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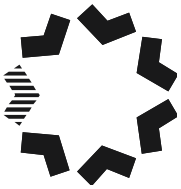

Light Regulation of the Moomba to Sydney Pipeline System

Application for a light regulation determination in respect of the covered portion of the Moomba to Sydney natural gas pipeline system

<u>Draft</u> Decision and Statement of Reasons

23 October 2008

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Abbreviations and Defined terms

ACCC	Australian Competition and Consumer Commission (which among other functions approved transmission pipeline access arrangements prior to the establishment of the AER) (www.accc.gov.au)
AEMC	Australian Energy Market Commission (www.aemc.gov.au)
AER	Australian Energy Regulator (www.aer.gov.au)
AGL	AGL Energy Limited (www.agl.com.au)
Council / NCC	National Competition Council (www.ncc.gov.au)
CSM	Coal seam methane
EAPL / Applicant	East Australian Pipeline Pty Limited (see www.pipelinetrust.com.au)
EGP	Eastern Gas Pipeline
EPIC	Epic Energy (www.epicenergy.com.au)
Gas Access Law	Third Party Access to Natural Gas Pipelines and the National Third Party Access Code for Natural Gas Pipeline Systems, Schedules 1 and 2 to the *Gas Pipelines Access (South Australia) Act 1997*
Gas Code	The National Third Party Access Code for Natural Gas Pipeline Systems, Schedule 2 to the *Gas Pipelines Access (South Australia) Act 1997*
ICB	Initial Capital Base
Jemena	Jemena Limited (www.jemena.com.au)
Limited access regime	An access arrangement that is not required to make provision for price or revenue regulation which may be submitted voluntarily by the service provider of a light regulated pipeline – see also s116 of the NGL and r45 of the NGR
MAPS	Moomba to Adelaide Pipeline System
MEU	Major Energy Users Inc
MSP	Moomba to Sydney Pipeline System
NGL	National Gas Law – the Schedule to the *National Gas (South Australia) Act 2008*

NGR	National Gas Rules – Rules made under s294 of the NGL including amendments by the AEMC
Origin	Origin Energy Retail Ltd (www.originenergy.com.au)
QSN Link	A 180km extension of the South West Queensland pipeline system (SWQP) to link that system to the MAPS and MSP. The QSN Link is expected to make initial gas deliveries in early 2009.
Standard consultative procedure	Procedure specified in Rule 8 of the NGR that the Council is required to apply in considering a light regulation application
Trade Practices Act / TPA	*Trade Practices Act 1974 (Cth)*
VTS	Victorian Transmission System

1 Draft Decision

1.1 This draft decision is issued in accordance with the National Gas Law and National Gas Rules as part of the Council's process for determining an application by East Australian Pipeline Pty Limited for light regulation of the covered portion of the Moomba to Sydney Pipeline System.

1.2 **Based on the information available at the time this draft decision was prepared, the Council proposes to make a determination that the services provided by the covered portion of the Moomba to Sydney Pipeline System be light regulation services.**

1.3 The Council's draft reasons for decision are set out in the following sections of this report.

1.4 The Council now seeks further submissions from interested parties in response to this draft decision and reasons. These submissions should be provided to the Council by 5pm on Thursday 13 November 2008. The Council then has 20 business days to make a final decision on this application. The Council's final decision can be expected on or before 11 December 2008.

National Competition Council
23 October 2008

2 Background

The Application

2.1 On 8 September 2008 East Australian Pipeline Pty Limited (EAPL)—which is part of the APA Group—applied for light regulation of the covered portion of the Moomba to Sydney Pipeline System (MSP).[1]

2.2 EAPL submitted a written application in accordance with the National Gas Rules (NGR) and containing the information required by r34. EAPL's application is available on the Council's website (www.ncc.gov.au).

2.3 The application contains an appendix of information that EAPL considers confidential to the APA Group (EAPL 1.4). This included details of specific terms negotiated with shippers, existing MSP Transport Agreements, contracted and available capacity, and changes to shippers' contract positions over time. The Council accepts that this information is commercially valuable to the APA Group and possibly other commercial parties and that it must be protected under s90 of the National Gas Law (NGL). The Council has disclosed the confidential information to the AER as provided for in s90(3). Where it considered it necessary, the Council has sought confirmation of the information provided by EAPL from the AER based on information the AER may have received on the MSP in relation to its regulatory powers.

Council process

2.4 In determining this matter the Council followed the standard consultative procedure set out in r8 of the NGR.

2.5 Notice of the application was published on the Council's website and in *The Australian* on 11 September 2008. The notice described the application and provided the address of the website on which the application was available. The notice also invited written submissions on the application. A 15 business day submission period was provided. Submissions closed on 2 October 2008.

2.6 The Council sought the views of the AER in relation to the application and in particular its factual content. The AER was initially consulted on receipt of the application and in the preparation of this draft decision. The Council envisages further consultation with the AER in the course of preparing its final decision.

[1] EAPL's application is dated 5 September, but it was provided after the close of business on that day. The application was received by the Council on the first subsequent business day (Monday 8 September).

2.7 The Council received three submissions on the application within the submission period prescribed by the NGR and allowed by the Council. A list of submissions is included at Appendix A. The submissions are available on the Council's website.

2.8 A further submission by TRUenergy was not provided within the prescribed submission period. The Council has not formally considered the TRUenergy submission as it was provided out of time. In any event, it raised no issues that were not raised in other submissions or as a result of the Council's consideration of EAPL's application. The Council emphasises the need for interested parties to make submissions within specified submission periods to ensure they can be properly taken into account and the decision process is not unduly extended.

2.9 In preparing this draft decision the Council has taken into account the application and the submissions received within the prescribed submission period, as well as its consultations with the AER and its own research and inquiries.

2.10 Interested parties (including EAPL) now have an opportunity to make further submissions on this draft decision. These will be taken into account by the Council in making its final decision. **Submissions in response to this draft decision close at 5pm on Thursday 13 November 2008**.

2.11 Appendix B contains a chronology of milestones and other significant events occurring in the process of considering this application. This appendix also sets out anticipated dates for the remaining steps in this process.

