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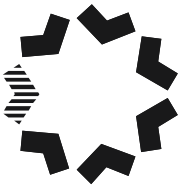

Light Regulation of the Kalgoorlie Kambalda Pipeline

Application for a light regulation determination in respect of the Kalgoorlie Kambalda Pipeline

Final Determination and Statement of Reasons

29 June 2010

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Abbreviations and defined terms

AA	Access arrangement
AER	Australian Energy Regulator (www.aer.gov.au)
APA	APA Group
BHPBNW	BHP Billiton Nickel West Pty Ltd
Council / NCC	National Competition Council
EDA	Energy Disputes Arbitrator of Western Australia
ERA	Economic Regulation Authority of Western Australia
Esperance Power	Esperance Power Station Pty Ltd
Gas Code	The National Third Party Access Code for Natural Gas Pipeline Systems set out in Schedule 2 to the *Gas Pipelines Access (South Australia) Act 1997*
GGP	Goldfields Gas Pipeline
KEP	Kambalda Esperance Pipeline
KKP	Kalgoorlie Kambalda Pipeline
km	kilometre
Limited access arrangement	An access arrangement that is not required to make provision for price or revenue regulation which may be submitted voluntarily by the service provider of a light regulated pipeline – see also s116 of the NGL and r45 of the NGR
NGA	*National Gas Access (WA) Act 2009*
NGL	National Gas Law – the Schedule to the *National Gas (South Australia) Act 2008*
NGL(WA)	The NGL as implemented in Western Australia by the *National Gas Access (WA) Act 2009*
NGR	National Gas Rules – Rules made under s 294 of the NGL including amendments by the Australian Energy Market Commission
SCPA	Southern Cross Pipelines Australia Pty Ltd

1 Final Determination

1.1 **Pursuant to s 114 of the National Gas Law, and in accordance with the National Gas Rules, the National Competition Council determines that the services provided by the Kalgoorlie Kambalda Pipeline be light regulation services.**

1.2 This determination comes into force 60 business days from the date of this determination (refer National Gas Law s 115).

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

National Competition Council
29 June 2010

2 Background

The application

2.1 On 22 April 2010 Southern Cross Pipelines Australia Pty Ltd (SCPA), a wholly-owned subsidiary within the APA Group (APA), applied for light regulation of the Kalgoorlie Kambalda Pipeline (KKP) pursuant to s 112 of the National Gas Law (NGL).

2.2 SCPA submitted a written application in accordance with the National Gas Rules (NGR) and containing the information required by r 34. SCPA's application is available on the Council's website (www.ncc.gov.au).

2.3 The application contains an attachment of information that SCPA considers confidential to APA (SCPA 1.3). This includes details of enquiries APA has received for services on the KKP since 1999 together with APA's understanding of the status of those projects. The attachment also provides details of the history of negotiations between SCPA and Burns & Roe Worley (now Esperance Power Station Pty Ltd (Esperance Power)), specific information on KKP contractual terms with the two current users (Esperance Power and BHP Billiton Nickel West Pty Ltd (BHPBNW)), and revenue earned by the KKP from these two users over the past ten years.

2.4 The Council accepts that the information in the confidential attachment is commercially valuable to SCPA and possibly to other commercial parties and that it should be protected under s 90 of the NGL. The Council has disclosed the confidential information to the Economic Regulation Authority of Western Australia (ERA) as provided for in s 90(3) of the NGL. Where necessary, the Council has sought confirmation of the information provided by SCPA from the ERA based on information the ERA may have received on the KKP in relation to its regulatory processes and powers.

Application of the NGL/NGR in Western Australia

2.5 The *National Gas Access (WA) Act 2009* (NGA) came into effect on 1 January 2010 and amends and implements the NGL in Western Australia. The amended NGL as it applies in Western Australia is referred to in this determination as the NGL(WA). The NGA also gives effect to the NGR in Western Australia.

2.6 There are a number of differences between the NGL in other jurisdictions and the NGL(WA). For the purposes of this determination, the main difference is that in Western Australia the relevant regulator is the ERA and the relevant arbitration body is the Western Australian Energy Disputes Arbitrator (EDA).[1] In other jurisdictions the relevant regulator and arbitration body is the Australian Energy Regulator (AER). Accordingly, references in this determination to the AER/ERA and AER/EDA are to be

[1] Refer s 9(1) of the *National Gas Access (WA) Act 2009.*

construed as referring to the ERA or EDA for pipelines in Western Australia, and to the AER for pipelines in other jurisdictions.

