas Rules' and 'Reference Tariff Variation Mechanism'

1588. The Authority accepts WAGN's amendments to the definitions of 'National Gas Regulations', 'National Gas Rules' and 'Reference Tariff Variation Mechanism' in the amended proposed access arrangement. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt the definitions of 'National Gas Regulations', 'National Gas Rules' and 'Reference Tariff Variation Mechanism' as defined in WAGN's amended proposed access arrangement.

'Delivery Point' and 'Receipt Point'

1589. The Authority refers to paragraph 1457 of this final decision and its reasoning regarding the definitions of 'Delivery Point' and 'Receipt Point'. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt the definitions of 'Delivery Point' and 'Receipt Point' as defined in WAGN's amended proposed access arrangement.

'National Gas Access (WA) Legislation' and 'User'

1590. The Authority accepts WAGN's submissions in relation to the definitions of 'National Gas Access (WA) Legislation' and 'User' in the amended proposed access arrangement. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt the definitions of 'National Gas Access (WA) Legislation' and 'User' as defined in WAGN's amended proposed access arrangement.

Draft Decision – Required Amendment 74

1591. '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.

Public Submissions**WAGN's submissions**

1592. WAGN has retained the definitions referred to in Required Amendment 74 without amendment, relying on the same analysis as for Required Amendment 61, above at paragraphs 1432 to 1452.

Other submissions

1593. No other submissions were received in relation to Required Amendment 74.

Authority's Assessment

1594. The Authority notes that WAGN has elected not to amend the definitions of 'Retail Market Rules' and 'Retail Market Scheme' in the proposed access arrangement as required by Required Amendment 74. The Authority notes, and relies upon its reasoning in relation to Required Amendment 61 at paragraphs 1458 and 1459 of this final decision.

1595. For the purposes of the Authority's proposed access arrangement revisions, the Authority will adopt the definitions of 'Retail Market Rules' and 'Retail Market Scheme' as set out in Required Amendment 74 of the draft decision.

APPENDICES

Appendix 1 - Glossary

Term	Definition
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.
Amended access arrangement information	The amended access arrangement information submitted by WAGN on 9 October 2010 with respect to the proposed revisions to the access arrangement for the GDS.
Amended proposed access arrangement	The amended proposed revision to the current access arrangement submitted by WAGN on 8 October 2010 in the form of a revised access arrangement.
Amended Template Haulage Contract	Annexure E to WAGN's proposed access arrangement submitted 8 October 2010.
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	The draft decision dated 17 August 2010 in relation to WAGN's proposed access arrangement.
Final decision	This final decision in relation to WAGN's amended proposed 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 (WA)</i> .
Initial access arrangement	The period commencing 18 July 2000 and ending on 24 August 2005.
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</i>

	<i>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 (WA)</i> 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 submitted 29 January 2010.
WA Local Regulations	<i>National Gas Access (WA) (Local Provisions) Regulations 2009</i>

Appendix 2 – Financial Model

A public version of the full Reference Tariff Model will be published on the Authority's website as soon as possible. It is provided as a separate document.

Appendix 3 – Reference Tariff Variation Mechanism

Preliminary Draft in relation to sections 2.2 to 2.4 of Annexure B to be addressed in the Authority's proposed amended access arrangement 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 x [Title of the Annexure to be included in the Authority's amended access arrangement]; and
- b) As a result of a cost pass through for a defined cost pass Through Event, under clause x of this Annexure x [Title of the Annexure to be included in the Authority's amended access arrangement].

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 Component 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 of Regulatory Operating Expenditure, that forecast is to be in real Dollars 2009.
- (d) Where, in this clause 2, reference is made to actual of 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 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:

$$P_{2011/12}^{ij} \leq p_0^{ij} (1 + V_{2011/12}) * \frac{CPI_{Mar2011}}{CPI_{Sep2009}}$$

where:

$P_{2011/12}^{ij}$ 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 Table 34;

$V_{2011/12}$ is calculated by applying the formula set out in paragraph (b);

$CPI_{Mar2011}$ is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2011 and

$CPI_{Sep2009}$ is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2009.

