



**FEEDBACK ON BINDING COMMERCIAL ARBITRATION
PROCESS FOR GAS PIPELINE ACCESS DISPUTES IN THE
NATIONAL GAS LAW
(Draft Amendments – January 2017)**

**AER submission to the Energy Council Secretariat
February 2017**

Introduction

The AER welcomes the opportunity to comment on draft amendments to the National Gas Law (NGL) as the first step to operationalising the recommendation made by Dr Vertigan's examination¹.

The extent of commentary provided at this stage is limited by the caveat that the draft amendments are only a portion of the final package, and that key details (such as the pricing principles and matters relating to the provision of information) are yet to be developed and will sit in the National Gas Rules (NGR). It is for this reason, at this stage, that the AER has chosen not to specifically address the list of questions posed in the covering Bulletin.

This submission provides high level commentary on issues the Secretariat might wish to consider further. The submission is structured as follows:

1. An outline of the AER's understanding of the rationale for the draft amendments.
2. Discussion of the issues associated with the central amendments - information disclosure and the arbitration process.
3. Broader issues relating to the draft that the Secretariat may wish to consider.

The AER is available to discuss the comments in this submission with the Secretariat, and to provide assistance or advice at any stage of this process.

1. The purpose of the draft amendments to the National Gas Law

In framing this submission the AER has examined the COAG Energy Council's communique² and Dr Vertigan's examination and recommendations.

In December the Energy Council accepted the four recommendations made by Dr Vertigan's examination of the Gas Pipeline Coverage Test (the examination) and requested that these be operationalised by 1 May 2017.

- Like the ACCC Inquiry³, the examination found that pipeline owners do have market power and that the existing regulatory arrangements require modification.
- The examination recommends: that the disclosure and transparency of pipeline service costs, pricing and contract terms and conditions be enhanced; and a framework for a binding commercial arbitration be introduced into the NGL. (The recommendations are at **Attachment A**).
- It is argued that the approach outlined in the examination has the potential to facilitate efficient commercial solutions while avoiding unnecessary regulatory burden.

In order to operationalise Dr Vertigan's recommendations, draft amendments to the NGL have been released for comment. We understand that the proposed amendments are intended to establish the framework within law and that further detail on the arbitration scheme, information disclosure requirements and pricing principles will be incorporated into the NGR. We also understand that a separate consultation process will be run to develop the required Rule changes.

Given this context, the following issues are raised for consideration.

¹<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Examination%20of%20the%20current%20test%20for%20the%20regulation%20of%20gas%20pipelines%20-%20Final%20Report.pdf>

²<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Energy%20Council%20Communique%20-%202014%20December%202016%20Version%201.0.pdf>

³https://www.accc.gov.au/system/files/1074_Gas%20enquiry%20report_FA_21April.pdf

2. Issues associated with the central amendments - information disclosure and the arbitration process

A clear statement of objectives

In order to ensure successful implementation of Dr Vertigan's recommendations it is important to clearly articulate and have a common understanding of what the overarching objective of the new mechanism is in the NGL, and how it relates to the National Gas Objective.

This understanding will guide the development of the arbitration model, the scope of the pricing principles and the degree of transparency that is required.

It will also guide future Rule changes.

Both the ACCC Inquiry and Dr Vertigan's examination found a business environment where market power exists, resulting in inefficient outcomes.

The principal problems identified are that parties negotiating for pipeline services have unequal levels of bargaining power, and unequal access to information.

Under the proposal outlined by Dr Vertigan's examination, gas transportation costs will be lowered through mandating greater disclosure and transparency of pipeline services, pricing and costs. Should this fail and a user and pipeline owner are still unable to reach agreement a "commercial solution" will be determined by an arbitrator. This proposed model was informed by pipeline and shipper feedback that there is little appetite for more onerous regulatory solutions.

Clear articulation of the objective of the amendments in the NGL, including of the role of the National Gas Objective, if any, in relation to these amendments, will provide clear guidance for the development of the NGR relating to information provision and collection, pricing principles and the arbitration model. It will also be a guide for any future Rule changes.

A clear statement of objectives will also provide a common reference point for industry on the purpose of these changes to the NGL and the NGR.

Impact of the arbitration principles on the commercial negotiation process

While the operational detail is to be developed, careful consideration should be given to the relationship between commercial negotiations and the outcome of any arbitration. This should include further consideration of the role of the NGO, the pricing principles and other factors that the arbitrator is required to consider.

While the AER supports the need to provide guidance for the arbitrator in the NGL, and as needed in the NGR, further discussion is encouraged (through the Gas Market Reform Group), of the implications for the commercial arbitration model of providing such guidance.

Parties are assumed to be negotiating on a commercial basis prior to the appointment of an arbitrator. Arbitration based on guidance brings in new factors that may not have been considered prior to the arbitration. The more factors an arbitrator is required to consider the more complex the decision making becomes, with consequential impacts on timeliness of decision making, and the potential for disputes regarding the weighting and interpretation to be placed on the guidance. The more constrained the arbitration, the more the approach is closer along the spectrum to a regulatory outcome, something that both pipelines owners and users informed Dr Vertigan that they did not want.

On the other hand, the prospect of arbitration in accordance with specified guiding principles may encourage pipeline operators to reach negotiated outcomes that are in accordance with those principles. In this case, recourse to arbitration would not be required, but the guiding principles would still have an important role to play, particularly if the objective of the new mechanism is to achieve more efficient pricing outcomes than those that would be likely to arise in a commercial

negotiation between a party who has market power and a party which does not. As Dr Vertigan noted, where the commercial negotiation process is working effectively, the resort to arbitration should be rarely required.

