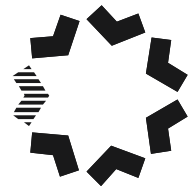


NATIONAL  
COMPETITION  
COUNCIL



## South Eastern Pipeline System

Application under the National Gas  
Law for a coverage determination for  
the South Eastern Pipeline System



**Draft recommendation**

**20 February 2013**

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## Abbreviations, defined terms and glossary

ABC	ABC Tissue Products Pty Ltd
APA	APA Group
APA first submission	APA's submission on the Application received by the Council on 16 January 2013
APA second submission	APA's submission on the Application received by the Council on 29 January 2012
Application	Application by KCA under s 92 of the NGL for a coverage determination for the SEPS, received by the Council on 28 November 2012
Beach submission	Submission by Beach Energy, received by the Council on 29 January 2013
Council	National Competition Council
Coverage Guide	<i>Coverage, revocation and classification of pipelines</i> , May 2012
CPA	Competition Principles Agreement dated 11 April 1995, between the Commonwealth, States and Territories of Australia
criterion (a)	Section 15(a) of the NGL
criterion (b)	Section 15(b) of the NGL
criterion (c)	Section 15(c) of the NGL
criterion (d)	Section 15(d) of the NGL
Epic	Epic Energy
FEED	front end engineering and design
firm (in respect of gas transportation services)	A firm service enables a user to reserve pipeline capacity with priority over buyers with an 'as available' service. An 'as available' (or interruptible) service does not reserve capacity <sup>1</sup>
Gas Code	<i>National Third Party Access Code for Natural Gas Pipeline Systems</i> (Schedule 2 to the Gas Pipelines Access (South Australia) Act 1997)
KCA	Kimberly-Clark Australia Pty Ltd (ACN 000 032 333)
KCA supplementary information	KCA's letter of 7 January 2013 in response to the Council's letter of 29 December 2012 to KCA requesting further information
LNG	liquefied natural gas
LPG	liquefied petroleum gas
MDQ	maximum daily quantity (of gas)
national gas objective	Section 23 of the NGL

<sup>1</sup> See: NERA 2008, pp 45-6.

NERA	NERA Economic Consulting
NGL	National Gas Law, which is set out in the Schedule to the <i>National Gas (South Australia) Act 2008</i> (SA) and applied as a law of South Australia by that Act and as a law of other States and Territories by an application Act in each jurisdiction
NGR	<i>National Gas Rules 2008</i> , promulgated as subordinate legislation to, the NGL
Origin	Origin Energy Limited
Origin submission	Submission by Origin, received by the Council on 29 January 2013
PASA	Pipelines Authority of South Australia
<i>Pilbara appeal decision</i>	<i>The Pilbara Infrastructure Pty Limited v Australian Competition Tribunal</i> [2012] HCA 36
relevant Minister	South Australian Minister for Mineral Resources and Energy the Hon. Tom Koutsantonis MP
SCA	SCA Hygiene Australasia Pty Ltd
SEA Gas	South Eastern Australia Gas Pipeline
SEPS	South Eastern Pipeline System
SESA	South East South Australia Pipeline

## Units of measurement

kPa	kilopascal (pressure); 1 000 pascals; 1 pascal is 1 newton per square metre; 1 standard atmosphere is approximately 101.3 kPa
PJ	petajoule (energy); 1PJ is 1 quadrillion ( $10^{15}$ ) joules or 1 000 TJ
PJ/a	petajoule per annum (rate of energy); 1 PJ/a equates to 2.74 TJ/d
TJ	terajoule (energy); 1 trillion ( $10^{12}$ ) joules or 0.001 PJ
TJ/day	terajoule per day (rate of energy); 1 TJ/day equates to 0.365 PJ/a

Conversion sources: [www.santos.com/conversion-calculator.aspx](http://www.santos.com/conversion-calculator.aspx)  
[www.convertunits.com/from/pascal/to/atmosphere+\[standard\]](http://www.convertunits.com/from/pascal/to/atmosphere+[standard])

# 1 Pipeline classification decision and draft recommendation

## Pipeline classification and relevant Minister

- 1.1 The Council has decided under s 98 of the National Gas Law (**NGL**) that the South East Pipeline System (**SEPS**) is a transmission pipeline and is not a cross boundary pipeline. This classification determines which of the Commonwealth or State Minister is the decision maker in respect of this application. The relevant Minister is the South Australian Minister for Mineral Resources and Energy the Hon. Tom Koutsantonis MP (**Minister**).<sup>2</sup>
- 1.2 The Council's reasons for its initial classification decision are set out in section 4 of this report.

## Draft recommendation

- 1.3 The Council's preliminary view, having considered available information relevant to the criteria for coverage in the NGL and having had regard to the national gas objective, is that criteria (a) and (d) are not met in relation to the SEPS.
- 1.4 The Council's draft recommendation, therefore, is that the Minister not cover the SEPS. The Council's reasoning for this draft recommendation is set out in sections 6 to 9 of this report.
- 1.5 If, contrary to the Council's recommendation, the Minister decides to cover the SEPS, the Council considers that that coverage should be for a period of 10 years. This aspect of the Council's advice is addressed in section 10 of this report.

## Form of regulation

- 1.6 The Council has decided under s 110 of the NGL that, if it were to be covered, the SEPS should be subject to light regulation. The Council's reasoning for this decision is set out in section 11 of this report.

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<sup>2</sup> Under s 2 of the NGL, for a transmission pipeline wholly within a participating jurisdiction, the relevant Minister is the 'designated Minister' as defined in the relevant application Act. Section 9 of the *National Gas (South Australia) Act 2008* (SA) defines 'designated Minister' as 'the Minister to whom the administration of this Act has been committed.' The South Australian Government website lists that Act as being part of Minister Koutsantonis' portfolio: <http://www.sa.gov.au/government/minister/19>

## Public consultation on the draft recommendation

- 1.7 The Council invites interested parties to make submissions and comments on its draft recommendation and will take any submissions and comments received into account in preparing its final recommendation to the Minister.
- 1.8 Interested parties should ensure that submissions on the draft recommendation are provided to the Council before **5.00pm on Thursday 14 March 2013**.
- 1.9 Submissions should be emailed to the Council at [gas@ncc.gov.au](mailto:gas@ncc.gov.au) (in both MS Word and PDF formats), with a hard copy sent to:

South Eastern Pipeline System  
National Competition Council  
GPO Box 250  
MELBOURNE VIC 3001

- 1.10 To assist interested parties to make submissions, the Council has published on its website ([www.ncc.gov.au](http://www.ncc.gov.au)) a number of guides, including the *Coverage, revocation and classification of pipelines* guide (**Coverage Guide**). The Council is currently updating its guides to take account of recent developments, particularly those resulting from the passage of the *Trade Practices Amendment (Infrastructure Access) Act 2010* and the High Court's decision in *The Pilbara Infrastructure Pty Limited v Australian Competition Tribunal* [2012] HCA 36 (**Pilbara appeal decision**). Interested parties preparing any submissions are advised to take account of these developments as well as the Council's observations in this report.



## 2 Application and public consultation

### Application

- 2.1 The applicant is Kimberly-Clark Australia Pty Ltd (ACN 000 032 333) (**KCA**).
- 2.2 On 28 November 2012, the Council received an application under s 92 of the NGL from KCA for a coverage determination for the SEPS (**Application**). The Council wrote to KCA on 29 November 2012 requesting further information. KCA's response of 7 January 2013 (**KCA supplementary information**) was published on the Council website.

### Public consultation on the Application

- 2.3 On 16 January 2013, APA Group, the owner/operator of the pipeline system (**APA**), provided a submission comprising background information to assist in the assessment of the Application (**APA first submission**). This information was published on the Council website and interested parties were invited to have regard to it in preparing submissions.
- 2.4 At the close of submissions on 29 January 2013, the Council had received:
- a further submission from APA (**APA second submission**)
  - a submission from Origin Energy Limited (**Origin**)
  - a submission from Beach Energy (**Beach**), and
  - a letter from KCA addressing matters raised in the APA first submission (**KCA letter**).
- 2.5 The submissions were published on the Council's website. The KCA letter contained some confidential information and was not placed on the website until the confidentiality issues were resolved.

### 3 The SEPS and the background to the Application

#### The pipeline and the pipeline service

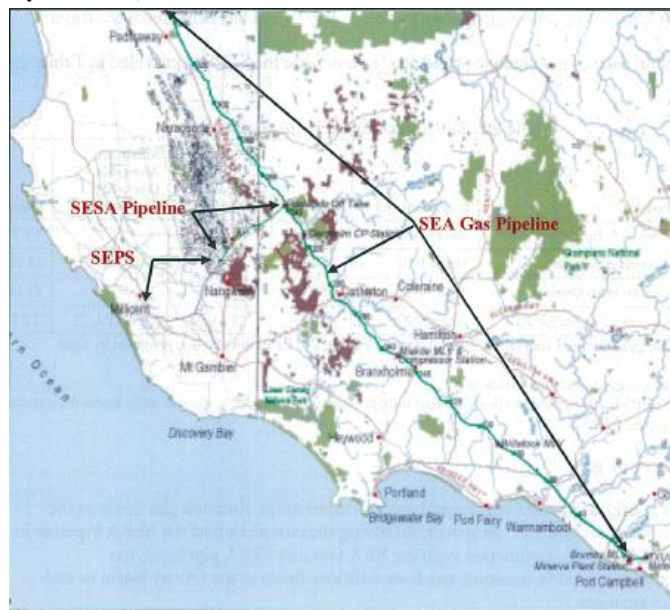
- 3.1 The SEPS is located in south eastern South Australia and consists of four pipeline segments in total some 70 kilometres in length:
- (a) the lateral from Katnook to Safries
  - (b) the pipeline from Katnook to Snuggery
  - (c) the pipeline from Glencoe to Mt Gambier, and
  - (d) the lateral from Kalangadoo to Nangwarry (decommissioned).<sup>3</sup>
- 3.2 The SEPS is linked to the eastern Australian gas transmission system via the South East South Australia pipeline (**SESA**). The SESA was constructed by Origin in 2005 following a greater than expected decline in production in the Katnook area to transport gas from the SEA Gas to Origin's Ladbroke Grove power station and the SEPS. The SESA connects to the SEPS at Katnook. Figure 1 below shows the location of the SEPS and the areas it serves. Figure 2 below shows the relationship between the SEPS and the SESA and the SEA Gas.

