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Dear Dr Vertigan,

ACCC submission on Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper

The Australian Competition and Consumer Commission (ACCC) appreciates the opportunity to comment on the Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper (the Options Paper).

The ACCC strongly supports the Gas Market Reform Group's (GMRG's) proposed information disclosure and commercial arbitration framework. We believe a critical element of the framework will be providing an appropriate fact base for commercial negotiation and arbitration, rather than prescribing any outcome for such arbitrations. The framework should not dictate the decision of an arbitrator (which could be higher or lower than actual costs) but rather, should focus on ensuring useful information is available and accessible to shippers to strengthen their bargaining position and improve commercial negotiations.

We consider a number of changes are necessary in order to ensure the framework works as intended and addresses the underlying market power concerns that initially led to the GMRG's review of the gas pipelines coverage test.

These changes relate to:

1. Ensuring the information disclosure obligations and arbitration mechanism apply consistently.

2. Reviewing exemptions in the framework to ensure the information disclosure obligations and arbitration mechanism properly address the findings of the East Coast Gas Inquiry that a large number of pipeline operators exercise market power.
3. The development of guidance in either the National Gas Rules (NGR) or in guidelines to the NGR and National Gas Law (NGL) that clearly explains how the information published under information disclosure obligations relates to the costs of providing gas transportation services and links the costs information to the application of costs-based pricing principles.

The ACCC's experience is that standard accounting financial statements provide little guidance on the costs of supply, particularly in relation to the valuation of pipelines. This is because standard financial statements typically rely on a pipeline operator's own valuation of its asset, which will be based on the prices being charged, irrespective of what prices may emerge from a commercial negotiation or arbitration. Providing guidance on asset valuation methodology will therefore better inform a commercial negotiation, and also ensure asset valuations and other key inputs are not used by pipeline operators to maintain monopoly prices.

4. A range of adjustments to specific elements of the arbitration mechanism to minimise the scope for gaming arbitral processes and to strengthen incentives for parties to reach commercial agreement. In particular, we consider it important that the threshold for triggering the arbitration mechanism is relatively low, recognising that in commercial arbitrations in the private sector there is typically no threshold requirement.

Attached is the ACCC's submission to the Options Paper outlining our recommendations in more detail.

Yours sincerely



Rod Sims
Chairman



Australian
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ACCC submission on Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper

April 2017

Contents

1. Executive Summary	1
2. Background.....	5
ACCC East Coast Gas Inquiry.....	5
Dr Vertigan's Examination	6
3. Objective of the Framework	6
4. Information Disclosure.....	7
4.1. Disclosure of cost information	8
4.2. Level of cost information	8
4.3. Exemptions.....	10
4.4. Compliance.....	12
Civil penalty provisions	12
Conduct provisions.....	12
Reporting standard.....	12
4.5. Other implementation issues.....	12
Publication of information	12
Timing.....	12
Costs of investigations.....	13
5. Arbitration Mechanism.....	13
5.1. Arbitration options	13
5.2. Access to arbitration	14
5.3. Exemptions.....	14
5.4. Information gathering powers.....	15
5.5. Arbitration guidelines	15
5.6. Outcomes of proceedings	15
5.7. Key design components.....	16
6. Arbitration Principles	18
6.1. Matters to be taken into account	18
6.2. Determining the reasonableness of an offer.....	18
7. Transitional arrangements.....	19

1. Executive Summary

The ACCC strongly supports the Gas Market Reform Group's (GMRG's) proposed Gas Pipeline Information Disclosure and Arbitration Framework (the 'Framework') and its preferred approach to implementing the regime.

The ACCC supports the overall objective of the information disclosure and arbitration regime to:

facilitate timely and effective commercial negotiations between shippers and the operators of non-scheme pipelines by:

(a) reducing the imbalance in bargaining power that shippers can face, and

(b) posing a constraint on the exercise of market power by pipeline operators.

The ACCC considers that measures to achieve these objectives should be directed to addressing the concerns the ACCC identified in its inquiry into the east coast gas market (the 'Inquiry')¹ that a large number of gas pipelines are engaging in monopoly pricing, which is adversely impacting the economic efficiency of the east coast gas market.²

The ACCC supports the following aspects of the GMRG's preferred approach:

- information disclosure relating to baseline information required by shippers and costs information of pipeline operators, including details related to asset valuation, depreciation, costs and cost allocation methodology
- a conventional arbitration framework, and
- pricing principles that are based on the actual cost of service provision supplemented by other principles.

However, the ACCC considers that there are a number of changes that are necessary to strengthen the Framework and ensure that the market power concerns identified in the East Coast Gas Inquiry are addressed. This will ensure that the commercial negotiation framework has an appropriate fact base from which to occur. These recommended changes are listed in the below table and relate to:

1. Ensuring the information disclosure obligations and arbitration mechanism apply consistently.
2. Reviewing exemptions in the framework to ensure the information disclosure obligations and arbitration mechanism properly address the findings of the East Coast Gas Inquiry that a large number of pipeline operators exercise market power.
3. The development of guidance in either the National Gas Rules (NGR) or in guidelines to the NGR and National Gas Law (NGL) that clearly explains how the information published under information disclosure obligations relates to the costs of providing gas transportation services and links the costs information to the application of costs-based pricing principles.

¹ ACCC, *Inquiry into the East Coast Gas Market*, April 2016.

² ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 20.

The ACCC's experience is that standard accounting financial statements provide little guidance on the costs of supply, particularly in relation to the valuation of pipelines. This is because standard financial statements typically rely on a pipeline operator's own valuation of its asset, which will be based on the prices being charged, irrespective of what prices may emerge from a commercial negotiation or arbitration. Providing guidance on asset valuation methodology will therefore better inform a commercial negotiation, and also ensure asset valuations and other key inputs are not used by pipeline operators to maintain monopoly prices.

