CWP LIGHT REGULATION SUBMISSION

1 October 2009

Application for light regulation determination for Central West Pipeline services by APT Pipelines (NSW) Pty Limited

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Part 1 - Introduction and Background
Introduction

1.1 This application is made by APT Pipelines (NSW) Pty Limited ABN 37 080 842 360 ("**APA**") pursuant to s.112 of the National Gas Law[1] ("**NGL**") for a determination that services provided by the covered Central West Pipeline be light regulation services for the purposes of the NGL. The covered Central West Pipeline transports gas from Marsden on the Moomba Sydney Pipeline (**"MSP"**) mainline to Forbes, Parkes, Narromine and Dubbo in the central west of New South Wales.

1.2 Gas from the CWP also flows into the Central Ranges Pipeline (**"CRP"**) at Dubbo, The CRP transports gas to Tamworth in northern New South Wales. The CRP was covered by application of the competitive tender process outlined in Chapter 3 of the 1997 National Third Party Access Code for Natural Gas Pipeline Systems (**"the Code"**). Under those provisions, the CRP will remain covered until 2019. The CRP is not the subject of this application.

1.3 This submission is divided into 4 parts, which consider the following:

- Part 1 – Introduction and background;
- Part 2 – Effectiveness criteria and the form of regulation factors (s.122(1)(a), s.122(2)(b) and s.16, NGL);
- Part 3 – Comparative costs of full and light regulation (s.122(1)(b), NGL); and
- Part 4 – National Gas Objective and other factors (s.122(2)(a) and (c), s.23, NGL)

Central West Pipeline

1.4 The CWP receives gas from its only receipt point on the MSP at Marsden and then transports gas to five delivery points at Forbes, Parkes, Narromine, Dubbo and Dubbo West. Gas from the CWP flows into the CRP at the Dubbo delivery point.

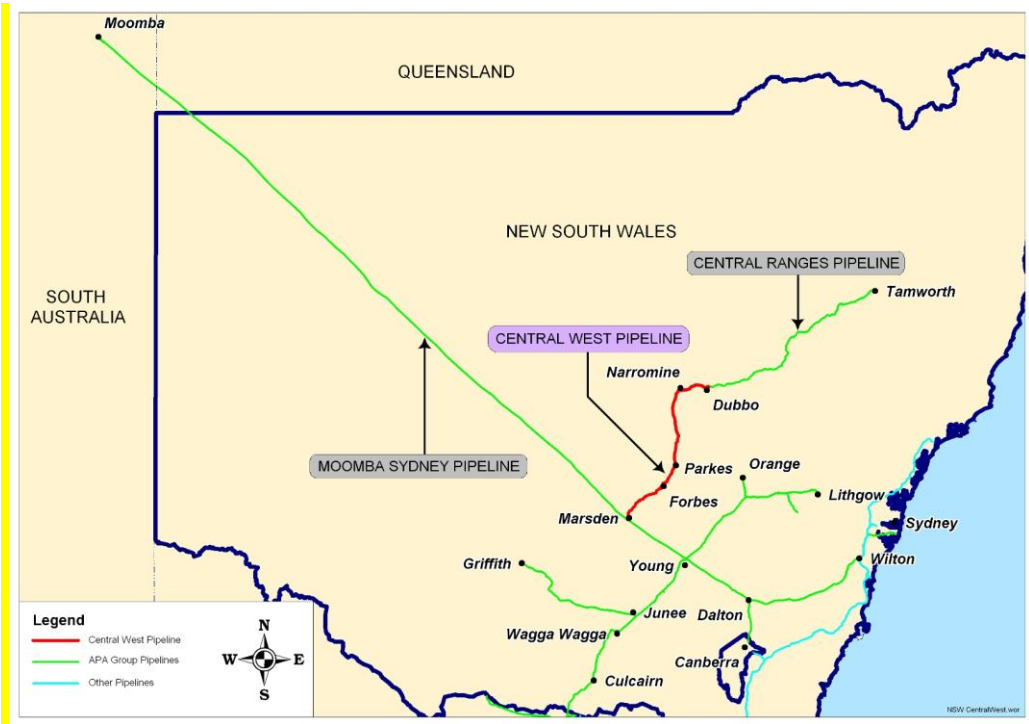
[1] The National Gas Law is set out in the Schedule to the National Gas (South Australia) Act 2008 (SA) which commenced on 1 July 2008.

1.5 The Central West Pipeline ("**CWP"**) comprises the following assets:[2]

- Marsden to Alectown – 130 kilometres of 219.1mm diameter pipeline;
- Alectown to Dubbo – 125 kilometres of 168.3mm diameter pipeline;
- Other assets including:
    - Metering, a line valve, a scraper station and an odorant station at Marsden
    - Above ground valve sites every 27 kilometres
    - Scraper stations at Alectown West and Dubbo
    - Five off-take stations and valves at Forbes, Parkes, Narromine, Dubbo and Dubbo West
    - Pipeline markers and cathodic protection test points.

1.6 The map below shows the general location of the CWP in relation to the MSP and the CRP as well as the demand centres that the CWP currently serves. Both the MSP and CRP are owned by APA. Further details and a description of the CWP can be found at www.apa.com.au.

Map 1: Location of the Central West Pipeline in Relation to Other Gas Pipeline Infrastructure in New South Wales



[2] The CWP Pipeline License is NSW License No 25.

1.7 The CWP is owned by APT Pipelines (NSW) Pty Limited which is part of the APA Group. The APA Group owns and operates a number of energy infrastructure assets in Australia including the MSP and the CRP. A list of major energy and infrastructure assets owned by APA Group as at the date of this application is set out at Attachment 1.

1.8 Although the CWP is connected to the MSP, the CWP is treated as being separate to the MSP under current and previous regulatory frameworks applying to natural gas pipelines. However the CWP is largely operated as an adjunct to the MSP, with the same staff and resources operating both the MSP and CWP.

1.9 In the 1990s AGL investigated the potential of transporting natural gas to Forbes, Parkes and Dubbo. However, the project's relatively small loads and the presence of competing fuels meant that its commercial viability was questionable. However the provision of Federal funding of $2 million to the Orana Regional Economic Development Organisation[3] ("**ORDO**") for the development of gas infrastructure in the region contributed towards making the Central West Project more commercially viable. A condition of the funding was that a tender process to select the preferred developer would be managed by ORDO. The AGL Group was selected as the preferred developer.

1.10 The CWP was constructed in 1998 and was covered from completion. The CWP was sold into the Australian Pipeline Trust (later to become the APA Group) when the Australian Pipeline Trust was established in 2000.

Regulatory background of the CWP

Coverage

1.11 Under the *Gas Pipelines Access (SA) Act* 1997 and the attached Code and schedules and the subsequent NGL, the CWP is a covered pipeline by reason of its inclusion in the list of covered pipelines under Schedule A of the Code. The CWP has remained covered.

[3] ORDO later became Orana Development & Employment Council.

1.12 In April 2000 and June 2001, the Australian Pipeline Trust as owner of the MSP applied for revocation of coverage of the MSP mainline. The CWP was not part of either of these applications. Following the 2001 application, the Minister published his decision that coverage of the MSP from Moomba to Marsden should be revoked from December 2003. Consequently, the MSP mainline from Moomba to Marsden is not covered.

1.13 This decision did not directly affect the CWP, although as a consequence of this decision users of the CWP transport their gas to Marsden via the uncovered MSP. For gas transported from Moomba to Dubbo for example, the uncovered portion of the MSP accounts for 942 kilometres of transportation with the CWP accounting for 255 kilometres.

1.14 In September 2008 the owner of the MSP applied to the NCC for the remaining covered sections of the MSP, consisting of mainlines and laterals, to be covered by light regulation under the NGL. This application was successful and in early 2009 these pipelines became light regulation pipelines.

1.15 Operationally and commercially, there are many parallels between the Northern and Griffith laterals (which were part of the successful MSP application for light regulation) and the CWP. Given these similarities, satisfaction of the light regulation criteria for the laterals suggests that the criteria would also be satisfied for the CWP. The application of the criteria to the CWP is considered in detail in this application.

CWP Access Arrangement

1.16 As required under the Code, APT Pipelines (NSW) Pty Limited submitted a proposed Access Arrangement ("**AA**") to the ACCC for the CWP together with the applicable Access Arrangement Information ("**AAI**") in December 1998. The AA and AAI were approved in October 2000.

1.17 A revised CWP AA and AAI are due to be submitted to the Australian Energy Regulator (**"AER"**) by April 2010.

Pipeline services generally

1.18 The determination sought under s.112 applies to pipeline services. A "pipeline service" is defined in s.2 of the NGL as:

> *(a) a service provided by means of a pipeline, including:*
>
> *(i) a haulage service (such as firm haulage, interruptible haulage, spot haulage and backhaul);*
>
> *(ii) a service providing for, or facilitating, the interconnection of pipelines; and*
>
> *(b) a service ancillary to the provision of a service referred to in paragraph (a),*
>
> *but does not include the production, sale or purchase of natural gas or processable gas.*

1.19 "Firm haulage" (or firm transportation) refers to a haulage service where the service provider essentially commits to receive and deliver a specified quantity of gas for a user, other than in very limited circumstances.

1.20 An "interruptible service" refers to a haulage service where the pipeline operator reserves the right to interrupt the service at any time (generally in times of peak demand). Interruptible services are accordingly less reliable than firm services. Providing both firm and interruptible services enables a service provider to maximise usage by those users who value the service most highly – i.e. the highest paying sources of demand.

1.21 "Backhaul" refers to arrangements for the transport of gas where the delivery point is located upstream of the point on the pipeline where the user receives its gas supply (whether from a producer, shipper or retailer).

1.22 "Interconnection" is the right to join other facilities (processing plants, pipelines, networks and end user facilities) with the relevant pipeline.

1.23 Other types of potential services not expressly referred to in the above definition are linepack, parking and storage. Essentially, these services are all variants of a storage type service whereby pipeline capacity that is not

otherwise committed for point-to-point transportation, can be utilised by shippers for the purpose of storing gas in the pipeline. While a normal part of a point-to-point haulage service includes the balancing of inputs and outputs by each shipper on any given day, the dedicated storage type services are in addition to these embedded imbalance services and typically require dedicated capacity that may otherwise be used for haulage.

Pipeline services provided by the CWP

1.24 There is at present only one receipt point for gas for transport on the CWP at Marsden. There are no current plans for any further CWP receipt points.

1.25 There are five delivery points on the CWP. These are located at Forbes, Parkes, Narromine, Dubbo West and Dubbo. There are no current plans for any further CWP delivery points.

1.26 Approximately 45% of the current load on the CWP continues beyond Dubbo to service delivery points on the CRP. Country Energy is the only shipper that has contracted loads for transportation on the CRP.

1.27 The only service currently acquired using the CWP is a firm forward haul transportation service. CWP does not currently have any shippers using interruptible, backhaul and storage services.

1.28 The firm forward haul service is the only reference service under the CWP AA. The Reference Tariff that applies to this service is based on a throughput charge (currently $2.95 per gigajoule ("**G/J**")). This throughput charge is a charge per gigajoule of gas transported and applies regardless of the distance of the delivery points from the Marsden receipt point and regardless of the demand peak characteristics or other load characteristics. Unlike the MSP, the CWP AA does not provide for a peak day capacity charge.

CWP gas shippers

Existing shippers

1.29 There are currently five shippers on the CWP. For each current shipper, the following table sets out details of receipt and delivery points. Details of services, usage, contract terms and relative proportions of the total throughput of the CWP are set out in the Confidential Attachment.

Table 1: Shippers on the CWP

Shipper	Customer type	Receipt points	Delivery points
AGL	Vertically integrated energy major	Marsden	All
Origin	Vertically integrated energy major	Marsden	All
Energy Australia	Large energy retailer	Marsden	Dubbo
TRU Energy	Vertically integrated energy major	Marsden	All
Country Energy	Large energy retailer Retailer as nominee for industrial	Marsden	All (including on transportation to CRP)

1.30 The shippers on the MSP comprise three categories – namely:

- large vertically integrated energy majors;
- large energy retailers; and
- retailers as nominees for large industrial end users. That is large industrial end users negotiate transportation terms and price directly with the CWP. The agreed terms are then offered by the CWP to the gas retailer selected by the end user as its gas supply retailer.

1.31 Each shipper on the CWP is either a vertically integrated energy major or large energy retailer. All the shippers are large, well resourced companies. A profile for each shipper is set out in Attachment 2.

Prospective shippers

1.32 CWP occasionally receives enquiries for new or additional services from existing shippers as well as potential new shippers.

1.33 Potential new shippers largely comprise new power station proponents. As residential and industrial gas usage on the CWP has followed a relatively low but steady growth pattern over the past years, any major growth in gas consumption is expected to come from the power generation sector.

1.34 The power station developer ERM Power Pty Limited is proposing to build a $700 million dollar 600 MW – 660 MW open cycle gas turbine power station near Wellington in Western New South Wales, in the region of the CWP. This power station is expected to use approximately 600 TJ of gas per annum. ERM have examined two options:

- Supply via the expansion of the CWP and construction of a new lateral from Alectown (near Parkes), to Wellington
- Supply via a new pipeline from Young to Wellington. Reports in mid 2009 indicated that ERM were investigating a more direct gas pipeline to the power station site, bypassing the CWP. [4] APA understands that this proposed pipeline would be a 200 kilometre 300mm diameter storage and transport pipeline from Young, on the MSP, to the ERM site at Wellington.