**Figure 1: Map of SEPS**



Source: APA first submission (detail)

<sup>3</sup> The Nangwarry lateral was constructed in 2001 to supply gas to the Carter Holt Harvey Ltd timber mill at Nangwarry. The lateral was decommissioned following closure of the mill in 2010.

**Figure 2: Map of SEPS, SESA and SEA Gas**

Source: South East Australia Gas Pty Ltd Annual Report (PL 13), 2004-2005.

Source: APA first submission

## Ownership of SEPS, associated pipelines and resources

- 3.3 The SEPS (excluding the Nangwarry lateral) was constructed in 1990-1991 by the South Australian Government and operated by the Pipelines Authority of South Australia (**PASA**), transporting gas from the Katnook gas fields to users in Penola, Snuggery and Mt Gambier. The South Australian Government sold the SEPS to Tenneco Gas Australia in 1995. The SEPS was transferred in 1996 to Epic Energy (**Epic**), the assets of which (except the Dampier to Bunbury Natural Gas Pipeline) were acquired in 2004 by Hastings Fund Management. The SEPS is now owned and operated by APA, following APA's 2012 acquisition of the Hastings Diversified Utilities Fund. APA acquired the SESA in 2007.<sup>4</sup> When the SEA Gas commenced operations, International Power, Origin and TruEnergy each held one third shares. The SEA Gas is now owned equally by APA and the Retail Employees Superannuation Trust. The pipeline is managed and operated by South East Australia Gas Pty Ltd, an independent company, and is maintained by APA.
- 3.4 Beach, following its acquisition of Adelaide Energy Ltd in 2012, holds four exploration permits, three production licenses and three retention licences in the South Australian part of the Otway Basin. Beach's interests include the gas fields in the Katnook area, the development of which prompted the initial construction of the SEPS, and the Katnook gas plant which is a receipt point on the SEPS. Origin owns and operates the Ladbroke Grove power station.

<sup>4</sup> APA also owns 33.4 per cent of Envestra, the South Australian gas distributor, and operates and maintains Envestra's network, including the Mt Gambier reticulation network.

## Coverage and revocation of coverage of the SEPS

- 3.5 The SEPS was listed in Schedule A of the *National Third Party Access Code for Natural Gas Pipeline Systems (Gas Code)* and was therefore a covered pipeline from the commencement of the Gas Code. In December 1999, Epic applied for revocation of the coverage of the SEPS. The Council recommended revocation in March 2000 and the relevant Minister revoked coverage on 6 April 2000.
- 3.6 In considering the revocation application the Council considered whether access would promote competition in gas sales markets by:
- encouraging new producers to compete for the business of gas users
  - enabling gas producers to offer gas at cheaper prices encouraging users to switch from other energy sources to gas, or
  - encouraging other pipelines to seek interconnection with the SEPS to assist inter-regional gas transport.
- 3.7 The Council was not satisfied that access would promote competition in any of these ways:
- There was little prospect of competition from new local producers and there was no evidence access might stimulate greater exploratory work. Should new discoveries in the area lead to a situation where access would promote competition, it was open to parties to seek re-coverage of the SEPS.
  - The only source of gas at the time was the Boral joint venture, which held all capacity on the SEPS. Epic therefore had little opportunity to extract higher transport tariffs, so access was unlikely to result in lower tariffs.
  - Given the patterns of supply and demand at the time and the relatively isolated location of the SEPS, there was no evidence that other parties would seek to interconnect to the SEPS.
- 3.8 The Council was not satisfied that criterion (a) was met. It also concluded that the costs of access were likely to outweigh the benefits and that criterion (d) was therefore not met.
- 3.9 For the purposes of the current Application the Council has considered the revocation recommendation but found it to be of limited assistance given the changes in the south east of South Australia since 1999. Further, at the time of the revocation application the early depletion of the Katnook reserves prompting the interconnection to SEA Gas via the SESA was not anticipated, nor was the decline in KCA's demand for gas.

## Contractual arrangements for the SEPS

- 3.10 KCA was a foundation customer for gas produced at Katnook and has been (and remains) the largest single user of gas shipped on the SEPS. It is the only gas user to negotiate transportation directly with the pipeline owner (now APA). The only other shipper of gas on the SEPS is Origin, which currently provides gas to KCA and the Safries facility (a potato processing plant at Penola owned by McCain Foods Australia) and reticulates gas to Mt Gambier. Origin previously supplied gas to Carter Holt Harvey at Nangwarry.
- 3.11 Under the foundation contract between SAGASCO and PASA, SAGASCO contracted for all of the capacity of the SEPS on a firm forward haulage basis<sup>5</sup> until 2010. SAGASCO was the South Australian gas company 51.7 per cent owned by the South Australian Government. The SAGASCO assets were sold to Boral in 1993 and the transportation rights under the foundation agreement were ultimately transferred to Origin. When the foundation contract expired at the end of 2010, Origin entered into a new three year agreement with Epic for approximately 55 per cent of the capacity of the SEPS (Origin submission, p 1). This means that since the expiry of the foundation agreement, there has been uncontracted capacity on the SEPS. By contrast, when Origin sold the SESA to APA, Origin entered into a 15.5 year transportation agreement for the SESA (commencing 2 July 2007) reserving all of the capacity of the SESA. Origin is the only shipper using the SESA and also the SEPS (despite available uncontracted capacity on the SEPS).
- 3.12 The Application has arisen from negotiations between Epic and KCA for gas transportation following the expiry of the foundation contract.
- 3.13 KCA submits that under the foundation contract a higher tariff applied until 2005 and a lower tariff for the last five years to 2010. KCA submits that it was informed by Epic that open access to the SEPS would be available upon expiry of the foundation contract but at a higher tariff: on the basis that the economic life of the SEPS was 60 years but only 20 years of depreciation had occurred to that time. Origin is currently acting as the intermediary retailer between KCA and Epic. While KCA is not privy to the details of the Epic-Origin contract, it considers that Origin is paying a rate considerably higher than was charged under the foundation contract and that this includes a significant element of monopoly rent (Application, p 9).
- 3.14 APA submits that KCA approached Epic in late 2011 seeking:
- a firm transportation service of a certain (confidential) maximum daily quantity (**MDQ**) (the MDQ was later scaled back)

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<sup>5</sup> A firm service enables a user to reserve capacity with priority over buyers with an 'as available' service. Priority tends to be more important where a pipeline is at or near capacity since 'as available' services will be delayed until firm commitments are met. 'As available' (or interruptible) tariffs are typically 30% higher than for firm services but are paid on quantities delivered rather than reserved capacity (NERA 2008, pp 45-6).

- an interruptible transportation service of additional gas (of a confidential quantity), and
  - a 3 600 kPa pressure service—KCA has historically required gas delivery at 850 kPa, but requires delivery at higher pressure to serve KCA's gas fired generation facility at the Millicent mill.
- 3.15 APA submits that Epic responded to the requests for firm and interruptible services by offering to charge KCA the same transportation tariffs (escalated by CPI) as those payable under Origin's 2011–2014 gas transportation agreement.
- 3.16 Further APA notes that KCA is seeking a higher pressure service and that this represents a significant change in the nature of the service provided by the SEPS. According to APA providing a higher pressure service would involve:
- constructing a new meter/regulating station at KCA's delivery point, with the cost to be recovered through the monthly delivery point capital and operating charges which would be determined once front end engineering and design (**FEED**) work had been carried out, and
  - the sterilisation of approximately 3.6 TJ/day capacity on the Katnook to Snuggery pipeline to guarantee the higher delivery pressure, with the costs to be recovered through a monthly pressure service charge calculated on the same basis as under the Origin agreement. (APA and KCA differ on whether the sterilisation charge is warranted.)
- 3.17 KCA and APA differ as to the sequence of events surrounding negotiation of the construction of a meter/regulating station (APA first submission and KCA letter) and the cost of doing so. Ultimately, KCA decided to install its own compressor at the custody transfer point to increase the pressure of gas into its plant.
- 3.18 KCA submits that APA (and formerly Epic) has been able to maintain its position as to what it will charge because there is no credible alternative to the SEPS for gas haulage to KCA's Millicent mill. It considers that APA's ability to extract monopoly rents would be constrained by access to the SEPS. It submits that if the SEPS were covered and subject to regulation, the initial capital base would be set significantly lower than the value that Epic has used to determine its new tariffs<sup>6</sup> (Application, pp 32-34).
- 3.19 APA disputes KCA's contention that the proposed tariff includes 'a significant element of monopoly rent'. It submits that the foundation contract is not the appropriate reference point for a new tariff because the foundation agreement made no provision for the recovery of operating expenditure, capital expenditure or return on capital over CPI. APA submits that the reduction in reserved capacity on the SEPS following the expiry of the

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<sup>6</sup> KCA claims that APA (and formerly EPIC) is basing the proposed tariff on a depreciated optimised replacement value for the SEPS.

foundation contract means the largely fixed costs of the pipeline must be spread across lower demand (APA second submission, [3.28]).

- 3.20 APA acknowledges that the risk of the SEPS being bypassed is low, but submits that its ability and incentive to exercise market power to the detriment of competition in dependent markets is constrained. It says that, because the pipeline is operating at 20-30 per cent capacity while the bulk of the costs (~90 per cent) are fixed, the pipeline owner actually has a 'commercial imperative' to encourage greater utilisation of the SEPS (APA second submission, pp 22-23).
- 3.21 KCA seeks coverage of the SEPS because it considers that Epic (APA) provides a monopoly service and coverage 'is the only feasible way for the establishment of shipping rates and the cost of new connections that do not contain monopoly rents' (Application, p 10).

