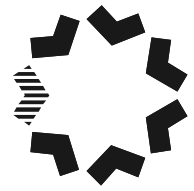


NATIONAL  
COMPETITION  
COUNCIL



# Light Regulation of the Central West Pipeline

Application for a light regulation  
determination in respect of the  
Central West Pipeline



**Draft Determination and  
Statement of Reasons**

**30 November 2009**



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## Abbreviations and Defined terms

AA	Access arrangement
AAI	Access arrangement information
ACCC	Australian Competition and Consumer Commission (which among other functions approved transmission pipeline access arrangements prior to the establishment of the AER) ( <a href="http://www.accc.gov.au">www.accc.gov.au</a> )
AER	Australian Energy Regulator ( <a href="http://www.aer.gov.au">www.aer.gov.au</a> )
AGL	AGL Energy Limited ( <a href="http://www.agl.com.au">www.agl.com.au</a> )
APPL / Applicant	APT Pipelines (NSW) Pty Limited (see <a href="http://www.pipelinetrust.com.au">www.pipelinetrust.com.au</a> )
Council / NCC	National Competition Council ( <a href="http://www.ncc.gov.au">www.ncc.gov.au</a> )
CRP	Central Ranges Pipeline
CSM	Coal seam methane
CWP	Central West Pipeline
Gas Code	The National Third Party Access Code for Natural Gas Pipeline Systems, Schedule 2 to the <i>Gas Pipelines Access (South Australia) Act 1997</i>
LAA	Limited access arrangement
Limited access regime	An access arrangement that is not required to make provision for price or revenue regulation which may be submitted voluntarily by the service provider of a light regulated pipeline – see also s116 of the NGL and r45 of the NGR
MSP	Moomba to Sydney Pipeline System
NGL	National Gas Law – the Schedule to the <i>National Gas (South Australia) Act 2008</i>
NGR	National Gas Rules – Rules made under s 294 of the NGL including amendments by the Australian Energy Market Commission (AEMC)
Standard consultative procedure	Procedure specified in rule 8 of the NGR that the Council is required to apply in considering a light regulation application
Trade Practices Act or TPA	<i>Trade Practices Act 1974 (Cth)</i>

## 1 Draft Determination

- 1.1 This draft determination is issued in accordance with the National Gas Law and National Gas Rules as part of the Council's process for determining an application by APT Pipelines (NSW) Pty Limited for light regulation of the Central West Pipeline.
- 1.2 **Based on the information available at the time this draft determination was prepared, the Council proposes to make a determination that the services provided by the covered Central West Pipeline be light regulation services.**
- 1.3 The Council's draft reasons for decision are set out in the following sections of this report.
- 1.4 The Council now seeks further submissions from interested parties in response to this draft determination and reasons. These submissions should be provided to the Council by 21 December 2009. The Council then has 20 business days to make a final determination on this application. The Council's final determination can be expected on or before 20 January 2010.

**National Competition Council  
30 November 2009**

## 2 Background

### The Application

- 2.1 On 2 October 2009 APT Pipelines (NSW) Pty Limited (APPL)—which is part of the APA Group—applied for light regulation of the Central West Pipeline (CWP) pursuant to s 112 of the National Gas Law (NGL). A list of the major energy infrastructure assets owned by APA Group—which relevantly includes the Moomba to Sydney Pipeline (MSP) and the Central Ranges Pipeline (CRP)—is set out at Attachment 1 to the application (APPL 1.1).
- 2.2 APPL submitted a written application in accordance with the National Gas Rules (NGR) and containing the information required by r 34. APPL's application is available on the Council's website ([www.ncc.gov.au](http://www.ncc.gov.au)).
- 2.3 The application contains an appendix of information that APPL considers confidential to the APA Group (APPL 1.4). This included details of specific terms negotiated with shippers, existing CWP transport agreements, contracted and available capacity, and the impact of the proposed new tariff structure on shippers. The Council accepts that this information is commercially valuable to the APA Group and possibly other commercial parties and that it should be protected under s 90 of the NGL. The Council has disclosed the confidential information to the Australian Energy Regulator (AER) as provided for in s 90(3) of the NGL. Where it considered it necessary, the Council has sought confirmation of the information provided by APPL from the AER based on information the AER may have received on the CWP in relation to its regulatory processes and powers.

### Council process

- 2.4 In determining this matter the Council followed the standard consultative procedure set out in r 8 of the NGR.
- 2.5 Notice of the application was published on the Council's website and in *The Australian* on 7 October 2009. The notice described the application and provided the address of the website on which the application was available. The notice also invited written submissions on the application. A 15 business day submission period was provided. Submissions closed on 28 October 2009.
- 2.6 The Council sought the views of the AER in relation to the application. The AER was initially consulted on receipt of the application and in the preparation of this draft determination. The Council envisages further consultation with the AER in the course of preparing its final determination.

- 2.7 The Council received one submission on the application from Country Energy. Some of the information contained in the submission was provided on a confidential basis. A public version of the submission is available on the Council's website.
- 2.8 In preparing this draft determination the Council has taken into account the application and the Country Energy submission, as well as its consultations with the AER and its own research and analysis.
- 2.9 Interested parties (including APPL) now have an opportunity to make further submissions on this draft determination. Any submissions received will be taken into account by the Council in making its final determination. **Submissions in response to this draft determination close at 5.00pm on 21 December 2009.**
- 2.10 Appendix B contains a chronology of milestones and other significant events occurring in the process of considering this application. This appendix also sets out anticipated dates for the remaining steps in this process.

