Australian Pipeline Limited ACN 091 344 704
Level 19, 580 George Street, Sydney NSW 2000
PO Box R41, Royal Exchange NSW 1225
P: +61 2 9693 0000 | F: +61 2 9693 0093
APA Group | apa.com.au

8 February 2017

COAG Energy Council Secretariat
GPO Box 787
Canberra ACT 2601

APA Group submission to the COAG Energy Council:
National Gas (South Australia) (Pipelines Access-Arbitration) Amendment Bill 2017

APA Group (APA) welcomes the opportunity to comment on the COAG Energy Council National Gas (South Australia) (Pipelines Access-Arbitration) Amendment Bill 2017.

APA supports implementation of Dr Vertigan's recommendations to mandate greater information disclosure and transparency of pipeline services for uncovered pipelines, alongside establishing a right for shippers to access commercial arbitration. These recommendations were accepted by the COAG Energy Council on 14 December 2016.

APA does not believe that the legislation as it is currently drafted reflects Dr Vertigan's recommendations.

APA is concerned that the draft legislation focuses on establishing an arbitration regime that has been derived from regulatory models instead of commercial ones, and does not appear to place sufficient emphasis on information disclosure and its role in supporting commercial negotiations. The focus on commercial negotiation, supported by commercial arbitration where those negotiations fail, were at the centre of Dr Vertigan's recommendations and his aim to retain existing incentives for investment and innovation in pipelines.

APA has included specific comments on the proposed legislation in the accompanying submission, and looks forward to continued positive engagement as this review progresses.

Please contact Peter Bolding, General Manager Strategy and Regulatory, on (02) 9693 0053 for further information.

Yours faithfully

Ross Gersbach
Chief Executive Strategy and Development

Implementation of COAG Energy Council decision

APA Group (APA) welcomes the opportunity to comment on the COAG Energy Council National Gas (South Australia) (Pipelines Access-Arbitration) Amendment Bill 2017.

The COAG Energy Council agreed to implement the recommendations arising from Dr Michael Vertigan's "Examination of the Current Test for the Regulation of Gas Pipelines". As stated in the relevant COAG Energy Council meeting Communique, this involves "mandating greater disclosure and transparency of pipeline services and pricing, and mandating commercial arbitration".[1]

The draft legislation released on 25 January does not implement this decision.

APA supports an increased information disclosure framework to give shippers confidence in their negotiations with pipeline owners, supported by a commercial arbitration framework in the event that commercial negotiations are not successful.

The proposed legislation focuses on the arbitration regime and does not include elements or heads of power associated with information disclosure. It is not clear whether these elements of the regime will be the subject of further legislative amendments. If not, the draft legislation would need amendment to provide for their implementation.

In respect of arbitration, the proposed legislation does not a establish a commercial arbitration framework, but rather a regulatory one that is very likely to fail in delivering the intended quick and effective arbitration outcomes for users and prospective users of pipeline services.[2]

Establishing both the information disclosure and the commercial arbitration regimes is critical to achieving the policy aims discussed by Vertigan and endorsed by the COAG Energy Council. It is not possible to understand and assess the scope and effectiveness of the arbitration scheme without seeing the details of the complete policy framework. This includes the types of information that will be disclosed by pipeliners, and how this will support commercial negotiations and overall framework design.

The following sections discuss the COAG Energy Council agreed policy aims, and the proposed legislative scheme in more detail.

Principles and intent of Vertigan framework

Policy objectives

Dr Vertigan, through his recommendations, is seeking to address a perceived or actual imbalance in negotiating power between shippers and prospective shippers and pipeline operators, arising principally from an information asymmetry between the parties and a lack of credible threat of regulation.[3] Dr Vertigan emphasises, however, that in addressing these issues both he, and access seekers, are looking to commercial rather than regulatory solutions.[4]

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[1] COAG Energy Council 2016, *COAG Energy Council Meeting Communique*, Wednesday 14 December, p 1