## 4 Pipeline classification

- 4.1 Where an application is made for a coverage determination, s 98 of the NGL requires the Council to classify the pipeline as either a transmission or a distribution pipeline and determine whether it is a cross boundary pipeline.
- 4.2 The Council must apply the pipeline classification criterion in s 13(1) of the NGL. The criterion requires a pipeline be classified according to whether its primary function is to:
- reticulate gas within a market—in which case the pipeline is a distribution pipeline, or
  - convey gas to a market—in which case it is a transmission pipeline.
- 4.3 Without limiting s 13(1), s 13(2) requires the Council to have regard to a range of factors in determining the primary function of a pipeline. Those factors are:
- (a) the characteristics and classification of, as the case requires, an old scheme transmission pipeline or an old scheme distribution pipeline;
  - (b) the characteristics of, as the case requires, a transmission pipeline or a distribution pipeline classified under this Law;
  - (c) the characteristics and classification of pipelines specified in the [NGR] (if any);
  - (d) the diameter of the pipeline;
  - (e) the pressure at which the pipeline is or will be designed to operate;
  - (f) the number of points at which gas can or will be injected into the pipeline;
  - (g) the extent of the area served or to be served by the pipeline;
  - (h) the pipeline's linear or dendritic configuration.

## Application and submissions

- 4.4 KCA notes that the SEPS was previously classified as a transmission pipeline in Schedule A of the Gas Code (Application, p 6).
- 4.5 APA submits that the SEPS should be classified a transmission pipeline, having regard to the pipeline classification criteria, including the characteristics and function of the SEPS. Origin also describes the SEPS as a transmission pipeline (Origin submission, p 2).
- 4.6 APA's views as to the characteristics of the SEPS in relation to the factors outlined at 4.3 above is outlined in Box 4.1 below.



**Box 4.1: APA's response to Section 13(2) matters**

Characteristic	APA Response	
Characteristics and classification of an old scheme transmission or distribution pipeline	The SEPS was originally classified as a transmission pipeline under schedule A of the Gas Code.	
Characteristics of a transmission or distribution pipeline classified under the NGL	At the time the NGL was implemented, the SEPS was not a covered pipeline. No consideration was therefore given to the status of the SEPS when the NGL was developed.	
Characteristics and classification of pipelines specified in the NGR	The NGR do not currently provide for this specification.	
Diameter of the pipeline	Katnook to Snuggery and Glencoe to Mt Gambier: 168.3 mm	Diameter is not really a measure of whether a pipe is transmission or distribution. It is really about pressure.
	Katnook to Safries: 60.3 mm	
	Kalangadoo to Nangwarry: 88.9 mm	
Pressure at which the pipeline is designed to operate (Max Allowable Operating Pressure (MAOP))	Katnook to Snuggery, Glencoe to Mt Gambier & Katnook to Safries: 10,000 kPA	Pressure above 1,050 kPA is generally considered transmission pressure. The operating pressure of the SEPS is therefore consistent with a transmission pipeline.
	Kalangadoo to Nangwarry: 9,850 kPA	
	Although the SEPS has a MAOP of 9,850 - 10,000 kPA, gas currently enters the pipeline at Katnook at around 5,000 kPA.	
Number of injection points	1 (Katnook)	
Area served by the pipeline (Pipeline length)	Katnook to Snuggery: 46.1 km	The SEPS services a number of discrete delivery points that are located some distance from Katnook, which is consistent with the characteristics of a point to point transmission pipeline.
	Glencoe to Mt Gambier: 18.9 km	
	Katnook to Safries: 4.5 km	
	Kalangadoo to Nangwarry: 18.9 km	
Linear or dendritic configuration of the pipeline	While there are two laterals branching off the SEPS, it essentially has a linear configuration, which is consistent with a transmission classification.	

Source: APA second submission, p 49

## Initial classification decision

- 4.7 The SEPS was classified as a transmission pipeline in Schedule A of the Gas Code. This was noted by KCA in its application and by APA in its first submission.
- 4.8 In the APA first submission, APA states that “the primary purpose of the SEPS is to convey gas to various locations in the south east corner of South Australia and *not* to reticulate gas within the locations serviced by the pipeline” and these are the reasons why the SEPS was originally classified as a transmission pipeline.
- 4.9 While the Gas Code classification ceased when coverage of the SEPS was revoked in 2000, the previous classification remains informative as the services the SEPS provides and its characteristics have not changed since the pipeline was first classified for the Gas Code.<sup>7</sup>
- 4.10 The maximum allowable operating pressure of the SEPS and its configuration (being largely linear with two laterals—one used and one decommissioned) are consistent with SEPS being for the conveyance of gas.
- 4.11 The SEPS has been used solely by Origin (and its predecessors) since the pipeline was first commissioned to ship gas to large end users at Snuggery, in the Penola region and to commercial and residential customers in the Mt Gambier region via the gas distribution network of Envestra. Gas is no longer supplied via the Nangwarry lateral.
- 4.12 Although the source of gas for the SEPS has changed during the life of the pipeline, the Council is satisfied that gas continues to be injected into the SEPS at one location in order to convey gas to several markets, as outlined above. As such the SEPS is appropriately classified as a transmission pipeline.

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<sup>7</sup> While the Kalangadoo to Nangwarry lateral has been decommissioned, as this pipeline segment was constructed and commissioned after the revocation of the SEPS’ coverage this change is immaterial in the context of the SEPS’ previous classification.

## 5 Coverage of pipelines

### Requirements of the NGL

- 5.1 Natural gas pipelines in Australia may be subject to access regulation according to the NGL and associated rules. In particular a person may apply to have a pipeline ‘covered’. The effect of coverage is to subject to regulation the terms and conditions on which the pipeline’s services are provided.
- 5.2 Where a person has applied for a coverage determination, the Council must apply the pipeline coverage criteria and make a recommendation to the relevant Minister that the pipeline be a covered pipeline or not be a covered pipeline (NGL, s 96).
- 5.3 The pipeline coverage criteria, set out in s 15 of the NGL, are:
- (a) that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline (**criterion (a)**)
  - (b) that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline (**criterion (b)**)
  - (c) that access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to human health or safety (**criterion (c)**), and
  - (d) that access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest (**criterion (d)**).
- 5.4 The Council must recommend in favour of a coverage determination where it is satisfied that all of the coverage criteria are met and must recommend against making a coverage determination if not satisfied that all the coverage criteria are met (NGL, s 97(2)).<sup>8</sup>
- 5.5 In deciding whether the coverage criteria are satisfied the Council must have regard to the national gas objective, set out in s 23 of the NGL. The national gas objective states that:

The objective of this Law 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.

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<sup>8</sup> In considering the Council’s recommendation and making his or her decision the relevant Minister must consider the same matters and meet the same requirements as the Council (NGL, s 100).

- 5.6 The Council’s approach to considering the coverage criteria and having regard to the national gas objective<sup>9</sup> is set out in the Coverage Guide. As noted above, the Council is in the process of updating the Coverage Guide to take account of (among other things) the *Pilbara appeal decision*. For the purposes of this application for coverage under the NGL (and as it has noted in the Coverage Guide) the Council considers it necessary to account for the effect of the *Pilbara appeal decision* particularly regarding the assessment of criteria (b) and (d).

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<sup>9</sup> KCA addresses the national gas objective as a separate consideration (see Application, pp 11-13). This misapplies the requirement in s 97(1)(b) of the NGL that the Council must have regard to the national gas objective ‘in deciding whether or not the pipeline coverage criteria are satisfied’. The Council is required to make its recommendation that a pipeline be covered or not covered according to the test set out in s 97(2) of the NGL, ie it must determine whether or not the criteria for coverage are satisfied.

## 6 Criterion (a)

### 6.1 Criterion (a) requires that

access (or increased access) to the pipeline services provided by means of the pipeline would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline.

### 6.2 The decision on coverage is directed to the question of whether the environment for competition in a market other than the market for the pipeline services (ie in an upstream or downstream market, referred to as a dependent market) would be improved. The issue is whether access or increased access to pipeline services on reasonable terms and conditions would improve the opportunities and environment for competition in a dependent market(s) so as to promote materially more competitive outcomes in that market. The assessment is concerned with the process of competition, rather than the particular commercial interests or pursuits of any party. If a dependent market is already effectively or workably competitive then it would be unlikely that access would improve the competitive environment such that criterion (a) is satisfied.

### 6.3 In assessing whether criterion (a) is satisfied, the Council:

- identifies relevant dependent (upstream or downstream) markets
- considers whether the identified dependent markets are separate from the market for the pipeline service, and
- assesses whether access (or increased access) would be likely to promote a materially more competitive environment in the dependent market(s).

## Dependent markets

### 6.4 In its application and supplementary materials KCA suggests several markets where it considers access or increased access to the SEPS would promote competition. KCA refers to:

- the Australian (and global) markets for paper tissue products (KCA supplementary information, p 2, Application, p 15) and other product markets in which local users compete (such as the potato processing market in which McCain Foods Australia's Safries facility operates)
- an (upstream) gas supply/production market centred on Katnook comprising local producers and other shippers delivering gas to Katnook via the SEA Gas and SESA pipelines, and
- a (downstream) market comprising 'usage of gas for industrial, commercial and domestic purposes in the lower South East region of SA' (KCA supplementary information, p 2) but also stating that 'there would be no

increased competition (or loss of competition) [for domestic users in Mt Gambier] should coverage be granted of SEPS' (KCA supplementary information, p 4).

- 6.5 APA submits that KCA identified: 'the upstream gas market at Katnook; the Australian tissue market; and the retail gas market in Mt Gambier' (APA second submission, [3.14]).<sup>10</sup>
- 6.6 Having considered these submissions, the Council considers that the most relevant dependent markets are:
- (a) a (downstream) market for the sale of gas for use by domestic, industrial and commercial users in the area served by the SEPS
  - (b) an (upstream) market for the production and sale of gas, and
  - (c) Australian markets for paper tissue products and other products.
- 6.7 The Council is satisfied that these markets are distinct from the market for services provided by the SEPS because:
- (a) the parties that provide the SEPS pipeline services and operate in the markets identified above are different, and
  - (b) the provision of the SEPS pipeline services involves the use of facilities that are distinct from the facilities used in the identified dependent markets.