Moomba to Sydney pipeline/Pipeline services

2.12 The MSP is made up of various pipelines as set out in Table 2-1.

Table 2-1 Pipelines in the MSP

	Pipeline	Length (km)	Pipeline numbers	Covered
a	Moomba to Marsden Pipeline	942	SA:PL7 (Moomba to Qld Border), Qld:PPL21 (SA border to NSW border, NSW:16 (NSW border to Wilton)	No
b	Marsden to Wilton Pipeline	357		Yes
c	Dalton to Canberra (known as the Canberra lateral)	58	NSW:21	Yes
d	Young to Lithgow (Northern lateral)	269	NSW:17, NSW:18, NSW:22	Yes
e	Young to Wagga Wagga (Wagga lateral)	134	NSW:19	Yes
f	Burnt Creek (on the Wagga lateral) to Griffith (Griffith lateral)	179	NSW:20	Yes
g	Culcairn to Wagga Wagga (known as the Interconnect)	88	NSW:23	No

2.13 The Moomba to Marsden pipeline (a), the Marsden to Wilton pipeline (b), the Canberra lateral (c), and the Wagga lateral (e) are jointly referred to as 'the mainline' (together 1491km). The Northern lateral (d) and the Griffith lateral (f) are jointly referred to as 'the regional laterals'.

2.14 The Moomba to Marsden pipeline (a) and the Interconnect (g) are not covered pipelines under the NGL. Coverage of the Moomba to Marsden pipeline was revoked in December 2003. The Interconnect has never been subject to coverage. These pipelines are not regulated and are not part of this application.

2.15 The other parts of the MSP have been covered since 1998 due to their inclusion in the list of pipelines subject to coverage from the commencement of the Gas Access Law and Gas Code. EAPL unsuccessfully sought revocation of coverage of most of the MSP in April 2000 and June 2001, although in response to the June 2001 application the relevant minister decided to revoke coverage of the Moomba to Marsden pipeline.

2.16 The MSP is not a designated pipeline prescribed by regulations under the NGL.[2] (Designated pipelines may not subject to light regulation.)

2.17 The MSP is owned and operated by EAPL which is part of the APA Group. A list of the major energy infrastructure assets owned by APA Group is set out at Attachment 1 to the application (EAPL 1.1).

2.18 The MSP has a value of $835 million in terms of the ICB as determined by the Australian Competition Tribunal in its 2004 determination (the ICB for the covered portion of the MSP was assessed as $331 million).

2.19 At the present time gas is received into the MSP at Moomba in the west and Culcairn in the south via the Victorian Transmission System (VTS) and the Interconnect. Gas is delivered to over 30 delivery points on the mainline and via the regional laterals. The VTS is owned and operated by APA GasNet, a subsidiary of the APA Group.

2.20 The delivery points for gas transported by the MSP are:

(a) Wilton, being the distribution network city gate for Sydney;

(b) Watson, being the city gate for the ACT; and

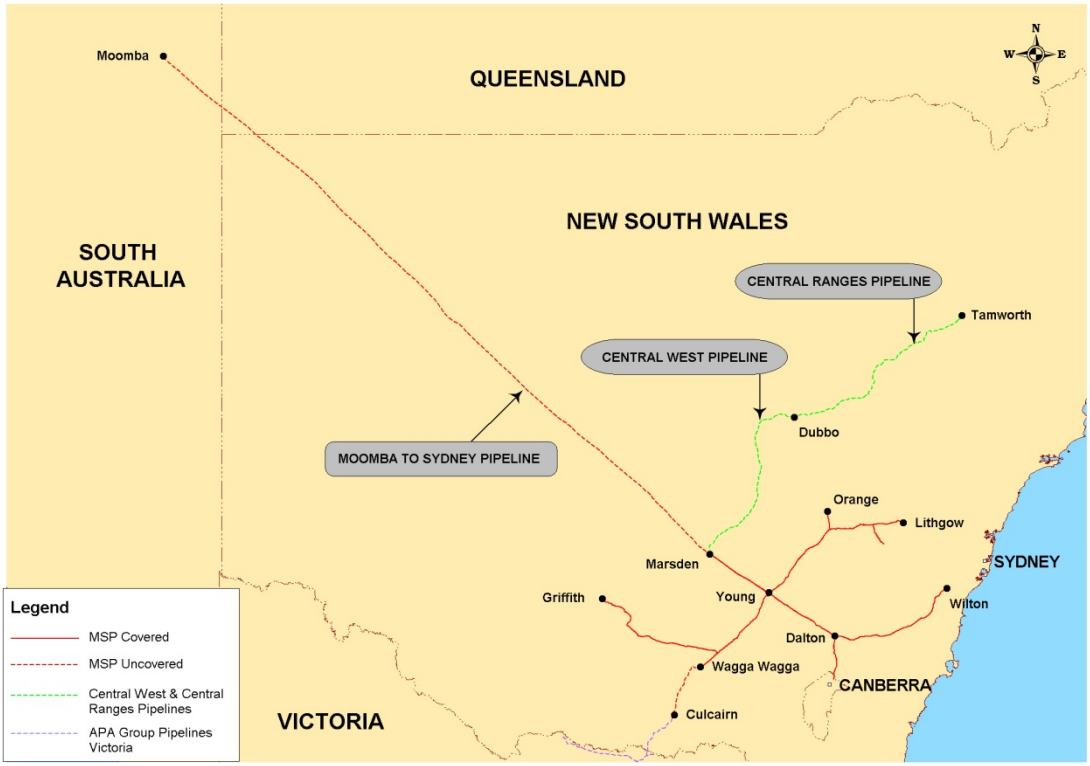
(c) various other points[3], as well as the Uranquinty power station.

[2] See National Gas (South Australia) Regulations, Regulation 4 and Schedule 1.

[3] See Attachment 3 to EAPL's application (EAPL 1.3) for a list of delivery points currently served by the MSP.

2.21 Map 2-1 shows the location of the MSP and adjacent pipelines and identifies the covered and uncovered parts of the system. Additional maps referred to in this report are contained in Appendix C. In particular Map C-1 illustrates the MSP and other pipelines in Eastern Australia and Map C-2 shows the location of existing, and proposed, gas fired power stations in NSW.

Map 2-1 - Location of the MSP



2.22 The MSP provides three types of transport services between these points:

- Firm – This is the main type of service provided by the MSP and requires that shippers pay a reservation charge for reserved capacity for a minimum term (usually 12 months) whether the capacity is used or not (a 'take or pay').