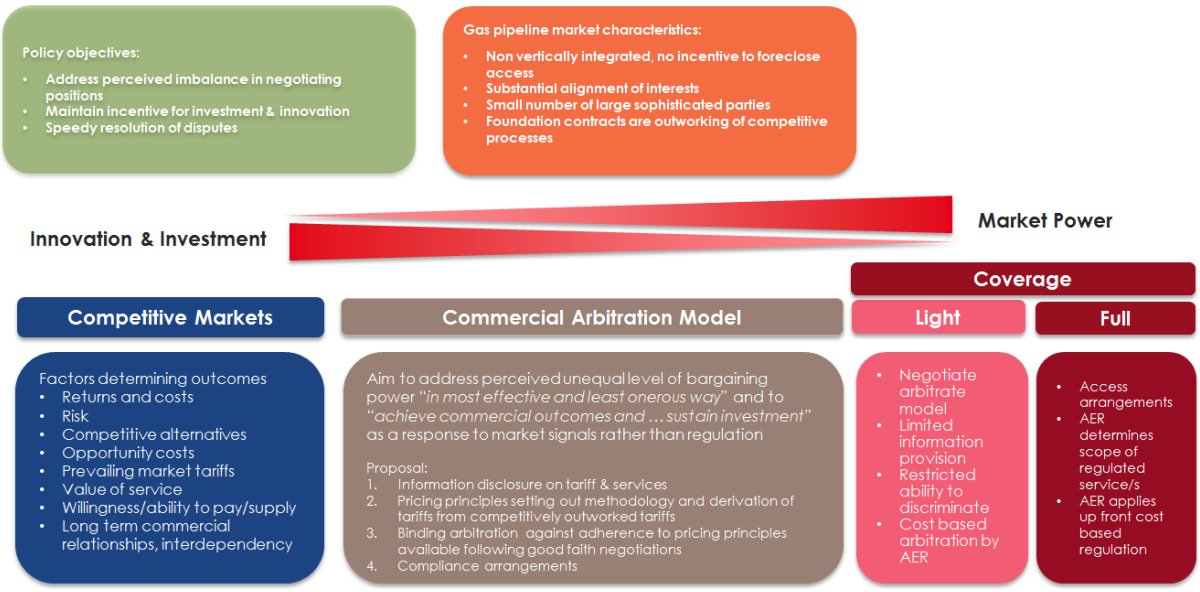
[2] Dr Michael Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, 14 December, p 90

[3] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, p 12

[4] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, p 77

Dr Vertigan is explicit in placing this proposed scheme beside the current arrangements for coverage, rather than replacing them.[5] He seeks to establish a regime for pipelines where full regulation is not justified, but which do not have all the characteristics of a fully competitive market for all the services they provide. This is best shown through a diagram setting out the spectrum of regulatory interventions appropriate to address market power concerns while preserving incentives for investment and innovation, which was Dr Vertigan's objective. This spectrum is set out in Figure 1 below. Importantly, the model to apply to non-scheme pipelines emphasises commercial negotiations, which benefits all parties to a negotiation, including smaller shippers, through the provision of information to support negotiations.

Figure 1 – Placement of commercial arbitration regime in spectrum of regulatory interventions



In particular, Dr Vertigan discusses the following policy objectives that are driving the scope of his proposed framework:

- Address perceived or actual imbalance in negotiating power between pipeliners and shippers;[6]
- Maintain incentives for investment and innovation in pipeline capacity and services;[7] and
- Expeditious resolution of disputes.[8]

To achieve these objectives, Dr Vertigan proposes increased information disclosure by pipeliners, including the publication of pricing principles as core to his proposal. In particular,

[5] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, p 91
[6] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, p 77
[7] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, pp 91-92
[8] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines*, p 90

the available information is intended to equip the access seeker with appropriate knowledge to successfully negotiate with the pipeliner with a credible threat of arbitration.[9]

Should they be unable to reach agreement, the access seeker and the pipeliner can then avail themselves of a legislated right to binding commercial arbitration. Dr Vertigan sees information disclosure and the pricing principles as the primary methods through which any negotiating power imbalance between the parties is addressed. Commercial negotiation will, then, be a backstop which is likely to be used sparingly. [10]

The draft legislation does not deliver this framework that was endorsed by the COAG Energy Council.

The remainder of the submission discusses specific elements of the draft legislation.

Comments on approach set out in the proposed legislation

Role of commercial arbitration in framework

While it would appear that the draft legislation is intended to put into effect the necessary legislative elements needed to implement Dr Vertigan's recommendations, the draft legislation focuses entirely on arbitration and its conduct. It does not contain provisions to establish the key elements of the framework, being information disclosure and pricing principles.