### **Central West Pipeline/Pipeline services**

- 2.11 The CWP transports gas from Marsden on the MSP mainline to Forbes, Parkes, Narromine and Dubbo in the central west of New South Wales. The CWP is a covered pipeline by reason of its inclusion in the list of covered pipelines under Schedule A of the National Third Part Access Code for Natural Gas Pipeline Systems (the Gas Code).<sup>1</sup> The CWP is not a designated pipeline<sup>2</sup> prescribed by regulations under the NGL.<sup>3</sup>
- 2.12 In its application, APPL notes that the CWP comprises the following assets:
- 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

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<sup>1</sup> And subsequently the NGL.

<sup>2</sup> Designated pipelines cannot be the subject of light regulation.

<sup>3</sup> See *National Gas (South Australia) Regulations*, Regulation 4 and Schedule 1.

- Pipeline markers and cathodic protection test points.
- 2.13 There are five delivery points on the CWP. These are located at Forbes, Parkes, Narromine, Dubbo West and Dubbo. 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. The CRP transports gas to Tamworth in northern New South Wales and was covered by application of the competitive tender process outlined in Chapter 3 of the National Third Party Access Code for Natural Gas Pipeline Systems (the Gas Code).<sup>4</sup> The CRP will remain covered until at least 2019. The CRP is not the subject of the current application.
- 2.14 There is at present only one gas receipt point, at Marsden, for transport on the CWP. As a result, users of both the CWP and CRP must transport their gas to Marsden, via the uncovered Moomba to Marsden segment of the MSP.<sup>5</sup>
- 2.15 Map 2-1 shows the location of the CWP and adjacent pipelines.

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<sup>4</sup> Competitive tender processes carried out in accordance with the Gas Code allowed for the tender to set the tariff, and other key aspects of third party access, for a new pipeline which was to be covered under the Gas Code. This was a two stage process. First, a party seeking a pipeline to be constructed was required to lodge with the ACCC a tender approval request, which set out the terms and conditions of the proposed tender. After this was approved, the applicant ran the tender. A final approval request could then be lodged with the ACCC seeking approval of the outcome of the tender. If approval was granted the proposed pipeline became a covered pipeline under the Gas Code and the successful tenderer, now the service provider, was required to submit a proposed access arrangement. This access arrangement had to retain the specified outcomes, such as reference tariffs, from the tender for the duration of the initial access arrangement period.

<sup>5</sup> Coverage of the Moomba to Marsden segment of the MSP was revoked from December 2003 following applications in April 2000 and June 2001 by the then owner, the Australian Pipeline Trust, for revocation of coverage of the entire MSP. The decision maker decided to revoke coverage of only part of the pipeline. On 19 November 2008, the Council made a light regulation determination for the covered portion of the MSP (Marsden to Wilton and certain laterals). The determination came into force 60 business days later.



Map 2-1 - Location of the CWP



- 2.16 The only service currently acquired using the CWP is a firm forward haul transportation service. A firm forward haul service is a service in which the service provider essentially commits to receive and deliver a specified quantity of gas for a user, other than in very limited circumstances.
- 2.17 The firm forward haul service is regulated under an approved access arrangement (AA). The reference tariff that applies to this service is based on a throughput charge (currently \$2.95 per gigajoule (G/J)). Other services are subject to negotiation. The AA and Access Arrangement Information (AAI) were submitted to the ACCC in December 1998 and approved in October 2000. A revised AA and AAI are required to be submitted to the AER by April 2010 if the CWP remains subject to full regulation.
- 2.18 Under the back-ended depreciation approach adopted for the CWP in the relevant AA, the CWP asset base will increase at the next regulatory reset in 2010 to approximately \$54 million. As a consequence, APPL will be granted an automatic increase to the CWP reference tariff. See Box 2-1 below for further information on back-ended depreciation.

**Box 2-1 Back-ended depreciation**

The approved AAI for the CWP from October 2000<sup>6</sup> provides the following information on back-ended (i.e. economic) depreciation and the CWP:<sup>7</sup>

*As is usually the case with “green-field” developments, the growth in pipeline utilisation will be a gradual process. For the CWP, this means that during the initial Access Arrangement Period estimated returns will not be sufficient to cover the total accounting expenses (including profit and depreciation) of providing the Reference Services. Accordingly there is a need for a mechanism to provide for the under-recovery of revenue in the early years of the CWP’s life which can be offset against over-recovery in the later years of operation.*

*The concept of economic depreciation provides such a mechanism and in respect of the CWP is necessary to achieve the objective of the Code, which requires that the Reference Tariffs should be designed with a view to providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service. (footnotes omitted).*

2.19 Table 2-1 summarises the use of pipeline services from the CWP by shippers and other relevant parties.

**Table 2-1 Use of CWP services**

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
TRUenergy	Vertically integrated energy major	Marsden	All
Country Energy	Large energy retailer Retailer as nominee for industrial	Marsden	All (including on transportation to CRP)

2.20 Users of the pipeline services provided by the CWP are vertically integrated energy companies (AGL, Origin, TRUenergy), energy retailers (Energy Australia, Country Energy) and some larger industrial retailers (Fletcher International Exports). There are currently no power stations serviced by the CWP. The largest end-user of the CWP is Fletcher International Exports in Dubbo.

2.21 There are also several potential users of the pipeline services provided by the CWP. These include proposed open cycle gas turbine power stations near Wellington and

<sup>6</sup> A copy of which can be found at <http://www.aer.gov.au/content/index.phtml/itemId/678956>.

<sup>7</sup> APT Pipelines (NSW) Pty Limited 2000, *Access Arrangement Information for Central West Pipeline*, September 2000, page 8.

Parkes from ERM Power Pty Limited and International Power Pty Limited respectively. These proposals are discussed in paragraphs 1.32 to 1.36 of the application (APPL 1).

