

Frequently Asked Questions

Q:1

What are the characteristics of the city gas business in Japan?

Japan has many mountainous regions, and there are few concentrations of population and industrial activity where city gas suppliers can achieve an advantage. For this reason, the availability of city gas is limited to just 5% of Japan's territory. Though there are around 210 city gas companies in Japan, the three biggest (Tokyo Gas, Osaka Gas and Toho Gas) together account for approximately 80% of nationwide city gas sales in volume terms. In addition to these city gas companies, there are around 1,700 community gas utilities and about 26,000 LPG suppliers. Most of these companies are small- or medium-sized operators.

Over 90% of the city gas sold in Japan is sourced from natural gas. Most of the gas is imported in the form of LNG. It takes 10 to 40 days to transport LNG to Japan in carriers. In Japan, gas suppliers are responsible for ensuring safe use of gas at the customer's site. Hence, gas rates also include the cost of periodic inspections and accident prevention measures. For this reason, prices tend to be higher than in Europe or North America. Unlike Europe and North America, Japan has no nationwide pipeline networks. Each city gas supplier supplies and sells city gas through a pipeline network developed for its own service area.

Q:2

How does Tokyo Gas structure its rates?

Service Agreement

In cases where Tokyo Gas supplies gas through the pipelines to meet general demand, the rate schedule "regulated" under the service agreement used to require an approval from the Minister of Economy, Trade and Industry. Under the amendments to the Gas Utility Industry Law in 1999, however, it became possible to change these rates simply by notifying the Minister, provided that these changes do not adversely affect any customers.

Optional Agreement

Tokyo Gas is permitted to offer rates and service terms other than those outlined in the above service agreement. This enables the Company to make efficient use of its gas

production and supply facilities. These agreements have to be reported to the Minister and the selection of this option is up to the customer.

Large-volume Supply

Under the Gas Utility Industry Law, the conditions for gas rate setting and market entry for service providers in the large-volume market are gradually deregulated. Effective from April 2004, customers who used 500,000 m³ or more qualified as large-volume customers. Moreover, from April 2007, the designation point for large-volume customers shifts to 100,000 m³ or more.

"Regulated" rates are calculated using a rate-base system. A simplified version of this calculation is shown below:

Operating cost, etc.	+	Fair return	-	Deductions, etc.	=	Total fair cost
<ul style="list-style-type: none"> • Cost of gas resources • Personnel expenses • Overhead • Depreciation • Non-operating expenses • Income taxes 		Calculated using the rate-base system, which involves multiplying fixed-asset investments, etc. by the appropriate ratio of fair return		<ul style="list-style-type: none"> • Profit from gas appliance sales, etc. • Profit from real estate business, etc. 		Represents an appropriate profit added to an appropriate cost under efficient management

* Price fluctuations in the foreign exchange rates and/or crude oil prices are reflected in the meter rate gas unit price every three months in accordance with the gas resource cost adjustment system. Consequently, the impact of such price fluctuations on revenue and expenditure is neutral in the medium or longer term.

Q:3

What are transportation service rates?

Transportation service is a process whereby Tokyo Gas receives gas from another supplier (the transportation supplier) into its pipelines and at the same time supplies an identical volume of gas via its pipelines in another location, while ensuring fair competitive conditions between existing operators and new participants to expand customer choice in a deregulated gas market. All companies that own or operate gas supply pipelines are required to provide transportation services. In principle they are required to prepare, make notification and publish agreements. There are two types: retail and linked. With retail, the transported

gas is sent out and delivered to the customer's site, while under the linked agreement, it is sent out and sold to customers through other general gas companies or pipeline operators. Before the revision of the Gas Utility Industry Law in April 2004, implementation of transportation service was limited to retail supply agreements, however, after that date, transportation service was expanded to wholesale supply. To ensure transparency and fairness, balances are published together with peak flow charts and transportation capacities for trunk pipelines.

Q:4

What is your relationship with Tokyo Electric Power Company (TEPCO)?

Tokyo Gas and Tokyo Electric Power Company (TEPCO) source about 70% of the total volume of their LNG purchases from joint LNG projects and are joint participants in projects based on upstream interests. Joint purchasing strengthens our bargaining power, since we can contract for large volumes.

Two of our three LNG terminals, the Negishi and Sodegaura Terminals, are operated jointly with TEPCO. This allows us to reduce capital investment and operating costs, and we can also improve operating rates through load leveling based on differences between peak demand patterns for electric power and gas. These advantages are reflected in lower production costs per unit of gas.