- Winter – This is the same as the firm service except for a shorter commitment period— typically for the 4 month winter period (June to September).

- As available – This is an interruptible service provided at a premium to the tariff for firm service as it does not involve a 'take or pay', although it may have a minimum monthly charge.

2.23 The MSP is also used to provide a parking service. This is a storage service whereby, for a fixed charge, a shipper may park or store gas in excess of a shipper's normal imbalance limit up to a maximum agreed quantity for delivery to the shipper at a later date.

2.24 The firm transport services on the covered portion of the MSP are regulated under an approved access arrangement.[4] Other services are subject to negotiation.

2.25 Table 2-2 summarises the use of pipeline services from the MSP by shippers and other relevant parties.

Table 2-2 Use of MSP services

Shipper/user	Receipt point	Delivery points	Principal use
AGL	Moomba	Wilton (Sydney)	Gas supply
		Canberra	
		Various	
		Mainline	
Origin	Moomba	Wilton	Gas supply
	Culcairn	Uranquinty	Electricity generation
		Culcairn	
Country Energy	Moomba	Various	Gas supply
Energy Australia	Culcairn	Wilton	Gas supply
TRUenergy	Culcairn	Wilton	Gas supply
VISY	Culcairn	Illabo	Tumut pulp mill

2.26 Users of pipeline services provided by the MSP are vertically integrated energy companies (AGL, Origin, TRUenergy), energy retailers (Country Energy, Energy Australia) and some larger industrial companies (VISY and others). The integrated energy companies and energy retailers generally use the transport services of the MSP to ship gas for on sale. At present only Origin uses gas transported by the MSP for electricity generation. Gas fired generation occurs at Origin's Uranquinty power station. Industrial users transport gas in their own right (in the case of VISY) or negotiate transport terms and tariffs with EAPL which are then made available to a nominated retail gas supplier of the user's choice for transporting gas to the user.

2.27 In addition to existing users there is a range of prospective other users of the pipeline services provided by the MSP (mainly to transport gas to proposed power stations). Further, existing users and industrial users may seek to obtain additional services. Map C-2 illustrates possible power station developments that might draw on gas transport services from the MSP.

[4] In May 1999 EAPL submitted a proposed access arrangement to the ACCC for approval. After a series of determinations, reviews and court proceedings, the access arrangement for the covered portion of the MSP was finally determined by the High Court in September 2007. The High Court, in effect, reinstated an access arrangement approved by the Competition Tribunal on 19 May 2005.

2.28 EAPL publishes a standing offer setting out the price and other terms and conditions for transport of gas on the MSP. It stated that the standard non price terms and conditions are consistent with the non price terms and conditions set out in its approved access arrangement. It also stated that the standard price (published tariff) is currently below the reference tariffs allowed in its access arrangement.

2.29 Each shipper or user has a transport agreement with EAPL. These are negotiated on a bilateral basis. As noted, some users negotiate a tariff and other terms with EAPL which can then be used by a shipper to transport gas for that user.

2.30 EAPL stated that all current shippers pay below the reference tariff and that shippers can, and do, negotiate with EAPL for variations to the standard terms of offer. Such negotiations have included requests for the provision of new or 'tailor-made' services, particularly in the case of new power stations projects, as well as negotiations to secure particular price and non-price terms.

3 Reasons for decision

3.1 Section 122 of the NGL sets out the principles governing the making of light regulation determinations. The section provides:

> (1) In deciding whether to make a light regulation determination ... the NCC must consider—
>
> (a) the likely effectiveness of the forms of regulation provided for under this Law and the Rules to regulate the provision of the pipeline services (the subject of the application) to promote access to pipeline services; and
>
> (b) the effect of the forms of regulation provided for under this Law and the Rules on—
>
> (i) the likely costs that may be incurred by an efficient service provider; and
>
> (ii) the likely costs that may be incurred by efficient users and efficient prospective users; and
>
> (iii) the likely costs of end users.
>
> (2) In doing so, the NCC—
>
> (a) must have regard to the national gas objective; and
>
> (b) must have regard to the form of regulation factors; and
>
> (c) may have regard to any other matters it considers relevant.

3.2 In essence the determination of whether or not to apply light regulation to the MSP turns on a comparison of the effectiveness and costs of the two forms of regulation provided for in the NGL:

- full (or access arrangement) regulation, and
- light regulation.

3.3 Because covered pipelines will have a level of market power, both forms of regulation have provisions to protect users and other parties that are dependent on access to a covered pipeline. Many of the obligations on covered pipelines under the NGL apply to both full and light regulation pipelines. The key difference between the two forms relates to the requirement to submit an access arrangement for approval by the AER. An access arrangement provides for up-front price regulation in that it must specify a reference tariff which requires approval by the AER.

3.4 There is no requirement for service providers of light regulation pipelines to submit an access arrangement. Service providers of a light regulation pipeline may voluntarily submit a limited access arrangement to the AER for approval. A limited access arrangement must provide key information about the pipeline and services offered, and state the terms and conditions (other than price or revenue) for access to the pipeline services likely to be sought by a significant part of the market.[5]

3.5 Access disputes in relation to light regulation pipelines are dealt with through a negotiate/arbitrate process, whereby the AER[6] can determine access prices and other terms if negotiations between the parties prove unsuccessful and an access dispute is notified. This process is similar to the negotiate/arbitrate process for services declared under Part IIIA of the TPA.

3.6 Irrespective of the form of regulation, service providers must disclose a range of information concerning a pipeline, although the scope of the information disclosure required in relation to light regulated pipelines is less than under full regulation.

3.7 A table comparing the main elements of full and light regulation is contained in the Council's exposure draft Guide to Light Regulation.[7] For ease of reference this is reproduced in Appendix D.

Effectiveness of regulation alternatives

3.8 EAPL submitted that light regulation would be no less effective than full regulation of the MSP. It argued that any market power arising from operation of the MSP was low due to the desirability of maximising throughput of the pipeline, the substitution threat from the EGP and increasingly other gas sources of gas supply that did not rely on the MSP, and the significant countervailing power of users. EAPL pointed to declining throughput and spare capacity on the MSP as evidence of reduced market power and the need to price pipeline services competitively to attract additional business.

3.9 EAPL further submitted that the information necessary for users to negotiate effectively in the negotiate/arbitrate environment established by light regulation would be available.