- 2.22 Each existing shipper has a transportation agreement with APPL. 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. APPL stated that of the existing gas transportation agreements, the non-price terms and conditions are largely consistent with those set out in the AA.
- 2.23 The Council notes however that the variation between the tariffs charged to users and the reference tariff is very limited.
- 2.24 APPL is currently finalising negotiations to allow changes to the transportation agreements with CWP shippers. These changes will result in the introduction of a capacity reservation charge which will be in addition to a throughput charge (i.e. two-tiered pricing). The capacity charge will allow for a reservation of peak day volume and would be payable regardless of the actual volume throughput. APPL explains the reasons for the change in paragraphs 1.42-1.46 of its application (APPL 1).

### 3 Reasons for decision

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

(1) In deciding whether to make a light regulation determination ... the NCC must consider—

(a) the likely effectiveness of the forms of regulation provided for under this Law and the Rules to regulate the provision of the pipeline services (the subject of the application) to promote access to pipeline services; and

(b) the effect of the forms of regulation provided for under this Law and the Rules on—

(i) the likely costs that may be incurred by an efficient service provider; and

(ii) the likely costs that may be incurred by efficient users and efficient prospective users; and

(iii) the likely costs of end users.

(2) In doing so, the NCC—

(a) must have regard to the national gas objective; and

(b) must have regard to the form of regulation factors; and

(c) may have regard to any other matters it considers relevant.

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

- full (or AA) regulation, and
- light regulation.

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

- 3.4 There is no requirement for service providers of light regulation pipelines to submit an AA. Service providers of a light regulation pipeline may voluntarily submit a limited access arrangement (LAA) to the AER for approval. A LAA must provide key information about the pipeline and services offered, and state the terms and conditions (other than price or revenue) for access to the pipeline services likely to be sought by a significant part of the market.<sup>8</sup> There is no indication APPL will submit a LAA if the CWP becomes the subject of a light regulation determination.
- 3.5 Access disputes in relation to light regulation pipelines are dealt with through a negotiate/arbitrate process, whereby the AER<sup>9</sup> can determine access prices and other terms if negotiations between the parties prove unsuccessful and an access dispute is notified. This process is similar to the negotiate/arbitrate process for services declared under Part IIIA of the TPA. To date, no access disputes concerning a light regulation pipeline have been notified to the AER.
- 3.6 Irrespective of the form of regulation, service providers must disclose a range of information concerning a pipeline, although the scope of the information disclosure required in relation to light regulated pipelines is less than under full regulation.
- 3.7 A table comparing the main elements of full and light regulation is contained in the Council's Guide to the National Gas Law, Part C - Light regulation of covered pipeline services.<sup>10</sup> For ease of reference this is reproduced in Appendix C.

### **Effectiveness of regulation alternatives**

- 3.8 APPL submitted that light regulation would be no less effective than full regulation in regulating the provision of services by the CWP. APPL acknowledged that as a covered pipeline there is a presumption that the CWP possesses market power. However, APPL argued that any market power arising from operation of the CWP was low due to the:
- (a) existence of spare pipeline capacity
  - (b) commercial imperatives faced by the CWP
  - (c) alternative energy sources available to users, and
  - (d) significant countervailing power of users.

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<sup>8</sup> The requirements for a LAA are set out in r 45 of the NGR.

<sup>9</sup> In Western Australia this role is undertaken by the Economic Regulation Authority (ERA) in its capacity as the Western Australian Energy Disputes Arbitrator, s 9(1) of the *National Gas Access (WA) Act 2009*.

<sup>10</sup> National Competition Council 2009, *A guide to the functions and powers of the National Competition Council under the National Gas Law, Part C* – May 2009.

- 3.9 APPL pointed to the CWP's inability to recover its annual costs as demonstrating that APPL has no ability to use any market power that might attach to the natural monopoly characteristics of the pipeline. APPL also noted that the shift to two-tiered pricing would be revenue neutral, and that if the CWP had been unregulated over the period from construction to 2010, tariffs would not have been any higher in any of those years.
- 3.10 APPL further submitted that the information necessary for users to negotiate effectively in the negotiate/arbitrate environment established by light regulation would be available. This information would be made available through its reporting obligations to the AER, including ring fencing, as well as other forms of mandatory disclosure such as its continuous disclosure obligations to the Australian Stock Exchange (ASX). In addition, as the CWP is in an unusual situation because of the negative depreciation, APPL stated that it would be prepared to publish relevant depreciation and RAB roll-forward data. Further information on the back-ended depreciation approach utilised by the CWP is provided in paragraphs 2.8-2.17 of the application (APPL 1).
- 3.11 It is the Council's view that the APA Group's continuous disclosure obligations to the ASX are unlikely to provide an adequate source of information regarding pipeline costs or other relevant information to existing and potential pipeline users.
- 3.12 While the Council notes APPL's offer to publish depreciation and RAB roll-forward data as a consequence of its unique back-ended depreciation arrangement, the Council does not consider that it is able to place such a condition on the making of a light regulation determination.
- 3.13 The Council does not consider that CWP's inability to recover its annual costs is demonstrative of APPL's inability to utilise the market power that attaches to the CWP. Rather, it is the Council's view that this revenue shortfall is largely a reflection of the back-ended depreciation approach agreed to in the AA (see Box 2-1). The Council is also sceptical of APPL's claim that prices would not have been any higher in the absence of regulation and notes that while there is some variation between the tariffs charged to some users and the reference tariff, tariffs generally follow those allowed in the AA.
- 3.14 Country Energy submitted that the move to light regulation of the CWP would render APPL unconstrained in its ability to recover monopoly rents from shippers and retailers on the CWP. Country Energy argued that the CWP enjoys significant monopoly power due to the limited countervailing market power of users and the lack of any meaningful substitution possibilities presented by electricity or other energy sources. Country Energy considered binding arbitration to be of little benefit in the absence of a benchmark by which to judge the appropriateness of any tariffs offered by the service provider. Country Energy dismissed APPL's claim that the change in tariff structure would be revenue neutral and noted that under light

regulation APPL is not committed to behave in any particular way in the future. Country Energy also stated that there are numerous problems arising from a shift to two-tiered pricing, including an inability to initiate a capacity charge without the contract loads downstream having daily read meters.