1.35 APA understands ERM is targeting a start date in 2013.

1.36 APA has received enquiries from the power generator International Power Pty Limited for a proposed 120 MW open cycle gas turbine peaking power station near Parkes, approximately 10 kilometres from the CWP. However, recent indications suggest that the development of this power station is unlikely to be progressed in the near term.

[4] See for example
http://www.abc.net.au/news/stories/2009/07/30/2640549.htm
http://www.wellingtontimes.com.au/news/local/news/general/gasfired-station-put-on-hold/1614978.aspx

Transportation contract terms and conditions

1.37 Each existing shipper has a gas transportation agreement with APT Pipelines (NSW) Pty Limited. The terms of the agreement are negotiated on a bilateral basis with the AA providing default terms and conditions in the absence of a negotiated agreement between the parties.

1.38 Of the existing gas transportation agreements, the non-price terms and conditions are largely consistent with those set out in the AA. There is however some variation between the tariffs and the Reference Tariff, details of which are set out in the Confidential Attachment.

1.39 CWP tariffs for users of the CRP are discounted from the Reference Tariff. The"CRP transportation service" is a negotiated service from Marsden to Dubbo for users of the CRP. The discounted tariff provides an incentive for end users of the CRP to use gas. This tariff was negotiated prior to APA acquiring the CRP in 2008. Country Energy is currently the only shipper using the CRP. The current CRP transportation tariff for the CWP is $2.07 per G/J.

1.40 As noted in paragraph 1.28, the Reference Tariff in the AA currently provides for charging on the basis of throughput rather than providing for any capacity charge. This differs to the MSP as well as other pipelines such as the Roma Brisbane Pipeline which charge on the basis of a capacity reservation component as well as throughput.

1.41 APA is currently finalising negotiations to allow negotiated changes to the transportation agreements with CWP shippers. These changes will result in a change in tariff structure, with tariff structures now incorporating both a capacity reservation charge and a throughput charge. The capacity charge will allow for a reservation of peak day volume and would be payable regardless of actual volume throughput. In addition to the capacity charge, there will continue to be a throughput charge reflecting the actual per G/J throughput.

1.42 APA sought to change the tariff structure for a number of reasons. The first is that a capacity reservation charge will provide incentives for shippers to better manage their loads. A capacity charge will benefit shippers who are growing their volumes. This is because as the capacity charge is fixed, shippers' average pipeline price paid will decrease if they can increase their volumes. The previous throughput tariff did not have this incentive for shippers to increase their volumes.

1.43 The capacity reservation charge also provides incentives for shippers to sign end users with flatter load profiles, such as industrial and commercial users, or otherwise develop flatter load profiles by encouraging existing users to use additional gas in non-peak periods. Flatter load profiles encourage more efficient utilisation of the pipeline infrastructure. Rather than the asset having to accommodate peaks for short periods while remaining underutilised during non-peak periods, a flatter load profile will take up more of the pipeline capacity for longer periods of time. A flatter, more predictable load also has operational benefits for the pipeline thereby reducing operating costs.

1.44 The capacity reservation charge also provides incentives for shippers to make more accurate peak day reservations. As shippers do not currently have any charges attached to their peak day reservations, these reservations are often not accurate. More accurate peak day reservations are likely to allow a more accurate assessment of current market requirements, and may free up some capacity for use by others which is currently assumed to be required. Accurate peak day reservations also have benefits for pipeline operation and capital planning. In particular they allow for more accurate future pipeline capacity augmentation planning.

1.45 The capacity reservation charge structure would make the CWP consistent with the current pricing structure for the MSP. All shippers on the CWP also use the MSP. The standardisation of charging approaches for the two pipelines will simplify contract management and invoicing for the entire transportation service benefiting both APA and shippers.

1.46 The charging of a capacity reservation charge for assets with high fixed costs is also consistent with principles of cost reflectivity and pricing efficiency, thereby providing price signals to asset owners, shippers and users. The

costs of the CWP are largely fixed. As such a tariff structure with a large fixed cost component is more cost reflective than a tariff structure with no fixed component.

1.47 The change in tariff structure is revenue neutral for APA. The impact of the change on individual shippers is set out in the Confidential Attachment. The intention is that over time, CWP revenue will increase as volumes increase due to the changed structure providing incentives to shippers to grow base load demand.

1.48 The change in charging structure would remain unaffected if the CWP was to be a light regulation pipeline.

Alternatives to shipping gas via the CWP

New pipelines

1.49 As outlined in paragraphs 1.32 to 1.36, proposed power station developments in the region have resulted in statements indicating that new pipelines are being considered. APA understands that in relation to the ERM proposal, land access work for the Young to Wellington pipeline has commenced. APA understands that in relation to the International Power proposal no new pipeline is currently envisaged beyond an 11 kilometre pipeline necessary to connect the proposed power station to the CWP.

1.50 With the potential for the development of coal seam gas in northern New South Wales, there is the potential for a new pipeline from the undeveloped coal seam gas fields to displace CRP load currently transported by the CWP. APA entered into a heads of agreement with Eastern Star Gas and Gastar Exploration, coal seam gas developers in northern New South Wales, to investigate arrangements to transport gas from the Narrabri coal seam gas project to south east Australian markets.[5]

[5] A press release related to this issue is located at http://www.apa.com.au/investor-centre/news/asxmedia-releases/2008/heads-of-agreement-with-eastern-star-gas-and-gastar-exploration.aspx

Pipelines proximate to CWP[6]

1.51 Rule 34(2)(b) of the NGR requires the CWP to identify alternate pipelines within 100 kilometres of the pipeline the subject of the application. There are two pipelines within 100 kilometres of the CWP. These pipelines are the MSP (and laterals) and the CRP. APA owns both of these pipelines.

1.52 The CWP and MSP are connected at Marsden. The MSP is owned by East Australian Pipeline Pty Limited which is part of the APA Group. The MSP transports gas received at Moomba and at Culcairn to Wilton (the distribution network city gate for Sydney), Watson (the city gate for the ACT) and various other points along the pipeline, including Marsden. The MSP is partially uncovered and partially covered by light regulation under the NGL. The MSP laterals are covered by light regulation.

1.53 The CWP and CRP are connected at Dubbo. The CRP connects the CWP at Dubbo to Tamworth in NSW. The CRP was commissioned in August 2006 and consists of approximately 294 kilometres of transmission pipeline which delivers gas to customers within the Tamworth region. The CRP is owned by Central Ranges Pipeline Pty Ltd which is part of the APA Group.

[6] Rule 34(2) (b) of the NGR requires an applicant to identify alternate pipelines within 100km of the pipeline the subject of the application.

Part 2 - Effectiveness criteria (s.122(1)(a))

Approach

2.1 Section 122(1)(a) of the NGL requires that:

"*In deciding whether to make a light regulation determination under Division 1 or to revoke a light regulation determination under Division 2, 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*;"

2.2 The term "effectiveness" is not defined in the NGL. The second reading speech does, however, provide some guidance as to the circumstances in which light regulation is intended to apply. In particular, it notes that the light regulation option should be available where it is likely to reduce costs "*while still providing an effective check on a pipeline's market power*". It goes on to note that *"[l]ight regulation may be particularly relevant for point to point transmission pipelines with a small number of users who have countervailing market power."*[7]

2.3 Light regulation essentially applies a "negotiate/arbitrate" model much like that provided for in Part IIIA of the *Trade Practices Act* 1974 ("**TPA**"). The model relies on users and service providers negotiating the terms of service provision. If the parties are unable to agree on those terms, binding arbitration by the AER can be sought.

2.4 The effectiveness of this model depends on the ability and willingness of users to engage in effective negotiations with the service provider so as to make the negotiations the mechanism through which commercially acceptable terms for both parties can be agreed. In other words, the negotiations need to be commercially meaningful and this requires an ability and incentive on the part of the user to protect its own interests when

[7] National Gas (South Australia) Bill 2008 Second Reading Speech, p.15.

negotiating with the service provider. If this is not the case, the arbitration mechanism becomes the one through which outcomes become principally determined. A single arbitration may be less costly than full regulation. However, the regulatory fixation of tariffs and terms for all users under full regulation, particularly where there are many users, would likely be more cost effective than a series of arbitrations, were that to be the outcome of light regulation.

2.5 Whether a user is able to protect its own interests in a negotiation is dependent on a range of factors including the degree of market power of the service provider, the countervailing power of the user and the access to relevant information. This is recognised in the second reading speech which notes that the National Gas Objective and the "form of regulation factors" guide the assessment of whether the circumstances are such that light regulation would be appropriate. Each of these factors is considered below in the context of the assessment of "likely effectiveness" under s.122(1).

2.6 In addition to considering whether users would have the ability and incentive to negotiate effectively under light regulation, s.122(1) requires a comparison of the effectiveness of full and light regulation to promote access to pipeline services. The key question here is would light regulation be at least as effective as full regulation in promoting access to pipeline services. If so, and the costs of light regulation are lower, then light regulation would be appropriate.

Position under full regulation

2.7 Since the finalisation of the AA in 2000, CWP has published terms and conditions of service including tariffs. As a full regulation pipeline, CWP was entitled to charge tariffs sufficient to recover its full cost of service. Under the applicable regulations several methodologies were available for recovering revenues including[8]:

- Cost of Service: where the revenue is set to recover costs; and

[8] Further details of these regulatory methodologies are available in Chapter 8 the National Third Party Access Code for Natural Gas Pipeline Systems.

- NPV: where revenue is set to deliver a net present value for the pipeline equal to zero.

2.8 It was recognised from the outset that market demand for CWP pipeline services would initially be low. Therefore in order to grow the market, a commercial decision was taken to charge a tariff in the early years of the pipeline's operation that was below the maximum tariff that would have been permissible under a regulatory cost of service building block approach. This approach was discussed with the ACCC at the time. The pipeline's owner proposed and the ACCC agreed that any under-recovery of full economic costs in these early years would be rolled into the asset base, which increases, so that the revenue may be recovered at a later date. The mechanism which allows this to occur is referred to as "back-ended depreciation"[9], which adjusts depreciation to allow for under-recoveries to be added to the capital base to be recovered at a later date. In effect, the back ended depreciation mechanism allows losses in the early years of the pipeline to be capitalised so that they may be recouped later if demand strengthens. The CWP pricing was based on this regulatory model. This regulatory model is consistent with the NPV approach.[10]

2.9 Set out below are the Reference Tariffs for the period from 2000 to the present. The tariffs were approved by the regulator applying the approach outlined above. The tariffs are currently determined by reference to throughput only, and no capacity charge is applied:

Table 2: CWP Regulatory Tariffs 2000-1 to 2009-10

Year	CWP Throughput Tariff $/GJ excl GST
2000-01	2.16
2001-02	2.36
2002-03	2.43
2003-04	2.51
2004-05	2.56
2005-06	2.62
2006-07	2.70
2007-08	2.76

[9] The CWP Access Arrangement Information discusses back ended depreciation at page 8.
[10] The CWP Access Arrangement Information, page 1, explicitly states that it uses the NPV approach to determine the calculation of tariffs.

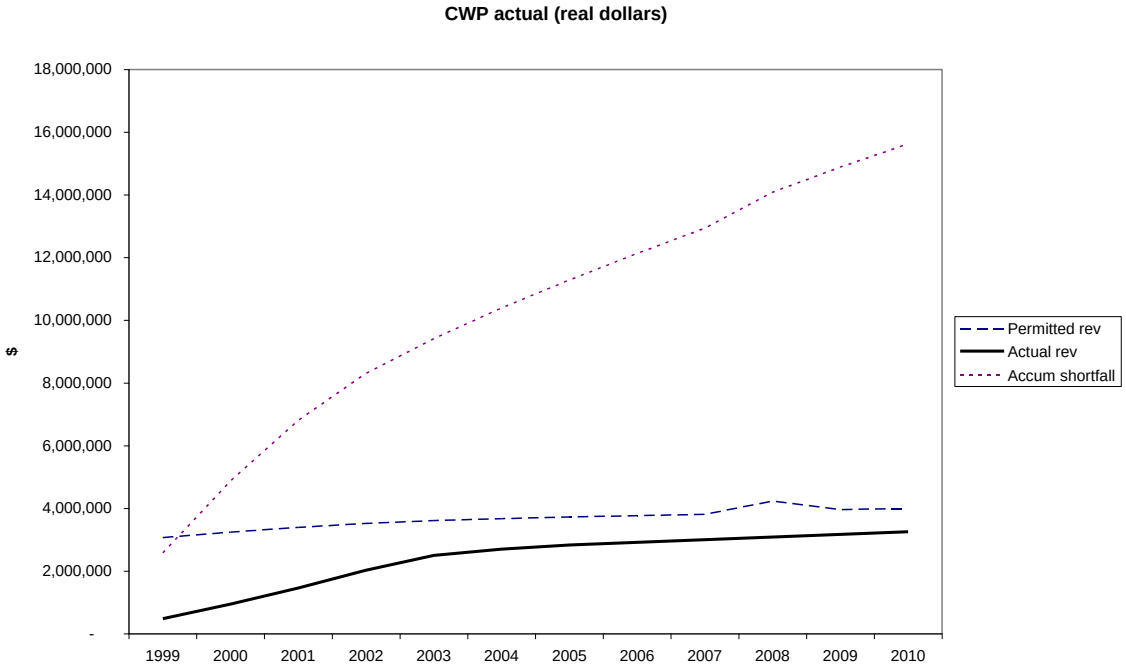
2008-09	2.88
2009-10	2.95

2.10 Under this model, CWP took volume risk. To date the approved volume forecasts have not been met. The shortfall in actual volumes has been significant and ranges from approximately 3% in 2000-2001 to approximately 54% in 2005-2006. These shortfalls have occurred every year. This shortfall in volumes can be seen in Table 4 at paragraph 2.46. These losses have not so far been recovered going forward.