3.10 The Major Energy Users Inc (MEU) submitted that light regulation would not provide effective regulation of the MSP. It argued that the MSP enjoyed significant market power due to the lack of substitution possibilities from the EGP or other pipelines, and APA Group's ownership of the Interconnect. The MEU considered that the lower

5 The requirements for a limited access arrangement are set out in r45 of the NGR.

6 In WA it is intended that this role be undertaken by the Economic Regulation Authority (ERA).

7 National Competition Council, Exposure draft of the Guide to the Council's role in light regulation determinations, August 2008.

disclosure requirements under light regulation would not provide a sufficient counter to this market power.

3.11 AGL stated that its preference is to negotiate with EAPL under the light regulation regime. AGL considered that a pipeline owner can exercise market power, particularly when capacity constraints appear, as these are not readily relieved in the short term. However, on balance AGL considered that the negotiate/arbitrate model is an effective way to achieve commercial resolution.

3.12 Origin did not oppose EAPL's application. Origin considered that the opportunities for flexibility in terms and conditions and specialised service offerings, combined with the availability of legislative safeguards—such as binding dispute arbitration by the AER—outweigh the risk of light regulation increasing the scope for EAPL to exercise market power.

3.13 The Council considers that the MSP will continue to have significant market power. In the Council's view barriers to entry in relation to provision of pipeline services are likely to remain significant for the foreseeable future. While some users or potential users may have access to substitutable sources of pipeline services or for other reasons possess countervailing power in negotiations with EAPL, these situations are likely to be more limited than suggested by EAPL in its application. The EGP or other sources of pipeline services cannot replace the MSP and for many users gas transported through other pipelines is complementary to, rather than substitutable for, gas transported by the MSP.

3.14 While some users may be able to switch between gas sources and pipelines at the margin, substantial proportions of many user's gas supply is dependent on access to the MSP.

3.15 The Council has also noted comments from the MEU concerning the availability of capacity on the MSP and the reasons for declining throughput. The declining throughput on the MSP appears to be only partially due to competition from other sources of pipeline services and factors such as declining production at Moomba have also contributed to the observed reduction. In the Council's view increasing demand for gas, including in particular for electricity generation, is likely to see continued strong demand for pipeline services including from the MSP. Of course this will also likely see the development of new pipelines, some of which will compete to some degree with the MSP.

3.16 The Council notes the east coast gas markets appear to be trending to a more competitive state with additional gas sources and new pipelines being developed.

3.17 EAPL suggest a range of factors that lessen market power associated with the MSP. While these factors will likely have some effect on market power this should not be overestimated. For example, CSM production is likely to comprise less than 5% of

current NSW gas supply. Similarly, while gas swaps are proposed as a means of reducing dependence on the MSP these arrangements remain rare.

3.18 However, this is an application for light regulation, not an application for revocation of coverage. The presence of market power associated with the MSP is not the critical issue. The critical issue is whether light regulation is less effective than full regulation in constraining the use of that market power.

3.19 In relation to this issue the Council notes:

- as a previously fully regulated pipeline, there is publicly available information in relation to the MSP much of which will continue to remain relevant under light regulation.
- under light regulation service providers are still required to disclose a range of information regarding pipelines, as well as details regarding negotiations with access seekers. Though these requirements are less than under full regulation the information disclosed will assist interested parties in determining the reasonableness of prices offered.
- many of the MSP's users have owned or operated pipelines and will therefore have a detailed understanding of pipeline cost structures. These companies in particular appear to be in a good position to evaluate costs claims when these are used to justify increased prices for pipeline services. Smaller users, and the bodies that represent these users, also have incentives to invest in maintaining or developing expertise in this regard. Pipeline services are a significant input cost for many users and these companies seem to have a significant incentive to keep these costs to reasonable levels.
- the non-discrimination provision in s136 of the NGL which prohibits a pipeline owner from engaging in price discrimination unless that discrimination is conducive to efficient service provision.
- light regulation includes recourse to arbitration by the AER and provisions for application to the NCC for the revocation of a light regulation determination.

3.20 On balance the Council believes that in the circumstances it finds here the light regulation regime will be as effective as full regulation in protecting users and other parties that are dependent on access to the pipeline. This is due to the availability of relevant pipeline costs information, as well as the legislative protections contained within the light regulation regime.

3.21 While the reporting requirements under light regulation are less than under full regulation, the Council considers the existence of historical data, and the knowledge of pipeline cost structures that some of the MSP's users would have acquired through their own pipeline operations, will ensure that at least the pipeline's largest users will

have sufficient access to information to allow them to negotiate effectively for access to the MSP. Further, the non-discrimination provisions in the NGL, as well as the reporting requirements of the light regulation regime, should ensure that smaller and new users are not disadvantaged.

3.22 Of course, information on its own will not protect users from service providers who are determined to take advantage of market power. However, where available information leads a party to believe the prices or other terms offered in access negotiations are unreasonable these parties have recourse to the AER for arbitration of an access dispute.

3.23 In the event of an arbitration the Council considers that the AER is in no less a position to determine an appropriate outcome than it would be if the pipeline were subject to full regulation.

Costs of form of regulation alternatives

3.24 In its application EAPL provided a comparison of the likely costs to it of submitting an access arrangement if full regulation is maintained. It estimated that costs of between $500,000 and $1,500,000 would be avoided if light regulation is allowed and that these values would be increased if full regulation lead to review and appeal proceedings. These costs would be repeated for each five-yearly regulatory review process. In addition EAPL estimated that ongoing compliance costs of approximately $9,000 per annum could also be avoided as the result of a light regulation determination.

3.25 EAPL's comparisons assumed that few if any arbitrations would be required under a light regulatory regime and therefore the costs to the various parties of operating within the resulting negotiate/arbitrate regime would not be materially different to those associated with a purely commercial arbitration.

3.26 Origin and the MEU accepted that EAPL would realise cost savings were it successful in seeking a light regulation determination. However, the MEU considered that the costs described by EAPL in relation to the last review process had been unnecessarily inflated by the number of appeals undertaken by EAPL. Further, the MEU stated that there was no certainty that light regulation would result in these savings being passed on to consumers. This, the MEU argued, would compromise the ability of light regulation to satisfy the NGL objective.