- (b) For the purpose of paragraph (a), $V_{2011/12}$ is calculated by applying the following formula:

$$V_{2011/12} = \frac{\Delta ROpex_{2010(1)} * (1 + WACC)^2 + \Delta ROpex_{2010/11} * (1 + WACC)^1}{ExpRev_{2011/12}}$$

and

$$\Delta ROpex_{2010(1)} = AROpex_{2010(1)} * \frac{CPI_{Dec2009}}{CPI_{Jun2010}} - FROpex_{2010(1)}$$

and

$$\Delta ROpex_{2010/11} = AROpex_{2010/11} * \frac{CPI_{Sep2009}}{CPI_{Mar2011}} - FROpex_{2010/11}$$

where:

<i>AROpex</i> ₂₀₁₀₍₁₎	is Actual Regulatory Operating Expenditure for the period from 1 January 2010 to 30 Jun 2010;
<i>FROpex</i> ₂₀₁₀₍₁₎	is \$4.092 million (real \$ as at 31 December 2009);
<i>AROpex</i> _{2010/11}	is Actual Regulatory Operating Expenditure for the period from 1 July 2010 to 30 June 2011;
<i>FROpex</i> _{2010/11}	is \$5.768 million (real \$ as at 31 December 2009);
<i>CPI</i> _{Dec2009}	is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 December 2009;
<i>CPI</i> _{Jun2010}	is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 June 2010;
<i>CPI</i> _{Sep2009}	is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2009;
<i>CPI</i> _{Mar2011}	is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2011;
<i>ExpRev</i> _{2011/12}	is \$155.715 (real \$ as at 31 December 2009) and
<i>WACC</i>	is 7.40%.

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:

<i>P</i> _{2012/13} ^{ij}	is the value of Tariff Component <i>j</i> of haulage Tariff <i>i</i> as varied on and from the first day of the variation period;
<i>p</i> ₀ ^{ij}	is the value of Tariff Component <i>j</i> of haulage Tariff <i>i</i> as set out in Table 34;
<i>V</i> _{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 2009.

(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 \$6.760 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

$ExpRev_{2012/13}$ is \$160.771 (real \$ as at 31 December 2009) and

$WACC$ is 7.40%.

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 34;

$V_{2013/14}$ is calculated by applying the formula set out in paragraph (b);

$CPI_{Mar2013}$ is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 31 March 2013 and

$CPI_{Sep2009}$ is the CPI All Groups, Weighted Average of 8 Capital Cities for the quarter ending on 30 September 2009.

(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 \$6.529 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 \$165.740 (real \$ as at 31 December 2009) and

$WACC$ is 7.40%.

Appendix 4 – Abbreviations

Abbreviation	For
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
AER	Australian Energy Regulator
APA	APA Group
APT	Australian Pipeline Trust
ARTC	Australian Rail Track Corporation
ASX	Australian Securities Exchange
BGN	Bloomberg Generic
Capex	Capital expenditure
CAPM	Capital Asset Pricing Model
CBBT	Composite Bloomberg Bond Transfer
CGS	Commonwealth Government Securities
Code	<i>National Third Party Access Code for Natural Gas Pipelines</i>
CPI	Consumer Price Index
DBP	Dampier to Bunbury Pipeline
DIC	Debt issuing cost
DNSPs	Distribution Network Service Providers
DRP	Debt risk premium
DUE	DUET Group
DWAT	Discounted Weighted Average Tariff
ENV	Envestra
ETS	Emissions Trading Scheme
FFM	Fama-French Model
FRC	Full Retail Contestability
GDS	Mid-West and South-West Gas Distribution Systems
GFC	Global Financial Crisis
GGT	Goldfield Gas Transmission
HDF	Hastings Diversified Utilities Fund
GJ	Gigajoules (10 ⁹ joules)

ICRC	Independent Competition and Regulatory Commission of the Australian Capital Territory
IMF	International Monetary Fund
IPART	Independent Pricing and Regulatory Tribunal of New South Wales
Kpa	Kilopascal
MJ	Megajoules
MRP	Market risk premium
N/A	Not Applicable
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
OECD	Organisation for Economic Cooperation and Development
Opex	Operating expenditure
RAB	Regulated Asset Base
RBA	Reserve Bank of Australia
RM	Risk margin
SFG	Strategic Financial Group Consulting
SKI	Spark Infrastructure
SOFA	Second Opinion Financial Advisory
SPN	SP Ausnet
SWIN	The South West Network owned and operated by Western Power
UAFG	Unaccounted For Gas
VAA	Value Advisor Associates
WA	Western Australia
WACOSS	Western Australian Council of Social Services
WACC	Weighted Average Cost of Capital
WAGN	Western Australian Gas Networks Pty Ltd

Appendix 5 – Confidential paragraphs 433 to 436 and Table 12