4. A range of adjustments to specific elements of the arbitration mechanism to minimise the scope for gaming arbitral processes and to strengthen incentives for parties to reach commercial agreement. In particular, the ACCC considers it important that the threshold for triggering the arbitration mechanism is relatively low, recognising that in commercial arbitrations in the private sector there is typically no threshold requirement.

Table – Changes recommended by the ACCC for the GMRG's consideration

Information disclosure framework
<p>In relation to information disclosure, the ACCC recommends the GMRG:</p> <ul style="list-style-type: none"> • ensure that the information disclosed by pipeline operators clearly relates to the cost of supply of transportation services, including asset valuation, rates of return and costs information • provide for guidance material on how disclosed information is to be used to calculate actual costs of transportation services, and how financial statements are to be prepared • set out a clear nexus between cost disclosure information and the pricing principles and how these will apply in arbitration • ensure consistency of the exemptions from the information disclosure requirements and the arbitrations framework • reconsider the current scope of exemptions from the information disclosure framework, which currently exempts a possible 27 out of 45 non-scheme pipelines. <ul style="list-style-type: none"> ○ The ACCC recommends exemption only for non-scheme pipelines that service a single shipper or do not provide third party access, where there is no capacity for third parties or for those with capacity less than 10 TJ/day. • consider a 'review of exemptions' mechanism to be administered by the AER. • make the information disclosure requirements a civil penalty provision, include a reporting standard in the information disclosure framework and consider specifying the form in which information should be presented and published on a pipeline operator's website • immediately start developing measures to prevent regulatory gaming between arbitration under light handed regulation for covered pipelines and arbitration under the proposed commercial arbitration framework.
Arbitration mechanism
<p>In relation to the arbitration mechanism, the ACCC strongly supports a conventional arbitration model. However, the ACCC considers that the GMRG should:</p> <ul style="list-style-type: none"> • broaden the proposed scope of the arbitration mechanism to include services that require the use of existing capacity or further augmentation (including extensions) of existing pipelines, to

ensure market power concerns identified in the East Coast Gas Inquiry are addressed.

- The ACCC supports exemptions of services supplied under foundation contracts for Greenfields pipelines.
- ensure exemptions from the scope of the arbitrations mechanism align with the information disclosure obligations. This is to encourage commercial agreement and limit the scope for delay in arbitrations.
- limit the need for information gathering by an arbitrator, providing for most information to be available under the information disclosure obligations. This will limit the scope for delay in reaching an arbitral determination.
- recommend the AER develop arbitration process guidelines for the arbitrator and disputing parties
- recommend the outcomes of arbitration determinations be provided to the AER
- GMRG or the AER develop a minimum set of requirements that must be included in any private arbitration framework
- clarify that existing contracts and terms of access are protected under the proposed framework and that pipeline operators should be prevented from locking up capacity by contracting it to related body corporates (for example)
- review the need for parties to have a right to have a hearing on request.
- provide the arbitrator with the right to conclusively determine what is relevant material
- allow for variation of an arbitration by agreement, and if agreement cannot be reached, by further arbitral determination provided it relates to a new matter or a significant change in circumstances.
- allow for the arbitrator to determine the costs of arbitration if parties cannot agree.
- allow the arbitrator to terminate proceedings provided that the threshold for seeking arbitration is not set unnecessarily high.

Arbitration principles

In relation to the arbitration principles, the ACCC supports the GMRG's preferred principles based upon actual costs of service provision. The ACCC considers the overall framework will be strengthened if parties can identify a range of likely arbitral outcomes. Accordingly, the ACCC recommends that the GMRG:

- specify and provide guidance on how to calculate actual costs. The ACCC considers the pricing approach in the NGL represents a good starting point and supports the AER developing a guideline that sets out how to calculate the actual cost of service provision, including how to value assets and determine other key inputs.
- include a consideration that the arbitrator should have regard to the value to a party of a timely decision on the pricing of the relevant service for a particular period of time, to properly recognise the commercial nature of the arbitration.

2. Background

ACCC East Coast Gas Inquiry

On 13 April 2015, the Minister for Small Business directed the ACCC to hold an inquiry into the competitiveness of the wholesale gas industry.³ The ACCC's inquiry found that unprecedented changes in the east coast gas market since 2012 can be attributed to three key factors:

- the magnitude of gas flows to the liquefied natural gas (LNG) projects in Queensland, which are removing gas from the domestic market
- low oil prices, which are resulting in declining investment in gas exploration and lower production forecasts for both domestic and LNG projects, and
- moratoria and regulatory restrictions, which are affecting onshore gas exploration and development.

The Inquiry also found that pipeline sector problems exacerbate gas supply and pricing issues in the domestic market.⁴ During the Inquiry, the ACCC was provided with evidence that a large number of existing pipelines have been engaging in monopoly pricing, giving rise to higher delivered gas prices for users and in some cases, lower ex-plant prices for producers.

The Inquiry found that pipeline operators are using market power to obtain above-efficient costs, and this monopoly pricing behaviour is affecting the achievement of economically efficient outcomes. Information asymmetries add to the issue, limiting the ability of shippers to identify any exercise of market power and to negotiate effectively with pipeline operators.⁵ In this regard, the Inquiry considered that 'if a similar obligation was imposed requiring the reporting of information on an individual pipeline basis for each gas transmission pipeline that operates on an open access basis (that is, both regulated and unregulated pipelines) then shippers would have more information to determine whether or not the prices they are offered on individual pipelines are cost reflective.'