- 3.15 The Council disagrees that the move to light regulation would render APPL “unconstrained” in its ability to recover monopoly rents from shippers and retailers on the CWP. A light regulation determination does not remove regulatory oversight and control over tariffs on the CWP.
- 3.16 The Council notes that the different levels of regulation that apply to the various pipelines that make up the system necessary to transport gas to users on the CWP or CRP—in particular the uncovered status of the MSP from Moomba to Marsden—may limit the effectiveness of regulation in respect of any one part of that system. It may be that where pipelines have common ownership a revenue shortfall due to regulation may be able to be recouped by the owner revising the tariff on another (primarily, unregulated) pipeline. This position is not changed significantly as a result of whether or not the CWP is subject to light regulation.
- 3.17 The Council also notes Country Energy’s issues with a proposed move to a two-tiered tariff structure. However as discussed below such a tariff is likely to be approved as part of a new AA in any event.
- 3.18 The AER has commented, and the Council agrees, that the proposed two-tier pricing structure is reasonable. In reaching this conclusion the AER noted that overall the proposed tariff structure is revenue neutral. The AER also noted that while the capacity component of the tariff is considerably higher than the throughput component this is common for tariffs for gas transmission pipelines. The capacity charge is designed to recover the fixed costs of delivering pipeline services, which are high in comparison to variable costs, which the throughput charge is designed to recover.
- 3.19 The Council notes that if a two-tiered tariff is implemented and capacity utilisation were to change significantly on the CWP (for example, because a significant new user, such as a power station, comes on board) and if there was no commensurate redistribution of the capacity component of the tariff and a user or users disputed this with APPL, this is a matter which could be determined by arbitration within a light regulation environment.
- 3.20 The Council considers that the CWP enjoys, and will continue to enjoy, significant market power. In the Council’s view barriers to entry in relation to the provision of pipeline services are likely to remain significant for the foreseeable future. This is the case despite the possibility that new pipelines and/or new coal seam methane (CSM) fields may be developed in the future. The Council recognises APPL’s comments in relation to spare capacity and commercial imperatives and considers that these

factors will only have a minor impact upon the market power enjoyed by the CWP. While some users or potential users may, because of their size or for other reasons possess countervailing power, in the Council's view these situations are likely to be more limited than suggested by APPL in its application. This is particularly so because for many users there is no other pipeline that may provide substitute services to those provided by the CWP. The fact that the same group of customers that currently use the CWP may also deal with APPL in relation to its other pipelines does not necessarily mitigate the market power of the CWP, particularly where a user faces no credible alternative to the CWP.

3.21 The Council also considers that there is unlikely to be significant competition from alternative energy sources. The Council notes that the quote extracted by APPL at paragraph 2.22 of its application, referring to a precedent of the Australian Competition Tribunal<sup>11</sup> for assessing market power, states that in the facts particular to that matter, competition may exist from competing pipelines, not alternative energy sources. There are no competing pipelines to the CWP.

3.22 As noted by APPL in its submission, a covered pipeline is presumed to have market power. While the presence of market power is the critical issue in an application for coverage or revocation of coverage, it is not the focus of the current inquiry. Rather, the critical issue for an application for light regulation is whether light regulation is less effective than full regulation in constraining the use of market power and the relative costs of the two approaches.

3.23 In relation to this issue the Council notes:

- as a currently fully regulated pipeline, there is publicly available information in relation to the CWP much of which will continue to remain relevant under light regulation. While the move to two-tiered pricing will reduce the value of this historical information, it will still be useful to users as the underlying costs of supplying the pipeline service will remain.
- according to the AER two-tiered pricing is relatively common amongst pipelines. The AER does not consider two-tiered pricing in of itself a bar to authorising an AA. Further, users of the CWP are also users of other pipelines which may be unregulated and/or employ two-tiered pricing and are also, in some instances, themselves the owners or operators of pipelines. These companies in particular appear to be in a good position to evaluate costs claims when these are used to justify increased prices for pipeline services. Smaller users, and the bodies that represent these users, also have incentives to invest in maintaining or developing expertise in this regard. Pipeline services are a significant input cost for many users and these companies seem to have a significant incentive to keep these costs to reasonable levels.

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<sup>11</sup> *Re Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 (4 May 2001).



- under light regulation service providers are still required to disclose a range of information regarding pipelines, as well as details regarding negotiations with access seekers. Though these requirements are less than under full regulation the information disclosed will assist interested parties in determining the reasonableness of prices offered.
- the non-discrimination provision in s 136 of the NGL which prohibits a pipeline owner from engaging in price discrimination unless that discrimination is conducive to efficient service provision.
- light regulation includes recourse to arbitration by the AER and provisions for application to the NCC for the revocation of a light regulation determination.

3.24 On balance the Council believes that in the circumstances it finds here the light regulation regime is likely to be similarly effective as full regulation in protecting users and other parties that are dependent on access to the pipeline. This is due to the availability of relevant pipeline costs information, which will retain much of its relevance despite the move to a two-tiered pricing regime, as well as the legislative protections contained within the light regulation regime.

3.25 In the absence of light regulation, the next AA for the CWP will likely adopt two-tiered pricing. The Council does not consider two-tiered pricing to be incompatible with a shift to light regulation. Of course, information on its own will not protect users from service providers who are determined to take advantage of market power. However, where available information leads a party to believe the prices or other terms offered in access negotiations are unreasonable these parties have recourse to the AER for arbitration of an access dispute.