2.11 Under this back-ended depreciation approach, the CWP asset base will increase at the next regulatory reset in 2010 to approximately $54 million, due to the effect of both inflation and agreed back ended depreciation. This value is based on the residual value regulatory model and the economic depreciation modelling underpinning the approved 2000 CWP AA.[11] APA estimates that by 2015 the asset base may be approximately $65 million. The diagram below shows the difference between actual CWP revenues and the revenues that would have been permitted under a strict cost of service building-block approach, together with the value of the accumulated revenue shortfall in real dollars. The higher allowed revenue and prices that would result from the cost of service building-block approach may not necessarily have been achieved in reality due to the impact of the higher prices on demand.

[11] Note that this nominal asset value is based on actual CPI to 2009 and an assumed CPI of 2.5% in 2010.

Diagram 1: CWP Under-recoveries of Actual Revenue compared to Potential Allowed Revenue under a Cost of Service Regulatory Approach

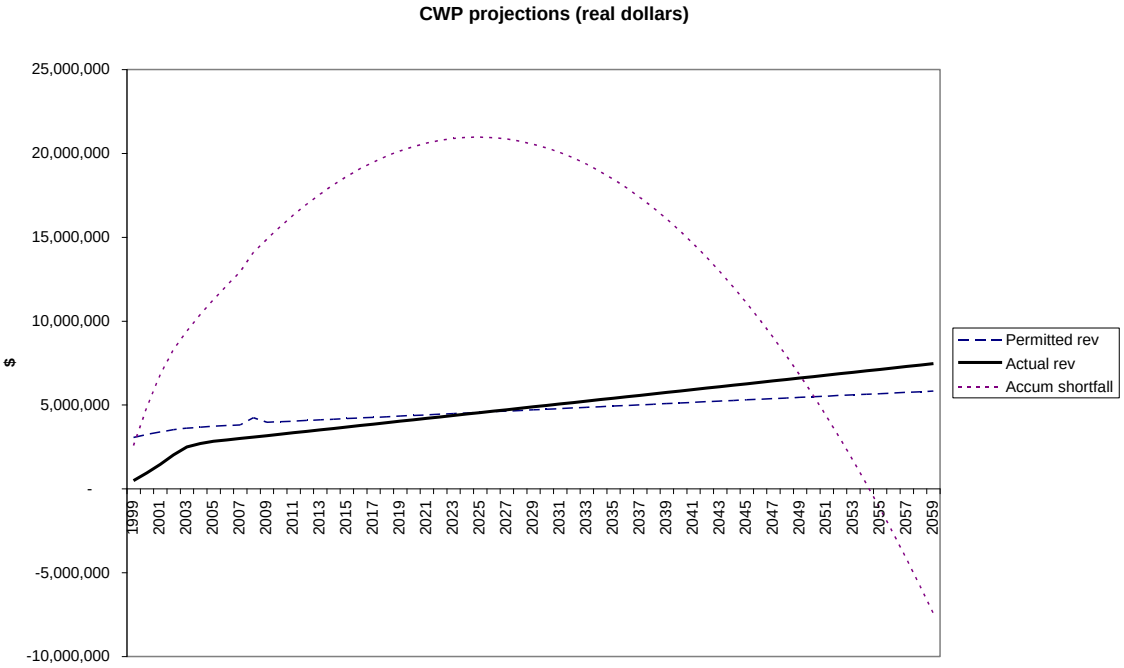


2.12 What this diagram shows is that regulation has not been a binding constraint on either CWP prices or the amount of revenue earned by the CWP in any of the first ten years of operation. Other factors, including alternative fuel options and the relatively high price elasticity of demand for gas users served by the CWP, have imposed a constraint on CWP pricing that has been more effective than regulation. Putting this point a little differently, if the CWP had been completely unregulated over the period from construction to 2010, tariffs would not have been any higher in any of those years.

2.13 Looking forward, it is possible to project the current rate of increase in actual revenue and the current rate of increase in permitted revenue. As, at the current time, the actual revenue is increasing somewhat faster than permitted revenue, the time may come when actual revenues may exceed permitted revenues. The chart below shows that this point may be reached by approximately 2026 (assuming linear extrapolation of both actual and permitted revenue from the values in 2009 and 2010). If that projection is

approximately correct, then regulation will not begin to affect CWP pricing until 2026 at the earliest.

Diagram 2: Time Period of Under-Recovery



2.14 While actual revenues may exceed instantaneous permitted revenues after 2026, the capitalised losses will not have been made good until approximately 2054 or later. This estimate is conservative because it does not take into account the time value of the accumulated losses. In principle, the foregone return on the capitalised losses is also recoverable. Under the terms of the CWP full regulatory arrangements, CWP is entitled to earn revenues in excess of the single-year revenue requirements until the capitalised losses have been recovered. That means that price regulation is unlikely to become a binding constraint on CWP prices within the next 50 years, based on these projections.

2.15 Given this fact, the removal of price regulation from the CWP as a result of a change to light regulation would be unlikely to have any impact on prices for the foreseeable future, as tariffs are expected to continue to be lower than the amount that otherwise may be charged under full regulation.

2.16 If the CWP were subject to light regulation, it would expect to continue to offer the same or similar standard non-tariff terms and conditions as approved

previously by the ACCC. The terms are well understood by shippers and CWP has little reason to move away from these terms and conditions, other than to rationalise and standardise terms and conditions with the MSP, CRP and other pipelines. It should be recognised that CWP shippers also use the MSP and CRP so any standardisation of terms and conditions would have benefits to both shippers and the CWP.

2.17 As discussed in paragraph 1.41, APA is proposing to effect changes to the tariff structure for the CWP to comprise both a capacity and throughput charge. This change in structure would be sought regardless of whether the pipeline was subject to heavy or light regulation. On the basis of current demand forecasts, the tariff restructure would not have a material impact on the total amount of revenue received. The specific impact of the tariff structure change on existing CWP shippers is set out in the Confidential Attachment.

Form of regulation factors

2.18 The form of regulation factors are set out in s.16 of the NGL. Essentially the 7 factors expressly listed in s.16 consider three key issues relevant in determining whether users would be able to negotiate effectively under light regulation – namely:

- the degree of market power of the service provider (s.16(a), (b), (c), (e), (f));
- the countervailing power of users (s.16(d), (e) and (f)); and
- the ability of users to access sufficient relevant information (s.16 (g)).

2.19 Each of the form of regulation factors is considered below in the context of these three considerations.

CWP low degree of market power

General approach

2.20 The CWP is a covered pipeline for the purposes of the NGL. Underlying this coverage decision is a presumption that the CWP possesses market power.

2.21 While the existence or otherwise of market power is properly a question that is pertinent to coverage decisions, the degree of market power is relevant to many of the form of regulation factors set out in s.16 of the NGL. Simplifying somewhat, where a covered pipeline's market power is great the argument for full regulation is stronger. Where the pipeline's market power is mitigated by other factors there is a greater chance that access seekers would be capable of negotiating effectively with the pipeline owner under light regulation, making the burdensome and costly machinery of full regulation unnecessary.

2.22 The Tribunal judgement in the EGP case in 2001[12] provides a relevant precedent for the method of assessing a gas pipeline's market power. The Tribunal concluded "*that EGP will not have sufficient market power to hinder competition based on the commercial imperatives it faces, the countervailing power of other market participants, the existence of spare pipeline capacity and the competition it faces from the MSP and the Interconnect. As EGP does not have market power, the Tribunal cannot be satisfied that coverage would promote competition in either the upstream or downstream markets*."[para 124]

2.23 The same tests as those applied by the Tribunal can be applied to the CWP in the circumstances it faces in 2008 by considering:

- the existence of spare pipeline capacity – (considered further in this section);
- commercial imperatives faced by CWP – (considered further in this section);
- alternative energy sources available to users – (considered further in paragraphs 2.43 to 2.47); and
- countervailing power of other market participants – (considered further in paragraphs 2.48 to 2.63).

[12] Re Duke Eastern Gas Pipeline Pty Ltd [2001] ACompT 2 (4 May 2001).

Existence of spare pipeline capacity

2.24 In considering the capacity of a pipeline, two measures are useful. The first is petajoules per annum **("PJ/pa")** which shows the theoretical volume of gas that a pipeline could transport were it to be full everyday of the year. Pipeline throughput is, however, highly seasonal with the winter months being the peak throughput periods. For this reason, it is also useful to consider terajoules per day **("TJ/day")** in order to consider available capacity during the year.

2.25 As the CWP is connected to the MSP at Marsden, the capacity of the CWP is impacted by the pressure on the MSP at Marsden. Currently pressure at Marsden is at 5000kPa and therefore the maximum capacity on the CWP is 9.4 TJ/ day.

2.26 The current contracted maximum daily throughput quantity ("**MDQ"**) at Marsden for the CWP is 10.8 TJ/day. However, this figure is not a reliable measure of actual utilisation as shippers have no incentive to accurately estimate MDQ as the current charging structure is wholly throughput based and does not provide for a capacity reservation charge.

2.27 A more accurate measure of pipeline utilisation is actual throughput. The 2008-2009 peak day flows on the CWP was 7.3 TJ/day.

2.28 Recent CWP usage is shown in the table below:

Table 3: Recent CWP Usage Information

	2007-8	**2008-9**
CWP Annual Volume TJ per annum	1,103	1,209
Maximum capacity (with MSP at 5000kPa) TJ per day	9.4	9.4
Average daily flow TJ per day	3.0	3.3
Utilisation at average daily flow	32%	35%
Peak day flow TJ per day	7.1	7.3
Utilisation at peak day flow	76%	78%

Thus it can be seen that there is substantial spare capacity on the CWP. Furthermore, as discussed in paragraph 1.43, one of the reasons for the change in tariff structure and introduction of capacity charging is demand management and to flatten loads. If effective in managing peak usage, additional pipeline capacity will become available.

2.29 While current forecast market demand would not support the expansion of the CWP, if required, the capacity of the CWP may be increased through compression. The capacity increase resulting from compression decreases with each additional compressor making each additional compressor comparatively more costly relative to capacity increase. Given there are currently no compressors on CWP, the addition of a compressor to increase capacity would be relatively cost effective and likely to meet internal investment hurdles were there to be sufficient demand.[13]

2.30 For the reasons set out above, there is currently ample capacity on the CWP and capacity constraints are not an issue for at least the near to medium term.

Commercial imperatives on CWP

2.31 The nominal CWP capital base in 2009-10 is $54 million, based on the residual value regulatory model and the economic depreciation modelling underpinning the approved 2000 CWP AA. In addition to capital costs, many of the operating costs are fixed and do not vary with throughput. The variable costs associated with the throughput of additional volumes on uncompressed pipelines such as the CWP are negligible (previous regulatory decisions have indicated that a benchmark of variable costs at 4% of total costs for compressed pipelines is reasonable).[14] Given such high fixed costs and low variable costs, maximising throughput is a major commercial imperative for CWP.

[13] A compressor would cost approximately $9 million to install and provide an additional capacity of 10 TJ/day. Such a compressor could be expected to incur operating costs of $400,000 per annum.
[14] See for example ACCC 2003 Final Decision EAPL Access Arrangement for MSP 2 October 2003, p xiii.

2.32 This was recognised by the Tribunal in the EGP case [para 117]:

"*There are strong commercial incentives for Duke to increase the throughput of the EGP, given its high capital cost, low operating costs and spare capacity."*

This assessment is equally valid for the CWP, particularly given its spare capacity and under-recovery of revenue to cover costs given current demand. The profitable operation of the CWP is dependant on increasing demand and throughput.

2.33 The existence of spare capacity and commercial imperative to increase throughput, temper any market power that the CWP may otherwise have. This issue is considered further below in applying the relevant specific form of regulation factors set out in s.16 of the NGL. The factors most directly pertinent to the issue of degree of market power are (a), (b), (c), (e), and (f).

Factor (a) presence and extent of barriers to entry in a market for pipeline services

2.34 The existence of high barriers to entry, if established, would tend to suggest a preference for heavy regulation. It should be borne in mind, though, that a pipeline should not be covered in the first place if barriers to entry were absent, as it would presumably lack market power. The case could be made that high barriers to entry tend to reduce a pipeline user's negotiating strength by limiting the alternatives to a negotiated settlement that may be available to the user. The weaker the user's negotiating position, the more likely that full regulation would be more effective than light regulation.

2.35 Seen in this light, the preference for one form of regulation or another would turn on the height or extent of barriers to entry, rather than their existence. The high capital costs of pipeline construction and the requirement to arrange foundation shipper contracts are likely to constitute barriers to entry. Nevertheless, the height of entry barriers for the CWP are lowered as:

- There is some potential for construction of new pipelines providing alternative routes to market for users and gas producers;

- There is some potential for development of new CSM production fields in Northern NSW which could allow users to receive gas without using the CWP; and
- the practice, among large pipeline users that hold significant capacity on long term contracts, giving them the potential to resell transport to third parties in competition with the pipeline owner.