The Inquiry therefore recommended the COAG Energy Council review:

- how the scope of the information disclosure provisions in the NGL should be expanded to allow the Australian Energy Regulator (AER) to obtain and publish information from unregulated pipelines operating on an open access basis
- the type of financial and operational information that pipeline operators should be required to disclose and the frequency with which it should be disclosed, noting that the purpose of this disclosure is to enable shippers to negotiate effectively with pipeline operators and to determine whether proposed prices are cost reflective, and
- the current test for regulation, with the recommendation that a new test around market power be implemented.⁶

³ ACCC, *Inquiry into the East Coast Gas Market*, April 2016.

⁴ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 8.

⁵ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 121.

⁶ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, pp. 11 and 141.

Dr Vertigan's Examination

In August 2016, the COAG Energy Council directed Dr Michael Vertigan to conduct an 'Examination of the current test for the regulation of gas pipelines' (the Examination).⁷

The Examination found that an uneven bargaining relationship exists in relation to the transport of gas, and that this is the major problem shippers face when seeking access to pipeline services.⁸ To address this power imbalance, the Examination recommended steps be taken to strengthen the negotiating position of shippers.

The Examination considered the most effective way to achieve this would be to enhance information transparency by introducing an information disclosure framework, and provide a more credible threat of intervention by implementing a binding arbitration mechanism where commercial negotiations fail. It was envisaged that any arbitration mechanism would retain commercial negotiation between parties as the primary focus, rather than regulatory solutions. In this regard, the Examination recommended that the disclosure and transparency of pipeline service costs, pricing and contract terms and conditions be enhanced, and a commercially-focused framework for binding arbitration be introduced into the National Gas Law (NGL).⁹

In order to give effect to Dr Vertigan's recommendations, options for the information disclosure and arbitration framework have been released for comment.

3. Objective of the Framework

It is the ACCC's understanding that the primary objective of the information disclosure and arbitration regime is to facilitate timely and effective commercial negotiations between shippers and operators of non-scheme pipelines by 're-balancing' the difference in bargaining power between shippers and pipeline operators, and by imposing a credible threat of intervention to act as a constraint on the exercise of market power.

The information disclosure requirements are intended to provide greater transparency, and reduce information gaps that otherwise create an uneven bargaining relationship between shippers and pipeline operators and which inhibit the ability of shippers to negotiate effectively.¹⁰

The threat of the arbitration mechanism is intended to encourage pipeline operators to behave appropriately during negotiations and parties to reach commercial agreement without having to resort to arbitration. However, where a pipeline operator is not acting appropriately, the arbitration mechanism should encourage shippers to utilise the dispute resolution mechanism.

The arbitration principles are designed to help parties identify the likely range of arbitral outcomes so that they are incentivised to reach agreement, and can be confident in negotiated outcomes.

⁷ Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016.

⁸ Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, p. 12.

⁹ Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, p. 4.

¹⁰ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 128.

As identified in the ACCC's Inquiry, a large number of pipelines have market power and as evidence suggests, have been engaging in monopoly pricing behaviour, setting above-efficient prices.¹¹ In order to achieve the above objectives, the information disclosure and arbitration regime must go to addressing these underlying economic efficiency concerns.

In addition, the ACCC recommends that the GMRG immediately start developing measures to address the likely inconsistency of treatment of covered pipelines subject to light regulation and non-scheme pipelines that will be governed by the framework proposed under this Options paper. For example, arbitration for covered pipelines under light handed regulation will potentially have a higher threshold for triggering the arbitral process than will operate for non-scheme pipelines under the commercial arbitration framework. The ACCC notes that once this framework is in place there will be scope for pipeline operators to 'forum shop' to find the least onerous framework and the one which most favours their commercial positions. The ACCC considers that measures should be identified to address the issues around the uncertainty surrounding how the AER would approach certain issues and the final outcome in light handed regulation, which has discouraged shippers from triggering the relevant NGL/NGR provisions.¹²

4. Information Disclosure

Overall, the ACCC considers the GMRG's proposed approach to the information disclosure requirements is likely to achieve the objective of the information disclosure framework to reduce information asymmetries, in order to enable shippers to identify the exercise of market power and negotiate more effectively with pipeline operators. It also limits the reliance to be placed on the proposed arbitration mechanism through improved commercial negotiations which reinforces the position that arbitration should be used as a last resort and only where negotiations fail.

The ACCC agrees that pipeline operators should be required to disclose the base level information shippers require when considering whether to seek access (as specified in the Options paper). However, the ACCC believes that standard accounting financial statements usually provide little guidance on the costs of supply, particularly in relation to the cost of building infrastructure.

The ACCC supports an approach that provides clear guidance to shippers – either in the pricing principles, or in a guideline prepared by the Australian Energy Regulator (AER) – on how cost information can be used to estimate the efficient cost of transportation services so as to be effective in empowering shippers in their negotiations with pipeline operators.

The ACCC considers the effectiveness of any information disclosure arrangements will directly affect parties' incentives to reach commercial agreement – or where commercial negotiations break down, to utilise the access dispute regime. In this respect, the ACCC considers a clear link should be made between how any disclosed information will interact with the proposed pricing principles, and how an arbitrator will determine prices. That is, the information disclosure regime should match the information required by the arbitrator in the arbitration process.

¹¹ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 20.

¹² ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 101.

4.1. Disclosure of cost information

The ACCC supports the disclosure of cost information that will enable shippers to determine the cost-reflective price of transportation services. As emphasised in the Inquiry, there is limited publicly available information on the costs incurred by pipeline operators in providing services, and the relationship between these costs and the prices charged for services.¹³ This affects the ability of shippers to identify monopoly pricing and negotiate effectively. Requiring pipeline operators to publish cost information will assist shippers in assessing the reasonableness of an offer and provide all parties with more confidence in negotiated outcomes. The ACCC's view is that anything less than cost information is unlikely to create an arbitral environment that sufficiently redresses the bargaining power imbalance that is resulting from the identified monopoly power.