## **Assessment of the effect of access on likely dependent markets**

### **Gas sales around the SEPS**

- 6.8 Competition in (downstream) gas sales is likely to be promoted if coverage of the SEPS enables (or significantly encourages) new entry by parties selling gas to users in the region of the SEPS: that is entry by a party other than the current supplier (Origin) or potential entry that at least constrains Origin's market behaviour in a material manner.
- 6.9 The key to increased competition in the gas sales market is the likelihood of entry or the threat of entry by gas suppliers in competition with Origin and the Council is assessing the application on this basis. The two potential sources of new gas supply into the region around the SEPS are gas supplied from outside the region of direct interconnection with the SEPS (via the eastern Australian transmission network and the SESA) and locally extracted and processed gas injected into the SEPS at Katnook.<sup>11</sup>

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<sup>10</sup> APA states that it has adopted the markets specified by KCA and, as it has not conducted its own analysis to identify relevant markets, does not endorse the markets as identified by KCA (APA second submission, [3.40] and footnote 46).

<sup>11</sup> KCA identifies a localised gas supply/production market around the entry point of the SEPS as a separate market. However, gas produced locally would be either used downstream in the

*New gas supply—external to the region of the SEPS*

- 6.10 The connection to the transmission network through the SESA and the SEA Gas provides the means for gas producers outside the region of direct interconnection to the SEPS to supply gas to users and potential users in the region of the SEPS in competition with existing suppliers.
- 6.11 Although all firm capacity on the SEA Gas is contracted until 2019 (or 2029 if the foundation customers exercise their option to extend) (APA second submission, [3.47]), the Council considers that gas transmission and supply is generally competitive to the point of interconnection between the SEA Gas and the SESA. That is, a prospective supplier of gas to users in the SEPS region could obtain gas at the point of interconnection of the SEA Gas and the SESA and transport it via the SESA to the SEPS at Katnook.
- 6.12 Origin holds a contract for 100 per cent of the capacity of the (uncovered) SESA until 2023. APA cannot sell any capacity on the SESA to another intending user for the period of the Origin contract. Prospective gas suppliers located in other basins seeking to use the SEPS to supply downstream users will therefore need to enter an arrangement with Origin (the incumbent shipper) or agree with APA to fund an expansion of the SESA in order for APA to provide a service on the SESA in addition to that available to Origin.
- 6.13 APA submits that the ability of gas producers in basins outside the region of the SEPS to supply gas to the region depends on obtaining access three pipelines: the SEPS, SESA and SEA Gas (APA second submission, [2.39]). KCA also notes that access to the SEPS is unlikely to result in increased competition from shippers with access to the SEA Gas because Origin holds all capacity on the SESA. KCA considers that this effectively prevents a SEA Gas shipper (other than Origin) from injecting gas into the SEPS (KCA supplementary information, p 1).
- 6.14 The Council agrees that an alternative supplier to Origin is unlikely to emerge in the current environment. Use of both the SEPS and the SESA is necessary for an alternative supplier from outside the region of direct interconnection with the SEPS to provide gas to Katnook and beyond. With Origin holding 100 per cent of the capacity of the SESA until 2023, an alternative non-local supplier would likely have to fund an expansion of the SESA in order to obtain the capacity on the SESA necessary to transport gas to Katnook for injection into the SEPS. In this environment it is unlikely that an alternative supplier would be able to deliver gas to users such as KCA downstream of Katnook more cheaply than would Origin.

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gas/energy sales market in the area of the SEPS or exported via the interconnected Australian pipeline network in which case it would form part of the upstream gas production and supply market.

*New gas supply—local*

- 6.15 The only likely new entrant that might be able to inject additional gas at Katnook is Beach, which owns local gas fields (including fields that have produced gas in the past) and the Katnook processing plant.
- 6.16 KCA submits that coverage of the SEPS would encourage Beach to explore and develop its fields and inject this gas into the SEPS where it would be available in competition with gas supplied by Origin via the SEA Gas and the SESA. Regarding this, KCA submits that Beach has advised that it anticipates injecting gas into the SEPS from the new (local) Jacaranda Ridge field and that access to the SEPS at a reasonable tariff may make such marginal sources of gas commercially viable (Application, p 14). KCA's argument is that
- access to SEPS by Beach Energy will increase upstream competition in gas supplies by allowing it to compete with Origin Energy which currently controls all gas injection into SEPS from SESA (KCA supplementary information, p 2).
- 6.17 Beach says that it is currently exploring in existing fields near Katnook (during first quarter 2013) and is proposing exploration in other areas capable of connection to Katnook in 2014 (Beach submission, pp 1-2). It plans to transport any gas it finds to Katnook for processing (so would likely be injected into the SEPS). Any gas found as a result of the 2013 exploration would be available in about 12 months and any gas from the other proposed exploration activity in about 2015-16 (although more quickly if Beach also finds oil).<sup>12</sup>
- 6.18 Beach submits that its motivation to process any gas it might find in the Katnook region is dependent on acceptable technical risk and the commercial position regarding gas transportation and gas prices. Beach advises that it has had some contact with Epic and proposes to speak with APA and Origin. The Council notes that if Beach is able to transport gas via the SEPS and also via an arrangement involving the SESA (such as a gas swap with Origin) then it would have options to supply gas both to users connected to the SEPS and to those beyond via the SESA. Beach's current exploration plans do not depend on coverage of the SEPS although reasonable terms for using the SEPS and the SESA and appropriately attractive gas prices are important to its development of the resource.<sup>13</sup>
- 6.19 APA concedes that, with declining demand on the SEPS, the prospect of the SEPS being bypassed is low. However, APA submits that most of its costs in respect of the SEPS are fixed and that with spare capacity on the pipeline it has an incentive to accommodate entry by a competitor to Origin if that entry would result in more gas being transported on the SEPS. It also submits that the pipeline owner would be expected to act in a non-discriminatory manner with respect to the price and non-price terms and conditions of access to the SEPS (APA second submission, [3.22]) and suggests that this is borne out by

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<sup>12</sup> Beach personal communication.

<sup>13</sup> Beach personal communication.



Epic having offered transportation services to KCA at the same tariff (adjusted for CPI) as that payable by Origin Energy (APA second submission, p 24, footnote 36).

- 6.20 It is difficult to be confident at this time that sufficient local gas will become available in the short to medium term. Beach will not know the extent of its gas reserves until it completes exploratory drilling scheduled for 2013 and 2014, and gas if found may not be available for some time. No locally sourced gas was supplied into the SEPS in 2012 and in the four previous years local production was between 0.4 PJ/a and 1.0 PJ/a (APA second submission, p 16). Current estimates of proved and probable (**P2**) reserves are 1 PJ and have been at this level for the last five years. According to APA, throughput for the SEPS declined to 1.43 PJ in 2012 (APA second submission, p 14). Current P2 local reserves therefore represent about one year's gas demand for KCA.
- 6.21 Access to the services of the SEPS does not appear to be necessary to encourage exploration, since Beach is exploring without this, although there may be an argument that access would promote competition in the downstream gas sales market if Beach (or another participant) discovers viable reserves capable of being injected into the SEPS but is unable to reach commercial agreement with APA to use the SEPS. However, on the information available, the Council is not convinced that access to the SEPS would materially increase the competitiveness of the gas sales market in the region of the SEPS in the mid term.
- 6.22 To the extent that the Mt Gambier retail market is seen as a separate dependent market the Council is considering it as part of the downstream gas sales market. In any case, promotion of competition in a separate Mt Gambier gas market consequent upon access or increased access to the SEPS would be dependent upon there being new entry or the threat of new entry that would materially constrain the behaviour of Origin. The analysis is therefore the same as for the more broadly defined gas sales market.

### **Upstream gas production and sales**

- 6.23 Australia's network of transmission pipelines provides for basin on basin competition in southern and eastern Australia. The transmission network enables, for example, gas producers in the Surat–Bowen, Cooper, Gippsland, Otway, Bass and New South Wales basins to sell gas to customers across Queensland, New South Wales, Victoria, South Australia, Tasmania and the Australian Capital Territory so enhancing the scope for competition in the areas served by the network (AER 2012, pp 94 and 99).
- 6.24 Gas from south east South Australia upstream of the SEPS is part of this competitive market. Producers (including Beach) are able to transport gas for supply to a range of locations in southern and eastern Australia using the transmission network. Any gas produced by Beach for example could be transported using the SEPS or using the SESA and the SEA Gas via an arrangement with Origin and others. Coverage of the SEPS (while potentially important to the competitive position of a local gas producer) is therefore unlikely to promote an increase in competition in the upstream gas production market.

- 6.25 In any case as noted above the information available to the Council suggests that the known volume of gas in the area of the SEPS is low, with P2 reserves for the Katnook region at 1PJ (figure unchanged for the last five years: APA second submission, p 16).<sup>14</sup> Beach continues to explore in the Katnook area and is proposing new drilling in 2014, but it will not know the scale of gas reserves for some time.
- 6.26 The Council considers that access to the SEPS is unlikely to promote a material increase in competition in the already competitive (upstream) gas production and sales market.