Factor (b) network externalities between natural gas services of the same provider

2.36 The network externality form of regulation factor is designed to consider whether interdependencies are a source of market power for the pipeliner. The NCC's Final Decision on light regulation of the MSP noted, in connection with this factor, that the following circumstances are conducive to light regulation (Table 3-1, p. 21):

- Stand alone pipeline activity, where a service provider has no other pipeline operations;
- Rights to pipeline capacity readily tradeable; and
- Transmission services and other end to end services generally involve less interdependence with other pipelines.

2.37 As APA is also the ultimate owner of the MSP, and as all gas transported through the CWP must also traverse the MSP, the CWP is not a stand-alone pipeline. On the other hand, rights to pipeline capacity on the CWP are readily tradeable. There is no impediment to shippers reselling their capacity to others. In fact, it is common practice for some of the vertically integrated energy majors to negotiate haulage on behalf of industrial customers.

2.38 There is, however, an important area of pipeline interdependence within the APA group's portfolio of natural gas pipelines. Throughout NSW and, in fact, nationally, APA sells to the same small group of shippers on most of its pipelines. This buyer interdependence gives them a significant degree of countervailing power. The network externalities tend, if anything, to weaken APA's bargaining position with regard to these multi-pipeline customers. Restrictions against price discrimination contained in s.136 of the NGL mean

that all pipeline customers can benefit from the strong bargaining position of these customers. (This is discussed further in paragraphs 2.88 to 2.91).

Factor (c) network externalities between natural gas service and other services of provider

2.39 While the APA Group does provide services other than natural gas transport services, it does not believe that there are any significant network externalities between these and the services provided by means of the CWP.

2.40 Specifically, the gas processing facilities operated by APA are in Queensland and deliver gas into the RBP. Other non-pipeline assets owned and/or operated by APA are nowhere in the vicinity of the CWP. APA operates electricity assets including Murraylink, Directlink and two small power stations in Queensland. APA owns and operates gas storage assets in Western Australia and Victoria. Major gas distribution networks owned or operated by APA are in Brisbane, Adelaide, and Victoria. APA also provides operation and maintenance services to Mariner Income Fund, the owner of the ethane pipeline which runs parallel to the MSP from Moomba to Qenos' chemical plant in Botany, Sydney.[15] The pipeline is a dedicated ethane pipeline with a single customer, being Qenos. It is difficult to see how APA could bundle the transportation services of the CWP together with the operating and maintenance services of the ethane pipeline as the nature of the services and the customers for the services are very different. In short, all non-pipeline assets of the APA group are geographically remote and operationally separate from the CWP.

2.41 For these reasons the other services of the APA Group do not create any network externalities with the CWP that might give rise to market power.

[15] APA has a 6% interest in the pipeline owner and also owns 100% of the management company to the ethane pipeline (APA (MIT) Pty Ltd).

Factor (e) presence and extent of any substitute in a market for the pipeline service

2.42 Other than electricity, the availability of substitutes for the pipeline service provided by the CWP appears currently to be quite limited. While the cross-price elasticity between gas and electricity for end-customers of the CWP is difficult to measure, the fact that current Regulated Tariffs fail to recover the full economic costs of the pipeline suggests that end-customers have attractive alternative energy sources. By inference, there must be economic substitutes, although it is difficult to say precisely what they are based on the limited information presently available.

Factor (f) presence and extent of any substitute in market for electricity or gas

2.43 The availability of energy substitutes for the energy transportation service provided by the CWP enhances the bargaining position of CWP users, and suggests a preference for light regulation. From a user's perspective, non-pipeline substitutes will depend on the nature of the user's business. For some types of users, there will be very limited non-pipeline substitute. These may include gas retailers, gas fired power stations, and industrial plants that do not have alternative fuel capability.

2.44 Nevertheless at the end-user level, it is more feasible to substitute away from gas in the event of price increases than to substitute away from electricity. This point was recognised in the MCE Expert Panel's report:[16]

"*Gas and electricity markets also display different characteristics in terms of the price elasticity of demand and the ability for consumers to seek substitutes. Energy services, and in particular electricity services, are generally considered to have relatively inelastic demand. This inelasticity reflects the essential nature of electricity to commercial and industrial activity and to modern domestic life. This is less so for gas which is considered to be*

[16] Expert Panel on Energy Access Pricing—Report to the Ministerial Council on Energy, April 2006. pp. 49-50.

a 'fuel of choice', meaning that it is subject to more competition from substitutes."

"While the cost of network services is only part of the final energy price seen by energy consumers, the energy price responsiveness of users can impose some constraints on the exercise of market power in some circumstances.
"For gas, it could be said that there is a stronger substitution effect, particularly for locations that do not require space heating to any great extent. Electricity, in general, provides a better substitute for gas than gas does for electricity. Consumers are better able to exercise a choice on the source of their energy supply where there are competing sources of supply to a common area."

2.45 To some extent, the ability of end-users to switch to electricity or other fuels such as LPG, coal, wood and diesel imposes some constraint on the pricing decisions of all players in the gas supply chain, including pipeline owners.

2.46 The CWP was completed in 1998. Prior to the completion of the CWP, energy needs of energy consumers in the region were met by electricity, LPG, diesel, coal and other fuel types. The table below shows that natural gas has had slower than forecast penetration into the market. One of the prime reasons for this is competition from other fuel types. Energy demand not otherwise satisfied by gas is satisfied by alternative fuel sources.

Table 4: Actual and Forecast Gas Volumes on the CWP

Year	Actual Annual Volumes – TJ per annum	Forecast Volumes as per Access Arrangement Information[17] – TJ per annum	% Difference
2000-01	700	720	-3%
2001-02	779	942	-17%
2002-03	781	1164	-33%
2003-04	723	1255	-42%
2004-05	711	1320	-46%
2005-06	632	1360	-54%
2006-07	951	1400	-32%
2007-08	1,103	1439	-23%
2008-09	1,209	1479	-18%

[17] CWP Access Arrangement Information, 2000, page 11.

2.47 There are currently no power stations serviced by the CWP. The largest end-user of the CWP is Fletchers Abattoirs in Dubbo. During negotiations for gas transportation on CWP, Fletchers has advised that it has alternative fuel options installed including LPG and coal boilers.

Countervailing power of users

2.48 An access seeker with countervailing power does not need to rely on full regulation to obtain an efficient pipeline tariff because it can discipline pipeline pricing itself. If there is one access seeker with countervailing power that can play a lead role in negotiations with the pipeline owner, and if other access seekers can obtain the benefit of prices negotiated by that leader, then a single firm or small number of firms with countervailing power may suffice to discipline access pricing, without the need for full regulation. As the non-discrimination clause of the NGL (s.136) would apply to the services sought by the largest customers, it would oblige the CWP to offer all customers any price advantage obtained by the larger shippers.

2.49 Countervailing power depends on the existence and attractiveness of alternatives to a negotiated settlement with the pipeline owner. A firm need not be large or powerful to wield countervailing power; it only needs to have good alternatives. Even a relatively small "footloose" customer has significant countervailing power as a result of the ability to take its business elsewhere. The evaluation of countervailing power therefore comes down to an evaluation of each customer's alternatives to buying gas transport from the CWP. This analysis of alternatives is necessarily specific to each type of customer. The types are considered in turn below.

<u>Vertically integrated energy majors</u>

2.50 AGL and Origin are the two largest energy wholesalers and retailers in Australia. Both are vertically integrated with upstream gas reserves, wholesale and retail assets. They are themselves pipeline developers.

2.51 They are the second and fourth largest users of the CWP. Combined they account for approximately on third of CWP's current throughput. This load is critical to the viability of the CWP.

2.52 As vertically integrated firms, both AGL and Origin have upstream reserves, the energy infrastructure knowledge and the retail market shares to support credible threats of bypass. Bypass can occur through swap contracts, and through the underwriting or development of new pipeline construction. Firms such as these operate both as gas retailers and owners of gas reserves. This position has been further heightened by the recent emergence of large CSM reserves in Queensland and NSW. When a single firm owns both the gas reserve and the retail customers, it is in a strong position to threaten to employ swap contracts[18] or to construct new pipelines that might bypass existing pipelines as a potential response to unsatisfactory pipeline pricing, terms and conditions. Examples of shippers constructing pipelines include:

- AGL's construction of the 115 kilometre, 400mm high pressure Berwyndale to Walllumbilla gas pipeline (announced on 17 January 2008);[19]
- Origin's construction of the Mortlake power station project which includes the construction of a 78 kilometre dedicated underground natural gas transmission pipeline;[20] and
- Origin's involvement in the SEAGas pipeline in 2004[21].

2.53 Finally, firms who are shippers of other APA pipelines around Australia or potential foundation shippers for new APA pipeline developments may exert commercial pressure on APA to ensure satisfactory pricing, terms or conditions on the CWP. The multiple-market interface between APA and some of its shippers gives these shippers countervailing power, even if the shipper may not be a large user of the CWP at present.

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18 On 6 May 2004, Origin and the Cooper Basin Producers, led by Santos, reached conditional agreement to swap up to 200 PJ of gas. Origin agreed to deliver gas produced in its central Queensland fields to the Producers at Roma. In return for the gas from Origin, the Producers agreed to redirect an equal quantity of Cooper Basin produced gas to Origin at the Moomba Gas Hub. For details, see the press release at http://www.originenergy.com.au/files/gasswapagreement_2.pdf (accessed 12 August 2008).

19 http://www.agl.com.au/about/ASXReleases/Pages/AGLtodeveloptheBerwyndaletoWallumbillagaspipeline.aspx

20 http://www.originenergy.com.au/files/Mortlakefactsheet2.pdf

21 Note that the co-developers of this project were also gas retailers being TruEnergy and International Power.

2.54 Some examples of these multiple-market interactions with vertically integrated energy majors include AGL (customer of RBP, the VTS, SEAGas and the MSP), Origin (customer of RBP, VTS, SEAGas and the MSP) and TRUenergy (customer of VTS, SEAGas pipeline and the MSP).

Stand-alone energy retailers

2.55 Firms such as Energy Australia and Country Energy constitute another important group of actual and potential pipeline users. Unlike the integrated energy majors, these energy retailers tend to operate stand-alone energy businesses that may lack the geographic diversity and the vertical linkages in gas that give the majors such a vast suite of alternatives.

2.56 These stand-alone retailers possess attributes that give them countervailing power with the CWP. First, in the case of CWP, they account for half of the CWP throughput and include the largest user of the CWP.

2.57 Second, these customers represent a source of customer diversity for APA and the CWP. Strategically, it is in APA and CWP's interest to reduce its reliance on the largest customers by diversifying its customer portfolio through an accommodation of expansion of the smaller retailers and other shippers. Such diversification reduces certain commercial risks associated with having a single dominant customer. Diversification assists in managing imbalances and smoothing load profiles.

2.58 Taking into account these strategic considerations CWP has an incentive to offer pricing and terms to stand-alone energy retailers that are no worse than those offered to the energy majors. Section 136 of the NGL would rule out inefficient price discrimination if the CWP were subject to light regulation.

Power stations

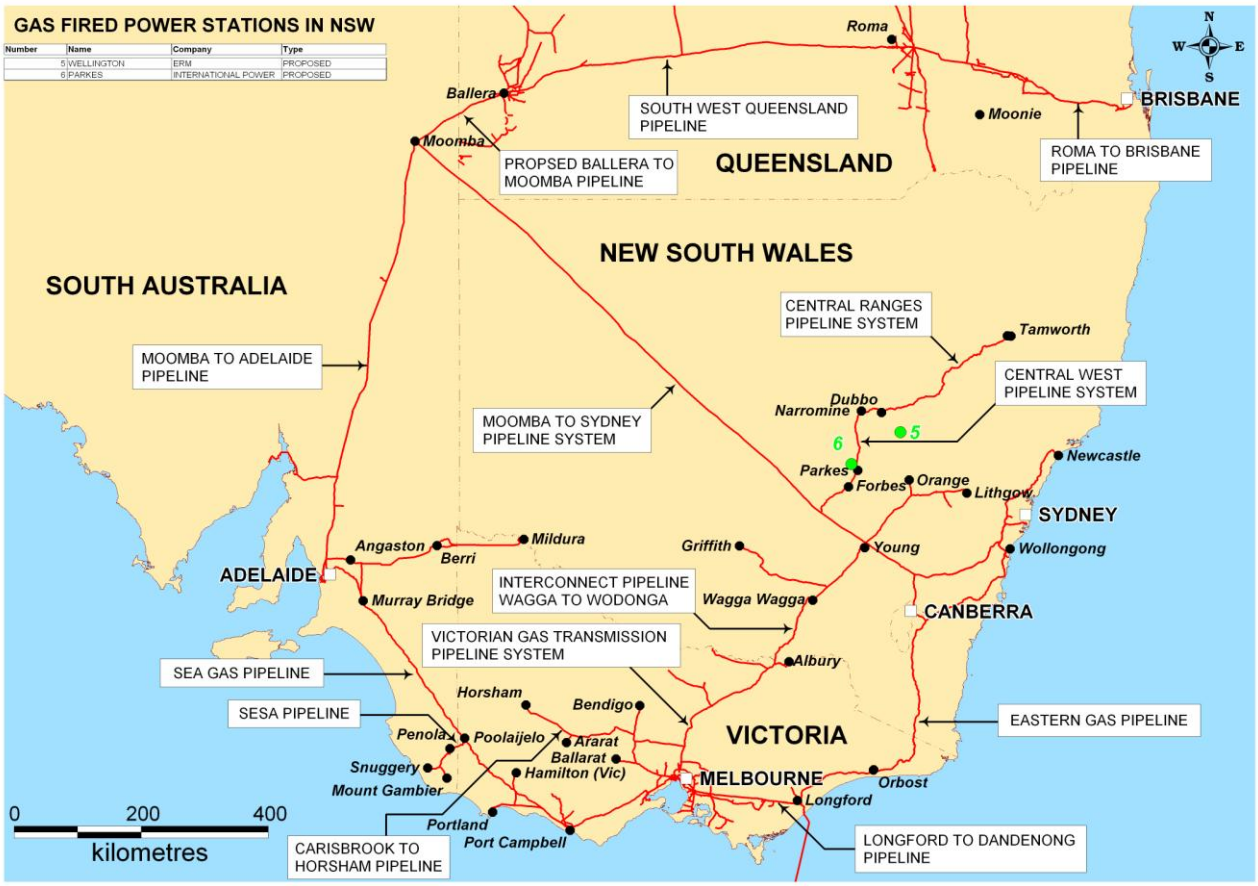
2.59 On the CWP a power station can wield countervailing power as a power station owner that is not yet committed to construction can threaten to build the power station in a location served by a rival pipeline, to not build it at all, or to build a bypass pipeline.