The ACCC considers that to the extent publication of gas transportation prices can aid in calculations of netback prices for individual gas shippers, this is likely to promote efficiency. That said, the ACCC acknowledges that on its own pricing information is unlikely to provide a sufficient indication of costs that would help shippers assess the reasonableness of an offer.¹⁴ This is because, without taking into account the customised nature of contracts in Australia, prices on their own may be misleading to shippers trying to determine whether a price payable by another shipper is for a comparable service. In addition, it is likely shippers would be using monopoly prices set above efficient costs as a comparison to determine what is reasonable. In this respect, pricing information alone is unlikely to address the underlying market power concerns.

Further, the ACCC notes that publication of gas transportation prices is likely to fall within the ambit of the gas market transparency measures announced by the Prime Minister on 15 March 2017. Accordingly, disclosure of pricing information (including appropriate levels of aggregation to protect commercial confidentiality), is likely to be further explored and developed by the ACCC and GMRG in their broader review of mechanisms to promote transparency and orderly market processes in the gas industry.

4.2. Level of cost information

The ACCC supports the proposed disclosure of, and agrees with, the base level information required by shippers when considering whether to seek access. The ACCC considers the base level information listed on pages 39-40 of the Options paper is sufficient to enable shippers to identify the services they can obtain, and the standing offers that are available.

The ACCC would support the GMRG's proposed level of cost information (that is, financial statements and demand information), subject to further guidance being provided on how this information can be used to determine the actual costs of providing transportation services.

It is unclear to the ACCC how information in financial statements would be used by shippers to estimate the efficient cost of supplying transportation services. The ability of shippers to be able to practically use information required to be disclosed will determine the value in having the information disclosure framework in place. Shippers need to be able to develop

¹³ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 128.

¹⁴ Gas Market Reform Group, *Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper*, March 2017, pp. 37-38.

some estimate of cost-reflective prices using the disclosed information, in order to effectively adjust the relative bargaining power of parties and make informed decisions about whether to enter into commercially negotiated contracts or seek arbitration.

In this regard, the ACCC has serious concerns about financial reporting that allows for asset valuations to be undertaken at a pipeline operator's own discretion. Often such valuations are based on the expected returns from current pricing, and so contradict the point of commercial arbitration.

The approach suggested by the GMRG is that financial reports be developed and disclosed publicly by pipeline operators. While these may be limited to standard accounting financial reports, it appears that the GMRG may be contemplating a broader set of financial statements than what would be developed in accordance with normal accounting standards.¹⁵ However, the ACCC notes that even in this situation, such reporting may be heavily reliant upon a pipeline operator's own valuation of its asset. The ACCC's experience with airports, where airport operators provide annual regulatory statements including an income statement, balance sheet and statement of cash flows, has been that accounting values have included asset revaluations undertaken at the airport's discretion. With regard to measures such as return on assets, an upward revaluation of an asset will subsequently provide a lower return on assets – and if asset values were used to set prices using an approach that provides for a particular rate of return, then an upward asset revaluation would result in an increase in access prices.

The ACCC notes that in its 2006 Review of Airport Regulation,¹⁶ the Productivity Commission concluded that airports had revalued assets for a range of non-price reasons and the intention of these revaluations was to provide a justification for higher charges at some stage in the future. The Productivity Commission considered that it was inappropriate to base increases in aeronautical charges on asset revaluations. The ACCC has expressed similar concerns about the pricing practice of the Port of Newcastle since its privatisation.¹⁷ Valuations left at the discretion of pipeline operators therefore have the potential to operate circularly – the higher the asset valuation, the higher the prices charged, which means rates of return will appear 'normal' at any pricing level.

In light of this, while the ACCC considers the information disclosure obligations could only require disclosure of financial statements, it will be critically important that they provide sufficient information to calculate cost-reflective prices and that they are linked to the application of the pricing principles. The ACCC strongly recommends that guidance be provided in order to ensure that asset revaluations and other assumptions are not used by pipeline operators in a manner to reinforce monopoly prices.

Specifically, the ACCC recommends guiding principles be included in the NGR, or a guideline be developed by the AER, that demonstrates how calculations could occur. The NGR or guideline should detail appropriate methodologies for asset valuation and explain how the cost disclosure information can be used to apply these methodologies. As discussed in section 6 of this submission, the ACCC strongly supports the adoption of an actual costs-based approach to pricing. While this is a broader scope for the NGR or

¹⁵ Gas Market Reform Group, Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper, March 2017, p. 139.

¹⁶ Productivity Commission, (2006), *Review of Price Regulation of Airport Services*, No. 40, December, Pages XXII-XXIII, http://www.pc.gov.au/data/assets/pdf_file/0013/63103/airport-services-overview.pdf

¹⁷ See speech by ACCC Chairman, <https://www.accc.gov.au/speech/ports-what-measure-of-regulation>, 20 October 2016.

guidelines than envisaged by the GMRG in section 3.4.2 of the Options paper, the ACCC considers that leaving scope for pipeline operators to use different methodologies for calculating asset valuation and other key inputs too broad, runs the risk of continual asset revaluation and changes in methodologies in order to either create uncertainty about arbitral outcomes (such that shippers may agree to prices substantially above reasonable costs) and/or continued recovery of monopoly prices for use of gas pipelines, which would leave the underlying issue of economic inefficiency unaddressed.