### **Tissue and paper products (and other product markets)**

#### *Tissue and paper products*

- 6.27 KCA states that access to SEPS has the potential to make KCA mill operations more competitive in the Australian and global markets for tissue based products.
- 6.28 The assessment required under criterion (a) is whether access or increased access would promote a material increase in competition in a related market, not whether any single user or group of users would become more competitive in their own market. KCA becoming more competitive in the tissue market as a consequence of lower gas transport charges would constitute a material increase in competition in a dependent market only where the increase in KCA's competitiveness is sufficient to affect the competitive conditions in that market. Where the market in question is already effectively competitive, the user in question represents a relatively small element of that market, or the effect on that user is minor, the benefit to the user will not be sufficient to satisfy criterion (a).
- 6.29 KCA states that its products (facial tissue, bathroom tissue and kitchen tissue) face competition from manufacturers located on Australia's eastern seaboard and that there is 'considerable competition' from imports. KCA advises that it has 'in the mid 30% range' of the Australian tissue market but that Australian manufacturers' market share is being eroded by imports. KCA submits that reduced transmission tariffs will enable it to lower its prices and, given its market share, the outcome would be downward price pressure on all suppliers and thus an increase in competition in the Australian tissue market.
- 6.30 KCA also submits that tissue manufacture is highly energy intensive and increasing energy costs compound the cost disadvantage of the Millicent mill putting the long term viability of the mill at risk. The implication of this is that KCA believes that its capacity to

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<sup>14</sup> In contrast, the Otway basin in Victoria produced 102 PJ in the year to June 2012 and as at August 2012 had P2 reserves of 847 PJ, while the corresponding figures for the Cooper basin in South Australia and Queensland were 95 PJ and 1 740 PJ (AER 2012, p 87). In 2012, Australian P2 reserves of natural gas were 98 000 PJ (plus 42 000 PJ of coal seam gas) and Australia produced 1 924 PJ of gas, of which 55 per cent (1 058 PJ) was for the domestic market (AER 2012, p 85).

obtain appropriate energy costs, achieved by coverage of the SEPS, is relevant to the extent of competition in the paper tissue market.

- 6.31 APA considers that KCA's characterisation of the tissue market suggests that the market is already effectively competitive but that if KCA was to scale back its operations at Sunggery then there would be a material reduction in competition (APA second submission, [3.50]). APA submits that it has no incentive to adversely affect competition in this market and that the viability of the SEPS is inextricably linked to the ongoing viability of gas users. APA says that this is especially so in the case of KCA, the largest user on the SEPS (APA second submission, [3.52]—[3.54]). APA also submits that the SEPS tariff is a relatively insignificant element in KCA's total input costs (detailed in APA second submission, [3.32]—[3.35]) and it is difficult to see how access or increased access could have any effect on competition in the national tissue market (APA second submission, [3.55]—[3.56]).
- 6.32 On the information available to the Council, the Australian paper tissue market appears to be already effectively competitive. There are four major Australian manufacturers: KCA (which holds about 35 per cent of the market), SCA Hygiene Australasia Pty Ltd (**SCA**) (holding around 30 per cent of the market in 2008: RISI 2008a), Encore Tissue Pty Ltd and ABC Tissue Products Pty Ltd (**ABC**). While KCA and SCA are historically the two largest participants, ABC has gained an increasing proportion of the market (PPISG 2010, p 13, RISI 2008a and RISI 2008b). Further, imports are increasing: for example, toilet paper imports doubled between 2004 and 2008 (ACS 2008, p 28) and in 2008 comprised a greater share of the Australian market than any single independent tissue company (RISI 2008a). Moreover, the high Australian dollar, by making tissue imports more price competitive, is likely to be facilitating the expansion of supermarket private label products (Euromonitor 2012).
- 6.33 In these circumstances, the Council considers that access (or increased access), even if it is assumed to reduce the price of delivered gas for KCA, is likely to have little effect on competitive conditions in the Australian paper tissue market. To the extent that it is relevant to identify a global tissue market the Council considers that access would not materially promote competition.

#### *Other product markets*

- 6.34 KCA submits that other local gas users will become more competitive in their respective markets should access to the SEPS be available, so promoting competition in these markets. KCA states for example that 'Safries [which processes potato products] and other gas using manufacturers in Mount Gambier will become more competitive in their markets should access be provided on SEPS at reasonable tariffs' (Application, p 16).
- 6.35 APA submits that cheaper imports are accounting for a growing proportion of the market for processed potato products and are starting to act as a substantial constraint on Australian manufacturers. APA also submits that the owner of the SEPS has no incentive

to act in a manner that would cause the Safries facility at Penola to reduce its gas use and that the gas tariff would account for only a very small proportion of Safries' input costs (APA second submission, [3.64]—[3.65]).

- 6.36 The potato processing market in Australia is dominated by McCain Foods Australia (which has manufacturing sites in Australia at Penola (South Australia), Ballarat (Victoria) and Smithton (Tasmania)) and Simplot (Birdseye) with imports increasing. In these circumstances the Council accepts that coverage of the SEPS (which would be relevant only for the McCain plant at Penola) would be likely to have little effect on the competitive environment in the Australian potato processing market.
- 6.37 KCA notes the Australian engineered wood market (giving the example of the Carter Holt Harvey mill at Nangwarry) but makes no express submission on the state of this market with or without access to the SEPS. The Council has no reason to dispute APA's submission that gas tariffs were not material to the closure of Carter Holt Harvey's Nangwarry mill and that reduced tariffs would therefore be unlikely to materially influence Carter Holt Harvey (or any other industry participant) to recommence mill operations at Nangwarry.
- 6.38 Neither McCain Foods Australia nor Carter Holt Harvey (identified by KCA as significant users of gas delivered via the SEPS) provided a submission on the application. This suggests perhaps that coverage of the SEPS might not be a significant issue for either party.

### **Preliminary conclusion on criterion (a)**

- 6.39 The Council's preliminary view is that criterion (a) is not satisfied.

## 7 Criterion (b)

- 7.1 Criterion (b) requires that ‘it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline’.
- 7.2 This coverage criterion is essentially the same as criterion (b) in the declaration criteria in Part IIIA of the CCA. The interpretation of the two provisions are inextricably linked with Court and Tribunal decisions in relation to each being adopted in respect of the other.
- 7.3 In its recent *Pilbara appeal decision* the High Court considered how declaration criterion (b) should be interpreted and held the provision “is to be read as requiring the decision maker to be satisfied that there is not anyone for whom it would be profitable to develop another facility” at [77]. In doing so the High Court overturned previous interpretations of this criteria which had focussed on the presence of natural monopoly characteristics.
- 7.4 The wording of declaration criterion (b) and coverage criterion (b) is essentially the same. Furthermore, Part IIIA of the CCA and the NGL share a similar genesis, as do the declaration and coverage processes and criteria contained in each. In the Council’s view there is no basis for distinguishing the interpretation of coverage criterion (b) from that given to declaration criterion (b) by the High Court.
- 7.5 On this basis coverage criterion (b) asks whether anyone could profitably develop another pipeline to provide the pipeline services provided by the SEPS.

## Application and submissions

- 7.6 KCA submits that criterion (b) is satisfied noting that:
- the SEPS is currently only using about half its uncompressed capacity and capacity could be doubled with compression
  - a new pipeline would have a much higher cost structure than SEPS as (although KCA does not know the financial details) PASA would have structured its initial investment to recover its investment within the operational life of the Katnook gas fields and the pipeline asset value has already been depreciated by some 20 years of operation
  - two pipelines sharing the same or moderately increased gas flows would both operate well below optimum capacity
  - the only way another entity could profitably transport gas from Katnook to Millicent is for shippers to underwrite the costs of duplicating the SEPS, which would require shippers to pay more for the alternative transport than the cost of shipping on the SEPS. Epic (APA) can thus prevent a new entrant by pricing transport on the SEPS at marginally less than the alternative, and

- advice it had received it from APA on the viability of building a pipeline to bypass the SEPS to connect either to the SESA or SEA Gas was that, while this would be possible, the costs would be unlikely to be less than haulage on the SEPS (KCA supplementary information, p 5).

7.7 APA acknowledges that criterion (b) is likely to be satisfied, considering that it would be unlikely to be profitable to develop another pipeline to provide the SEPS service either as a stand-alone pipeline or as part of a larger project. APA's views in summary are as follows.

- The costs of constructing a stand-alone pipeline, even if some optimisation of the size of the pipeline is undertaken, would be substantially higher than the written-down value of the SEPS because: construction costs have increased in real terms since the SEPS was constructed; an optimised (smaller) pipeline would not be materially less expensive to develop (and in any case best practice is develop pipelines no less than 6" in diameter); and easements can be costly to negotiate. With SEPS operating at 20-30 per cent of capacity and demand at around 1.4—2.9PJ/a, a new entrant would be unlikely to find it profitable to develop a new pipeline unless it was able to charge a much higher tariff, even if all current users of the SEPS switched to a new pipeline.
- Beach is one party who might find it profitable in the future to develop a new pipeline as part of a larger project. Gas produced at Beach's Katnook gas plant has a locational advantage over gas produced in offshore Otway fields which must be transported to the entry point of the SEPS. However for the development of another pipeline to be profitable Beach must be able to produce sufficient volumes of gas and there must be sufficient demand for that gas. APA submits that, given the low level of P2 reserves in the Katnook fields (around 1PJ for the last five years) and low production volumes (between 0.37 and 1.01 PJ/a from 2008—2011 with no gas supplied into SEPS in 2012), the prospect of Beach profitably developing a new pipeline in the short to medium term is low.<sup>15</sup>

## The Council's assessment

7.8 No party submits that criterion (b) is not met. The Council notes in particular KCA's submission that it sought advice from APA on the viability of building a pipeline to bypass the SEPS to connect either to the SESA or SEA Gas and was advised that the cost of this would be unlikely to be less than the cost of haulage on the SEPS.

7.9 The Council has itself considered whether anyone might profitably develop another pipeline to compete with the SEPS. While Beach might contemplate building another

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<sup>15</sup> APA submits that it has no information that enables it to comment on the likelihood of any large end-user of gas developing a pipeline as part of a larger project.

pipeline, the Council considers such an outcome to be unlikely, certainly in the short to medium term. Beach would need to discover a viable commercial quantity of gas. While Beach is exploring in the South Australian on-shore Otway Basin and is assessing the potential to restart production from existing fields, it may not know the potential volume of gas resources in the Katnook area for some time. If its exploratory drilling finds commercial volumes, these would likely not be developed significantly until 2015-16. Further, if Beach did find sufficient volumes it may, in the view of the Council, see greater benefit in duplicating the SESA to connect to the broader transmission network or in engaging with Origin (which holds all capacity on the SESA) to transport gas through a gas swap or similar arrangement.