2.60 It is usual practice for power station proponents to base their initial financial commitment on a network of long-term contracts with all key suppliers, including the pipeline owner. Once established, these contracts protect the power station owner's investment from hold-up threats. The countervailing power that is derived from the owner's freedom of choice over power station location and whether the project proceeds is employed to lock the pipeline into long-term arrangements.

2.61 There are currently no existing gas fired power stations served by the CWP; however APA receives numerous enquiries from potential gas power station projects, including some located on the CWP. The two most advanced proposals are the ERM proposal at Wellington and the International Power proposal at Parkes. (These projects are discussed in paragraphs 1.32 to 1.36). There have also been other approaches from developers for potential power station projects.

2.62 The following map which shows the location of the Wellington and Parkes proposed power station projects on the CWP where APA services.

Map 2: Proposed Power Stations in the Region Served by the Central West Pipeline



Key to map above:

No.	Name	Company	Type
5	Wellington	ERM	Proposed
6	Parkes	International Power	Proposed

Large industrials

2.63 Large industrial gas customers have, and often exercise the option of buying gas transport services from a large pipeline customer instead of contracting directly with the pipeline. This option gives large industrial customers a degree of countervailing power with respect to the pipeline. In essence, the industrial customers are able to promote a form of competition between the pipeline owner and its major customers, like AGL and Country Energy, who can act as resellers of transport capacity.

Access to information

2.64 An important point of distinction between light regulation and full regulation is the degree of mandatory information disclosure by the pipeline owner. Under full regulation, the owner is obliged to prepare voluminous access arrangement information documents which are publicly disclosed. These documents contain a great deal of detail on pipeline costs, capital expenditure plans, utilisation forecasts, and other matters that are designed to enable an interested member of the public to virtually replicate the service provider's estimate of the revenue requirement and reference tariffs.

2.65 Under light regulation, however, this particular form of information disclosure is not mandatory. The effectiveness of light regulation depends, in part, on the quality and extent of the information that would be available to access seekers without that mandatory disclosure.

2.66 Matters such as the price, availability, terms and conditions of supply for pipeline services are disclosed by the pipeline owner under light regulation through (among other requirements), reporting obligations to the AER and ring fencing reports.[22]

2.67 Other forms of mandatory disclosure, including the AER annual monitoring programme and obligations concerning continuous disclosure to the ASX will ensure that certain fundamental facts concerning the pipeline owner's corporate affairs and the pipeline itself will continue to be publicised in a timely manner.

2.68 In relation to cost information, a large component of the relevant cost information is already in the public domain as a consequence of past regulatory pricing assessments of the CWP. This information is often time invariant or can be deduced from current macroeconomic settings and past regulatory precedent, for example the WACC could be estimated by reference to the risk-free rate, inflation, market risk premium, debt/equity ratios etc. In

[22] Information disclosure requirements under the NGL and Rules for light regulation pipelines includes disclosure of price and terms and conditions of offer (r36), rules relating to facilitating access requests (s107, r108, r109, r112), registers of spare capacity (r111), ring-fencing obligations (s.141), performance reports to AER (s.64) and reports to AER on access negotiations (r37).

other words, a large part of the CWP cost base can be readily deduced by a third party without reference to any new information disclosure by the owner.[23]

2.69 Capital expenditure tends to either be a major capital works programme (in which case a market announcement may be required under the ASX Listing Rules) or ongoing stay in business capital which generally continues at a constant rate over the life of the asset making previous costs (disclosed as part of the prior regulatory process) a good predictor for future costs. Given the relatively small size of the CWP any stay in business capital expenditure is likely to be correspondingly small. For example, in the CWP AAI[24] capital expenditure in nominal terms is between $7,000 and $12,000 per annum. As such capital expenditure is both small and relatively stable and predictable.[25]

2.70 Similarly, operating expenditure tend to continue at a constant rate over the life of the asset, previous costs act as a good predictor for future costs. For example in the CWP AAI operating expenditure in nominal terms is between $774,000 and $997,000 per annum. These expenditure components are broken down between various operating and administration components.[26]

2.71 Operating expenditure is approximately 20% of the annual total of CWP's costs. Thus small variations in operating cost are likely to have less impact on pricing than changes in the rate of return. Shippers are also able to apply industry accepted benchmarks for assessing operating costs for pipelines. For example, the ACCC has previously accepted that the pipeline operating cost should be in a range of 2% of replacement cost for uncompressed pipelines to 5% of replacement cost for fully compressed pipelines.[27]

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[23] The CWP is in an unusual situation because of the negative depreciation, which means that the regulated asset base has been increasing since 1999 due to capitalised losses. To the extent that this characteristic of the CWP might make it difficult for customers to estimate a cost-of-service tariff, APA would be prepared to publish relevant depreciation and RAB roll-forward data.

[24] CWP Access Arrangement Information 2000 page 10.

[25] The one exception is that in 2008 $830,000 of capital expenditure in SCADA was scheduled to occur. This has not occurred to date. APA is currently operating a program to replace SCADA in New South Wales.

[26] The one exception is that in 2008 operating expenditure was scheduled at $1,444,000 due to pipeline pigging costs. This occurred but in 2009 rather than 2008.

[27] ACCC (2001) Final Decision Access Arrangement proposed by Epic Energy South Australia Pty Ltd for the Moomba to Adelaide Pipeline System Date: 12 September 2001 p57 and p 203.

2.72 As discussed above in paragraph 2.52, both Origin and AGL are themselves pipeline developers. These firms clearly possess the necessary technical and commercial expertise to enable them to assess the reasonableness of CWP costs. In addition Country Energy operates gas networks in regional New South Wales and would have the capability to assess the reasonableness of CWP costs.

2.73 In addition, under the AER's Annual Compliance Guideline light regulation pipelines are required to report on price discrimination and access negotiations.[28] This information is made publicly available.

2.74 APA considers that the information provision required under the NGL and the Rules in particular, when combined with existing publicly available sources, would provide shippers with sufficient information to enable them to negotiate effectively with APA were the CWP subject to light regulation.

Incentive to negotiate/arbitrate

2.75 The issue around incentives to negotiate or arbitrate comes down to one simple question: given the potential upside, is it worth the trouble to negotiate hard over pipeline access pricing, terms and conditions? Perhaps the clearest indication that shippers have such an incentive is the fact that such negotiating does in fact occur.

2.76 CWP has negotiated price reductions with shippers and end users due to a recognition by the CWP that it needs to retain and grow volumes through the CWP and a recognition that to do this it must compete with alternate fuel sources.

2.77 Similarly, the proposed change of tariff structure to a capacity and throughput charge was negotiated with each individual shipper. Details of the effect of the change on each shipper given expected demand is set out in the Confidential Attachment.

[28] See, for example, AER Annual Compliance Guideline, November 2008 page 5, page 8.

Industrial, commercial and residential gas usage – incentives to negotiate

2.78 The fact motivating this inquiry into incentives is that, for many pipeline users, the cost of gas haulage on the CWP represents a relatively small part of the total cost of doing business. Management time and effort may consequently be prioritised to other areas. A firm may not take advantage of its ability to obtain a better pipeline tariff if it lacks the commercial incentive to invest in that endeavour. In contrast, where a user has both the ability and incentive to engage in a vigorous negotiation on terms and conditions of supply, light regulation is more likely to be effective.

2.79 The table below, representing APA's internal estimates of the relative magnitude of the components of the delivered price of gas (per GJ) to various classes of end-customer, is presented in order to evaluate this incentive.

Table 5: Relative Magnitude of the Cost Components of the Delivered Gas Price in the CWP Region

	Industrial	**Commercial**	**Domestic**
Wellhead gas price	\$3.50-\$5.00		
MSP Transmission (to Marsden)[29]	\$1.00 - \$1.25		
CWP Transmission (same for all delivery points on the CWP)	\$2.95		
Distribution Network	\$1.00 to \$3.00	\$4.00 to \$8.00	\$10.00 to \$20.00
Retailer Margin (5 - 10%)	\$0.40 - \$1.20	\$0.60 -\$1.70	\$0.80- 2.90
Total delivered price	\$8.80 - \$13.40	\$12.00 - \$19.00	\$18.30 – \$32.10

2.80 At first glance, the CWP transmission price, at \$2.95 per GJ appears to represent a small component of the total delivered price of gas to all customer types except industrial users.

2.81 It is important to recognise, however, that the CWP transmission price is large in comparison to the retailer margin for all of these end-customer types. A

[29] Note that these figures are an estimate of the load factor adjusted tariffs. For this reason, the figures differ to the headline posted tariffs.

5% reduction in the CWP tariff, of $0.15/GJ, would represent at a 12-35% increase in the retailer margin for industrial customers, a 8-25% increase in the retailer margin for commercial customers, and approximately a 5-19% increase in the retailer margin for domestic customers. The impact on retailer profitability would be greater than these figures because profit represents only a portion of the retailer margin. The remainder of the retailer margin would represent the recovery of fixed and common costs of retailing, including back office functions and marketing.

2.82 Accordingly, the prospect of a reduction in CWP transmission prices would be worth the effort of gas retailers to bargain hard. A further relevant consideration is that CWP transmission represents one of the few parts of the delivered cost of gas on which meaningful price reductions could conceivably be achieved through negotiations. The prospects of negotiating price reductions for the two largest components of the delivered gas price, being the wellhead price of the gas molecules and the distribution network charges, is limited.

2.83 The wellhead price of gas is determined in a complex manner on the basis of price arbitration (in most cases) between the gas producers and the energy retailers. The gas producers have considerable countervailing power which has only recently been challenged by the emergence of competition between gas basins. The nature of this price-setting process, the economics of exhaustible resources, and the range of alternatives facing a gas producer means that a user has very little realistic prospect of negotiating a lower gas molecule price.

2.84 Distribution network charges are subject to full regulation, and are likely to remain so for the foreseeable future. The distribution network tariffs are set by regulation, with very little, if any, scope for bargaining.

Power station gas usage – incentives to negotiate

2.85 Gas-fired power stations differ from other end-users in that their load profile is uneven over a 24 hour period and may differ substantially from one day to the next. This feature of generation demand arises from the peak or intermediate nature of gas-fired generation. Gas-fired generation is not always dispatched. When it is dispatched it is often for relatively short periods of the day corresponding to high or shoulder demand periods on the National Electricity Market.

2.86 For this reason, the gas transport service required by power stations is not the firm forward reference service to which the regulated tariff applies. Instead, each power station must negotiate a custom-made gas transport service with the pipeline. In this sense, a move to light regulation from heavy regulation would make little difference at all to power station customers of the pipeline.

2.87 APA estimates that the CWP transport price would represent a significant proportion of the short run marginal cost of power generation in the CWP region. Any power station operator would have a strong incentive to bargain hard to minimise the price.

Light handed effective for all shippers

2.88 Section 136 of the NGL prohibits price discrimination under light regulation. Section 136(1) states that "*A covered pipeline service provider must not engage in price discrimination when providing light regulation services*." Section 136(2) qualifies this prohibition somewhat by stating that subsection (1) "*does not apply if the covered pipeline service provider engages in price discrimination that is conducive to efficient service provision.*"

2.89 The term "price discrimination" is not defined in the NGL so it presumably carries the straightforward meaning that different prices may not be charged for the same service.[30]

[30] This is the way "discrimination" was interpreted in the now repealed section 49 of the Trade Practices Act 1974 banning anti-competitive price discrimination.

2.90 Under light regulation, the practical effect of s.136 would likely be to confer on all access seekers the benefits that are able to be negotiated by those pipeline shippers with the greatest amount of countervailing power—the vertically integrated energy majors. In other words, as long as the energy majors negotiate for the types of pipeline services that are demanded by other shippers, these other shippers should be able to receive equivalent pricing by reason of the non-price discrimination requirement regardless of the degree of countervailing power they may have. This is subject to any efficient price discrimination which is permitted under s.136.