2.7 Section 20 of the NGA contains a transitional provision for the KKP. It provides that the service provider of the KKP has until July 2010 to submit an access arrangement (AA) for the KKP, apply for revocation of coverage, or apply for a light regulation determination.

Council process

2.8 In determining this matter the Council followed the standard consultative procedure set out in r 8 of the NGR.

2.9 Notice of the application was published on the Council's website and in *The Australian* newspaper on 27 April 2010. The notice described the application, provided the address of the Council's website on which the application was available, and invited written submissions on the application. A 15 business day period for submissions was provided, with a closing date of 18 May 2010. The Council did not receive any submissions on the application.

2.10 The Council also consulted with the ERA in its consideration of the application.

2.11 The Council released its draft determination in favour of light regulation on 1 June 2010. A 15 business day period for submissions was provided, with a closing date of 23 June 2010. The Council did not receive any submissions on the draft determination.

2.12 In preparing this final determination the Council has taken into account the application, the Council's consultation with the ERA, and its own research and analysis. Appendix B contains a chronology of milestones and other significant events occurring in the process of considering this application.

Kalgoorlie Kambalda Pipeline/Pipeline services

2.13 The KKP is a transmission pipeline transporting gas from Kalgoorlie to Kambalda in Western Australia. The KKP is a covered pipeline by reason of its inclusion in the list of covered pipelines in Schedule A of the *National Third Party Access Code for Natural Gas Pipeline Systems* set out in Schedule 2 to the *Gas Pipelines Access (South Australia) Act 1997* (Gas Code). Pipelines which were covered pipelines under the Gas Code have been deemed by Schedule 3 of the NGL to be covered pipelines under the NGL. A pipeline that is a designated pipeline as prescribed by the regulations under the NGL cannot be the subject of light regulation. The KKP is not a designated pipeline.[2]

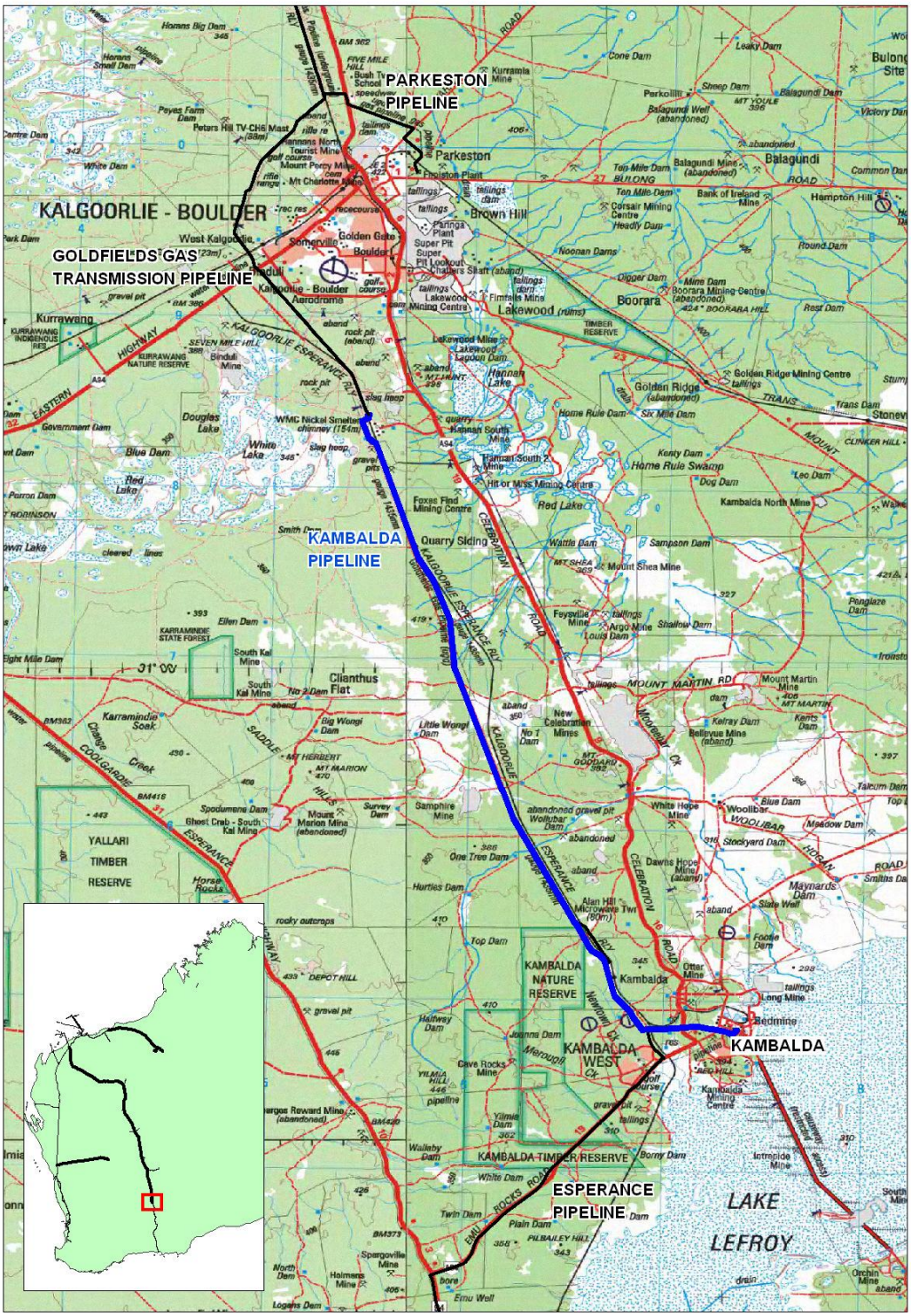
[2] See *National Gas Access (WA) (Part 3) Regulations 2009*, Regulation 4 and Schedule 1.

