Q1 How does Tokyo Gas set its rates?

Tokyo Gas' rates are divided into the following three categories:

Service agreement Tokyo Gas uses "regulated" rates approved by the Minister of Economy, Trade and Industry (METI) to bill customers for gas supplied through pipelines to meet general demand. Under a May 1999 amendment to Japan's Gas Utility Industry Law, it became possible to reduce these rates simply by notifying METI, provided the change does not adversely affect any customers.

Optional agreements 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 METI and the selection of this option is up to the customer.

Large-volume supply A March 1995 amendment to the Gas Utility Industry Law deregulated tariffs and area of supply for customers with contract volumes of two billion m^3 or more. Rates and other supply terms can be determined by agreement between gas suppliers and customers. Since April 2004, large-volume customers have been defined as customers with yearly contract volumes of 500,000 m^3 or more.

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

Operating cost, etc. + **Fair return** − **Deductions, etc.** = **Total fair cost**

Operating cost, etc.	Fair return	Deductions, etc.	Total fair cost
• Cost of gas resources • Personnel expenses • Overheads • 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	• Profit from gas appliance sales, etc. • Profit from real estate business, etc.	Represents an appropriate profit added to an appropriate cost under efficient management

Q2 Although you regard Tokyo Electric Power as your biggest competitor, you purchase LNG jointly. What are the implications of this relationship?

There are two facets to the relationship between Tokyo Gas and Tokyo Electric Power Company (TEPCO): cooperation and competition. We cooperate on the procurement of LNG, and we jointly operate LNG terminals.

As far as LNG procurement is concerned, Tokyo Gas and TEPCO both procure over 70% of their total LNG requirements through joint projects. Because joint purchasing translates into larger contract volumes, our bargaining power with sellers is strengthened, allowing us to purchase LNG at a lower cost.

Tokyo Gas has three LNG terminals in Tokyo Bay. Of these, the Negishi LNG Terminal and Sodegaura LNG Terminal are jointly operated with TEPCO. The benefits of joint operation include reduced capital investment and operating costs. Moreover, since the two companies have different peak demand seasons, we can level loads and improve capacity utilization, leading to lower gas manufacturing costs.

From a marketing perspective, the two companies are fiercely competitive. We compete for gas sales, especially in the area of industrial supplies, following TEPCO's recent entry into the gas market. Meanwhile, the long-standing competition between gas and electric power is intensifying in the commercial and residential sectors. We predict this competition will grow stronger in coming years. To prevail, we must offer customers optimal value. Tokyo Gas believes it is crucial to provide solutions, including energy services, that truly meet the needs of users, not simply to supply gas or power in isolation.

Q3 Does Tokyo Gas have an M&A strategy targeting local gas companies?

Tokyo Gas currently wholesales gas to 17 city gas companies surrounding its service area. These sales account for about 10% of total sales volumes, and we anticipate a high growth rate of 5.3% annually over the next five years. The wholesale supply business allows Tokyo Gas to earn income without an increase in assets, so our basic policy calls for the active development of this market. There is also a possibility that hostile takeovers would have an adverse effect on our wholesale business, so we have no plans for aggressive M&A.

We have made acquisitions in the past, however. We assumed operation of the municipal gas business of Konosu City in Saitama Prefecture, which was privatized in April 2002. If an optimal M&A opportunity with the potential to increase our corporate value and benefit our customers arises, we will consider acting on the opportunity in line with the wishes of the other party.

Q4 Have there been any important developments recently in terms of deregulation? What is the status of the third-party access scheme?

To promote fair competition in the gas market, all owners and operators of gas supply pipelines are required to provide third-party access (TPA), and draw up and publish TPA agreements. This change allows access to pipelines owned by firms that were not subject to regulation under the Gas Utility Industry Law, such as electric power companies and suppliers of natural gas produced in Japan. Until recently, TPA was possible only for gas retailing. Now it is also available for wholesaling. To ensure the fairness of TPA charges and enhance the transparency of revenues and expenditures concerning the use of pipelines, general gas utilities and pipeline operators are required to disclose accounts based on accounting procedures introduced for TPA.

An April 2004 amendment to the Gas Utility Industry Law broadened the scope of liberalization to include customers with annual contract volumes of 500,000m^3 or more, as well as expanding TPA arrangements as described above. Tokyo Gas now has two types of TPA agreements: one for retailing to large-volume customers and the other for wholesaling.

The average unit price in TPA agreements for retailing is set at ¥7.20/m^3 (Tokyo area) and the average unit price for wholesale customers is ¥6.60/ m^3.