### **Preliminary conclusion on criterion (b)**

7.10 The Council's preliminary view is that criterion (b) is satisfied.

## **8 Criterion (c)**

8.1 Criterion (c) requires that

access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to health or safety.

8.2 The safe use of natural gas transmission pipelines through appropriate operator practice and regulation is well established in Australia. The Council is not aware of any reason why access to the services provided by the SEPS would compromise human health or safety.

8.3 No party has submitted that criterion (c) is not met in respect of the SEPS.

8.4 KCA notes that there have been no concerns raised about the safe operation of the SEPS over its lifetime. Further, KCA reports that Epic (prior to acquisition by APA) advised that the uncompressed capacity of 25TJ/d is twice the current utilisation and capacity could be safely increased with compression.

### **Preliminary conclusion on criterion (c)**

8.5 The Council's preliminary view is that criterion (c) is satisfied.



## 9 Criterion (d)

### 9.1 Criterion (d) requires that

access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest.

### 9.2 ‘Public interest’ is not defined in the NGL. However the term imports consideration of a wide range of matters.

### 9.3 Criterion (d), being expressed in the negative, does not require the Council to be satisfied that access would be in the public interest, only that access would not be contrary to the public interest (*Re Services Sydney Pty Ltd* [2005] ACompT 7, [192]).

## Application and submissions

### 9.4 Both KCA (Application, p 21) and APA (APA second submission, [3.88]) approach criterion (d) as an assessment of whether the benefits of coverage outweigh the costs.<sup>16</sup>

### 9.5 KCA’s submissions include that ‘[i]n an overall qualitative sense, coverage [of the SEPS] is likely to provide a significant public benefit’, and ‘[a]s there is a strong indication there will be a net benefit to consumers as a result of regulation of the SEPS, there will not be an outcome from coverage that would be contrary to the public interest, thereby satisfying criterion (d).’ (Application, pp 23 and 24.) KCA says that Epic enjoys monopoly rents for transport on the SEPS and that this is ‘unconscionable’ (Application, p 9) or ‘inequitable’ (KCA supplementary information, p 4). Drawing on the factors listed in clause 1(3) of the CPA, it submits that access will have a number of public benefits including:

- allowing KCA to implement its energy efficiency intentions
- supporting ecological goals
- providing social welfare, access and equity benefits
- protecting regional employment
- lowering gas prices for all gas users served by SEPS
- making gas using manufacturers more competitive, and
- encouraging greater and more efficient utilisation of an underutilised asset (Application pp 21-22).

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<sup>16</sup> Both KCA and APA also refer to the Coverage Guide as indicating that the Council has previously approached criterion (d) on this basis. As noted at paras 1.10 and 5.6 above, the Council is in the process of updating its guides to take account of the *Pilbara appeal decision*.

- 9.6 APA submits that the costs of coverage outweigh the benefits because there are no tangible competition or other public benefits of coverage but significant regulatory costs (APA second submission, [3.99]—[3.102]). APA submits that there will be neither competition benefits nor any other public benefits arising from coverage (APA second submission, [3.99]—[3.101]).
- 9.7 APA submits that the costs to all parties for coverage of the SEPS over 10 years would be \$2.35 million for full regulation. On the basis that the parties have been unable to agree tariffs and therefore the light regulation dispute resolution provisions are likely to be triggered, APA estimates the costs of light regulation for 10 years to be \$970 000. It submits that the costs are particularly significant in light of the small volumes of gas transported on the SEPS: assuming gas throughput on the SEPS remains at around 1.4 PJ/a, 10 cents per GJ and 6 cents per GJ would be added to the cost of gas transport for full and light regulation respectively (APA second submission, [3.96]—[3.97]).

### **The Council's assessment**

- 9.8 The Council's task under criterion (d) is to identify whether there is any matter that might result in access (or increased access) to the pipeline services provided by the SEPS being contrary to the public interest even if the other coverage criteria are met. Criterion (d) is concerned with identifying reasons why a pipeline should not be covered even when the other coverage criteria are satisfied.
- 9.9 The Council has considered whether there are any matters, including matters identified in the Application and submissions, that lead to the conclusion that access or increased access would be contrary to the public interest.
- 9.10 In its application KCA raises a number of affirmative public benefits it says would flow from access to the SEPS. These are listed at paragraph 9.5 above. In its submissions APA challenges KCA contentions in regard to these benefits.
- 9.11 At best any affirmative benefits from access might offset public costs that would otherwise be assessed under this criterion. But where another coverage criteria is not satisfied that is the end of the matter—coverage is not available. Under the NGL, positive public interest factors cannot overcome a failure to satisfy one or more coverage criterion to allow coverage of a pipeline. That, for example, access might help preserve employment in a region is not sufficient to allow coverage of a pipeline when the pipeline would not materially promote competition in dependent markets.
- 9.12 The Council has considered whether the costs of regulation of the SEPS might be such that, when compared to the benefits of access, access or increased access would be contrary to the public interest.
- 9.13 As the Council has determined that the SEPS, if covered, will be subject to light regulation (see section 11 below), APA's higher end estimates of the costs of regulation

are not applicable. The Council also considers that APA may have overestimated the costs of light regulation of the SEPS. Some of the cost that APA has attributed to the regulation of the SEPS will have already been incurred in the regulation of other APA pipelines or would be incurred regardless of coverage of the SEPS. Further, it should not be assumed that recourse will be had repeatedly to the dispute resolution provisions since the principal ground of dispute is the transport tariff, so arbitration is unlikely to be necessary beyond the setting of the tariff or the basis upon which the tariff is to be determined. The Council does not consider that regulation of the SEPS would involve unusual regulatory costs. Nonetheless, the Council accepts that the costs of regulating the SEPS would not be inconsequential.

- 9.14 While APA's submission that the costs of regulation would substantially increase transport tariffs because of the low volumes of gas transported on SEPS may have some basis, the Council considers that the low volumes of gas transported on the SEPS may create an incentive on the parties to avoid dispute resolution. This is because the costs of dispute resolution are likely to quickly dissipate any potential gain in the form of a higher tariff for APA or a lower tariff for KCA.
- 9.15 The Council notes that in its assessment of criterion (a) it has not found that access to the SEPS would materially promote competition in any dependent market. Consequently no material benefit to the public arises from that source. There are however costs of regulation which would arise if the SEPS were covered. In circumstances, where the Council is not satisfied under criterion (a) that there will be a public benefit resulting from a material promotion of competition, the Council considers that generally it cannot be satisfied in respect of criterion (d).

### **Preliminary conclusion on criterion (d)**

- 9.16 The Council's preliminary view is that criterion (d) is not satisfied.

## **10 The period of any coverage of the SEPS**

- 10.1 While the Council's draft recommendation is that the Minister decide not to cover the SEPS, the Council is giving consideration in its recommendations to an appropriate period of any coverage so that advice is available to the Minister should he decide to cover the pipeline.
- 10.2 Should the Minister decide to cover the SEPS the Council considers that the appropriate period of coverage is 10 years. If the SEPS were covered for this period then coverage would end at about the same time that the contract held by Origin for 100 per cent of the capacity of the SESA will expire. At the end of the Origin contract it might be expected that gas producers located in basins outside the region of the SEPS will have greater incentive to supply gas to users in the area downstream of Katnook via the SESA and the SEPS pipelines.

## 11 Form of regulation

11.1 The NGL provides that when making a coverage recommendation the Council must also determine whether to make a light regulation determination that will apply to the pipeline services should the pipeline be covered.<sup>17</sup> If the relevant Minister decides to cover the pipeline services, then the Council's determination decides the form of regulation that applies to the covered pipeline services.

11.2 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.

11.3 In essence, determining whether to make a light regulation determination turns on a comparison of the effectiveness and costs of the two forms of regulation provided for in the NGL. This requires an examination of the effectiveness of light regulation as compared to full regulation in constraining the use of market power and promoting access to pipeline services, and the relative costs of the two approaches. If light regulation is similarly effective as full regulation but involves lower costs, then light regulation is the more appropriate form of regulation.

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<sup>17</sup> Sections 109 and 110 of the NGL.

- 11.4 The key difference in the forms of regulation is that a covered pipeline that is subject to full regulation must submit a full access arrangement to the AER for approval. An access arrangement provides for up-front price regulation in that it must specify a reference tariff to be approved by the AER. Service providers of a light regulated pipeline are not required to submit an access arrangement, although they may voluntarily submit a limited access arrangement to the AER for approval.<sup>18</sup>
- 11.5 The negotiate/arbitrate model that exists under light regulation substitutes ex-post regulation for ex-ante regulation. It does not remove regulatory oversight of prices.
- 11.6 In the event of an access dispute concerning a light regulation pipeline, the dispute may be dealt with via arbitration following notification of the dispute. In an arbitration the AER can determine access prices and others terms and conditions of access. This process is similar to the negotiate/arbitrate model for services declared under Part IIIA of the CCA. To date, no access disputes concerning a light regulation pipeline have been notified to the AER or the Economic Regulatory Authority (the regulator in Western Australia).<sup>19</sup>
- 11.7 Irrespective of which form of regulation applies, services providers must disclose a range of information, under the NGL and NGR, concerning a covered pipeline, although the scope of that disclosure is less for a light regulation pipeline than those subject to full regulation. Many of the other obligations on covered pipelines under the NGL apply to both full and light regulation pipelines.
- 11.8 Further information on the different forms of regulation and the Council’s process in considering whether to make a light regulation can be found in the Council’s publication *A guide to the functions and powers of the National Competition Council under the National Gas Law, Part C – Light regulation of pipeline services*, which can be downloaded from the Council’s website, [www.ncc.gov.au](http://www.ncc.gov.au).

## Form of regulation factors

- 11.9 Section 16 of the NGL sets out the form of regulation factors the Council must have regard to in deciding whether light regulation is the appropriate form of regulation for the SEPS, should it be covered. These factors—(a) to (g)—are set out in the first column of Table 11.1. More generally, Table 11.1 summarises the Council’s views on how each form of regulation factor might, in principle, affect its determination of a light regulation application.