2.14 The KKP is connected to and receives gas that is transported by the Goldfields Gas Pipeline (GGP). Although the KKP is connected to the GGP, it is treated as being separate to the GGP under current and previous regulatory frameworks. However, in the application SCPA notes that the KKP is generally operated as an adjunct to the GGP and shares the same staff and resources.

2.15 Gas from the KKP also flows into the Kambalda Esperance Pipeline (KEP) at Kambalda and is transported to Esperance. The KEP is owned by Esperance Pipeline Co. Pty Ltd and was built in 2004 primarily to supply gas to the Esperance Power Station. The KEP is not a covered pipeline under the NGL.

2.16 Map 2-1 shows the location of the KKP and adjacent pipelines.

Map 2-1 - Location of the KKP



2.17 In its application, SCPA states that the KKP comprises of 44.3 km of 219 millimetre diameter pipeline and ancillary assets, and has an estimated total capacity of 26 TJ/day. There are currently two users of the KKP and three delivery points.

2.18 BHPBNW is the largest customer of the KKP and until 2004 it was the only customer. The KKP's other customer, Esperance Power, constructed the KEP in 2004. The delivery points are:

- BHPBNW nickel smelter facilities at Kalgoorlie
- BHPBNW nickel concentrator facilities at Kambalda and
- Esperance Power Station at the Kambalda delivery point into the KEP.

2.19 The only service currently provided by the KKP is a firm forward haul service, which is a service where the pipeline operator essentially commits to receive and deliver a specified quantity of gas for a user, other than in very limited circumstances.

2.20 SCPA advises that it has received several enquiries about interruptable services on the KKP from potential shippers but that no commercial agreements have resulted from these enquiries. An interruptable service refers to a haulage service where the pipeline operator reserves the right to interrupt at any time (usually during periods of peak demand). The enquiries have mostly been from mining ventures and power stations. Details of those enquiries are set out in the confidential attachment to the application (SCPA 1.3).

2.21 SCPA also received an enquiry in 1999 from the Water Corporation of Western Australia for the transportation of gas to fuel pumps on a proposed desalination plant. Whilst the plan for the proposed plant was rejected by the previous state government, the Water Corporation indicated in October 2009 that the project remained a future water supply option.

2.22 According to SCPA, none of these enquiries is likely to lead to reasonably foreseeable new demand for the services provided by the KKP.