Cost disclosure information should be clearly linked to the pricing principles. That is, cost disclosure information should be capable of being used as an input into the calculation or determining of prices under the pricing principles that will be used by an arbitrator to determine the reasonableness of an offer. This will provide guidance to the parties on likely arbitral outcomes and therefore create the desired credible threat of arbitration. This will encourage shippers and pipeline operators to reach commercial agreement and, in doing so, limit the exercise of market power by pipeline operators in being able to charge excessive prices. This is also likely to contribute to the timeliness of arbitral determinations, by reducing the need for the arbitrator to obtain additional information or advice on how to determine access prices according to the pricing principles.

To ensure consistency and that disclosed cost information is useful to shippers, the ACCC agrees that a guideline should be developed under the NGR on how financial statements are to be prepared. This would enable shippers to readily identify inputs that will be used in the estimation of likely arbitrated prices and promote predictable and consistent arbitral outcomes. The ACCC supports the AER developing the guideline and considers the pricing principles and valuation guidelines in the NGR are a good starting point.

The ACCC notes that the intention of whether any developed guidelines will be binding should be made clear. If the guidelines are voluntary, then they may provide limited benefit to shippers, given pipeline operators would not be obliged to follow them. The ACCC favours binding guidelines.

4.3. Exemptions

During the Inquiry, the ACCC found that the 'majority of existing transmission pipelines' have market power and face limited constraints, with a large number of major arterial pipelines using market power to engage in monopoly pricing.¹⁸ There was also evidence that suggests that even where another pipeline (or route) could represent a competitive constraint, the theoretical option of an alternative pipeline (or route) was not constraining prices in practice.¹⁹ In this regard, the ACCC suggests the GMRG consider limiting the exclusion of pipelines from the information disclosure requirements and/or application of the arbitration mechanism.

The ACCC is concerned that, under the GMRG's proposed approach, a possible 27 of 45 pipelines identified in the Options paper could be exempt from the information disclosure requirements while only 11 are exempt from the arbitration mechanism. A lack of alignment between the information disclosure arrangements and the arbitration mechanism in this way has the potential to significantly delay arbitrated determinations for a significant number of

¹⁸ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 92.

¹⁹ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p.98.

pipelines (as time will be needed for information to be prepared and disseminated to the arbitrator and parties). It may also operate to diminish the potential for commercial negotiation to deliver workably competitive outcomes. This is because if parties do not have the information to ascertain the likely outcome of arbitration then there is likely to be greater incentive, particularly for the pipeline operator who will hold more information, to either rely more heavily on delayed arbitral outcome or to seek shipper agreement to prices substantially above underlying costs.

The ACCC recognises there are costs associated with information disclosure, however ownership of gas pipelines is limited, with many operators owning multiple pipelines.²⁰ The availability of the proposed gas information is likely to significantly improve market competitiveness by providing a more equal footing in contract negotiations, and limiting the ability of pipeline operators to use their significant market power to set unreasonably high prices. This, in turn, will lead to more economically efficient outcomes and benefits for gas market participants across all levels of the supply chain.

In light of the benefits information disclosure is likely to provide, the GMRG could consider imposing information disclosure rules, that if a pipeline operator is required to publish information on at least one pipeline – or some other specified number of pipelines – it owns or has an interest in, the pipeline operator should be required to report on all of its pipelines (regardless of whether an exemption applies). There is a risk that if some pipelines are regulated and some are not, this could see pipeline operators shifting costs between regulated and non-regulated pipelines in order to recover more than efficient costs.

That said, the ACCC supports exemption from all information disclosure requirements for non-scheme pipelines that service a single shipper or do not provide third party. This would align with the regime for covered pipelines under the NGL. However, such an exemption should be confined to pipelines that do not have capacity to provide any services to third parties. This will ensure that where the capacity of a pipeline is not fully contracted, arbitration will be available to shippers to promote efficient use of any spare capacity and pipelines more broadly.

Consistent with the GMRG's recommendation, the ACCC also supports exemption of non-scheme pipelines from the financial statements and demand information publishing requirements if they fall below 10 TJ/day. This is in line with the Bulletin Board reporting thresholds (once the proposed rule change is implemented).²¹

The ACCC also supports the GMRG's view that the AER is an appropriate body to oversee the exemption mechanism and recommends consideration be had to a 'review of exemptions' mechanism where, for example an access seeker could request the AER to review the legitimacy of a pipeline operator's claimed exemption.

²⁰ For example, APA owns 13 out of the 30 or so transmission pipelines on the east coast. See ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 96.

²¹ A rule change request is due to be submitted to the AEMC shortly. See COAG Energy Council, Gas Market Reform Package Appendix A – Energy Council response to ACCC and AEMC's reports, August 2016; and Gas Market Reform Group, Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper, March 2017, p. 45.

4.4. Compliance

Civil penalty provisions

The ACCC supports the GMRG's view that the information disclosure requirements should be classified as a civil penalty provision that would allow the AER to issue an infringement notice for non-compliance. The ACCC considers this the most effective way to ensure pipeline operators comply with the requirements, with an appropriate, proportionate and timely consequence where there is failure to comply.

Conduct provisions

The ACCC does not consider classifying the information disclosure requirements as a conduct provision is appropriate. While it may provide additional incentive for pipeline operators to ensure information is up-to-date and pipeline operators are complying with the information disclosure requirements, the disclosure requirements do not directly affect a shipper's ability to access a pipeline. As such, there is unlikely to be sufficient nexus between non-disclosure and any potential loss or damage so as to warrant recovery of any amount of loss or damage by action against a person in court.

Reporting standard

The GMRG sought views on whether a reporting standard should be included in the new disclosure framework, which, amongst other things, could state that information provided by the pipeline operator must not be knowingly false or misleading.