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

### **Costs of form of regulation alternatives**

3.27 In its application APPL provided a comparison of the likely costs to it of submitting an AA under full regulation to those it expected to incur under light regulation. It estimated that a change to light regulation for the CWP would result in a cost saving to APPL in the order of \$400,000, primarily due to the fact that no AA would be required under light regulation. These savings would be repeated for each five-yearly regulatory review process. In addition APPL estimated that ongoing compliance costs of approximately \$9,000 per annum could also be avoided as the result of a light regulation determination, though it acknowledged that these latter savings are immaterial.

- 3.28 In order to assess the comparative cost of access disputes and arbitration (under full and light regulation respectively), APPL assumed that the frequency of disputes under each form of regulation would be unlikely to differ materially, noting that there has been no evidence of an increase in the number of disputes on light regulation pipelines. However, APPL recognised that while a single arbitration may be less costly than full regulation, 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.
- 3.29 APPL also suggested in its application that, in addition to comparing the costs to the pipeline service provider, users and potential users of the CWP and end users, the Council should also consider the effect on the costs to the AER. APPL estimated that the AER may also save \$400,000 over a five-year period if it were not required to approve an AA for the CWP and would make additional savings as it would also avoid the costs of any subsequent review proceedings.
- 3.30 The AER considers that it is difficult to quantify any cost savings for it if the CWP becomes the subject of light regulation.
- 3.31 The Country Energy submission did not address the potential costs savings from moving to light regulation.
- 3.32 The Council notes that as only one pipeline has been designated a light regulation pipeline—being part of the MSP—it is too early to comment on the likely number of pipeline access disputes that may arise in relation to light regulated pipelines.
- 3.33 In the Council’s view, a shift to light regulation is likely to result in modest but significant cost savings. These will principally accrue to the service provider. Savings for other parties are less certain but the Council does not need to be satisfied that savings will be widespread in order to make a determination in favour of light regulation.
- 3.34 The Council notes however the potential for cost savings to be eaten up by numerous or lengthy arbitrations of access disputes. The Council is concerned that the proposed shift to two-tiered pricing on the CWP may generate a volume of disputes. If this were to be the case, the cost savings from light regulation might be unlikely to arise. Indeed it could be more expensive to consider the level of a two-tier tariff in a series of access arbitrations than in the context of considering a revised AA for the CWP. If so, light regulation would be unlikely to be appropriate until a transition to the new tariff structure occurs.
- 3.35 APPL has indicated that it is finalising negotiations with CWP shippers to allow changes to its transport agreements to implement its proposed new tariff structure and that this change is revenue neutral overall. Other than Country Energy, none of these shippers made a submission in response to APPL’s application for light regulation. This may indicate that the scope for significant disputes is limited and that

APPL has sufficient incentives to commercially negotiate access terms and conditions to avoid access disputes. This would be consistent with the Council making a light regulation determination.

## **National gas objective**

3.36 In making a light regulation determination the Council must have regard to the national gas objective contained in s 23 of the NGL. That section provides:

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

3.37 APPL suggested that a change to light regulation of the CWP would involve material cost savings, principally for APPL, but also for shippers and the AER. These cost savings would improve the efficiency of delivery of pipeline services and accordingly, the national gas objective would be satisfied. APPL also contended that a move to light regulation of the CWP would involve no disadvantage to customers in the form of higher prices or reduced service quality or availability. Consequently, APPL stated that the shift to light regulation would not bring about any loss in allocative efficiency.

3.38 Country Energy acknowledged that a change to the tariff structure for the CWP may further the national gas objective in promoting efficient operation and use of, natural gas services. However, Country Energy considered that this benefit could be retained under the current regulatory regime through the amendment of the tariff structure in the existing AA or the submission of a new AA in 2010 with a revised tariff structure.

3.39 In the Council's view, 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. As noted in paragraph 3.33, the Council agreed that the shift to light regulation would provide cost savings. Further, the Council does not consider that the shift to light regulation would disadvantage pipeline users or end users, with the recourse to binding arbitration, in particular, providing an effective restraint on the exercise of market power.

3.40 For these reasons, the Council considers that light regulation is appropriate having regard to the national gas objective.

## **Form of regulation factors**

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

- 3.42 More generally, Table 3-1 summarises the Council's views on how each form of regulation factor might, in principle, affect its determination of a light regulation application. The table is taken from the Council's Guide to the National Gas Law, Part C - Light regulation of covered pipeline services.<sup>12</sup>
- 3.43 Table 3-2 provides a summary of the submissions in respect of the form of regulation factors made by APPL in its application and by Country Energy in its submission on the application.

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<sup>12</sup> At paragraph 7.58.

**Table 3-1 Consideration of form of regulation factors**

<b>Form of regulation factor (s 16)</b>	<b>Circumstances conducive to light regulation</b>	<b>Circumstances where light regulation less likely</b>
(a) the presence and extent of any barriers to entry in a market for pipeline services	Barriers to entry present but are relatively low	Barriers to entry relatively high.
(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider	Stand alone pipeline activity, where a service provider has no other pipeline operations  Rights to pipeline capacity readily tradeable  Transmission services and other end to end services generally involve less interdependence with other pipelines	Greater interdependence, where a service provider has other pipeline interests in the same regions as a pipeline for which light regulation is sought  Rights to pipeline capacity not readily traded  Distribution services (especially established ones) are likely to be more interdependent with other pipeline services
(c) presence and extent of any network externalities (that is, interdependencies) between a natural gas services provided by a service provider and any other service provided by the service provider in any other market	Service provider has no involvement in upstream or downstream markets (at least in areas served by a pipeline for which light regulation is sought)  Ring fencing and other regulatory requirements effectively prevent a service provider from taking advantage of market power in upstream or downstream markets	Service provider has upstream or downstream involvements in gas or other energy businesses  Upstream or downstream involvements are in related but not ring fenced activities, or ring fencing of pipeline operations is ineffective
(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)	Large or concentrated users  Users with by-pass opportunities  High interdependence between users and service provider  Users involved in pipeline services elsewhere (such users may face lesser information asymmetry given their direct knowledge and experience of pipeline operations)	Many small users  Users have limited resources  Diverse user interests (for example where users span different industries or economic sectors)  Significant users have the capacity to pass through higher pipeline service costs (these users may have less incentives to expend resources to resist increases in pipeline costs)  Poorly represented users
(e) the presence and extent of any	Greater substitution possibilities exist	Lower substitution options