Regulatory background to the Kalgoorlie Kambalda Pipeline

2.23 Despite being a covered pipeline under the Gas Code and subsequent NGL, no AA has ever been submitted for the KKP. SCPA has requested and been granted a series of time extensions by the ERA and its predecessor, the Office of Gas Access Regulation, for the lodgement of an AA. SCPA states that an important motivation for these applications was that the substantial cost of preparing an AA and access arrangement information did not seem to be justified having regard to the KKP's small size.

2.24 SCPA submits it is relevant that neither of its customers (BHPBNW and Esperance Power) has objected to any of the extensions of time granted by the ERA. SCPA has reached commercial agreements with both its customers over the past decade

without an AA being in place and without the need for arbitration. A party who was dissatisfied with the progress of commercial negotiations could also have notified the ERA and triggered a requirement for SCPA to lodge an AA for the KKP within 90 days. SCPA advises that only one such trigger event occurred (in 2002), however further negotiations resulted in a commercial agreement and the regulatory notice was withdrawn.

2.25 SCPA argues that this history suggests that light regulation would be effective for the KKP. SCPA expects that the commercial behaviour of parties under light regulation would be very similar to the commercial behaviour observed to date—that is, agreements would be reached without an AA in place and without the need for arbitration.

3 Reasons for decision

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

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

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

3.3 The key difference between the two forms relates to the requirement to submit an AA for approval by the AER/ERA. An AA provides for up-front price regulation in that it must specify a reference tariff which requires approval by the AER/ERA. There is no requirement for service providers of light regulation pipelines to submit an AA, although they may voluntarily submit a limited access arrangement to the AER/ERA for approval.[3] There is no indication SCPA will submit a limited access arrangement if the KKP becomes the subject of a light regulation determination.

3.4 Light regulation does not free a service provider to increase tariffs or earn monopoly rents. The negotiate/arbitrate process that operates under light regulation substitutes ex post regulation for ex ante regulation. It does not remove regulatory oversight of prices.

[3] The requirements for a limited access arrangement are set out in r 45 of the NGR.

3.5 Access disputes in relation to light regulation pipelines are dealt with through an arbitration process, whereby the AER/EDA can determine access prices and other terms if negotiations between the parties prove unsuccessful and an access dispute is notified. This process is similar to the negotiate/arbitrate process for services declared under Part IIIA of the *Trade Practices Act 1974 (Cth)*. To date, no access disputes concerning a light regulation pipeline have been notified to the AER/EDA.

3.6 Irrespective of the form of regulation, service providers must disclose a range of information concerning a pipeline, although the scope of the information disclosure required in relation to light regulation pipelines is less than under full regulation. Many of the other obligations on covered pipelines under the NGL apply to both full and light regulation pipelines.

3.7 A table comparing the main elements of full and light regulation is contained in the Council's Guide to the National Gas Law, Part C – Light regulation of covered pipeline services.[4]

Effectiveness of regulation alternatives

3.8 The critical issue in an application for light regulation is whether light regulation is likely to be as effective as 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.

3.9 SCPA submits that light regulation would be no less effective than full regulation in achieving the national gas objective for the services provided by the KKP. SCPA argues that any market power arising from the operation of the KKP is low due to the:

(a) relatively low barriers to entry to the market served by the KKP, given its short length and concentrated customer base

(b) few network externalities, which are unlikely to convey additional market power on the KKP

(c) upstream GGP being a covered pipeline

(d) substantial countervailing power of existing users, who are few in number and well informed

(e) countervailing power of prospective users, who are likely to be mining companies or power stations, until their costs are sunk and

(f) availability of adequate information to existing and prospective users to enable them to negotiate effectively.

[4] National Competition Council 2009, *A guide to the functions and powers of the National Competition Council under the National Gas Law, Part C* – May 2009.

3.10 In the Council's view, the KKP enjoys, and will continue to enjoy, some market power. The Council considers that barriers to entry for the provision of pipeline services are likely to continue for the foreseeable future, largely due to there being no alternative pipelines in the vicinity of the KKP that could impose competitive tension by threatening to bypass it. However, the Council considers that barriers to entry are not particularly high as there may be some ability to construct a bypass to the KKP given its relatively short length (44.3 km). The Council further observes that a range of substitutes exist for the gas consumed by the KKP's users (in the form of diesel, electricity, coke and other fuels) and that users have a degree of countervailing market power. These factors reduce the level of market power which the KKP would otherwise enjoy.