The Vertigan report discusses information disclosure and pricing principles (being information on the methodology for determining prices) as the foremost mechanism to support commercial negotiation. APA understands this to mean the publication of information on pricing and services for all parties, not just in relation to a negotiation or a dispute. Despite this, the legislation makes very limited reference to information disclosure or pricing principles. The pricing principles are presented as but one in a range of matters to be considered by the arbitrator, and information disclosure appears to occur primarily in the conduct of a commercial negotiation.[11]

This will not deliver the model envisaged by Dr Vertigan where information disclosure and pricing principles are the primary methods through which any negotiating power imbalance between the parties is addressed.

Scope of arbitration

APA considers that the proposed scope of arbitration, with the vast range of considerations that the arbitrator is intended to take into account, is incapable of delivering the intended expeditious commercial resolution of disputes.

As noted above, Dr Vertigan's recommendations sought to place emphasis on commercial negotiations, informed by information and pricing principles, with the role of arbitration as an effective backstop threat when those negotiations fail. Further, the intent was that arbitration would be speedy – the report states that 'the framework would be designed for expeditious resolution of the dispute with provisions to avoid delay and gaming".[12] Indeed, the

[9] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines,* p 89

[10] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines,* p 90

[11] Draft National Gas (South Australia) (Pipelines Access-Arbitration) Amendment Bill 2017 section 216F(2)

[12] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines,* p 90

effectiveness of the threat of arbitration is undermined in the absence of mechanisms to ensure speedy resolution of disputes.

APA believes that the inclusion of a broad scope of considerations for arbitration as set out in the draft legislation means that the legislation cannot achieve the policy intent of the expeditious resolution of disputes, thereby undermining its effectiveness as a credible threat during negotiations.

The draft legislation provides the arbitrator with enormous discretion. Section 216M states that the arbitrator must take into account:

- The national gas objective;
- Pricing principles specified in the rules;
- Any other principle specified in the rules; and
- Any other matter the arbitrator considers appropriate.

APA notes that the scope of the arbitrator's discretion under these arrangements for unregulated pipelines is significantly broader than the AER's discretion under NGL and NGR for scheme pipelines.

The broad ambit of considerations for the arbitrator is inappropriate in the context of commercial arbitration. The NGO is not relevant to the conduct of a commercial arbitration. The role of the arbitrator in the commercial arbitration is to decide on the matters before it, which go to the specifics of the commercial arrangement and the matters in dispute, not the broader balancing of competing policy objectives as set out in the NGO.

Indeed, the suggestion in Dr Vertigan's recommendation that structures such as 'final offer arbitration' be considered gives a clear indication that the policy intent of the arbitration regime is not for the arbitrator to consider broader policy matters, but instead to decide on the specifics of the matter before it.

Requiring the arbitrator to take account of the NGO can be expected to create considerable uncertainty of process, as well as to extend the decision making time for the arbitrator. This leads to disincentives for investment and innovation. APA assesses that the incentives for investment and innovation under the proposed arbitration regime would be poorer than those under full regulation because of the uncertainty that the scheme would create.

For the new arbitration framework to be successful in supporting commercial negotiations, investment and innovation, and in ensuring that any arbitration is speedy, the assessment criteria and powers of the arbitrator need to be clearly defined and confined to a finite set of matters.

APA considers this can be achieved by placing the emphasis on information disclosure and pricing principles to support commercial negotiation, rather than the rules and structure of commercial arbitration. Supporting commercial negotiation between the parties through information disclosure, instead of relying on arbitration to resolve disputes, benefits all parties to the negotiation, in particular smaller shippers that would not need to bear the costs of arbitration in reaching a commercial deal.

This emphasis can be achieved by linking the arbitrator's decision to whether the offer to the access seeker is consistent with the pipeline pricing principles and standard terms and

conditions.[13] This approach would put the pipeline pricing principles, and the information disclosure that accompanies them, at the centre of a scheme which retains reliance on commercial negotiation, where they operate as an effective right to access on particular terms, enforceable through the arbitration process.