Form of regulation factor (s 16)	Circumstances conducive to light regulation	Circumstances where light regulation less likely
<p>substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service</p>	<p>Relatively high elasticity of demand suggesting bypass or other substitution opportunities exist</p> <p>Transmission pipelines (demand is generally more elastic than for distribution services)</p> <p>Availability of large (independent) storage capacity</p> <p>Ability to defer gas production/expansion for significant periods</p>	<p>Low elasticity</p> <p>Distribution pipelines (especially established distribution pipelines with a high market penetration)</p>
<p>(f) the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)</p>	<p>Fuel choice available to significant proportion of users</p> <p>Narrower relative prices per unit energy produced from different fuel sources</p> <p>Use of multi fuel plant</p>	<p>Wider relative prices between fuel types</p> <p>Gas dependent users</p> <p>Other energy sources have efficiency disadvantage</p> <p>Dedicated gas plant</p>
<p>(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider</p>	<p>Previously regulated pipelines (A significant base of publicly available and regulator tested information will be available for use on negotiations)</p> <p>Historic pipeline costs available and previously exposed to public/industry scrutiny</p> <p>NGL information disclosure requirements operative</p>	<p>Previously unregulated pipelines</p> <p>NGL information requirements impeded (for example through use of related party contracting which prevents effective scrutiny of underlying costs)</p>

**Table 3-2 Application of form of regulation factors to APPL application**

Form of regulation factor (s 16)	Applicant	Other submissions
(a) the presence and extent of any barriers to entry in a market for pipeline services	<p>High capital costs of pipeline construction and the requirement to arrange foundation shipper contracts are likely to constitute barriers to entry. However, barriers to entry mitigated by:</p> <ul style="list-style-type: none"> <li>• construction of new pipelines providing alternative routes to market for users and gas producers</li> <li>• potential for development of new CSM production fields in northern NSW which could allow users to receive gas without using the CWP</li> <li>• the practice, among large pipeline users, of holding significant capacity on long term contracts giving them the potential to resell transport to third parties in competition with the pipeline owner.</li> </ul>	
(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider	<p>The CWP is not a stand-alone pipeline —all gas transported on the CWP must also traverse the APA Group owned MSP.</p> <p>Nevertheless, APA noted that rights to pipeline capacity on the CWP are readily tradeable.</p> <p>Further, the fact that APA sells to the same small group of shippers on most of its pipelines highlights a source of buyer interdependence which gives users a significant degree of countervailing power.</p>	

<b>Form of regulation factor (s 16)</b>	<b>Applicant</b>	<b>Other submissions</b>
<p>(c) presence and extent of any network externalities (that is, interdependencies) between a natural gas services provided by a service provider and any other service provided by the service provider in any other market</p>	<p>In addition to gas transport the APA Group provides gas processing and electricity services. However, any network externalities between these and the services provided by means of the CWP are insignificant because the other services are geographically remote and operationally separate from the CWP.</p>	<p>Country Energy submit that given APA is the ultimate owner of the MSP and all shippers on the CWP also use the MSP, such interdependency within the APA group is suggestive of market power on the CWP. This is undiluted by the fact that APA must deal with the same group of shippers on both the CWP and MSP. (CE 1 at 6.7)</p>
<p>(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)</p>	<p>The market power of the CWP is limited by the existence of the countervailing market power possessed by users.</p> <p>The vertically integrated energy majors, AGL and Origin, enjoy countervailing market power by reason of their large combined usage of the CWP, which combined accounts for approximately one third of CWP’s current throughput. Further, the majors have the resources necessary to make credible threats of bypass through either swap contracts or the construction of new pipelines. Shippers have exercised this power in the past, and there are numerous examples of shippers constructing new pipelines.</p> <p>Stand-alone energy retailers, such as Energy Australia and Country Energy, also enjoy countervailing market power by reason of their large usage combined of the CWP. Stand alone energy retailers are important to CWP because they represent a source of customer diversity for the APA Group and the CWP.</p>	<p>Country Energy rejects APPL’s claim that it or any other retailer is in a strong negotiation position with the provider. (CE 1 at 6.4)</p> <p>Country Energy submit that the only time a user/retailer has any bargaining power is when it has a new customer as this is the only time when the load is fully contestable. Further, any bargaining power may be further diluted should gas fired generation on the CWP emerge. (CE 1 at 6.5)</p> <p>Recognising that new connections is predicted to have only minor growth, Country Energy submit that as its customers are established foundation customers with loads that are mostly entrenched and not contestable, it is the provider that holds the power. (CE 1 at 6.6)</p>



<b>Form of regulation factor (s 16)</b>	<b>Applicant</b>	<b>Other submissions</b>
	Power stations that have 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.	
(e) the presence and extent of any substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service	Other than electricity, the availability of substitutes for the pipeline service provided by the CWP appears to be quite limited. That current regulated tariffs fail to recover the full economic costs of the pipeline suggests that end-customers have attractive alternative energy sources.	Country Energy submitted that there are no meaningful substitutes to the CWP pipeline services as there is no alternative for the delivery of gas to customers supplied through the CWP as it is a radial feed line, and not part of a ring main system. (CE 1 at 6.1 and 6.2)  Further, Country Energy submitted that there are no meaningful substitution possibilities presented by electricity or other energy sources. (CE 1 at 6.3)
(f) the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)	For some types of pipeline users and end-users of gas—gas retailers, gas fired power stations, and some industrial plants—electricity is not a substitute for gas. For others, particularly at the end-user level, substitution between electricity and gas may be feasible. It is likely to be more feasible to substitute away from gas in the event of price increases than to substitute away from electricity. In addition, substitution options may also include fuels other than electricity, such as LPG, coal, wood and diesel.	