3.11 SCPA submits that the information necessary for users to negotiate effectively in the negotiate/arbitrate environment established by light regulation would be available to existing and prospective users. Although no AA has ever been lodged for the KKP, which means the information about pipeline costs that would have emerged during the process for considering an AA is not publicly available, SCPA argues that the existing users (BHPBNW and Esperance Power) have good knowledge of the relevant facts due to their historical involvement and experience with the KKP. SCPA argues that prospective users have access to a large pool of experienced pipeline industry consultants who are routinely involved in gas access price negotiations, which would enable them to negotiate effectively.

3.12 Whilst the Council accepts that the current users of the KKP have access to the information required to negotiate effectively, it has some concern about the ability of prospective users to gain access to the specific information needed to do so. The Council acknowledges that there is a potential for imbalance in the negotiations between SCPA and prospective users.

3.13 The Council agrees that the potential for imbalance in access negotiations is alleviated to some extent by the fact that any prospective users are likely to be well-resourced mining companies or power station operators who have access to industry consultants, which would assist them with effective negotiations. Further, under light regulation SCPA is still required to disclose a range of information regarding the KKP, as well as details regarding negotiations with access seekers. Though these requirements are generally less than under full regulation, SCPA must still publish its terms and conditions of access, including the prices on offer, and capacity information on its website. The Council considers this information will assist prospective users in determining the reasonableness of prices offered.

3.14 SCPA submits that the non-discrimination requirements in the NGL will allow prospective users to 'piggyback' on the existing users' detailed understanding of the KKP's costs. In other words, SCPA argues that any new tariff offers will be tied to the tariffs paid by existing users for comparable services. The Council notes that SCPA's contention is not entirely borne out because the non-discrimination provision in s

136 of the NGL *does* permit a service provider to engage in price discrimination where it is conducive to efficient service provision. The scope of the discretion to introduce differing tariffs has yet to be tested.

3.15 On the other hand, the Council observes that a light regulation determination does not remove regulatory oversight and control over tariffs and other aspects of access to the KKP. As a light regulation pipeline, the KKP would remain subject to information provision requirements and if the EDA is required to arbitrate an access dispute, it may determine access prices and other conditions. For these reasons, the Council considers that the information available to the ERA/EDA under light regulation would be similar to the information available in an AA.

3.16 SCPA argues that existing and prospective users of the KKP have the incentive to negotiate with SCPA regarding the KKP tariff because the transmission tariff is one of the few components of the delivered cost of gas on which price reductions could conceivably be achieved. SCPA notes that the history of its negotiations with BHPBNW and Esperance Power demonstrates that the parties have been willing to engage in lengthy discussions over price differentials that represent only a small proportion of the total KKP tariff. In light of this history, the Council accepts that a change to light regulation is unlikely to dampen the parties' incentives to enter into effective access negotiations.

3.17 In addition, the Council recognises the ability of arbitration to generate efficient outcomes should commercial negotiations between the parties fail. Arbitration is a process in which the EDA comes to its own views, using if necessary its information gathering powers to help it reach its decision. As such, information asymmetries, where they exist, are not going to penalise a user who notifies the EDA of a dispute. Where the EDA arbitrates price and non-price terms, the result has the potential to be the same as that reached in an AA under full regulation.[5] If a dispute is notified to the EDA, the Council considers that the EDA is in no less a position to determine an appropriate outcome than it would be if the pipeline were subject to full regulation.

3.18 SCPA observes that the situation of the KKP under full regulation has been very similar to the situation that would have arisen under light regulation, due to the regulatory history of the ERA granting time extensions for the lodgement of an AA. SCPA has reached commercial agreements with its two customers during that period without the need for an AA, or a regulatory determination of an ex ante reference tariff, and without recourse to arbitration. This has saved all parties significant costs.

3.19 The Council considers that the unusual regulatory history of the KKP is a relevant factor in its determination. The Council agrees that due to the absence of an AA for the KKP under full regulation, the position of the KKP under light regulation would be

[5] The outcome of an arbitration will of course depend on the matters in dispute which may be less than what a service provider is required to address in an AA.

very similar to the experience to date. The fact that the users of the KKP have reached commercial agreements with SCPA in the absence of an AA and without recourse to arbitration supports the Council's view that light regulation would be no less effective than full regulation for the KKP.