Commercial arbitration arrangements that are limited to the degree to which an offer is consistent with those public pricing principles (including that any discretion in relation to the offer is appropriately and consistently applied) would deliver certainty to both pipeline operators and shippers as it provides a public benchmark for offers to access seekers, and a right for access seekers to themselves assess the appropriateness of any offer before recourse to commercial arbitration.

Model of arbitration

The COAG Energy Council agreed to implement a scheme that included commercial arbitration. Dr Vertigan recommended commercial arbitration as it would continue to deliver and support commercial outcomes and therefore sustain investment.[14]

The draft legislation, however, sets out a scheme of regulatory arbitration, based on existing access regime schemes under national electricity and gas law.[15] Regulatory arbitration schemes are fundamentally different from commercial arbitration in respect of their aims and conduct. Using a regulatory arbitration scheme as a model has meant that the draft legislation is far more prescriptive than it needs to be, and does not place adequate emphasis on the ability of the parties to reach commercial agreement.

In terms of the spectrum set out in Figure 1, the proposed arbitration scheme is in line with that which would apply at the coverage end of the spectrum where the pipeline provider has significant market power to justify full regulation. This is not the scheme intended by Dr Vertigan and agreed by the COAG Energy Council, which was to provide a right of access to a commercial arbitration scheme for pipelines that do not satisfy the coverage test, and commercial negotiation is possible with the support of increased information disclosure.

APA recommends that officials investigate existing commercial schemes as a more appropriate basis for the arbitration framework to apply to non-scheme pipelines.

Two tier arbitration

The draft legislation currently provides for a two tier approach to arbitration. Under the first tier, the prospective user or the pipeliner can notify the scheme regulator (the AER) that there is a dispute, and the scheme regulator must refer the matter to an arbitrator unless it determines that the request should not be referred by reference to a list under 216J(2). If referred, the arbitrator then determines the matter.

APA does not consider it necessary to have a two tier process for arbitration. There is no need for the AER to operate as an effective 'gate keeper' to arbitration. Instead, the arbitrator

[13] The COAG Energy Council has agreed to another stream of work to create a set of standard terms and conditions for primary and secondary contracts (COAG Energy Council 2016, Gas Market Reform Package Appendix A – Energy Council response to ACCC and AEMC's reports, response to AEMC recommendation 6, 19 August, p 4). APA anticipates that the standard form terms and conditions intended as an outcome of this process would form the basis of any offer for access to pipeline services.

[14] Vertigan 2016, *Examination of the current test for the regulation of gas pipelines,* p 91

[15] COAG Energy Council Gas Major Project Implementation Team 2017, *Gas Market Reform Bulletin, Bulletin Three*, January, p 1

can determine whether a matter is trivial, vexatious, or the other matters listed under the proposed section 216J(2).

In circumstances where the parties cannot agree to an arbitrator, as a backstop, the rules or regulations can provide for a tie breaker by reference to a body such as the Institute of Arbitrators and Mediators Australia to assign an appropriate arbitrator, as is usual in commercial arbitration mechanisms.

There are a number of advantages in having a single step path to arbitration.

The first is that a single step process provides for a faster and more streamlined path to arbitration, without the interlay of a decision by the AER, which would add considerable time to the process. The AER decision also introduces scope for judicial review proceedings if a party disagreed with the AER's decision, which could considerably delay the decision-making process.

Secondly, it brings forward the threat (and cost) of arbitration for the parties, putting more pressure on the parties to reach a commercial outcome without recourse to arbitration.

It also removes the need for prescriptive timelines and processes for seeking access and arbitration – the process would more closely mirror commercial arrangements where the parties to the dispute 'self-execute' the regime and the right to activate arbitration without third party or regulatory involvement.

No need for a rules-based process for seeking access

The legislation appears to establish a head of power for the rules to specify how an access seeker may approach a pipeliner for access, and the information that must be provided by an access seeker and a pipeliner (section 216F).

Specifying these matters in the NGL and NGR is unnecessary and intrusive; it is not the commercial approach proposed by Dr Vertigan. The ACCC, in its Inquiry into the east coast gas market, found no evidence of denial of access to pipeline services.[16] It is therefore unclear what problem these provisions are seeking to address.

Further, the vast majority of requests for new services occur between parties that already have a commercial relationship in place. Interposing a layer of bureaucracy in this relationship will only lead to delays in commercial processes and the potential for unnecessary 'administrative' barriers to seeking arbitration where these processes are not precisely followed.