2.91 Even relatively small shippers should not be disadvantaged in the event that CWP is granted light regulation status. This protection would not necessarily be available to small shippers under full regulation in the current circumstances of the posted tariff being lower than the regulated tariff, as there is no corresponding prohibition against price discrimination in that case.

Summary on effectiveness criteria

2.92 For the reasons discussed in this Part 2, light regulation would be no less effective than full regulation in regulating for the provision of services by the CWP to promote access to the pipeline services.

2.93 The reasons for this are three-fold. First, the degree of any market power CWP may have is low due to the commercial imperative for CWP to maximise throughput. While pipeline alternatives for the CWP are limited, the degree of any market power is low given the substitution threat of alternate fuels such as electricity as well as spare capacity on the CWP. To charge prices higher than current prices would risk volume reductions on the CWP that might threaten its commercial viability. This is evidenced by the fact that the CWP has never to date been able to charge tariffs that recover its full economic costs in any year.

2.94 Second, the shippers on the CWP are in fact all major shippers on the MSP mainline with strong countervailing power. Each of the five CWP shippers is capable of using its bargaining position on the MSP mainline to ensure that it obtains attractive terms on the CWP.

2.95 Third, the information required by users to enable them to negotiate effectively with APA would be available under light regulation. Further costs information can be derived from industry sources, particularly by the large users which are pipeline developers in their own right.

2.96 These factors combine to provide users with an ability to negotiate effectively under light regulation. Users would also have the incentive to do so. The estimated margin and cost figures discussed in paragraphs 2.79 to 2.82 suggest users have a financial incentive to negotiate to obtain the most favourable terms.

2.97 In addition, for the reasons discussed below in Part 4, a change to light regulation would be consistent with the national gas objective.

2.98 For these reasons, the “effectiveness” criteria set out in s.122 (1) (a) are satisfied in the case of the MSP.

Part 3 - Comparative cost of forms of regulation

(s.122(1)(b))

Overview and approach

3.1 Section 122(1)(b) of the NGL requires an assessment of the differences in likely costs between the full and light forms of regulation for the CWP. This assessment requires consideration of the likely costs for efficient service providers, efficient users and prospective users and end users.

3.2 This requires a comparison of two counterfactuals – namely, the likely costs of the CWP under light regulation compared with the likely costs of its continued full regulation. In considering the cost differences, this submission focuses on the differences in application between the two forms of regulation as it would apply to the CWP and attributes cost estimates to those differences.

3.3 The consideration of costs set out in this section focuses on:

- the costs to APA as the service provider; and
- the costs to the shippers being the users.

3.4 In the case of shippers who are also industrial end users, these shippers are both “users” and “end users” for the purposes of s.122((1)(b)), and, as such, the cost savings of light regulation attributable to these shippers is relevant in their capacity as both users and end users.

3.5 For other end users, the degree of any cost savings attributable to a change to light regulation would depend on the extent the cost saving from light regulation is passed through by shippers. This is something that APA is unable to comment on. For this reason, this submission focuses on the cost savings of light regulation for APA and the shippers, but not for end users.

3.6 The assessment of the costs of regulation outlined in this Part 3 assumes APA is an efficient service provider. This assumption is consistent with general capital market disciplines on APA to minimise costs and maximise

efficient outcomes. For the same reason, it is also assumed that current and prospective users are efficient for the purposes of s.122(1)(b).

Nature and outcomes of commercial negotiations unaffected by form of regulation

3.7 As discussed above, shippers and prospective shippers on the CWP currently negotiate tariffs and transportation agreements with APA. The nature of the negotiations that currently occur with shippers would be unlikely to be adversely affected by a change to light regulation.

3.8 In relation to access to information, as discussed in paragraphs 2.64 to 2.74, the information provision obligations under the NGL, the Rules, ASX Listing Rules and generally available industry information will enable shippers to continue to negotiate effectively with APA. In APA's experience, the key information which shippers rely on to negotiate with APA include the following:

- Currently offered and prior CWP tariffs and terms, including previous regulatory benchmarks;
- Tariffs and terms offered by other pipelines, including other APA pipelines;
- The costs of bypass; and
- The cost of gas supply from competing basins, although in the case of the CWP this is not a major consideration.

3.9 This information would continue to be available to shippers in negotiating with APA under a light regulation regime.

3.10 While light regulation does not require the disclosure of detailed cost of supply information such as stay in business capital and operating cost information, as is the case under full regulation, the availability of prior cost information through the full regulatory process, the disclosure requirements under the NGL and Rules as well as the involvement of some shippers in their own pipeline developments means that shippers would be able to ascertain sufficient cost information to effectively negotiate with APA for CWP services.

Major shippers can and do perform their own estimates of pipeline costs and use these in tariff negotiations. As such, APA would expect that the difference in cost to shippers of estimating the necessary cost information between full and light regulation would be relatively minor.

3.11 As set out in the Confidential Attachment, shippers on the CWP are currently paying both the Reference Tariff as well as negotiated tariffs that differ from the Reference Tariff. Under the proposed new pricing structure (discussed at paragraphs 1.41 to 1.48), all shippers would be charged a negotiated tariff and not the Reference Tariff. Given this, there is unlikely to be any material cost difference in the negotiation process itself to APA, shippers, prospective shippers and end users were the CWP to be subject to light regulation.

Differences between forms of regulation

3.12 There are three key differences from a comparative costs perspective between the full and light forms of regulation. They are:

- the management of access arrangement processes;
- compliance with required regulatory processes; and
- dispute resolution.

AA and AAI processes

3.13 The main cost of full regulation is the requirement under s.132 of the NGL for a service provider to submit a full AA and AAI in accordance with the Rules.

3.14 Under full regulation APA will be required to submit an AA and AAI for the CWP for consideration by the AER by April 2009 and every 5 years[31] thereafter. In contrast, light regulation pipelines must only publicly provide the price and terms and conditions for access, and report periodically to the regulator on access negotiations.[32]

[31] Note that there is some flexibility in the time frames applying to access arrangement duration but five years is a general standard.
[32] National Gas Rule 36 and 37.

Costs to APA

3.15 The development and regulatory evaluation/approval of an AA and AAI for the CWP to a position that would be acceptable to the regulator would be expected to take about 12 to 18 months, but could be longer based on previous APA Group experience of preparing AAs. This time frame can be further supported by reference to AER Guidelines which suggest a six month pre lodgement consultation period[33] and the NGR which provides for up to a 13 month AA process following submission (Rule 13).

CWP

3.16 There has only been one CWP AA to date. This AA was undertaken in the period 1999-2000. The AA-related costs for the CWP were not included in the public CWP AA documentation. The costs of the AA appear to have been included in a general administration and overheads cost. This cost explicitly included a cost for regulation.[34] As the AA was prepared by AGL prior to APA's ownership of the asset, APA does not have documentary evidence of these costs.

3.17 APA's estimate of the AA costs, both of internal resources and external advisors is approximately $400,000. Given the lack of firm AA cost data from the CWP or similar pipelines, APA has estimated that the CWP AA would require:

- One senior manager full time for 12 months $250,000
- Consultancy advice on specialist topics[35] $ 50,000
- Modelling support $ 50,000
- Support from engineering, legal and commercial staff $ 50,000

[33] AER, 2009, Access Arrangement Guideline: Final, p19
[34] APT Pipelines (NSW) Pty Limited, 2000, Access Arrangement Information for Central West Pipeline, p13.
[35] In a typical AA process external expert advice and support is obtained for volume forecasts, operating expenditure forecasts, capital expenditure forecasts and cost of capital issues. Other advice may be obtained depending on particular issues relevant to the asset.

3.18 The total cost of these activities would be $400,000. The costs could increase if contentious issues arose which needed additional consultancy advice or if the process was delayed or extended.

3.19 In order to validate this figure, benchmark cost estimates for the AAs of other APA owned pipeline since 2000 may help to establish a general empirical relationship between AA costs and the size or complexity of a transmission pipeline. APA recognises that other pipelines are substantially larger in size and value than the CWP, and consequently recognises that the AA costs for the CWP are likely to be lower in absolute terms. Nevertheless, all of the AAs are governed by the same legal and regulatory requirements, which may give rise to fixed costs of an AA for transmission pipelines of any size. Other APA-owned pipelines were chosen for this analysis because relevant cost data is most readily available for these.

Goldfields Gas Transmission Pipeline

3.20 APA owns and operates the Goldfields Gas Transmission Pipeline. The recent AA and AAI process currently underway for the Goldfields Gas Transmission Pipeline provides a useful benchmark of future AA costs. The estimated APA costs for the Goldfields Gas Transmission Pipeline AA are $1,300,000.[36]

3.21 This AA and AAI process is expected to be finalised in late 2009. These costs have not yet been approved by the regulator. These costs include external consultant's costs and the internal costs of a regulatory manager, analysts, and engineers, other technical and financial managers as well as senior management involvement.

[36] Note that the GGT document "Supporting Information to Proposed Revisions to Access Arrangement" as submitted to Economic Regulation Authority on 7 April 2009 page 132 indicates that these costs may be as high as $1.9 million. It should be recognised that this $1.9 figure includes various ERA charges and $1.3 million is a figure that is comparable with other figures in this submission.

VTS

3.22 APA owns and operates the Victorian Transmission System ("**VTS**"). The recent AA and AAI process for the VTS completed in June 2008 provides an indicator of future AA costs. GasNet submitted that the AA include regulatory reset costs of $950 000 for the AA period. These regulatory reset costs of $950 000 were accepted by the AER and included in the cost base which will be recovered by GasNet via the AA tariffs. The actual final external cost of the GasNet AA was $1.015 million[37]. In addition to these external costs, APA incurred significant internal costs associated with the development of the AA. Accordingly, overall the cost of the VTS AA to APA was approximately $1,500,000.[38]

RBP

3.23 APA owns and operates the RBP. The AA and AAI process for the RBP was completed in March 2007.

3.24 The regulator accepted the proposed AA costs of $500,000.[39] The total actual external costs for this AA were $366,831. In addition to these external costs, internal APA staff salaries and overheads are estimated to be in the order of at least $450,000, based on a conservative estimate of a manager and an analyst working full time on the RBP AA for 18 months. Thus overall the cost of the RBP AA to APA was approximately $817,000.

MSP

3.25 The APA application for light handed regulation of the MSP noted (at para 3.18) that AA costs of $1.4m were accepted by the ACCC in its Draft Decision

[37] Further information on these costs is available at, APA, 2008, MSP Light Regulation Submission: Application for light regulation determination for Moomba to Sydney Pipeline services by East Australian Pipeline Pty Limited, p58.
[38] It should be recognised that work on AAs continues at a low level between AA reset times – for example capital expenditure is subject to prudency tests prior to internal approval and then recorded for incorporation into the capital base roll forward calculation.
[39] ACCC,2006, Final Decision Revised access arrangement by APT Petroleum Pipelines Ltd for the Roma to Brisbane Pipeline20 December 2006 p84.

on the access arrangement in 2000. That cost pertained to the entire MSP, which was covered at that time.

3.26 The same light handed application noted (para 3.19) an AA cost for the covered part of the MSP in 2009 of $586,000.

Summary of AA cost information for transmission pipelines

3.27 The table below summarises the AA cost information discussed in the preceding paragraphs.

Table 6: Information Used in AA Cost Analysis[40]

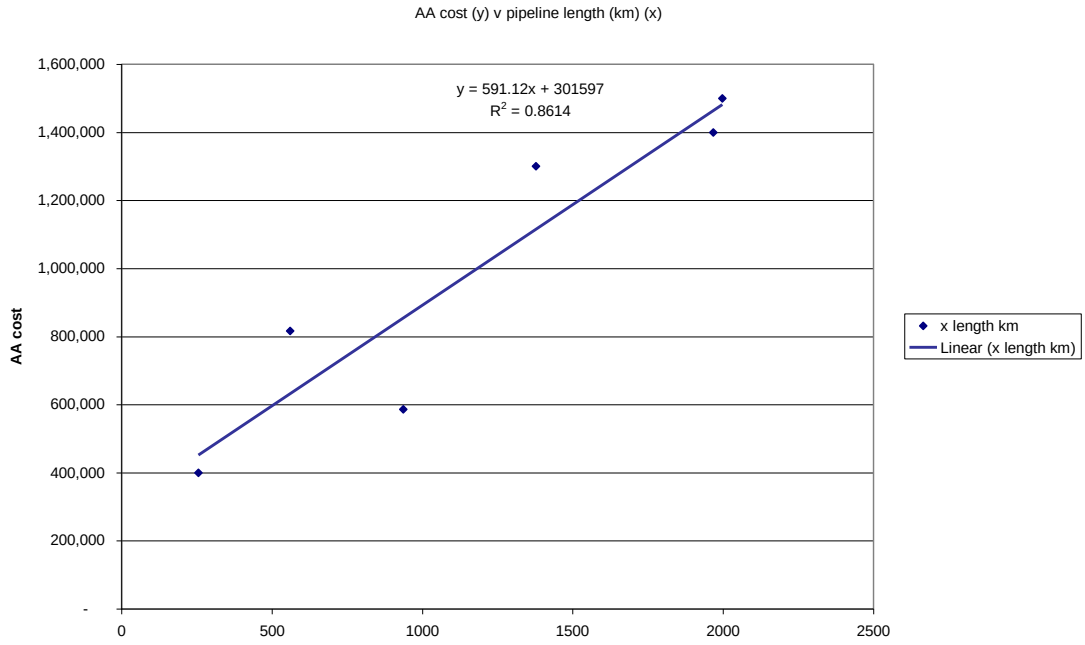
	Estimated AA Cost to APA (Internal & External Costs)	Asset base at Reset	Operating Cost in Year 1 of the New AA	Pipeline Length (kilometres)	Forecast Volumes in Year 1 of the New AA
CWP ($2010)	$400,000	$53,767,000 (estimate)	$1,013,000 (estimate)	255	1,250 (estimate)
RBP ($2006)	$817,000	$296,410,000	$8,310,000	560	51,100
GGT ($2009)	$1,300,000	$446,200,000	$26,800,000	1378	32,400
Victorian PTS ($2007)	$1,500,000	$560,740,000	$27,890,000	1997	228,400
MSP -Entire pipeline ($2003)	$1,400,000	$834,600,000	$18,600,000	1967	95,400
MSP Regulated Pipeline ($2008)	$586,000	$423,915,000 (estimate)	$11,012,000 (estimate)	937	69,264 (estimate)

The data in the table above was examined graphically to search for empirical relationships between cost and the various possible metrics of pipeline size shown above. The correlation between AA cost and forecast volumes was poor. However the correlations between cost and these other metrics were

[40] The figures for the CWP and the MSP Regulated Pipeline in 2008 are both based on internal APA estimates. The CWP estimates are based on internal APA estimates. The MSP estimate was based on APA internal workings undertaken in preparation for an MSP AA that was to be lodged in 2008. As the MSP became a light regulation pipeline this AA was never lodged.