3.20 For the above reasons, the Council is of the view that light regulation would be similarly effective as full regulation in protecting users and other parties that are dependent on access to the KKP.

Costs of form of regulation alternatives

3.21 SCPA estimates that a change to light regulation would result in a total cost saving to it of around $400 000 or more in each regulatory period. This is primarily due to the fact that no AA would be required under light regulation. Because an AA has never been submitted for the KKP, SCPA refers to the costs of preparing AAs for other APA pipelines as a guide when calculating the estimate. SCPA estimates that its direct cost of an AA for the KKP would be at the lower end of the range from $300 000 to $380 000. SCPA adds to this figure its estimate of the ERA's service charge of around $100 000, making a total of approximately $400 000 in costs to SCPA.

3.22 Unlike regulators in other jurisdictions, the ERA recovers part of its costs from covered pipelines in Western Australia.[6] The ERA levies two charges: a standing charge, which is an allocation among covered pipelines in Western Australia of the ERA's 'core function costs' (the allocation to the KKP is 2.72 per cent); and a service charge, which is the means through which the costs of regulation specific to each pipeline are recovered from each pipeline owner. SCPA estimates that the likely service charge levied by the ERA for an AA for the KKP would be around $100 000. SCPA submits that whilst a change to light regulation would not affect its standing charge, it would reduce the service charge levied by the ERA because the ERA would avoid the cost associated with the AA process.

3.23 The Council notes the potential for cost savings to be eaten up by numerous or lengthy arbitrations of access disputes. In this regard, SCPA observes that should arbitration be required, a single arbitration may be less costly than full regulation. However, if the outcome of light regulation is a series of arbitrations, then the regulatory fixation of tariffs and terms under full regulation, particularly if there are many users, is likely to be more cost effective. SCPA notes that in the past 10 years, no users of the KKP have relied on dispute resolution, and that commercial agreements have been reached on a voluntary basis with minimal regulatory involvement. Based on this experience, SCPA argues that reliance on dispute resolution would similarly be minimal under light regulation.

[6] The power to do so is conferred by the *Economic Regulation Authority (Gas Pipelines Access Funding) Regulations 2003.*

3.24 The Council agrees that the likelihood of access disputes regarding the KKP under light regulation is likely to be low, having regard to the experience to date.

3.25 It was not possible for SCPA to estimate the cost savings that might accrue to existing and potential shippers with a change to light regulation. SCPA submits that there is some potential for cost savings to result as shippers would avoid the need to participate in the AA process. SCPA is unable to comment on whether a change to light regulation would result in any cost savings for end users.

3.26 In the Council's view, a shift to light regulation is likely to result in cost savings for SCPA, although the Council has doubts about the level of savings suggested by SCPA. Some savings for other parties such as the ERA, shippers and end users are also likely, although these may be small.

National gas objective

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

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

3.28 SCPA submits that a change to light regulation of the KKP would involve material cost savings, principally for SCPA. These cost savings would improve the efficiency of delivery of pipeline services and accordingly, the national gas objective would be satisfied. SCPA contends that a move to light regulation of the KKP would not disadvantage customers in the form of higher prices or reduced service quality or availability, so there would be no loss in allocative efficiency. It also notes that unlike other jurisdictions where the AER is the relevant regulator, in this case no cost savings would accrue to the ERA because the ERA recovers its costs from the pipeline owners it regulates.

3.29 SCPA argues that because of the countervailing power of the KKP's users, and a 10 year history of successful commercial negotiations without resort to regulatory tariff-setting or arbitration, light regulation would be no less effective than full regulation.

3.30 In the Council's view, where light regulation is similarly effective to full regulation but involves a lower cost, it is the most suitable form of regulation and a light regulation determination is consistent with the national gas objective. As noted in paragraph 3.26, the Council agrees that the shift to light regulation would provide cost savings. Further, the Council does not consider that the shift to light regulation would disadvantage pipeline users or end users, particularly with the recourse to binding arbitration providing a restraint on the exercise of market power.