3.27 AGL disagreed with EAPL's assertion that the cost of arbitrating under light regulation would be much the same as the costs of an access dispute under full regulation, and highlighted the greater complexity under light regulation arbitration.

3.28 The Council expects that the costs savings of moving from full regulation to light regulation would sit at the lower end of EAPL's estimated $500,000 to $1,500,000

range per review process. As EAPL notes, it is unlikely that future determination of an appropriate access arrangement will result in a trail of review and appeal proceedings and in particular now that the regulatory asset base has been determined that will not be a matter for future dispute as that value is "locked in". While reduced costs in the order of $500,000 may be relatively modest, they are nonetheless significant.

3.29 It is likely that the bulk of any potential savings will accrue to the service provider. Savings to other parties are less certain. The Council does not need to be satisfied that savings will be passed on to users and end-users in order to make a determination in favour of light regulation.

3.30 While the move to light regulation promises significant cost savings, the Council recognises that these savings would be very quickly reversed should negotiations fail. Indeed, it is possible that the cost of light regulation would be greater than the cost of full regulation should enough users seek arbitration by the AER. Nevertheless, the Council is of the view that these costs, as well as the threat of revocation of a light determination, will provide a substantial incentive for EAPL to commercially negotiate access terms and conditions for pipeline services to avoid access disputes.

National gas objective

3.31 In making a light regulation determination the Council must have regard to the national gas objective contained in s23 of the NGL. That section provides:

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

3.32 EAPL suggests that a change to light regulation of the MSP would enhance efficiency in three principal ways and therefore light regulation of the MSP would be consistent with the national gas objective. Firstly, EAPL submits that light regulation would reduce its costs, and the costs for users and ultimately end users. Secondly, EAPL suggests that regulatory risks are "inherently greater" under full regulation than light regulation and that a shift to light regulation can be expected to result in a reduction in risk and uncertainty and therefore its cost of capital and that these changes are efficiency enhancing. Finally, EAPL suggests that there is greater flexibility for it and shippers to develop/request specialised and more useful service offerings and terms in a light regulated environment and this too is efficiency and welfare enhancing.

3.33 The first of these submissions and elements of EAPL's other arguments in relation to the national gas objective are encompassed in subsection (b) of s122 and have been discussed in that context. The other elements of EAPL's argument are however questionable and EAPL's assertions as to differences in risk, uncertainty and flexibility between light and full regulation are not backed with factual analysis.

3.34 In the Council's view there are regulatory risks and uncertainties associated with either form of regulation and it is not clear that overall these are inherently greater for one form or the other. While light regulation may "inherently" lessen risk and uncertainty for EAPL, and may even lower its cost of capital, this is at best a partial analysis as light regulation may increase risk and uncertainty for users or other relevant parties. There is nothing "inherent" in where the balance between these interests lies and the overall effect in terms of promoting the national gas objective. It is also unclear why alternative service offers cannot be arrived at under either regulatory form where it is appropriate to do so.

3.35 It is also unclear why light regulation offers significantly greater scope to develop flexible outcomes. The existing access arrangement appears to offer scope for such arrangements to have been developed, albeit within an overall regulatory constraint. It is not clear to the Council why mutually beneficial arrangements cannot be concluded whether in a light or full regulation context.

3.36 In the Council's view it is inappropriate to regard light regulation as a less effective form of regulation. Indeed to the extent this were the case it could well lead to rejection of a light regulation application.

3.37 Where light regulation is similarly effective to full regulation but involves a lesser cost across all relevant parties it is the most suitable form of regulation and a light regulation determination is consistent with the national gas objective. In this case, for these reasons rather than the reasons submitted by EAPL, the Council considers that light regulation is appropriate having regard to the national gas objective.

Form of regulation factors

3.38 Section 16 of the NGL sets out the form of regulation factors the Council must have regard to in deciding whether to apply light regulation to the MSP. These factors—(a) to (g)—are set out in the first column of Table 3-1.

3.39 More generally, Table 3-1 summarises the Council's views on how each form of regulation factor might, in principle, affect its decision on a light regulation application.

3.40 Table 3-2 provides a summary of the submissions in respect of the form of regulation factors made by EAPL in its application and by the parties that made submissions on the application.

Table 3-1 Consideration of form of regulation factors

Form of regulation factor (s16)	Circumstances conducive to light regulation	Circumstances where light regulation less likely
(a) the presence and extent of any barriers to entry in a market for pipeline services	Barriers to entry present but are relatively low	Barriers to entry relatively high.
(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider	Stand alone pipeline activity, where a service provider has no other pipeline operations Rights to pipeline capacity readily tradeable Transmission services and other end to end services generally less involve less interdependence with other pipelines	Greater interdependence, where a service provider has other pipeline interests in the same regions as a pipeline for which light regulation is sought Rights to pipeline capacity not readily traded Distribution services (especially established ones) are likely to be more interdependent with other pipeline services
(c) presence and extent of any network externalities (that is, interdependencies) between a natural gas services provided by a service provider and any other service provided by the service provider in any other market	Service provider has no involvement in upstream or downstream markets (at least in areas served by a pipeline for which light regulation is sought) Ring fencing and other regulatory requirements effectively prevent a service provider from taking advantage of market power in upstream or downstream markets	Service provider has upstream or downstream involvements in gas or other energy businesses Upstream or downstream involvements are in related but not ring fenced activities, or ring fencing of pipeline operations is ineffective
(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)	Large or concentrated users Users with by-pass opportunities High interdependence between users and service provider Users involved in pipeline services elsewhere (such users may face lesser information asymmetry given their direct knowledge and experience of pipeline operations)	Many small users Users have limited resources Diverse user interests (for example where users span different industries or economic sectors) Significant users have the capacity to pass through higher pipeline service costs (these users may have less incentives to expend resources to resist increases in pipeline costs) Poorly represented users
(e) the presence and extent of any	Greater substitution possibilities exist	Lower substitution options