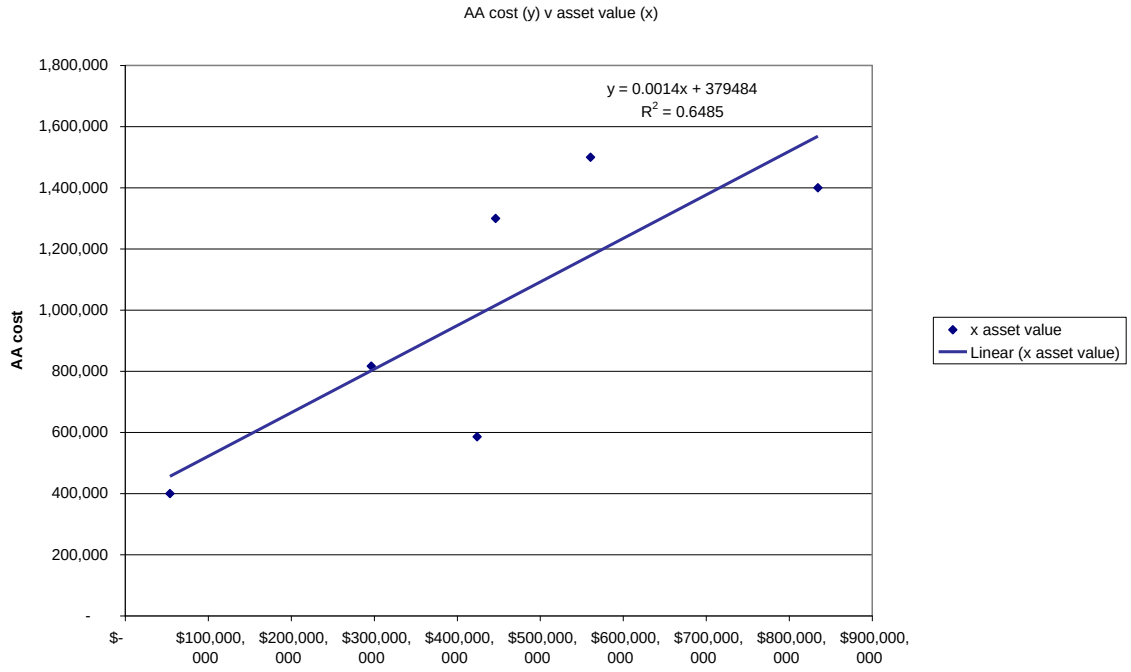
good. The following three charts illustrate these correlations. First AA cost versus pipeline length:

Diagram 3: Correlation between the Cost of an AA and Pipeline Length



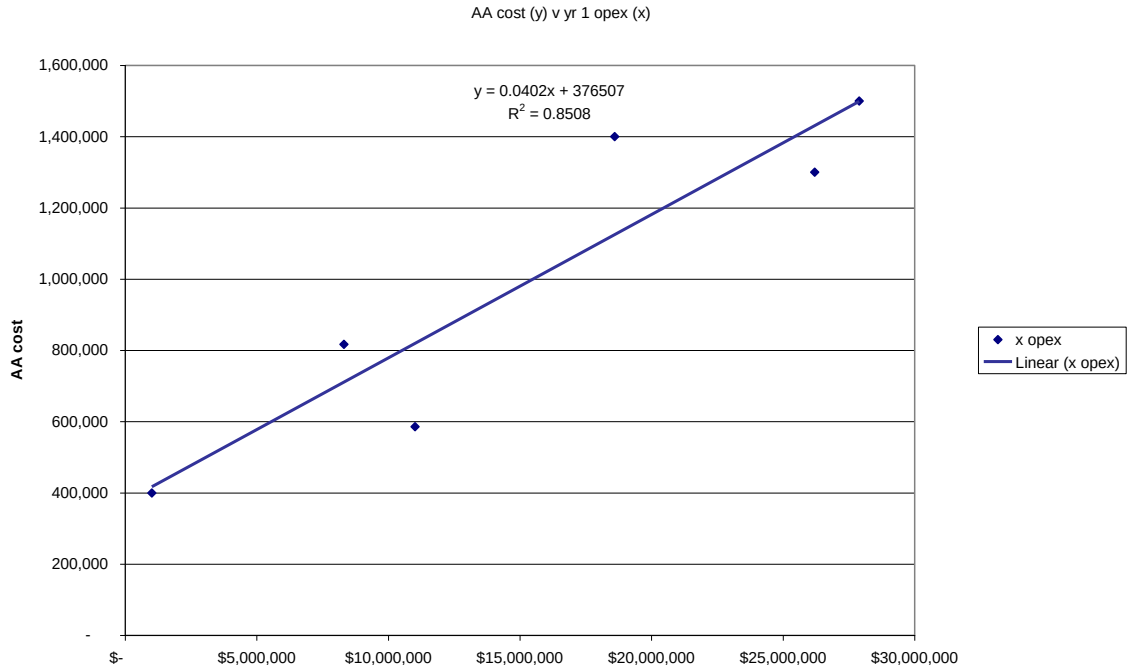
3.28 Then AA cost versus asset value at the commencement of the AA period:

Diagram 4: Correlation between the Cost of an AA and Asset Value



3.29 Finally, AA cost versus operating expenditure in year 1 of the new AA. (Operating expenditure is often an indicator of the complexity of the pipeline system and consequently the complexity of the AA).

Diagram 5: Correlation between the Cost of an AA and Operating Expenditure



3.30 While the number of points is small, the correlation coefficients, R^2 are high. Significantly, the y-intercept of the best-fit lines all lie within the range $290,000 to $380,000. This finding suggests the existence of a minimum fixed cost of any AA for a transmission pipeline within this range.

3.31 Given the size of the CWP, the cost of its AA could be expected to be somewhat above the range $290,000 to $380,000. Thus the estimate of $400,000 is reasonable based on this analysis.

3.32 Accordingly, a change to light regulation for the CWP would result in a cost saving to APA in the order of at least $400,000 as no AA would be required.

Costs to shippers and end users

3.33 It is difficult for APA to quantify another party's costs in the AA process, but APA believes the internal costs incurred by shipper's management and regulatory specialists would be reasonably significant.

Cost of ongoing AA management and compliance

Costs to APA

3.34 There are a numerous ongoing regulatory compliance obligations that apply to both full regulation pipelines and light regulation pipelines, notably:

- ring fencing requirements (NGL ss.139-141, s.143, ss.147-148),
- access dispute resolution (NGL, s.185, s.195, s.200, ss.202-204, s.206, s.214);
- facilitation of access (NGR, r108-109, r111-112); and
- confidentiality (NGR r138-139).

3.35 The costs of complying with these obligations are assumed to be similar for both light and full regulation pipelines.

3.36 There are numerous ad hoc regulatory tasks relating to responding to proposed laws, regulations and regulatory guidelines and reviewing coverage and regulatory decisions relating to other regulated assets. These tasks are undertaken for both light and full regulation pipelines, but due to the nature of full regulation, it is reasonable to assume that the costs for such activities are likely to be greater for full regulation pipelines.

3.37 There are specific ongoing regulatory compliance obligations which apply only to either full regulation pipelines or light regulation pipelines. These are outlined below.

<u>Ongoing compliance obligations</u>

3.38 In addition to incurring costs related to the establishment and revision of an AA there are also specific ongoing internal costs associated with managing and complying with full regulation and AAs including:

- AA queue management (NGL s135, NGR r103);
- complying with AA capacity trading requirements and AA change of receipt and delivery point requirements (NGR r105-106);
- facilitation of access by posting the AA on a website (NGR r107); and
- ensuring compliance with AAs. This in turn requires:

- management of AA tariff escalation processes including AA tariff escalation correspondence;
- management of cost pass through processes (including nil return correspondence);
- ensuring consistency of contracts with AAs where applicable; and
- management of internal compliance programs to ensure AA processes and requirements are being met by staff. In the case of APA this involves an internal quarterly compliance report by relevant managers and officers.

3.39 In the case of light regulation pipelines, in addition to incurring costs related to publishing tariffs and terms and conditions on its website there are also specific ongoing internal costs associated with managing and complying with light regulation including:

- reporting to the AER on access negotiations relating to light regulation services (NGR r37);
- updating tariffs and terms and conditions on the website; and
- management of internal compliance programs to ensure tariffs and terms and conditions are being met. In the case of APA this involves an internal quarterly compliance report by relevant managers and officers.

3.40 APA does not separately cost regulatory compliance activities. However, given the nature of the regulatory obligations the costs of complying with these ongoing compliance obligations is likely to be somewhat lower under light regulation, as the tasks are less onerous. Under light regulation, the pipeline has an option to submit a limited AA. As this election is voluntary on the part of the pipeline, this cost is not included in this analysis.

Comparison of ongoing regulatory costs

3.41 APA does not separately cost regulatory compliance activities. It was noted that costs to the pipeline of meeting ongoing compliance obligations are somewhat lower under light regulation. Based on an allocation of the regulatory department budget APA estimates that the costs of ongoing regulatory management for each individual full regulation asset are

approximately $36,500 per annum, whereas the costs for each light regulation asset are approximately $27,500 per annum. (These estimates include the costs of complying with obligations common to both types of assets).

3.42 These estimates are based on the following assumptions:

- Half of all budgeted regulatory costs relate to ongoing compliance and associated tasks.
- The costs of meeting regulatory obligations that apply equally to both full and light regulation pipelines are identical for both types of pipelines.
- The costs of meeting regulatory obligations that apply only to full pipelines are assumed to be approximately twice that of the costs of meeting regulatory obligations that apply only to light pipelines.

3.43 It should be recognised that these estimates are not based on extensive experience as the introduction of light regulation occurred in 2008 and to date APA's experience of light regulation compliance management is limited.

3.44 On this basis, APA estimates that the cost savings to it for ongoing regulatory compliance associated with a change to light regulation for the CWP would be approximately $9,000 per annum or $45,000 over 5 years. This difference is not material and given the potential for variance, is not included in the total costs assessment in section 4.

Costs to shippers and end users

3.45 The costs of ongoing AA management and compliance are generally incurred by the regulated entity and the regulator, rather than shippers and end users. Costs to shippers and end users of ongoing AA management and compliance are likely to be minimal.

Dispute resolution

3.46 In the near term, it is anticipated that existing shippers will move to new negotiated contracts reflecting the new tariff arrangements. These contracts would typically include dispute resolution mechanisms providing for arbitration

for certain disputes. Given this, any substantive difference to the costs associated with the resolution of disputes under full or light regulation wold be unlikely. In addition, all CWP shippers are also shippers on the MSP where they have negotiated contracts. Similarly, these contracts have commercial dispute resolution clauses.

3.47 In respect of new and prospective shippers, under full regulation, access disputes can be brought against CWP to require compliance with the AA terms and conditions. The outcomes and remedies that can be sought by potential users in relation to reference services are limited to those terms and conditions set in the access arrangements.[41]

3.48 In order to assess the comparative cost of access disputes and arbitration (under full and light regulation respectively), APA has assumed that the frequency of disputes under each form of regulation would be unlikely to differ materially. While it may be supposed that this assumption is questionable as the existence of heavy regulation may be assumed to act to discourage access disputes, APA believes the assumption is supported by the evidence that there has been a general lack of access disputes on heavy regulation pipelines, light regulation pipelines and unregulated pipelines.

3.49 If a change to regulatory status from heavy to light or uncovered was believed to increase disputes, this would be seen in an increased number of disputes on light regulation pipelines and unregulated pipelines. This has not occurred.