Form of regulation factors

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

3.32 More generally, Table 3-1 summarises the Council's views on how each form of regulation factor might, in principle, affect its determination of a light regulation application. The table is taken from the Council's Guide to the National Gas Law, Part C –Light regulation of covered pipeline services.[7]

3.33 Table 3-2 provides a summary of SCPA's submissions in relation to the form of regulation factors.

[7] At paragraph 7.58.

Table 3-1 Consideration of form of regulation factors

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
(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)	Large or concentrated users Users with by-pass opportunities High interdependence between users and service provider Users involved in pipeline services elsewhere (such users may face lesser information asymmetry given their direct knowledge and experience of pipeline operations)	Many small users Users have limited resources Diverse user interests (for example where users span different industries or economic sectors) Significant users have the capacity to pass through higher pipeline service costs (these users may have less incentives to expend resources to resist increases in pipeline costs) Poorly represented users

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

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

Form of regulation factor (s 16)	Applicant
(a) the presence and extent of any barriers to entry in a market for pipeline services	Barriers to entry to the market served by the KKP are relatively low having regard to: • its short length (44.3 km) compared to other Australian transmission pipelines, which means that the capital cost of bypass is relatively low and • the highly concentrated customer base of the two existing customers, of which one accounts for a large percentage of pipeline revenue. A concentrated customer base makes it easier for customers to organise a coalition in support of a bypass threat, making such a threat more credible. Some indication of the feasibility of bypass can be observed from the construction of the KEP in 2004 which is 341 km long and involved an estimated capital cost of between $35 million and $45 million. The business case for constructing a KKP bypass pipeline of only 44.3 km with much higher throughput would be relatively stronger. During negotiations with the KEP proponents Burns & Roe Worley, APA was conscious of the risk of bypass, which would have been relatively straight forward and cost-effective for the proponents.
(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	The KKP is not a stand-alone pipeline—all gas transported on the KKP must also traverse the upstream GGP. SCPA and another APA entity are majority shareholders in the joint venture which owns the GGP. Because the GGP is a covered pipeline, this vertical relationship is unlikely to create any opportunities for vertical leverage or other types of network externalities which might affect the interests of KKP customers. APA's other pipeline operations are geographically separate from the KKP which suggests a lack of interdependence. The KKP is a transmission pipeline, which indicates less interdepedence than would be the case for a distribution network. The downstream transmission KEP is under separate ownership. Rights to pipeline capacity on the KKP are readily tradeable.

Form of regulation factor (s 16)	Applicant
(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	Neither SCPA nor APA owns, retails, or consumes any of the gas transported by the KKP, such that the vertical functional separation of the KKP is complete. Whilst APA does provide services other than the transportation of natural gas, there are no significant network externalities between these services and the services provided by the KKP. All non-pipeline assets owned and/or operated by APA are geographically remote and operationally separate from the KKP. Therefore APA's other services do not create any network externalities with the KKP that might give rise to market power.
(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)	The market power of the KKP is limited by the existence of the substantial countervailing market power of its current users, BHPBNW and Esperance Power, who are well informed about the KKP's costs. Western Mining Corporation was the original owner of the KKP and BHPBNW purchased Western Mining Corporation's nickel assets at Kalgoorlie and Kambalda. As the former owner of the KKP, BHPBNW has ample cost information regarding the pipeline. Esperance Power constructed the KEP, which covers similar terrain to the KKP. The cost data relevant to the KEP provide Esperance Power with an excellent understanding of the KKP's cost drivers. BHPBNW can make a credible bypass threat in relation to its Kalgoorlie nickel smelter, as the offtake point is within 400 metres of the end of the GGP. BHP Billiton buys gas transportation services from many other APA pipelines and can link pricing outcomes on one pipeline to negotiations on other pipelines. Prospective users, which are likely to be power stations or mining operators, also have countervailing power until their costs are sunk. It is industry practice to make the sinking of costs contingent on long-term contracts that contain acceptable terms and conditions. Prospects for additional non-mining power stations along the KKP route are slight. Mining operators principally use gas to generate electricity. Most miners near the KKP have alternative options for obtaining electricity (such as on-site diesel generation), which gives them countervailing power.
(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	There was a potential risk of bypass faced by the KKP during the negotiations with the proponents of the KEP. The location of the KKP's principal load, BHPBNW's Kalgoorlie nickel smelter, so close to the start of the KKP, creates a particularly acute risk of bypass.