The ACCC considers that if this includes a requirement that an independent auditor provide a declaration that the disclosed information is true and correct, the ACCC supports the inclusion of such a standard. The financial benefits to a pipeline operator of slightly erroneous disclosure may number in the tens of millions of dollars and to avoid creating an environment which could reward errors, a reporting standard with significant consequences should be included.

4.5. Other implementation issues

Publication of information

The ACCC agrees that the information to be disclosed should be published by pipeline operators on their website, in order to align with the covered pipelines regime. The ACCC notes that there may also be value in publishing this information in a single, neutral location to make it easier for shippers to compare data and offers. Specifying the form in which information should be listed is also likely to assist with this.

Timing

The ACCC supports the GMRG's expectations as to the frequency with which information should be published by pipeline operators.

Costs of investigations

The ACCC notes the GMRG's approach to costs associated with investigation work. It may be worth requiring a pipeline operator to provide an indicative range of likely costs to a shipper prior to undertaking any required investigative activity (similar to the scheme for covered pipelines).²² Alternatively, it may be appropriate to allow a shipper to dispute the costs of an investigation within an arbitration.

5. Arbitration Mechanism

Overall, the ACCC supports the GMRG's proposal to adopt conventional arbitration with enhanced procedural protections and partial transparency. The ACCC considers the arbitration mechanism is likely to achieve its intended objective to provide the desired threat of intervention that will encourage pipeline operators to engage appropriately during negotiations. While arbitration should rarely be required where commercial processes are working effectively, the framework is also likely to encourage parties to seek arbitration in the event negotiations fail.

The ACCC has, however, identified a number of additional measures or changes the GMRG may wish to consider to strengthen the effectiveness of the arbitration mechanism and minimise the scope for processes to be gamed.

5.1. Arbitration options

The ACCC considers predictability and transparency are essential features of all regulatory frameworks and can also help reduce the frequency of commercial arbitration in the current context. A degree of predictability around likely arbitral outcomes will be a key contributor to the success of the Framework and parties reaching commercial agreement.

The ACCC strongly supports the conventional arbitration model favoured by the GMRG as it provides for a timely arbitral outcome that addresses the underlying market power and efficiency issues, by requiring the arbitrator to take into account the actual costs in providing the pipeline service. The benefit of commercial arbitration is that the arbitrator has flexibility within the arbitration to set prices that can also take into account broad commercial and investment considerations as well as the commercial benefits of reaching a timely agreement.

The ACCC supports an arbitration option that provides incentive for pipeline operators to settle, and this is likely to be done through an expectation of more cost oriented prices along with the risk of public notification of a dispute and the risk of backdating arbitral determinations, which would alleviate the risk of gaming. Certainty of supply availability and information as to costs prior to arbitration should empower shippers in their negotiations with pipeline operators who may otherwise be in a position to take advantage of their market and bargaining power.

The ACCC considers the conventional arbitration model with cost-based pricing principles appropriately balances:

- the objective of a mechanism that provides for a commercially-focused framework

²² National Gas Rules, r 112(3)(b)(iii).

- avoids undermining the incentive for investment and innovation, and
- provides adequate protections to small shippers to access the arbitration mechanism in the event commercial negotiations fail.

5.2. Access to arbitration

The ACCC suggests broadening the proposed scope of the arbitration mechanism to include services that require the use of existing capacity or further augmentation of the pipeline (including extensions). Expanding the circumstances in which a shipper can utilise arbitration for an access dispute would address concerns raised in the Inquiry about ‘the market power wielded by some pipeline operators, the ways in which this market power is being exercised, and the detrimental effect it is having on economic efficiency and consumers more generally’²³.

These concerns are exacerbated by the limited competitive constraints on pipeline operators which allow operators to exercise market power in the supply of services not covered by foundation contracts (or by covered pipeline regulation, which relates only to the base services and not, other, non-reference services).

5.3. Exemptions

As mentioned in section 4.3 above, the ACCC recommends caution in considering whether to provide exemptions to pipeline operators, given the current lack of constraint on pipeline operators exercising market power.

In particular, and as noted in section 3, the ACCC is concerned that only applying the arbitration mechanism to non-scheme pipelines is likely create inconsistency of treatment of covered pipelines subject to light regulation and non-scheme pipelines that will be governed by the proposed framework. Therefore, the ACCC recommends the GMRG immediately commence work to identify measures to address the issues around the effectiveness of the threat of regulation under the current NGL and NGR to constrain market behaviour and prevent ‘forum shopping’.

The ACCC notes that the Examination concluded that the most effective way to address the negotiating imbalance that shippers can face is to institute a credible threat of intervention in the event commercial negotiations fail. When coupled with an information disclosure framework, the threat of intervention should incentivise parties to reach agreement through commercial negotiations and therefore arbitration would likely be triggered in limited circumstances.

Regardless of which arbitration mechanism is implemented, and consistent with the proposed information disclosure exemption framework, the ACCC supports exemption of non-scheme pipelines that service a single shipper or do not provide third party access where these pipelines do not have capacity for third parties and are not owned by operators reporting, or subject to, arbitration under the proposed Framework.

In relation to Greenfields pipelines, the ACCC supports exemption under the NGR for services and prices contracted for under foundation contracts, given our findings in the Inquiry that prices in foundation contracts appear to reflect the competition between pipeline

²³ ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 92.

operators to supply the pipeline. This would ensure the incentive for efficient investment in new Greenfields pipelines is maintained. However, beyond original foundation contract price terms and conditions, the ACCC considers the commercial arbitration process should be available to shippers and pipeline operators.

The ACCC considers that the AER is the appropriate body to monitor information disclosure compliance and oversee arbitration applications and referrals.