That said, the effectiveness of the negotiation process will need to be assessed against the overall objectives of the new mechanism, and the principles that are to guide the arbitrator will need to clearly align with those objectives. If efficient pricing is an important objective, for example, it may be that the NGO should be given a more prominent role, rather than being one factor (alongside the other guideline principles) that the arbitrator must take into account.

Head of power to allow for development of the detail of an arbitration model

AER suggests including a general provision allowing the NGR to address other aspects of the conduct of an arbitration process: such as the ability of the arbitrator to seek expert assistance, and the timeframe in which a decision is to be made.

The AER suggests that a broad head of power be included so that details relating to the arbitration process can be developed in the NGR.

Examples of matters that may be detailed in the NGR are:

- arbitrator may need to be able to seek technical assistance;
- the timeline within which an arbitration decision is to be made;
- conditions which may cause the timeframe for a decision to be reconsidered (stop the clock); and
- engagement of experts and how these costs are to be allocated.

Interaction of Dr Vertigan's recommendations with the existing regulatory approach

It is too early to comment on how the information requirements and arbitration model will interact with the existing regulatory regime. It may be appropriate to deal with these issues via a separate process.

The scope of what pipelines and services are covered by the draft amendments should be considered carefully to ensure no unintended outcomes.

The AER suggests that further consideration be given to how the information requirements and arbitration model will interact and sit within the existing regulatory regime (including light regulation). Dr Vertigan's examination was aware of the need to consider the interaction of the existing regime with the proposals being developed, and considered that the commercial arbitration framework should apply to all open access pipelines (recommendation 2 Attachment A).

The AER notes that there are various ways in which any overlaps between the application of the proposed information requirements and arbitration framework, and the existing regulatory structure, could be managed.

As currently drafted, the limitation of the application of the access dispute mechanism to 'non-scheme' pipelines means, for example, that it will not be available to users/prospective users of covered pipelines. For example, where an extension to, or expansion of a pipeline has been deemed not to form part of the covered pipeline.

The AER also suggests that further consideration be given to whether it is appropriate to apply the proposed arbitration mechanism to pipelines that are dedicated to a particular user and are not made available for third party access.

Ensure there are sufficient powers to develop the information disclosure and transparency provisions (Recommendations 1 and 3, Attachment A) envisaged by Dr Vertigan's examination

That the information powers to collect and disclose, and ensure compliance and validation are sufficient for a nominated body to be able to undertake the task as envisaged by Dr Vertigan.

Dr Vertigan's examination sought to provide greater access to information so that commercial negotiations between pipeline operators and shippers could be supported, with arbitration as a last resort in the event of no agreement being reached between parties.

Specifically, Dr Vertigan recommended the disclosure and transparency of pipeline service pricing, and contract terms and conditions be enhanced; including requiring the provision of information on the full range of pipeline services which are available or sought. The provision of information is to be inclusive of disclosure of the costs incurred by the pipeline operator in providing the proposed service.

As expected, the draft amendments defer detail relating to information disclosure to be dealt with in the NGR. At this stage it is to be determined which information must be made available generally and which information is to be made available based on the circumstances of the access request or access dispute. The draft amendments do not provide a head of power to allow for the publication of information as envisaged by Dr Vertigan - that is, for the publication of information outside the context of a specific access request or access dispute.

Dr Vertigan's examination also suggested that consideration be given to the need for the information provided to be subject to appropriate validation and/or compliance processes.

The AER therefore suggests that consideration be given to including an additional head of power in the NGL to enable these matters to be addressed.

3. Broader issues relating to the draft that the Secretariat may wish to consider

Circulation of an explanatory memorandum to accompany the draft amendments

The AER would welcome the circulation of a further consultation draft of the amendments, accompanied by an explanatory memorandum.

Circulation of another draft of the amendments might be better informed if accompanied by an explanatory memorandum, so as to guide the reader on the purpose of the amendments and on how they are to be interpreted.

Review of the arbitration information disclosure framework

It is suggested the draft amendments provide for a review of the arrangements before the end of 5 years to assess the effectiveness of the arbitration information disclosure framework and whether the coverage test should be changed.

Recommendation 4 of Dr Vertigan's examination is that the information transparency/arbitration model be allowed to operate for a period of 5 years, after which an assessment be made of its effectiveness and whether the coverage test needs to be replaced.

It is suggested that the NGL state specifically that before the end of 5 years the arrangements be subject to independent review, in light of Dr Vertigan's recommendation 4.

Attachment A: Dr Vertigan's recommendations

Recommendation 1

That the disclosure and transparency of pipeline service pricing and contract terms and conditions be enhanced, including requiring the provision of information on the full range of pipeline services which are available or sought (not solely focused on forward haul services)

Recommendation 2

That a framework for binding arbitration, available to all open access pipelines in the event parties are unable to reach a commercial agreement, be introduced into the National Gas Law.

Recommendation 3

That the GMRG be tasked with developing a detailed design of the disclosure and transparency requirements and of the arbitration framework, after consultation with industry, other stakeholders, the ACCC, the AER and the AEMC, with recommendations to be considered by the COAG Energy Council in mid-2017.

Recommendation 4

That no change be made to the current coverage test at this stage. The appropriateness of amending the coverage test should be reviewed within five years after the arbitration framework is operational.