At the marketing level, however, we are competitors. TEPCO has moved into the gas market and is now a com-

peting supplier of gas, especially for commercial and industrial use. We have always competed with electric power in the residential market, but in recent years this competition has intensified with the advent of all-electric systems. In fiscal 2006 we successfully implemented a range of strategies, including market promotions for gas appliances, and in-depth demand development focusing on major subscribers. As a result of these initiatives, we are able to hold the percentage of newly built houses with all-electric systems in our service area to 8.0%.

Tokyo Gas responds to various forms of competition by going beyond the supply of individual energy products, such as gas and electric power. Our ultimate goal is to provide our customers with optimal value by responding to their real needs, including their energy service needs.

Q:5

What is the definition of the “energy service business”?

Energy service providers build facilities to provide one-stop sources of energy services, such as cogeneration systems that produce both electricity and heat. This type of service has major advantages for customers, including reduced energy costs and ease of implementation, as there is no need for a large initial investment. There are also significant environmental benefits. Efficiency improvements have turned the energy service business into a high growth area characterized by rapidly improving profitability.

In 2002, Tokyo Gas moved to expand its involvement in the energy service business by establishing a wholly owned

subsidiary, ENERGY ADVANCE Co., Ltd. The company operates very efficiently by capitalizing on the LNG procurement systems and advanced engineering capabilities of the Tokyo Gas Group, making the most of the high added value that can be achieved with cogeneration systems. It targets environmentally concerned customers, especially in the Kanto region, where demand is high.

By March 2007, it had signed a cumulative total of 175 contracts for 274 MW, and it had received subsidies for 80 schemes totaling 185 MW.

Q:6

How has the Kyoto Protocol affected Tokyo Gas?

The targets set down in the Kyoto Protocol for the reduction of Japanese greenhouse gas emissions will require urgent action to strengthen energy conservation, which is a key component of countermeasures against global warming. Natural gas is expected to play an increasingly important role in this context. For example, the “Kyoto Protocol Target Achievement Plan” adopted by the government in April 2005 acknowledges that natural gas produces the lowest CO₂ emissions of any fossil fuel during combustion and identifies the increased use of highly efficient natural gas equipment and systems as an important way to combat global warming.

The needs and expectations of gas customers and society in general toward natural gas are expected to expand still further in the future. The natural gas business is the core segment for the Tokyo Gas Group, and this trend is seen as an opportunity to achieve further growth and development.

Under the Keidanren Voluntary Action Plan, the gas industry is expected to reduce its CO₂ emissions per unit and in terms of total outputs. Tokyo Gas has made steady progress toward the achievement of these targets through measures that include a conversion to high-caloric gas and the implementation of various energy-saving initiatives at its city gas production plants.

Q:7

What processes are used by Tokyo Gas when making investment decisions?

Since fiscal 2003, Tokyo Gas has based decisions on new investments, the continuation of investments and exits from investments on Tokyo Gas Economic Profit (TEP), which is our version of Economic Value Added (EVA®), together with Net Present Value (NPV) and Internal Rate of Return (IRR). These three indicators are used as common standards throughout the Tokyo Gas Group.

The Investment Evaluation Committee assesses plans that involve investment, equity participation or debt guarantees on the basis of risks and returns. The results of these

deliberations are reflected in decisions at management meetings or meetings of the Board of Directors. Derivative transactions are subject to market risk management rules.

Management meetings are held each week and are attended by executives at the senior executive officer level and above, as well as the two corporate auditors. Final decisions on important management issues are made after in-depth discussion, including deliberations by the Investment Evaluation Committee in the case of investment decisions.

Q:8

What is your policy on the utilization of real estate owned by Tokyo Gas?

Our core business is the integrated energy business, and we see the real estate business as a support segment for this. Earnings from the real estate business are used in core business activities. If there are opportunities to improve the asset value of large sites, we undertake appropriate development projects that allow us to maximize the potential and value of those sites while also minimizing risk.

In principle, development projects are funded from the proceeds of land sales, and care is taken to avoid any impact on our integrated energy business. Risk limitation is

a priority, and our strategies in this area include joint development with outside partners.

The Tokyo Gas Group has numerous business sites in the Tokyo metropolitan area. We see effective real estate management as an important way of strengthening the competitiveness of our integrated energy business by improving efficiency and reducing costs. For this reason, we are also actively targeting improvements in the efficiency of our real estate activities and centralizing our facilities to achieve an optimal distribution of sites.