Form of regulation factor (s16)	Circumstances conducive to light regulation	Circumstances where light regulation less likely
substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service	Relatively high elasticity of demand suggesting bypass or other substitution opportunities exist Transmission pipelines (demand is generally more elastic than for distribution services) Availability of large (independent) storage capacity Ability to defer gas production/expansion for significant periods	Low elasticity Distribution pipelines (especially established distribution pipelines with a high market penetration)
(f) the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)	Fuel choice available to significant proportion of users Narrower relative prices per unit energy produced from different fuel sources Use of multi fuel plant	Wider relative prices between fuel types Gas dependent users Other energy sources have efficiency disadvantage Dedicated gas plant
(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider	Previous regulated pipelines (A significant base of publicly available and regulator tested information will be available for use on negotiations) Historic pipeline costs available and previously exposed to public/industry scrutiny NGL information disclosure requirements operative	Previously unregulated pipelines NGL information requirements impeded (for example through use of related party contracting which prevents effective scrutiny of underlying costs)

Table 3-2 Application of form of regulation factors to EAPL application

Form of regulation factor (s16)	Applicant	Other submissions
(a) the presence and extent of any barriers to entry in a market for pipeline services	The height of barriers to entry into the markets served by the MSP has reduced significantly over the life of the MSP. Factors contributing to this are: • construction of new pipelines providing alternative routes to market for users and gas producers • large pipeline users holding significant capacity on long term contracts and reselling transport to third parties in competition with the pipeline owner • the emergence of coal seam methane (CSM) as an alternative gas supply requiring new transport routes • use of swap contracts as an alternative to pipeline transport	The MEU, AGL and Origin all submitted that EAPL had understated the height of barriers to entry in the markets served by the MSP and the market power associated with the MSP. In particular, they noted: • the EGP is currently fully contracted and unlikely to provide a significant competitive constraint upon the MSP (MEU 1, paragraph 44; AGL 1, page 2); • the high costs, considerable time lag and regulatory uncertainty involved in pipeline construction mean that the barriers to entry remain material for short to medium term negotiations (Origin 1, paragraph 3.1.1) • there is no evidence to suggest that reselling transport to third parties places a competitive restraint upon the MSP (MEU 1, paragraph 46) • current CSM capacity is extremely small and the potential for future capacity growth is uncertain (MEU 1, paragraph 49; AGL 1, page 3) • swap contracts have not been widely embraced in the industry and have not emerged as a genuine alternative to pipeline transport (MEU 1, paragraph 52)
(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider	APA group pipelines generally do not connect with the MSP Although completion of the QSN capital link will allow a link from APA's Roma to Brisbane pipeline or Carpentaria Gas pipeline to the MSP, this link will be through a pipeline owned by a third party (EPIC) and the direction of the gas flow on the various pipelines makes it unlikely that gas would flow between these pipelines and allow for any network externalities to emerge. While the VTS connects to the MSP through the Interconnect, the	The MEU acknowledged that network externalities tend not to be an issue in the case of Australian gas transmission pipelines (MEU 1, paragraph 45). However, the MEU considered that APA's ownership of the VTS and interconnect gives APA some market power over gas supplies from Moomba and further north when the QSN link is completed (MEU 1, paragraph 57).

Form of regulation factor (s16)	Applicant	Other submissions
	full regulation status of GasNet precludes the possibility that APA's joint ownership of it and the MSP could be a source of market power. There is a possibility of bundling services on connected pipelines to obtain network benefits. This type of bundling does occur for services that have off take points on the laterals of the MSP and the Central West Pipeline (CWP) (which connects to the MSP at Marsden)	
(c) presence and extent of any network externalities (that is, interdependencies) between a natural gas services provided by a service provider and any other service provided by the service provider in any other market	In addition to gas transport the APA Group provides gas processing and electricity services. However, any network externalities between these and the services provided by means of the MSP are insignificant because the other services are geographically remote and operationally separate from the MSP	The MEU agreed that there are no network externalities with the MSP and other network service providers that might give rise to market power (MEU 1, paragraph 58).
(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)	The MSP has a low degree of market power, in part, because shippers have significant countervailing power. Shippers capable of switching between pipelines wield substantial countervailing power in negotiations with service providers because they have good alternatives. In addition, the non-discrimination clause of the NGL (s136) means that EAPL would be obliged to offer all MSP customers any price reductions obtained by the larger shippers through negotiation unless it was not efficient to do so	The MEU referred to the Productivity Commission's Report *Review of the Gas Access Regime* (June 2004), which stated that countervailing power was limited for users that have no real fuel or energy substitute or are located in a market that is serviced by a single transmission pipeline for which there is excess demand (MEU 1, paragraph 20). AGL and Origin submitted that the bargaining power of shippers was limited because shippers generally rely on both the MSP and EGP to fulfil their gas requirements, and are unable to easily switch between the two due to capacity constraints and long-term contracts (AGL 1, page 3; Origin 1, paragraph 3.2.2).

Form of regulation factor (s16)	Applicant	Other submissions
(e) the presence and extent of any substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service	The switching behaviour of shippers and the change in the MSP's market share since construction of the EGP indicates that demand for transport services using the MSP is relatively elastic. • The MSP has progressively lost market share to the EGP since 2000, which provides evidence of the high degree of substitutability between the two pipelines. • Pipeline competition is increasing. Sydney Gas Limited currently supplies approximately 12 TJ/day (at 100% load factor) of CSM to Sydney from its Camden gas field in competition to the MSP and EGP. Sydney Gas is directly connected to the Jemena distribution network in Sydney and does not rely on the MSP or the EGP. Rather than using the MSP producers at Moomba or producers connected via the QSN Link can use the Moomba to Adelaide Pipeline System, which provides a substitute source of gas transportation to demand centres. In addition the QSN Link may potentially provide some capability for gas to be transported to Queensland.	The MEU noted that the progressive loss of market share by MSP to EGP since 2000 may be due to other factors such as the quality/price of Longford gas supplies or the relative available capacities of the two pipelines (MEU 1, paragraph 59). The MEU also stated that the Sydney Gas supply of 12TJ/day is relatively marginal and that given the relatively expensive gas resources of Moomba, it is unlikely that the QSN link would be used to transport gas from Moomba to Queensland (MEU 1, paragraph 60). Origin submitted that the ability for new investment to choose to locate near the pipeline that provides the most favourable prices had been overstated and that the location of major gas consuming facilities was in part determined by the availability of suitable development sites (Origin 1, paragraph 3.2.3).
(f) the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)	For some types of pipeline users and end-users of gas—gas retailers, gas fired power stations, and some industrial plants—electricity is not a substitute for gas. For others, particularly at the end-user level, substitution between electricity and gas may be feasible. It is likely to be more feasible to substitute away from gas in the event of price increases than to substitute away from electricity. In addition, substitution options may also include fuels	The MEU agreed with the applicant's acknowledgment that there is limited substitutability between gas and electricity for many end-users of gas (MEU 1, paragraph 65). Further, the MEU stated that substitution, contrary to the Central Ranges Pipeline example provided by the applicant, was unlikely given the very capital intensive processes required to revert from gas to another form of fuel (MEU 1, paragraph 66).