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<sup>18</sup> The requirements for a limited access arrangement are set out in r 45 of the NGR.

<sup>19</sup> Three pipelines regulated by the AER are subject to light regulation. One pipeline in Western Australia, regulated by the Economic Regulatory Authority, is subject to light regulation.

**Table 11.1: The form of regulation factors and circumstances surrounding their application**

Form of regulation factor (s 16)	Circumstances conducive to light regulation	Circumstances where light regulation less likely
(a) the presence and extent of any barriers to entry in a market for pipeline services	Barriers to entry present but are relatively low	Barriers to entry relatively high
(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider	Stand alone pipeline activity, where a service provider has no other pipeline operations  Rights to pipeline capacity readily tradeable  Transmission services and other end to end services generally 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

Form of regulation factor (s 16)	Circumstances conducive to light regulation	Circumstances where light regulation less likely
(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>Large or concentrated users</p> <p>Users with by-pass opportunities</p> <p>High interdependence between users and service provider</p> <p>Users involved in pipeline services elsewhere (such users may face lesser information asymmetry given their direct knowledge and experience of pipeline operations)</p>	<p>Many small users</p> <p>Users have limited resources</p> <p>Diverse user interests (for example where users span different industries or economic sectors)</p> <p>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)</p> <p>Poorly represented users</p>
(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	<p>Greater substitution possibilities exist</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>Fewer substitution options</p> <p>Low elasticity</p> <p>Distribution pipelines (especially established distribution pipelines with a high market penetration)</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>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>



Form of regulation factor (s 16)	Circumstances conducive to light regulation	Circumstances where light regulation less likely
(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>Previous 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>

## Effectiveness of regulation alternatives

11.10 The positions of KCA and APA on the appropriate form of regulation differ. KCA supports full regulation while APA considers that light regulation will be just as effective as full regulation in promoting access with lower associated costs. While the premise of the Origin submission is in direct response to the application and whether or not the pipeline should be covered, its claim that the SEPS does not require an access arrangement—which would be required if the SEPS were subject to full regulation—is also relevant to the form of regulation question.

11.11 If the SEPS is covered, KCA seeks full regulation. KCA states that:

Light handed regulation best applies where the regulator already has a good understanding of the reasonable costs incurred in providing the services being regulated. This understanding comes from previous assessments where the regulator has detailed information about the service from previous regulatory reviews. Based on this knowledge the regulator has sufficient information on which to assess proposals from the service provider and so either agree or reject proposals made under light handed regulation.

In the case of SEPS the pipeline has never undergone a regulatory review and as a result the regulator has no previous knowledge which it could use to assess the reasonableness or otherwise of a proposal put to it by Epic. (Application, p 26)

...the least cost to consumers will be provided by full regulation because until there is understanding and acceptance of the fundamentals for developing a tariff, LHR [light handed regulation] is unlikely to be the best alternative for consumers (Application, p 25).

11.12 KCA's response to each of the form of regulation factors as follows:

a) Due to SEPS having such large amounts of spare capacity, it is not economically efficient to build duplicate assets. This is a major barrier to entry for any new entrant

b) SEPS effectively only provides one service – that of gas transportation to three major usage points (Safries, KCA and Mount Gambier)

c) Epic does not provide any other energy service in the region

d) Any user of gas in the region must use SEPS unless they are sufficiently physically close to SESA or SEAGas pipelines that bypass is feasible. This means that Epic has a monopoly of gas transportation over much of the lower south east region of SA and all gas users have to use the services offered by Epic. That Epic has consistently sought a large increase from the foundation tariff for future gas transport and that KCA has resorted to seeking coverage, attests to consumers having little countervailing market power to combat the market power held by Epic

e) ...there is demonstrably no substitute for the service provided by SEPS. Equally there is no elasticity of demand for the service required.

f) As there is no commercial alternative form of thermal energy in the region there is no substitute nor does varying demand for gas influence on the cost of the service provided by Epic.

g) There is sufficient information publicly available which provides evidence that Epic is seeking a monopoly rent. However much of the data needed to assess the extent of this rent is not available because it requires a regulatory assessment to be made of all the circumstances surrounding SEPS and the historical recoveries made under the 20 year foundation contract between Origin/Sagasco and Epic/PASA, in order to develop a sound basis on which to establish the principles that should apply to a reasonable and equitable tariff for use of SEPS. A regulator would have access to this information, which supports the view that full regulation of SEPS is required, at least for the initial setting of tariffs. (Application, pp 25-26)

11.13 KCA explores in some depth the methodology and approach it claims should be employed to set the appropriate tariff for the SEPS, in support of its assertion that because the SEPS has not been regulated since coverage was revoked in 2000 light regulation is inappropriate. In support of full regulation, KCA concludes that:

...at least for the initial setting of a tariff for SEPS, a full and detailed regulatory review is essential to ensure that the tariff set provides Epic with sufficient revenue to continue the commercial operation of SEPS into the future, but to also reflect that Epic does not gain a monopoly rent from the services SEPS provides, particularly as a result of depreciating the asset more than once. (Application, p 31)

11.14 Should SEPS be covered, APA favours light regulation as APA considers it would be as effective in promoting access as full regulation with lower costs being imposed on the owner and users of the SEPS. APA also submits that light regulation is also more likely to promote the national gas objective than full regulation (APA second submission 4.2).

(a) In exploring these aspects further, APA submits that in respect of promoting access to the SEPS, light regulation would be no less effective than full regulation because:

- any purported market power of APA as the owner of the SEPS will be offset by its commercial imperative to address the largely fixed costs (~90 per cent) in operating the pipeline by increasing the pipeline's utilisation beyond its current level of 20-30 per cent. Furthermore, the offset of any market power of APA will also occur via the countervailing power possessed by Origin Energy;
- existing and prospective users would have sufficient information, incentives and ability at their disposal to negotiate effectively with the owner of the SEPS; and

- dispute resolution under light regulation will impose a further discipline on the owner of the SEPS and provide users with an appropriate level of protection if negotiations break down,

(APA second submission, 4.3)

11.15 KCA argues that the underutilisation of the SEPS creates a significant barrier to entry because the spare capacity on the SEPS makes it economically inefficient to build another pipeline. The Council acknowledges the presence of barriers to entry, in combination with the recent change in ownership of the SEPS from Epic to APA, indicates that the service provider is likely to possess some market power. The Council notes, however, APA's submission that any market power it may have is "offset by the commercial imperative it has to encourage greater utilisation" of the SEPS. Drawing on the Council's findings and conclusions in chapter 6 concerning the promotion of competition in respect of coverage criterion (a), the Council considers that despite the barriers to entry, any market power is likely to be tempered by the current under utilisation of SEPS and the fixed nature of its operating costs. The Council agrees that it is reasonable to assume that given the fixed costs associated with operating the SEPS, a rational service provider will have commercial imperatives to want to seek to increase throughput on the SEPS.

11.16 The prospect of alternative fuel sources being available may also act as a constraint on any market power of the service provider. For example, KCA states in its application that at a time when gas was limited supply it was able to replace the natural gas then sourced at Katnook and utilised by KCA's mill at Millicent with liquefied petroleum gas (Application, p 6). While KCA states the costs are "excessive" the availability of substitutes is a relevant consideration in terms of form of regulation factors (d)-(f) and demonstrates that substitution possibilities do exist as the KCA Millicent mill is not entirely dependent on natural gas for its operations. The availability of substitutes may also serve to mitigate the potential market power of a service provider.

11.17 Form of regulation factor (g) examines the extent to which there is information available to a user or prospective user and the appropriateness of that information to enable informed negotiations between a user/prospective user and the service provider. APA submits that such information exists, even under light regulation. APA points to the disclosure requirements of the NGL and NGR concerning the price and non-price terms and conditions of access, and the availability of capacity, (APA second submission, Box 4.1, p 47). APA also points to the availability of other information such as the AER's annual compliance programme which requires providers of light regulation pipelines to report on price discrimination and access negotiations and information that may be discerned about APA's corporate affairs and its pipelines because of its obligations as a listed public company under the Australian Stock Exchange's (ASX) continuous disclosure obligations.

11.18 While the Council accepts APA's submission that such information exists, the Council agrees with KCA that the fact that the SEPS has not been regulated for more than a

decade limits the amount of information publicly available for the pipeline, particularly in regard to pricing. Furthermore, the Council believes any disclosure of information by APA to the ASX is likely to be inadequate to the interests and information needs of existing and potential users of the SEPS. Accordingly, the Council considers that there is likely to be a degree of information asymmetry between the service provider and KCA, as an existing user and also any potential users. The lack of information currently available about the SEPS could be expected to have less impact on Origin which is a key player in the energy industry. This can reasonably be expected to put KCA at a disadvantage in negotiating with APA. While full regulation would require greater disclosure by the service provider, the Council considers that information imbalances are likely to be more or less the same irrespective of the form of regulation. The statements by Origin that an access arrangement will not necessarily provide tariffs for all of the services sought by KCA and that additional services would continue to be negotiated services separate to an access arrangement (Origin submission, p 3) are informative in this regard.

- 11.19 On balance, the Council considers that the light regulation regime will be as effective as full regulation in protecting users and other parties dependent on access to the SEPS. This is due to the disclosure requirements of the service provider for the SEPS under light regulation and the availability of dispute resolution via arbitration by the AER. The Council considers that the AER is in no less a position to determine an appropriate outcome via arbitration than it would be if the SEPS were subject to full regulation. Indeed, the Council considers that should arbitration be necessary, the access outcomes may even be enhanced on what could be available to users via an access arrangement because the arbitration determination may address bespoke arrangements in response to particular access issues.