5.4. Information gathering powers

The GMRG proposes that to the extent the arbitrator believes it does not have sufficient information available to apply pricing principles the arbitrator will have the power to obtain this information. While the ACCC does not oppose the arbitrator having the power to request more information to inform a decision, the ACCC considers that the overall disclosure and arbitration framework will be more effective if parties to a dispute already have key information and are able to predict with some accuracy the range of likely arbitral outcomes. Parties may be more likely to reach agreement if their separate estimates of likely arbitral outcomes are similar and having the bulk of necessary information already publicly available to parties and the arbitrator will facilitate this. Accordingly, the ACCC favours the majority of necessary information being available under the information disclosure arrangements. The ACCC notes that reducing the need for the arbitrator to obtain additional information also has the advantage of reducing the scope for delay of arbitral processes while additional information is obtained, disseminated and assessed.

5.5. Arbitration guidelines

The ACCC supports the GRMG's approach in having the AER develop a set of guidelines that provide the arbitrator with guidance on the requirements of the arbitration (including key procedural requirements, timeframes and the determination form), as well as a guide that provides disputing parties with guidance on the arbitration process. The ACCC notes that there may be some efficiency gains in the AER preparing a single set of guidelines that deal with both these sets of issues.

Noting that the intent of these guidelines is to inform both parties (the arbitrator and the disputing parties) of the arbitration process, the ACCC is concerned that where potential process errors are made and further disputes result, parties may try to rely on the guidelines as legal documents – or alternatively seek to persuade the arbitrator to implement different arbitral processes that may result in significantly different outcomes across arbitrations that deal with similar issues. The GMRG may therefore wish to consider the legal status of these guidelines, noting that guidelines under certain frameworks can be legally binding.

5.6. Outcomes of proceedings

For transparency reasons, the ACCC supports publication of information regarding the existence of arbitrations, as this is likely to be useful in incentivising pipeline operators to reach commercial agreement prior to arbitration (and reduce the likelihood of further arbitrations being sought by other shippers). The ACCC also supports the reporting of arbitral outcomes to the AER, to assist in monitoring the effectiveness of the proposed Framework over time.

Given the new gas transparency measures announced by the Federal Government on 15 March 2017, the information provided to the AER about arbitral outcomes is also likely to be used in any public reporting on gas transportation arrangements. The level of aggregation necessary to protect commercially sensitive information will be considered against the benefits of transparency and providing a clear indication of netback prices will likely be considered further in this context.

5.7. Key design components

The ACCC supports the GMRG's proposed approach to the key design components of the arbitration mechanism which include: access proposals; protection of existing contractual rights; safeguards to avoid distorting investment; oversight by the AER; selection of the arbitrator; binding nature of arbitration; costs; types of services eligible to be arbitrated; exemption framework; termination of arbitration; and correction of errors.

However, the GMRG may wish to consider the following issues and suggestions:

- a) In addition to written requests being required in accordance with the negotiating framework for access proposals, the ACCC suggests the GMRG or AER could develop a set of minimum requirements that should be included in any private framework unless approval is obtained from the AER.

The GMRG proposed that the NGR provide pipeline operators the flexibility to develop their own guidelines for setting their negotiating framework for access to their pipelines. The ACCC considers that a set of guidelines could be developed so that negotiating frameworks generally include a minimum set of requirements. The GMRG could nominate an appropriate body to provide compliance oversight of frameworks with the guidelines. The ACCC notes that if the proposed approach is going to reference a pipeline operator's negotiated framework, this then assumes that there is always a fair negotiation framework provided in the contract and applicable to the issue in question. In an environment where there is market power present, this may not always be the case.

- b) The ACCC agrees that existing contracts and terms of access should be protected under the proposed framework and pipeline operators be prevented from locking up pipeline capacity by contracting it to (for example) related body corporates of the pipeline operator. The ACCC suggests this intention be spelt out, for example in the explanatory memorandum that will accompany the final version of the NGL draft Amendment Bill.²⁴
- c) The ACCC queries whether the NGR should provide an arbitrator with the power to determine its own jurisdiction to hear a matter. The ACCC notes that there is some potential that this will introduce uncertainty and unpredictability into the regime, as different arbitrators may have different views about what a failure to negotiate in good faith involves. (This threshold issue is discussed further in paragraph j below). It may therefore be preferable for the AER to act as the gatekeeper on these matters so that a consistent approach is adopted for all disputes. The ACCC agrees with the AER that if the AER is not to have a "gatekeeper role" in deciding whether the dispute

²⁴ National Gas (South Australia) (Pipelines Access-Arbitration) Amendment Bill 2017.

should be arbitrated, the need for the dispute process to be triggered by notifying the AER is unclear.