Form of regulation factor (s16)	Applicant	Other submissions
	other than electricity, such as LPG, coal, wood and diesel. 'The importance of substitution between gas and alternate fuels is also illustrated by the example of the Central Ranges Pipeline which was completed in 2006. The proponents of this pipeline project asked [the MSP Service Provider] for a discounted tariff to enable the project to proceed. At the posted tariffs for the MSP and the regulated Central West Pipeline, the Central Ranges Pipeline project was not viable because households and industrial users could meet their needs at lower cost using electricity or other fuels (including coal, wood, LPG and diesel) instead of gas. Subsequently, [the MSP Service Provider] offered a discounted tariff to all shippers six months prior to commencement of the project. Even with these lower tariffs, the project has not met projected volume targets, primarily due to competition from alternate fuels.' (EAPL 1 at [2.86])	
(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider	Reporting and information disclosure requirements under the NGL and the NGR combined with existing publicly available information sources (including previous access arrangements) would provide shippers with sufficient information to enable them to negotiate effectively with the MSP service provider should the MSP be subject to light regulation.	The MEU, AGL and Origin all submitted that access to information was likely to be restricted under light regulation, and that the relevance of pipeline cost information already in the public domain would decrease over time and may prove to be a weakness in the light regulation model (Origin 1, paragraph 3.3.1; AGL 1, page 4; MEU 1, paragraph 101).

3.41 It is the Council's view that consideration of the form of regulation factors and the circumstances of the MSP, support the view that light regulation is likely to be similarly effective as full regulation.

3.42 As discussed in paragraphs 3.13 to 3.17 the Council considers that barriers to entry in relation to provision of pipeline services are significant and the levels of countervailing power possessed by users and potential users of the MSP is for many users limited.

3.43 However the small number of large users (some of which may be able to exercise choice and countervailing power), the lack of notable network externalities and the availability of historic pipeline costs coupled with many users' own experience in operating pipelines support the conclusion that light regulation will not leave the relevant parties worse off than full regulation.

Other matters

3.44 The Council has considered whether there are any 'other matters' that may be relevant to its decision and to which regard should be had under s122(2)(c).

3.45 EAPL in its application suggested that, in addition to comparing the costs to the pipeline service provider, users and potential users of the MSP and end users, the Council should also consider effect on the costs to the AER as a relevant factor under s122(2)(c). EAPL estimated that the AER might save between $500,000 and $1,500,000 if it were not required to approve an access arrangement for the MSP and would make additional savings as it would also avoid the costs of subsequent review proceedings.

3.46 The AER considers that any cost savings for it are likely to be smaller than suggested by EAPL.

3.47 The Council considers that any cost savings for the AER will be quickly extinguished if the AER is required to undertake arbitrations of access disputes.

3.48 The Council considers that while this is a factor which should bear on its decision, it is not a significant determinant of the application.

3.49 The Council does not consider that there are any further matters, arising from submissions it received or otherwise, that are not encompassed within the other elements of its consideration and required consideration under s122(2)(c).

Council's conclusions

3.50 In summary the Council's conclusions are:

- Light regulation is likely to be similarly as effective as full regulation of the MSP – users and other interested parties are likely to be in a position to notify an access dispute where this is necessary and in such an event the AER is no less able to address relevant issues as it would be in a full regulation context.

- Light regulation is likely to involve less cost for the service provider, and provides scope for some savings for users and possibly end users.

- For these reasons light regulation of the MSP is consistent with promotion of the national gas objective.

- Consideration of the form of regulation factors supports these conclusions.

- a small additional benefit from light regulation exists from a reduction in costs incurred by the AER and it redeploying resources to other activities, although the level of this benefit will be eroded if the AER is required to undertake arbitration of disputes within the negotiate/arbitrate process applying to light regulation pipelines.

3.51 Subject to further analysis and consideration of submissions it receives on this draft decision, the Council should make a light regulation determination in respect of the MSP.

Appendix A – Index of submissions and documents

Application

EAPL 1	MSP Light Regulation Submission, 5 September 2008 - Application for light regulation determination for Moomba to Sydney Pipeline services by East Australian Pipeline Pty Limited
EAPL 1.1	Attachment 1: APA Group – Company Details
EAPL 1.2	Attachment 2: Shipper information
EAPL 1.3	Attachment 3: Rule 34 - Compliance Checklist
EAPL 1.4	Confidential attachment (Not publicly available)

Submissions in response to the application

AGL 1	AGL Energy Limited
Origin 1	Origin Energy Retail Ltd
MEU 1	Major Energy Users Inc

Appendix B – Chronology

Date	Cumulative business days	Action/Event
8 September 2008	0	Application received
10 September 2008		AER advised of application and consultation commenced
11 September 2008	3	Notice of application published in *the Australian* and on the Council's website, seeking submissions in response to the application Likely interested parties advised of application
2 October 2008	19	Period for submissions on the application ended (15 business days from date of notice)
23 October 2008	34	Draft decision released
13 November 2008	49	Period for submissions on the draft decision ends (15 business days from release of draft decision)
		Final decision made by Council
11 December 2008	69	Maximum period for making of Council decision (20 business days from close of submissions on draft recommendation)
8 January 2009		4 month period allowed by standard consultative period ends

Appendix C – Maps

Map C-1 The MSP and other SE Australian pipelines

Map C-2 Existing and proposed gas fired power stations in NSW

Key to Map C-2 above:

No.	Name	Company	Type
1	Uranquinty	Origin	Existing
2	Marulan	Delta	Proposed
3	Marulan	Energy Australia	Proposed
4	Canberra	ACTEWAGL	Proposed
5	Wellington	ERM	Proposed
6	Parkes	International Power	Proposed
7	Colongra	Delta	Under Construction
8	Hunter Valley	Macquarie Generation	Proposed
9	Tallawarra	TRUenergy	Existing
10	Bamarang	Delta	Proposed
11	Leaf's Gully	AGL	Proposed
12	Moss Vale	Loran Energy	Proposed
13	Tomago	Macquarie Generation	Proposed