Form of regulation factor (s 16)	Applicant
(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)	The principal load on the KKP is BHPBNW, which receives its gas at its Kalgoorlie nickel smelter and Kambalda nickel concentrator. Gas represents less than half of the energy inputs for BHPBNW's facilities, which also use diesel, electricity, coke, and other fuels for their energy inputs. This shows that they have a range of energy options. Diesel was the main source of fuel for these facilities prior to the advent of natural gas. Gas is generally cheaper than diesel but the price difference is not great. Securing gas supply usually involves entry into long term supply contracts, whereas diesel can be secured through shorter term contracts. LNG can also be a substitute for gas.
(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider	Reporting and information disclosure requirements under the NGL and the NGR, combined with additional reporting obligations to the ERA, and obligations concerning continuous disclosure to the ASX, would provide users with sufficient information to enable them to negotiate effectively should the KKP be subject to light regulation. Although no AAs have been lodged for the KKP, which means that source of information about pipeline costs is not publicly available, the current customers (BHPBNW and Esperance Power) have good knowledge of the relevant facts regarding the KKP for historical reasons. Prospective customers have access to a large pool of experienced pipeline industry consultants who are routinely involved in gas access price negotiations, which would enable them to negotiate effectively.

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

3.35 As discussed in paragraph 3.10, the Council considers that barriers to entry in relation to provision of pipeline services are not particularly high due to the KKP's short length and some risk of bypass. Further, the Council observes that the current users of the KKP have a level of countervailing power as they are well informed about the KKP's costs and have successfully negotiated commercial agreements with SCPA over the past 10 years. Prospective users may have some degree of countervailing power (albeit less than the current users) until their costs are sunk, but have the ability to make their investments contingent on long term supply contracts. The availability of substitutes for gas means that users are not wholly dependent on gas transported by the KKP for their energy needs.

3.36 Whilst the KKP is not a stand-alone pipeline, the Council is of the view that the full regulation of the GGP is likely to prevent any network externalities that might harm the interests of the KKP's users. In addition, the vertical functional separation of the KKP and its geographical remoteness from APA's other assets (except for the GGP) support the view that there is a lack of notable network externalities.

3.37 The Council has some concern regarding the lack of publicly available pipeline information for prospective users. However it considers that the reporting and information disclosure requirements under the NGL and NGR, together with recourse to binding arbitration, will not leave the relevant parties worse off under light regulation than they would be under full regulation. Further, the Council considers that adequate incentives exist for parties to enter into commercial negotiations and that this conclusion is supported by the experience to date.

Other matters

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

The Council's conclusions

3.39 In summary the Council's conclusions are:

- Light regulation is likely to be similarly as effective as full regulation of the KKP. Users and other interested parties may notify an access dispute where this is necessary and in such an event the EDA is no less able to address relevant issues than it would be in a full regulation context.

- Light regulation is likely to involve cost savings primarily for SCPA, but also for other parties.
- Light regulation of the KKP is consistent with promotion of the national gas objective.
- Consideration of the form of regulation factors supports these conclusions.

3.40 The Council therefore concludes that it should make a light regulation determination in respect of the KKP.

Appendix A – Index of submissions and documents

Application

SCPA 1	Application by Southern Cross Pipelines Australia Pty Ltd for Light Regulation of the Kalgoorlie Kambalda Pipeline
SCPA 1.1	Attachment 1: APA Group – company details
SCPA 1.2	Attachment 2: Rule 34 – compliance checklist
SCPA 1.3	Attachment 3: Confidential attachment (not publicly available)

No submissions were received in response to the application or in response to the draft determination

Appendix B – Chronology

Date	Cumulative business days	Action/Event
22 April 2010	0	Application received
27 April 2010	2	Notice of application published in *The Australian* and on the Council's website, seeking submissions in response to the application Likely interested parties advised of application
4 May 2010	7	ERA advised of application and consultation commenced
18 May 2010	17	Period for submissions on the application ended (15 business days from date of notice)
1 June 2010	27	Draft determination released
23 June 2010	43	Period for submissions on the draft determination ends (15 business days from release of draft determination)
29 June 2010	47	Final determination released
21 July 2010		Maximum period for making of Council decision (20 business days from close of submissions on draft determination)
22 August 2010		4 month period allowed by standard consultative period ends