- d) Parties involved in arbitration should mutually agree on an arbitrator from a list of arbitrators developed in consultation with relevant institutions (such as, the Resolution Institute and the Australia Dispute Centre) and established under the Rules. Where parties are unable to reach agreement within a specified time frame (say, five working days as suggested in the Options paper), the ACCC considers the AER is an appropriate body to nominate an arbitrator to resolve the dispute.
- e) The ACCC questions the need to provide a hearing if a party requests one in an arbitration – such a right of request could be gamed to delay the implementation of an arbitral decision. The ACCC suggests that parties could request a hearing but that this is to be ultimately determined by the arbitrator, to minimise delay and costs for parties in participating in the arbitration.
- f) Similarly, while the ACCC supports only directly relevant documentation being provided to the arbitrator, we recommend the determination of whether or not specific material is directly relevant is to be conclusively determined by the arbitrator in order to facilitate timely arbitral decisions and avoid unnecessarily long arguments as to what is and is not directly relevant.
- g) The ACCC supports the proposed tight timeframes for the arbitrator in considering a dispute, as it appropriately recognises the commercial nature of the arbitration and the value to the parties in having a timely decision made. That said, the ACCC notes it would be preferable that the arbitrator be given the discretion to extend the timeframe rather than require agreement by the parties. The arbitrator, rather than the parties, will be in the best position to assess whether an extension is needed. A possible compromise would be to give the arbitrator the ability to exercise this discretion once, with any further extensions to be by agreement of the parties only.
- h) To ensure an access determination can accommodate the changing needs of both parties (subject to the terms and conditions of the determination), parties wishing to vary an access determination should be permitted to do so under the NGR. Variations should be allowed where parties agree as this is consistent with the commercial focus of the mechanism. While provision could also be included to allow parties to trigger the arbitration mechanisms if they are unable to agree on a variation, to avoid serial notification, the ACCC recommends that this only be permitted where there has been a significant change of circumstance or where it relates to a new matter (e.g. provision of a new service).
- i) The ACCC considers the costs of arbitration (including costs associated with the arbitration process and the cost of the arbitrator) should be equally shared between parties seeking an outcome. The NGR should provide for the arbitrator rather than parties to determine if expert advice is needed, to limit the scope for gaming and delay. The ACCC supports an arrangement where parties can agree on a clear cost limit for expert advice, which in the absence of agreement can also be determined by the arbitrator, having regard to the relative capacity of parties to pay for these costs and, if disputed, for final determination by the arbitrator.
- j) The ACCC agrees that there should be some provision for an arbitrator to terminate an arbitration where the dispute in question is trivial or the notification is vexatious.

However, the ACCC considers it is important that such powers do not act as a barrier to the use of the arbitration mechanism. The ACCC considers the threshold to arbitration should be relatively low to ensure that arbitration is an accessible option for parties and acts as a credible threat in commercial negotiations. The ACCC notes that there is generally no threshold to seeking arbitration in commercial negotiations. Under arbitral arrangements imposed under the NGL and NGR, and those included in Parts IIIA and (previously) XIC of the CCA, the parties are able to seek arbitration if it can be established they are 'unable to agree'. The ACCC considers this sets an appropriate threshold for accessing commercial arbitration (having regard to the relative bargaining power of pipeline operators and shippers), and that in order to use the arbitration mechanism only one party need provide sufficient evidence to establish both parties have been unable to agree.

6. Arbitration Principles

The ACCC supports the use of arbitration principles (comprising pricing principles as well as broader principles to supplement these) to provide guidance to an arbitrator on the matters to be taken into account when making a determination. As already mentioned, if a clear nexus is drawn between the information required to be provided under the disclosure framework and the pricing principles, parties to an access dispute will be able to independently determine the range of likely arbitral outcomes from a common and appropriate fact base. In these circumstances, commercial agreement is more likely to be achieved.

The effectiveness of the pricing principles will depend in part upon how clearly the principles and the ways in which they can be applied are described.

6.1. Matters to be taken into account

Provided the pricing principles are based on actual costs incurred by a pipeline operator then the ACCC expects they will operate to counteract (at least to some degree) the market and bargaining power the ACCC identified in the Inquiry as being used in the supply of gas pipeline services. In this way, the ACCC expects the pricing principles would promote more economically efficient outcomes and therefore would be broadly consistent with the NGO. For this reason, the ACCC agrees that the NGO need not be included as a consideration an arbitrator must take into account in making a determination.

The ACCC also recognises that part of the benefit of the proposed framework is that it should facilitate more timely commercial agreement compared to a more regulatory intervention. Accordingly, the ACCC favours the inclusion of all the criteria listed on page 138 of the Examination in the pricing principles and also the inclusion of an additional principle, namely the value to party of a timely decision on the pricing of the relevant service for a particular period of time.

6.2. Determining the reasonableness of an offer

The ACCC strongly supports the GMRG's view that an arbitrator should assess the reasonableness of an offer based upon a comparison with the actual costs of service provision. However, the ACCC considers that the process for applying such a test should also be specified in some way. This will provide an arbitrator with clear direction as to how

the reasonableness of an offer is to be determined as well as ensure consistency and predictability of arbitral outcomes. The ACCC strongly supports an actual costs based approach to determining prices, with clear guidance provided on how these are to be arrived at or estimated by an arbitrator.

For example, the NGR or a guideline could be developed on an appropriate methodology for calculating the actual cost of service provision and, in particular, how to value relevant assets and determine the value of other key inputs. This would, as the Examination states, prevent “inappropriate revaluations” and would substantially narrow the areas for potential dispute.

While the ACCC acknowledges the GMRG’s point that being overly prescriptive as to the way in which the assessment is carried out may lead to what could be considered more ‘regulatory outcomes’ rather than purely commercial, the ACCC considers the objective that parties reach commercial agreement is most likely to be achieved if parties are aware of what they can expect from arbitration, using a common and appropriate fact base. Therefore, being specific in the considerations an arbitrator will take into account and how an arbitrator can apply these to its calculations of reasonable pricing, is likely to best promote successful negotiation in a way that is directed to the market power and bargaining power issues that gave rise to the development of this proposed framework in the first place.

The ACCC considers the pricing principles and valuation guidelines in the NGR are a good starting point and we recommend that the AER be tasked with preparing the guideline.

7. Transitional arrangements

The ACCC supports the GMRG’s proposed transitional arrangements to expedite implementation of the information disclosure and arbitration framework. In particular, the ACCC supports commissioning the assistance of a consulting firm with expertise in financial reporting requirements to work with the GMRG and the AER on the development of guidelines, which would mean pipeline owners commence information reporting by 30 October 2018, rather than April 2019.