Appendix D – Key features of light vs full regulation

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
Service provider subject to general duties: – Must be a specified legal entity (principally a corporation - s 131). – Must not engage in conduct to prevent or hinder access (s 133). – Obliged to disclose gas supply information in certain circumstances (r 138).	No difference.
Subject to 'ring-fencing' requirements – Must not carry on a related business (s 139). – Must keep marketing staff separate from associate's related businesses (s 140). – Must keep consolidated and separate accounts (s 141). – Must comply with any AER regulatory information instrument about information reporting (s 48). – Must keep sensitive information confidential (r 137). – Any additional requirements ring-fencing imposed by the AER under s 143.	No difference.
Contracts with associates must not be entered into, varied or given effect to if they substantially lessen competition in a market for natural gas services or breach competitive parity rule unless approved by the AER under the rules (ss 147 and 148 and r 32). Entering into or varying an associate contract must be notified to the AER (r 33).	No difference.
Subject to rules relating to facilitating requests for access and information disclosure: – Requirements to publish information and access arrangement (r 107). – Must provide certain information about tariffs (r 108).	Subject to same rules as for full regulation pipelines and additionally: – Must report annually to the AER on access negotiations (r 37).

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
– Must not bundle services (r 109). – Must respond to request for access in structured manner (r 112).	– Must publish terms and conditions of access, including prices on offer, on website (r 36).
Requirement to submit and have in force a full access arrangement which sets out terms and conditions of access and reference tariffs for services likely to be sought by a significant part of the market (s 132). Importantly: – Non-price conditions subject to AER approval, including capacity trading requirements, changes of receipt and delivery points, extension and expansion requirements and queuing requirements (rr 103 - 106). – Total revenue to be determined by the AER taking into account the revenue and pricing principles (s 24 and 28) and using the building blocks approach to economic regulation (r 76) which is highly dependent upon: – rules relating to the establishment and roll forward of a regulatory capital base; – determination of a rate of return on capital; – assessment of regulatory depreciation allowances and schedules; – estimates of corporate income tax (where post-tax model adopted); – maintenance and reporting of incentive arrangements; – determining allowances for operating expenditure; – creating a reference tariff variation mechanism based upon total revenue and appropriate cost allocation; and – complex arrangements relating to surcharges, capital contributions,	No requirement to submit or have in force a full access arrangement. A limited access arrangement (governing only non-price terms and conditions) may be submitted for approval by the service provider if it chooses to do so (s 116). Note that only conforming capital expenditure is included in a capital base while a pipeline is on full regulation, however if a light regulation pipeline returns to full regulation actual capital expenditure in the intervening period is rolled into the capital base (r 77(3))

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
speculative investment and capital redundancy (see generally Part 9 of the NGR).	
Requirement to submit detailed access arrangement information with an access arrangement and keep this information available (rr 42 - 43). This extends to detailed financial and operational information (r 72). The AER may also impose additional information requirements to allow them to assess an access arrangement as a regulatory information instrument (s 48).	No general requirement to submit or have approved access arrangement information. Minimal access arrangement information on capacity required if service provider chooses to submit a limited access arrangement (r 45(2)).
Requirements relating to compliance (usually annually) with the reference tariff variation mechanism to increase reference tariffs by the control mechanism (including any pass through arrangements) (r 97).	No such requirements imposed.
A user or prospective user is able to notify to the dispute resolution body (the AER everywhere but Western Australia) an access dispute about any aspect of access to pipelines services provided by means of a covered pipeline (s 181) and the access determination may deal with any matter relating to the provision of a pipeline service to a user or prospective user (s 193). The dispute resolution body must take into account the national gas objective and revenue and pricing principles in resolving a dispute (s 28). Existing user rights and usage are protected (s 188) and the applicable access arrangement must be applied (s 189). Geographical extensions of a pipeline cannot be ordered (r 118(1)(b)). Note that pipeline services which are not likely to be sought by a significant part of the market (i.e. non-reference services) may still be subject of an access dispute even though no price is provided by the access arrangement (s 181).	Access dispute provisions apply, any approved limited access arrangement must be applied, but otherwise price and non-price terms and conditions determined by the dispute resolution body. In relation to capacity expansions, for a light regulation pipeline the access seeker needs to fund the expansion entirely (r 118(2)(a)), an extension or expansion requirement in an access arrangement governs the ability for a service provider to be required to fund the expansion of a full regulation pipeline (r 118(2)(b)).
Price discrimination between users recognised in both prudent discount provisions (r 96) and pricing principles for distribution services (r 94). While service providers can offer other discounts, these would not be reflected in reference tariffs (r 96).	Prohibition on engaging in price discrimination unless that discrimination is conducive to efficient service provision (s 136).

Full (access arrangement) regulation	**Light regulation (additions or differences from full regulation)**
Must comply with queuing requirements in an approved access arrangement (s 135).	Where a limited access arrangement is in force, the queuing policy must be complied with under s 135. Where no limited access arrangements are in place, issues about the priority of access could be resolved as part of an access dispute.
Other than for the queuing requirements, service providers and users are free to agree on alternative terms and conditions of access than set out in the access arrangement (s 322).	No difference.
Pre-existing contractual rights protected (ss 188 and 321).	No difference.
The extent to which an extension or expansion of a pipeline is taken to be part of the covered pipeline, and regulated by the regime, is governed by the extensions and expansion requirements in the access arrangement (s 18).	As for full regulation where a limited access arrangement applies, but otherwise all extensions and expansions are taken to be part of the covered pipeline (s 19).
May apply to be uncovered if no longer satisfied coverage test (s 102).	No difference. Note also that any person can at any time apply to revoke the light regulation determination (s 118).
Must, for interconnected transmission pipelines, disclose information to the Bulletin Board: – nameplate rating (r 170). – 3-day capacity outlook (r 171). – linepack/capacity adequacy indicators (r 172). – nominated and forecast delivery nominations (r 173). – actual delivery information (r 174).	No difference.
Must, unless exempt distribution network, maintain a register of spare capacity on its website (r 111).	No difference.