<b>Form of regulation factor (s 16)</b>	<b>Applicant</b>	<b>Other submissions</b>
(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider	Reporting and information disclosure requirements under the NGL and the NGR, combined with additional reporting obligations to the AER, obligations concerning continuous disclosure to the ASX and existing publicly available information sources (including previous access arrangements) would provide shippers with sufficient information to enable them to negotiate effectively with the CWP service provider should the CWP be subject to light regulation. In addition, both Origin and AGL are themselves pipeline developers and therefore clearly possess the necessary technical and commercial expertise to enable them to assess the reasonableness of CWP costs.	<p>Country Energy submitted that users would not have the benefit of reference tariffs if the CWP was to be the subject of light regulation and as such there would be no certainty as to the price Country Energy and consequently an end user might be required to pay for the pipeline services.</p> <p>Country Energy also submitted that the availability of arbitration as a check on the ability to dictate prices is illusory. (CE 1 at 4.1).</p>

- 3.44 It is the Council's view that consideration of the form of regulation factors and the circumstances of the CWP support the view that light regulation is likely to be similarly effective as full regulation.
- 3.45 As discussed in paragraphs 3.13 and 3.20 the Council considers that barriers to entry in relation to provision of pipeline services are significant and the levels of countervailing power possessed by users and potential users of the CWP is for many users limited. Further, the Council disagrees with APPL's contention that the fact that APPL sells to the same small group of shippers gives these users a significant degree of countervailing power. Where a shipper has no credible alternative to the CWP, the Council believes the CWP will enjoy significant market power.
- 3.46 However, the small number of large users (some of which may be able to exercise choice and countervailing power), the lack of notable network externalities, the availability of historic pipeline costs coupled with many users' own experience in operating pipelines, and the availability of binding arbitration should support the conclusion that light regulation will not leave the relevant parties worse off than full regulation, despite the removal of a reference tariff for CWP services.
- 3.47 The Council also notes that most users of the CWP have had experience in dealing with both uncovered and light regulation pipelines such as the MSP. This experience should assist these users in negotiating for CWP services.

### **Other matters**

- 3.48 The Council does not consider that there are any further matters, arising from submissions it received or otherwise, that are not encompassed within the other elements of its consideration and required consideration under s 122(2)(c).

### **Council's conclusions**

- 3.49 In summary the Council's conclusions are:
- Light regulation is likely to be similarly as effective as full regulation of the CWP – users and other interested parties may notify an access dispute where this is necessary and in such an event the AER is no less able to address relevant issues as it would be in a full regulation context.
  - Light regulation is likely to involve modest but significant cost saving for the service provider.
  - For these reasons light regulation of the CWP is consistent with promotion of the national gas objective.
  - Consideration of the form of regulation factors supports these conclusions.

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

## **Appendix A – Index of submissions and documents**

### **Application**

APPL 1	CWP Light Regulation Submission, 1 October - Application for light regulation determination for Central West Pipeline services by APT Pipelines (NSW) Pty Limited
APPL 1.1	Attachment 1: APA Group – Company details
APPL 1.2	Attachment 2: Shipper information
APPL 1.3	Attachment 3: Rule 34 - Compliance checklist
APPL 1.4	Confidential attachment (not publicly available)

### **Submissions in response to the application**

CE 1	Country Energy, 28 October 2009
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## Appendix B – Chronology

Date	Cumulative business days	Action/Event
2 October 2009	0	Application received
6 October 2009		AER advised of application and consultation commenced
7 October 2009	3	Notice of application published in <i>The Australian</i> and on the Council's website, seeking submissions in response to the application  Likely interested parties advised of application
28 October 2009	18	Period for submissions on the application ended (15 business days from date of notice)
30 November 2009	41	Draft determination released
21 December 2009	56	Period for submissions on the draft determination ends (15 business days from release of draft determination)
20 January 2010	76	Maximum period for making of Council decision (20 business days from close of submissions on draft determination)
2 February 2010		4 month period allowed by standard consultative period ends

## Appendix C – Key features of light vs full regulation

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
<p>Service provider subject to general duties:</p> <ul style="list-style-type: none"> <li>• Must be a specified legal entity (principally a corporation - s 131).</li> <li>• Must not engage in conduct to prevent or hinder access (s 133).</li> <li>• Obligated to disclose gas supply information in certain circumstances (r 138).</li> </ul>	<p>No difference.</p>
<p>Subject to 'ring-fencing' requirements</p> <ul style="list-style-type: none"> <li>• Must not carry on a related business (s 139).</li> <li>• Must keep marketing staff separate from associate's related businesses (s 140).</li> <li>• Must keep consolidated and separate accounts (s 141).</li> <li>• Must comply with any AER regulatory information instrument about information reporting (s 48).</li> <li>• Must keep sensitive information confidential (r 137).</li> <li>• Any additional requirements ring-fencing imposed by the AER under s 143.</li> </ul>	<p>No difference.</p>
<p>Contracts with associates must not be entered into, varied or given effect to if they substantially lessen competition in a market for natural gas services or breach competitive parity rule unless approved by the AER under the rules (ss 147 and 148 and r 32). Entering into or varying an associate contract must be notified to the AER (r 33).</p>	<p>No difference.</p>
<p>Subject to rules relating to facilitating requests for access and information disclosure:</p> <ul style="list-style-type: none"> <li>• Requirements to publish information and access arrangement (r 107).</li> <li>• Must provide certain information about tariffs (r 108).</li> <li>• Must not bundle services (r 109).</li> <li>• Must respond to request for access in structured manner (r 112).</li> </ul>	<p>Subject to same rules as for full regulation pipelines and additionally:</p> <ul style="list-style-type: none"> <li>• Must report annually to the AER on access negotiations (r 37).</li> <li>• Must publish terms and conditions of access, including prices on offer, on website (r 36).</li> </ul>