3.50 During the ten years of operation of the Code, only one access dispute had been commenced, that being by AGL against APA in 2007 (refer to section 4 of Part 2 above). Similarly, under Part IIIA of the *Trade Practices Act 1975*, only two arbitrations for non-pipeline assets have occurred in the 10 years of its operation.[42]

3.51 The comparative cost of an access dispute with an arbitration would depend on the nature and scope of the dispute and the approach taken by the AER in determining the dispute. For any given dispute, it would be reasonable to

[41] Under s.189 of the NGL, the AER must give effect to applicable access arrangements.
[42] Refer to www.accc.gov.au for details of the Part IIIA arbitrations by Services Sydney against Sydney Water in 2007 and Virgin Blue against Sydney Airport in 2007.

assume that the costs associated with an access dispute and an arbitration would be in the same order of magnitude on the basis that the AER would determine both.

Costs comparison

3.52 The table below summarises APA's estimates of likely costs and cost savings to APA of a change from full to light regulation for the CWP for a 5 year regulatory reset period. It should be recognised that these estimates are based on limited sample sizes and are subject to large error tolerances.

Table7: Costs of Full and Light Regulation on the CWP

	Full regulation	**Light handed regulation**	**Cost saving of change to light handed for 5 year reset period**
Commercial negotiations			No change given new negotiated contracts are expected
AA and AAI process	$400,000	n/a	$400,000 (additional cost savings associated with appeals from AA processes)
Ongoing compliance			No material difference although there are likely to be some minor cost savings associated with light regulation
Arbitrations by existing shippers			No change
Arbitrations by new shippers			No change
Total cost saving to APA			**$400,000 (plus any AA appeal costs)**

3.53 As set out in the table above, a move to light regulation for the CWP would result in an expected cost saving of $400,000 for every five-year period because the costs of preparing and obtaining approval for the AA and AAI

would be saved. Costs associated with any appeals arising from the AA process would also be saved.

3.54 The principal cost savings to existing and prospective shippers of a change to light handed regulation would relate to their participation in the AA and AAI processes including submission, public consultation processes and any subsequent dispute process. While the cost savings to shippers are more difficult for APA to estimate, some level of savings could be expected to exist.

3.55 It is difficult for APA to comment on whether light regulation would result in any cost savings to end users as this depends on the extent of any pass through of cost savings by shippers. In the case of industrial customers, however, given their position as both shippers and end users, cost savings of light regulation can be attributed to them in both their capacities.

Part 4 - National Gas Objective and Other Factors

National Gas Objective

4.1 Section 122(2)(a) requires the NCC to have regard to the national gas objective in considering the criteria for light regulation set out in s.122(1).

4.2 The national gas objective is to "*promote efficient investment in, and 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*." (NGL, s.23)

4.3 In evaluating whether this objective would be met by light regulation of the CWP it is necessary to consider efficiencies (productive, allocative and dynamic) in the provision of CWP pipeline services as well as in upstream and downstream markets where competition is the key driver to welfare gains.

Cost savings on CWP pipeline services

4.4 The principal reason why a change to light regulation for the CWP would enhance efficiency (and therefore welfare) in the provision of pipeline services is that it would reduce APA's costs.

4.5 There would be cost savings to APA, shippers and end-users associated with the change to light regulation. This effect was quantified and explained in some detail in Part 3 of this submission. These improvements would make expenditure on the CWP more productively efficient.

No loss of allocative efficiency with light handed regulation

4.6 As the effectiveness section of this application explained, a move to light handed regulation of the CWP would involve no disadvantage to customers in the form of higher prices or reduced service quality or availability. The CWP's inability to recover its annual costs demonstrates that APA has no ability to

use any market power that might attach to the natural monopoly characteristics of the pipeline.

Other relevant factors – AER costs

4.7 Section 122(2)(c) of the NGL allows the NCC to have regard to "any other matters it considers relevant" in assessing an application for light handed regulation.

4.8 In relation to the comparative costs of full and light regulation, APA considers it appropriate for the NCC to have regard to the likely cost savings to the AER.

4.9 The conduct and determination of the AA and AAI process consumes significant resources by the AER. Typically, under the AA process the AER:

- Engages in pre consultation with the asset owner
- Commissions consultants reports on the AA and AAI as submitted
- Releases Issues paper and co-ordinates public forums
- Engages in discussions with the asset owner and other parties to confirm facts
- Receives and assesses submissions from multiple parties on the AA, AAI and related issues
- Releases a Draft Decision
- Receives and assesses submissions from multiple parties on the Draft Decision
- Engages in further discussions and assesses arguments put forward by parties
- Releases a Final Decision
- Potentially, writes their own AA if the submitted AA is non- complying and/or act as a party to an appeal

4.10 APA estimates that the AER would spend similar amounts of labour and time on assessing an AA and AAI and making Draft and Final Decisions as asset owners do in compiling and submitting the AA and AAI and making arguments to support their case. On this basis, APA would estimate that the AER's costs of considering and determining an AA process would be

$400,000. Much of this cost could be saved and internal resources redeployed by a change to light regulation for the CWP.

Summary on National Gas Objective

4.11 Light regulation of the CWP would involve a material cost savings, principally for APA, but also for shippers and for the AER. This cost savings would improve the efficiency of delivery of pipeline services. Because of the unique commercial circumstances facing the CWP (including significant spare capacity, countervailing customer power, and a historic inability to cover its annual costs) light regulation would be no less effective than heavy regulation. In its Final Decision on the MSP light regulation application, the NCC noted (paragraph 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."

Attachment 1

APA Group – Company Details

1. List of APA owned assets

This list covers all major APA Group owned assets but is not exhaustive

Asset Management

APA Asset Management (operates Envestra assets)

APA Operations (EII) (operates Energy Infrastructure Investments assets)

Corporate Shareholdings

30% of Envestra Limited

19.9% of Energy Infrastructure Investments Pty Limited

33% of SEAGas Pipeline

6% of Mariner Income Fund (owns the Moomba to Botany ethane pipeline)

100% of APA (MIT) Pty Limited provides some management services to Mariner Income Fund

Gas Networks

Allgas Gas Network (South East Queensland)

Central Ranges Gas Networks

Gas Pipelines

Amadeus Basin to Darwin Pipeline (96% owned)

Carpentaria Gas Pipeline

Central Ranges Gas Pipeline

Central West Gas Pipeline

Goldfields Gas Pipeline and associated laterals (88% owned)

Mid West Pipeline (50% owned)

Moomba to Sydney Pipeline

Parmelia Gas Pipeline

Roma to Brisbane Pipeline

SESA Pipeline

Victorian Principal Transmission System

Gas Storage

Mondarra Gas Storage

Victorian LNG Gas storage

Energy Infrastructure Investments (EII) Assets

Note that some assets now owned by EII were previously owned by APA. These are included in this table for information only. APA has a 19.9% interest in the EII assets.

Assets owned by EII which were previously owned by APA include:

Gas Processing

Kogan North Gas Processing

Tipton West Gas Processing

Gas Pipelines

Bonaparte Gas Pipeline

Telfer Gas Pipeline

Wickham point Pipeline

Electricity generation

Daandine Power Station

X41 Power Station

Electricity Transmission

Directlink Interconnector

Murraylink Interconnector

2. Substantial Security Holders

APA comprises Australian Pipeline Trust **(APT)** and APT Investment Trust **(APTIT).** APA is listed on the Australian Stock Exchange as stapled units in each of APT and APTIT. Security holders that hold more than 5% of currently issued units are as follows:

As at 14 August 2009	Securities	%
Petronas (includes shares held by Petronas Australia and East Australia Pipeline Marketing)	85 948 475	17.24%
HSBC Custody Nominees (Australia) Ltd	28 897 803	6.00%
Total Securities	498 633 596	

Attachment 2

Shipper information

AGL Energy Limited – www.agl.com.au

AGL Energy was formed following the merger of AGL and Alinta in October 2006 resulting in the integration of both companies' energy infrastructure assets and the separation of AGL's energy retail, generation and gas upstream assets. AGL Energy sells gas and electricity primarily in Australia. AGL also has substantial interests in coal fired, gas fired and renewable power generation and in upstream gas reserves and upstream gas operations.

Since 2007 AGL Energy has become an integrated energy company focusing on providing gas and electricity to over 3 million retail customers in Australia.

At mid September 2009 it had a market capitalisation of over $6,000 million. Its total revenue for the year ended 30 June 2009 was $5,995.7 million.

Origin Energy Limited – www.originenergy.com.au

Origin Energy is a vertically integrated Australian energy company involved in oil and gas exploration and production; electricity generation; electricity, natural gas and LPG retailing and energy trading. It is one of Australia's leading energy retailers with over 3 million customers.

At mid September it had a market capitalisation of approximately $13,350 million. Its total revenue for the year ended 30 June 2009 was $8,042 million.

TRUenergy Holdings Pty Ltd – www.truenergy.com.au

TRUenergy, previously known as TXU, is a gas and electricity provider for residential customers and businesses and also owns power stations and a gas plant. The group operates in Victoria, South Australia and New South Wales and has 1.3 million customers. TRUenergy is ultimately wholly owned by the Hong Kong based CLP Group.

Country Energy – www.countryenergy.com.au

Country Energy was formed from the merger between energy retail and distribution companies Advance Energy, Southern Energy and North Power in 2001 and in 2005 it merged with another rural New South Wales energy retailer, Australian Inland. The company's sole shareholder is the State Government of New South Wales. It provides electricity to around 800,000 customers in New South Wales, Victoria, Queensland, South Australia and the Australian Capital Territory. Its total revenue in the year ended 30 June 2008 was $2,308 million.

Energy Australia – www.energyaustralia.com.au

Energy Australia was formed in 1996 from a merger between Orion Energy and Sydney Electricity. It operates solely in the supply of electricity and gas in South Australia, Victoria, Queensland, ACT and New South Wales. Its total revenue for the year ended 30 June 2008 was $3,096 million. It is one of Australia's largest gas and electricity suppliers, supplying energy to over 1.5 million customers.

Attachment 3

Rule 34 - Compliance *Checklist*

Clause 34 of the National Gas Rules **("NGR")** specifies information required to be included in an application for a light regulation determination. These information requirements are set out as follows:

(1)(a) Application to be in writing

The application is in writing

(1)(b) Identify the pipeline that provides, or is to provide, the services for which the determination is sought and include a reference to a website at which a description of the pipeline can be inspected; and

Refer to paragraphs 1.4 to 1.10

(1)(c) Include a description of all pipeline services provided or to be provided by means of the pipeline; and

Refer to paragraphs 1.24 to 1.28.

(1)(d) Include the applicant's reasons for asserting that the pipeline services should be light regulation services; and

The services provided by the CWP should be subject to light regulation as the criteria set out in s.122 of the NGL are satisfied for the reasons set out in this submission.

(1)(e) Include other information and materials on which the applicant relies in support of the application

Refer to the information and material set out in this submission.

(2)(a) The capacity of the pipeline and the extent to which that capacity is currently utilised; and

Refer to Table 3 at paragraph 2.28.

(2)(b) For a transmission pipeline, a description of:

(i) All locations served by the pipeline (i.e. all locations at which receipt or delivery points for natural gas carried by the pipeline exist); and

(ii) All pipelines that currently serve the same locations; and

(iii) All pipelines that currently pass within 100 km of any location served by the pipeline; and

The current delivery points on the CWP are set out at paragraph 1.25. The current receipt point on the CWP is set out at paragraph 1.24.

For details of which pipelines are proximate to these receipt and delivery points, refer to paragraphs 1.51 to 1.53.

[Note that clause (2) (c) applies to distribution networks and therefore is not applicable to the CWP]

(2)(d) A description of the pipeline services provided, or to be provided, by the pipeline; and

Refer to paragraphs 1.24 to 1.28.

(2)(e) An indication of any other sources of energy available to consumers of gas from the pipeline; and

Refer to paragraphs 2.43 to 2.47.

(2)(f) The identity of the parties with an interest in the pipeline and the nature and extent of each interest; and

The CWP is wholly owned by APT Pipelines (NSW) Pty Limited ABN 37 080 842 360. Staff who operate the pipeline are employed by APT Management Services Pty Limited ABN 58 091 668 110.

Both APT Pipelines (NSW) Pty Limited and APT Management Services Pty Limited are wholly owned subsidiaries within the APA Group ("**APA"**). APA comprises Australian Pipeline Trust and APT Investment Trust. APA is an ASX-listed energy transportation company owned by approximately 100,000 security holders.

APA operates an internalised management structure with direct operational control over its assets.

Security holders that hold more than 5% of currently issued units in APA are noted in Attachment 1.

(2)(g) A description of the following relationships:

(i) any relationship between the owner, operator and controller of the pipeline (or any 2 of them);

(ii) any relationship between the owner, operator or controller of the pipeline and a user of pipeline services or a supplier or consumer of gas in a location or geographical area served by the pipeline;

(iii) any relationship between the owner, operator or controller of the pipeline and the owner, operator or controller of any other pipeline serving any one or more of the same locations or the same geographical area; and

APT Pipelines (NSW) Pty Limited is the owner, operator and controller of the CWP. APT Pipelines (NSW) Pty Limited is a wholly owned subsidiary within the APA Group.

APA has no ownership interest in any shipper or producer using the CWP and as far as it is aware, no shipper or producer using the CWP has any ownership interest in APA.

APA owns 100% of the Central Ranges Pipelines and the Moomba Sydney Pipeline as well as the Victorian Transmission System.

(2)(h) An estimate of the annual cost to the service provider of regulation on the basis of light regulation and on the basis of full regulation; and

Refer to Part 3.

(2)(i) Any other information the applicant considers relevant to the application of the National Gas Objective or the form of regulation factors in the circumstances of the present case.

Refer to the submission.

Confidential Attachment

[Information removed]