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

- 11.20 APA claims substantial cost savings associated with light regulation. KCA estimates that in a light regulation scenario where a single arbitration of the terms and conditions of access occurs, the costs of light regulation for the owner and users of the pipeline would be 40 per cent lower than if full regulation applies (\$86 000 pa as compared to \$140 000 per annum). In the event of no disputes giving rise to an arbitration, these costs savings could grow to as much as 90 per cent (APA second submission, 4.3 and Table 3.2). These figures and purported savings derive from APA's claim that an initial access arrangement would cost \$500 000 to prepare, with subsequent access arrangements costing in the vicinity of \$400 000, which the Council considers may be overstated. APA also claims it would have sizeable ongoing compliance costs which are either reduced substantially or eliminated in the light regulation scenario.

- 11.21 In support of full regulation, KCA claims

...the least cost to consumers will be provided by full regulation because until there is understanding and acceptance of the fundamentals for developing a tariff, LHR

[light handed regulation] is unlikely to be the best alternative for consumers (Application, p 25).

- 11.22 Other than as quoted above at 11.21, KCA did not explore the cost aspects of the different forms of regulation although it pointed to its examination of criterion (d) in its application in noting that the “costs of full regulation can be accommodated and still provide for a net public benefit” (Application, 7.1 at p 25).<sup>20</sup> The Council notes KCA’s statement in support of full regulation that “there is such a massive difference between the view of Epic and KCA in regard to the fundamentals used to develop a mutually acceptable outcome” (Application, 7.1 at p 25).
- 11.23 APA also claims that the costs of the regulator (the AER) will be 88 per cent lower under light regulation as compared to full regulation, in a scenario where one arbitration is undertaken by the AER. If dispute resolution is not activated, then APA estimates the cost savings to be as much as 99 per cent when compared to full regulation (APA second submission, 4.3).
- 11.24 There is some potential for cost savings to be eroded by lengthy or numerous arbitrations of access disputes. In this regard, APA submits that a single arbitration is estimated to cost approximately \$100 000 (APA second submission, Table 3.2). Should light regulation result in a series of arbitrations, then the regulatory determination of tariffs and terms and conditions of access under full regulation may actually be more cost effective.
- 11.25 The Council recognises the prospect of access disputes arising in regard to the SEPS under light regulation. Under the current arrangements, the Council considers that any such dispute is unlikely to arise in association with Origin’s use, given its agreement with APA on transport, and is more likely to be triggered by KCA, and or APA, in regard to KCA’s needs and arrangements. As much of KCA’s application considers the pricing methodology used in relation to the SEPS, the possibility of a dispute over tariffs cannot be dismissed. The Council does not accept however KCA’s claims that, due in part to the SEPS being unregulated for the better part of a decade, these issues can only be assessed by way of a full regulatory review required by full regulation. The AER, as both the regulator and the arbitrator under light regulation, approaches an arbitration from an informed platform and is sufficiently resourced, experienced and charged with information gathering powers necessary to make a determination on matters in dispute. An AER arbitration determination may well include examining pricing methodology and setting tariffs. The AER is equally equipped to undertake such a task in an arbitration under the light regulation regime as it is in approving an access arrangement required by full regulation. The Council is satisfied that should an access dispute arise, the outcome

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<sup>20</sup> KCA also drew on Epic’s submission as to costs in its application for revocation. Given the lapse of time since the application for revocation was made and the fact that the regulatory regime has changed in the intervening period with the introduction of the NGL, the Council considers it inappropriate to attach any weight to these quantifications (see Application pp 22-24).

of an arbitration by the AER may result in terms and conditions of access on par with what may be achieved via the AER reviewing and approving an access arrangement.

11.26 While the Council anticipates that access disputes may occur under light regulation of the SEPS, more likely triggered by KCA than Origin, it anticipates the number of access disputes to be low, although there may be a number of matters in contention in any one dispute.

11.27 Where the number of access disputes is expected to be low, light regulation is likely to result in lower costs for APA than would full regulation, although the savings may not be of the magnitude APA claims. Some reductions for other parties, such as the AER, users and consumers may also be achieved, although they are likely to be small.

### **National gas objective**

11.28 In making a light regulation determination, the Council must have regard to the national gas objective in s 23 of the NGL, which provides:

The objective of this law [the NGL] is to promote the 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.

11.29 APA submits that light regulation would promote the national gas objective because it “would result in a greater level of productive, allocative and dynamic efficiency than would be available under full regulation, which would, in turn, benefit the long-term interests of end-users” (APA second submission, 4.2).

11.30 KCA supports full regulation and contend that full regulation will result in “the least cost to consumers” because it is necessary for the “fundamentals for developing a tariff” to be understood and accepted (Application, p 25).

11.31 In the Council’s view, where light regulation is similarly effective to full regulation but involves a lower cost, it is the more suitable form of regulation and a light regulation determination is consistent with the national gas objective. The Council accepts that light regulation for the SEPS will involve lower costs than full regulation. Further, the Council considers it unlikely that light regulation would disadvantage pipeline users, given the availability of recourse to binding arbitration and the powers of and scope of considerations that the AER may address in an arbitration.

### **Other matters**

11.32 The Council does not consider that there are any further matters arising from submissions received or otherwise, that are not encompassed within its consideration above and as required under s 122(2)(c) of the NGL.

## **Preliminary conclusion on the form of regulation**

- 11.33 Having considered the form of regulation factors, the costs of regulation and the national gas objective and having regard to the current utilisation of and arrangements concerning the SEPS, the Council considers that light regulation is likely to have similar effect as full regulation and will be a lower cost means of regulation.
- 11.34 Under light regulation users and prospective users may notify an access dispute and in such an instance the AER is no less able to address issues in dispute and any other matters concerning access than it would be in the case of full regulation.
- 11.35 The Council's preliminary conclusion is, therefore, that in the event that the Minister decides to cover the SEPS, it should make a light regulation determination for the SEPS.



## 12 Information taken into account by the Council

For the purposes of s 261(7) of the NGL, the following three tables set out the submissions, reports and material relied upon by the Council in preparing this draft recommendation.

**Table 12.1 Application and submissions**

Author	Date	Title	Confidential
APA	16 January 2013	<i>Response to SEPS coverage application: Background material provided to the NCC (APA first submission)</i>	No
	29 January 2013	<i>Response to SEPS coverage application (APA second submission)</i>	Yes, redacted version provided
Beach Energy	29 January 2013	<i>Letter to Council, Re: Application for Coverage of South West Pipeline System (Beach submission)</i>	No
	6 February 2013	<i>Email to Council summarizing personal communication, Note on discussion Rayner/Campbell 4 February 2013 (Beach personal communication)</i>	No
Kimberly-Clark Australia Pty Ltd	October 2012	<i>Application for coverage of a pipeline, received by the Council 28 November 2012, (Application)</i>	Yes, redacted version provided
	7 January 2013	<i>Response to Council request for further information, Application for Coverage of the South Eastern Pipeline System (KCA supplementary information)</i>	No
	29 January 2013	<i>Letter to Council, Application for Coverage of the South Eastern Pipeline System (KCA letter)</i>	Yes, redacted version provided
Origin	29 January 2013	<i>Letter to National Competition Council, Application for coverage of the South Eastern Pipeline System (Origin submission)</i>	No

**Table 12.2 References**

Author	Date	Title	Confidential
AER (Australian Energy Regulator)	2012	<i>State of the Energy Market 2012</i>	No
APA	2012	<i>Undertaking to the Australian Competition and Consumer Commission, Given under section 87B</i>	No

Author	Date	Title	Confidential
		<i>of the Competition and Consumer Act 2010 by APT Pipelines Ltd (CAN 009 666 700) and Australian Pipeline Ltd (CAN 091 344 704) (in its own capacity and in its capacity as trustee of each of the Australian Pipeline Trust and the APT Investment Trust), July 2012</i>	
Euromonitor	2012	<i>Tissue and Hygiene in Australia, April 2012 (summary only—obtained at <a href="http://www.euromonitor.com/tissue-and-hygiene-in-australia/report">www.euromonitor.com/tissue-and-hygiene-in-australia/report</a> on 5 February 2013)</i>	No
Hilmer Committee (Independent Committee of Inquiry into a National Competition Policy)	1993	<i>National Competition Policy,: Report by the Independent Committee of Inquiry, August</i>	No
NERA (NERA Economic Consulting)	2008	<i>The Gas Supply Chain in Eastern Australia, A report to the Australian Energy Market Commission, March 2008</i>	No
PPISG (Pulp & Paper Industry Strategy Group)	2010	<i>Final Report, March 2010</i>	No
RISI	2008a	<i>Producers great and small—taking a close look at the Australian tissue business</i> ( <a href="https://www.risiinfo.com/magazines/March/2008/PPI/Producers-great-and-small-taking-a-close-look-at-the-Australian-tissue-business.html">https://www.risiinfo.com/magazines/March/2008/PPI/Producers-great-and-small-taking-a-close-look-at-the-Australian-tissue-business.html</a> )	No
	2008b	<i>Taking on the giants—ABC Tissue successfully challenged the global players in Australia</i> ( <a href="https://www.risiinfo.com/magazines/pulpandpaper/magazine/international/April/2008/Taking-on-the-giants-ABC-Tissue-challenged-global-players-in-Australia.html">https://www.risiinfo.com/magazines/pulpandpaper/magazine/international/April/2008/Taking-on-the-giants-ABC-Tissue-challenged-global-players-in-Australia.html</a> )	No

**Table 12.3 Legal sources**

<b>Tribunal and court decisions</b>
<i>In the matter of Fortescue Metals Group Limited</i> [2010] ACompT 2; (2010) 242 FLR 136
<i>Re Services Sydney Pty Ltd</i> [2005] ACompT 7; (2005) 227 ALR 140
<i>The Pilbara Infrastructure Pty Limited v Australian Competition Tribunal</i> [2012] HCA 36 ( <b><i>Pilbara appeal decision</i></b> )
<b>Legislation</b>
<i>Competition and Consumer Act 2010</i> (Cth) ( <b>CCA</b> )
<i>National Gas Rules 2009</i> ( <b>NGR</b> )
<i>National Gas (South Australia) Act 2008</i> (SA) ( <b>NGL</b> )