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
<p>Requirement to submit and have in force a full access arrangement which sets out terms and conditions of access and reference tariffs for services likely to be sought by a significant part of the market (s 132). Importantly:</p> <ul style="list-style-type: none"> <li>• Non-price conditions subject to AER approval, including capacity trading requirements, changes of receipt and delivery points, extension and expansion requirements and queuing requirements (rr 103 - 106).</li> <li>• Total revenue to be determined by the AER taking into account the revenue and pricing principles (s 24 and 28) and using the building blocks approach to economic regulation (r 76) which is highly dependent upon: <ul style="list-style-type: none"> <li>• rules relating to the establishment and roll forward of a regulatory capital base;</li> <li>• determination of a rate of return on capital;</li> <li>• assessment of regulatory depreciation allowances and schedules;</li> <li>• estimates of corporate income tax (where post-tax model adopted);</li> <li>• maintenance and reporting of incentive arrangements;</li> <li>• determining allowances for operating expenditure;</li> <li>• creating a reference tariff variation mechanism based upon total revenue and appropriate cost allocation; and</li> <li>• complex arrangements relating to surcharges, capital contributions, speculative investment and capital redundancy (see generally Part 9 of the NGR).</li> </ul> </li> </ul>	<p>No requirement to submit or have in force a full access arrangement. A limited access arrangement (governing only non-price terms and conditions) may be submitted for approval by the service provider if it chooses to do so (s 116).</p> <p>Note that only conforming capital expenditure is included in a capital base while a pipeline is on full regulation, however if a light regulation pipeline returns to full regulation actual capital expenditure in the intervening period is rolled into the capital base (r 77(3))</p>



<b>Full (access arrangement) regulation</b>	<b>Light regulation (additions or differences from full regulation)</b>
<p>Requirement to submit detailed access arrangement information with an access arrangement and keep this information available (rr 42 - 43). This extends to detailed financial and operational information (r 72). The AER may also impose additional information requirements to allow them to assess an access arrangement as a regulatory information instrument (s 48).</p>	<p>No general requirement to submit or have approved access arrangement information. Minimal access arrangement information on capacity required if service provider chooses to submit a limited access arrangement (r 45(2)).</p>
<p>Requirements relating to compliance (usually annually) with the reference tariff variation mechanism to increase reference tariffs by the control mechanism (including any pass through arrangements) (r 97).</p>	<p>No such requirements imposed.</p>
<p>A user or prospective user is able to notify to the dispute resolution body (the AER everywhere but Western Australia) an access dispute about any aspect of access to pipelines services provided by means of a covered pipeline (s 181) and the access determination may deal with any matter relating to the provision of a pipeline service to a user or prospective user (s 193). The dispute resolution body must take into account the national gas objective and revenue and pricing principles in resolving a dispute (s 28). Existing user rights and usage are protected (s 188) and the applicable access arrangement must be applied (s 189). Geographical extensions of a pipeline cannot be ordered (r 118(1)(b)).</p> <p>Note that pipeline services which are not likely to be sought by a significant part of the market (i.e. non-reference services) may still be subject of an access dispute even though no price is provided by the access arrangement (s 181).</p>	<p>Access dispute provisions apply, any approved limited access arrangement must be applied, but otherwise price and non-price terms and conditions determined by the dispute resolution body.</p> <p>In relation to capacity expansions, for a light regulation pipeline the access seeker needs to fund the expansion entirely (r 118(2)(a)), an extension or expansion requirement in an access arrangement governs the ability for a service provider to be required to fund the expansion of a full regulation pipeline (r 118(2)(b)).</p>
<p>Price discrimination between users recognised in both prudent discount provisions (r 96) and pricing principles for distribution services (r 94). While service providers can offer other discounts, these would not be reflected in reference tariffs (r 96).</p>	<p>Prohibition on engaging in price discrimination unless that discrimination is conducive to efficient service provision (s 136).</p>
<p>Must comply with queuing requirements in an approved access arrangement (s 135).</p>	<p>Where a limited access arrangement is in force, the queuing policy must be complied with under s 135. Where no limited access arrangements are in place, issues about the priority of access could be resolved as part of an access dispute.</p>

<b>Full (access arrangement) regulation</b>	<b>Light regulation (additions or differences from full regulation)</b>
Other than for the queuing requirements, service providers and users are free to agree on alternative terms and conditions of access than set out in the access arrangement (s 322).	No difference.
Pre-existing contractual rights protected (ss 188 and 321).	No difference.
The extent to which an extension or expansion of a pipeline is taken to be part of the covered pipeline, and regulated by the regime, is governed by the extensions and expansion requirements in the access arrangement (s 18).	As for full regulation where a limited access arrangement applies, but otherwise all extensions and expansions are taken to be part of the covered pipeline (s 19).
May apply to be uncovered if no longer satisfied coverage test (s 102).	No difference. Note also that any person can at any time apply to revoke the light regulation determination (s 118).
<p>Must, for interconnected transmission pipelines, disclose information to the Bulletin Board:</p> <ul style="list-style-type: none"> <li>• nameplate rating (r 170).</li> <li>• 3-day capacity outlook (r 171).</li> <li>• linepack/capacity adequacy indicators (r 172).</li> <li>• nominated and forecast delivery nominations (r 173).</li> <li>• actual delivery information (r 174).</li> </ul>	No difference.
Must, unless exempt distribution network, maintain a register of spare capacity on its website (r 111).	No difference.