Where information is not appropriately shared between parties in a negotiation, this would be relevant to the arbitrator's consideration as to whether both parties have negotiated in good faith.

Pipeliner operators have an interest in ensuring that interested parties can access pipeline capacity. APA's website contains significant detail on how to access pipeline capacity, and the terms on which capacity may be made available to existing or prospective users. It is not necessary to mandate this process in the NGL or NGR.

[16] ACCC 2016, *Inquiry into the east coast gas market*, April, p 102

No need for positive requirement to negotiate in good faith

The draft legislation includes an obligation for the parties to negotiate in good faith (section 216G). APA considers that this is an unnecessary obligation that unduly limits normal commercial behaviour, particularly where a shipper is effectively 'sounding out' the market.

APA considers it is more appropriate for this requirement to be a threshold question for access to arbitration, whereby the party seeking arbitration needs to show the arbitrator that they conducted their side of the negotiation in good faith.

Arbitration where there is competition for services

The current binding dispute resolution processes for covered pipelines (both full and light regulation) has an exclusion in relation to services that are subject to genuine competition (NGL section 187).

APA considers that this exclusion should apply equally to services subject to competition in relation to non-scheme pipelines, and should form one of the threshold considerations for the arbitrator when determining whether a referral to arbitration has merit.

Greenfields pipelines

Greenfields pipelines are carved out of the coverage regime through the operation of the 15-year no coverage decision available under the NGL. This carve out is intended to stimulate investment in greenfields developments, specifically recognising that these types of investments are subject to competition and are inherently risky.

To ensure a consistent recognition of these competitive pressures and market risks, APA believes a similar carve out should be given to greenfields projects from the arbitration regime.

Application of arbitration regime to contract variations

Section 216F(1)(b) of the draft legislation appears to extend to arbitration regime to apply to contract variations without exception.

This is not acceptable.

Extension of arbitration powers to contract variations allows a user to effectively reopen a contract and its terms to arbitration after agreement. This would fundamentally undermine investment incentives and certainty for pipeline investment.

The proposed scheme should not apply to matters that are already dealt with under an existing contract. For example, if a contract provides a process for adding a new delivery point to a contract, or for extending a contract, then a shipper should not be able to seek arbitration on these matters – the prevailing contract arrangements apply.

Further, contracts for infrastructure provide for dispute resolution in the event that the parties are unable to reach agreement on matters which arise under the contract. The mandated arbitration regime should not supercede or displace this contractual dispute resolution mechanism.

Further, the commercial arbitration regime should not vary or override a pre-existing contractual right.

Pricing principle and arbitration model legislative framework

APA considers that the proposed legislation does not strike the right balance in respect of the provisions proposed to be included in legislation, those in rules, and in individual pricing principles.

APA considers that the legislation should establish the rights of parties to commercial arbitration and the heads of power for the National Gas Rules. The Rules should include specific information disclosure requirements for pipeliners, the requirements for individual pipeliner pricing principles, and necessary rules associated with the selection of a commercial arbitrator.

Individual pipeliner pricing principles must be consistent with the Rules and published by the pipeliner, along with other information required under the Rules in respect of the published pipeliner standing offers. Individual customer offers can vary from the standing offer in ways described under the pipeliner's pricing principles.

The role of the commercial arbitrator is to determine individual offers to shippers, by reference to the public pipeliner pricing principles. This includes determining whether any discretion in relation to the offer is appropriately and consistently applied, and determining (where necessary) how any discretion should be applied.

The role of the scheme regulator is limited to its current compliance and enforcement function in respect of the NGL and NGR, rather than being an approval body or a decision maker under the scheme. This approach matches the intent of the regime as setting up rights under commercial arrangements, that are effectively self-executing and complying as they apply between the parties.

APA also considers that there is a role for an independent auditor in the scheme. The role of the auditor is to assess and confirm that a pipeliner's standing offers are an accurate outworking of the application of the pipeliner's pricing principles. APA envisages that the auditor would be privately appointed by the pipeliner (potentially from a panel approved by the AER), similar to the approach taken by the ACCC in respect of section 87B undertakings under the Competition and Consumer Act.

This pipeline principle and arbitration model framework is set out in Figure 2 below.

Figure 2 – Pricing principle and arbitration framework