Santos GLNG

3 November 2017

Gas Market Reform Group
c/o Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

(via email: enquiries@gmrg.coagenergycouncil.gov.au)

RE: DRAFT FINANCIAL REPORTING GUIDELINES FOR NON-SCHEME PIPELINES – CONSULTATION PAPER

GLNG Operations Pty Ltd (**GLNG**) welcomes the opportunity to provide the following submission in respect of the *Draft Financial Reporting Guidelines for Non-Scheme Pipelines* (**the Draft Guidelines**) released by GMRG on 9 October 2017.

GLNG acknowledges the rationale for both National Gas Rules (NGR) Part 23 and the Draft Guidelines which aims to facilitate access on reasonable terms to services provided by non-scheme pipelines, with a key component to provide prospective users of non-scheme pipelines with increased information to reduce the potential imbalance in bargaining power.

The Draft Guidelines seeks to address this through publishing representative financial information whilst looking to limit additional reporting, where the consultation paper seeks comments to address areas where this can be improved.

GLNG recommends the following amendments to the Draft Guidelines and related templates and processes consistent with the objectives of NGR Part 23 and the Draft Guidelines:

- ***Overall exemption of pipeline assets that service a single facility consistent with Day-ahead Auction:***

  GLNG strongly recommends, consistent with the preliminary view of the GMGR consultation on the Day-ahead Auction, that there would be little value in subjecting pipeline assets that service a single facility to the Day-ahead Auction. GLNG therefore similarly strongly recommends these facilities would be exempt from the Draft Guidelines, where publication of the financial data for these facilities would not add value to the market.

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- ***Section 1.4 Definitions: Clarification of responsible entity***

The Rules define a 'service provider' to mean any person who owns, controls or operates a pipeline. In the context of the obligation in to publish information according to the Guidelines in Rule 552(1) this definition creates uncertainty where there are multiple service providers for a single non-scheme pipeline (as is commonly the case in joint ventures).

The uncertainty stems from the following aspect of the Guideline:

1. There is a definition of 'reporting entity' that limits the obligation to publish financial statements in section 3 of the Guideline to only one service provider, but does not apply to the other sections.

2. Section 4, 5 and 6 of the Guidelines also include publication obligations. These obligations apply to particular financial reports (sometimes also referred to as 'statements'), and the Guidelines expressly state that a single set of financial statements are to be reported for each non-scheme pipeline 'even if there is more than one service provider'. However, there is no provision equivalent to the one in section 3 of the Guidelines that limits the obligation to publish the template reports to a single service provider.

3. The objectives of the Guidelines would be met if only one service provider entity publishes the required financial reports, and it is in the interests of all persons (particularly prospective users) that there be only one source of the relevant reported information to avoid the risk of a discrepancy between two or more sources.

GLNG recommends that it be stated in each relevant section of the Guidelines (or in section 1 of the Guidelines in a manner that is applicable to all relevant sections) that the obligation to publish financial reports or other information will be satisfied by the publication of the information by a single service provider, being the operator of the pipeline particularly if there is a joint venture arrangement (a concept that is employed, for example, in the case of bulletin board reporting by pipeline operators).

- ***Section 3 Entity Financial Statements [Box 3.2]: Unrepresentative if combined with significant/ multiple non-pipeline assets***

Qu1. What existing entity level financial statements are prepared by service providers?

Where the non-scheme pipeline is a non-core business, the reporting information available through audited entity financial statements would typically cover several different asset types combined. In this case, the pipeline is potentially only a minor component of the financial statements.

Qu3. Are service providers likely to face any challenges publishing entity level financial statements?

GLNG highlights the potential limitations of publishing entity level financials, where the direct owner also holds significant and/ or multiple non-pipeline assets. The value of the financial statements are significantly reduced and potentially distorted as a method of determining the validity of the standard pricing on offer for the pipeline services. It is for this reason GLNG recommends where the reporting entities audited accounts contain significant and/ or multiple non-pipeline assets, the entity financial statements are not required to be published.

Similarly, this is compounded where there are multiple entities with a large interest. The information then available to the potential shipper is severely limited in value, when considering the negotiation of price and non-price terms.

- ***Section 4 Pipeline Financial Statements [Box 4.1] – Interest and Tax: Limitations on benefits if Joint Venture operated, so total of all parties***

Qu8. Income Statement - Should interest expense and tax expense be required to be included in the pipeline income statement?

For the situation where a pipeline is operated under a joint venture, GLNG contends that interest and tax expenses are not material to informing shippers' understanding of their negotiation position and the difficulties in allocation outweigh the potential benefits.

The issues in providing tax and interest information where the pipeline is operated under a joint venture stem from the pipeline asset being held in the separate balance sheets of the individual partner companies. Under this circumstance, it is often the case that the pipeline is a non-core asset and may be represented as only a minor element of the company's balance sheet which covers multiple unrelated non-pipeline assets with tax and interest expenses covering the total company business and not identifiable for the specific pipeline. Extracting tax and interest expenses for a specific pipeline for each partner that owns the pipeline is not possible given their other assets.

- ***Section 4 Pipeline Financial Statements [Box 4.1] – Liabilities and Equity: Limited benefits if operated by Joint Venture hence total of all parties***

Qu10. Balance Sheet - Should liabilities and equity be disclosed in the pipeline balance sheet?

GLNG recommend that liabilities and equity are not disclosed as the critical information to a shipper's negotiation position is already available via the Income Statement with cost of liabilities.

- ***Section 4 Pipeline Financial Statements – Joint Venture Operated: Limited benefits if operated by Joint Venture, hence total of all parties***

Qu13. Is it feasible to report pipeline financial information in the event the pipeline is owned by multiple service providers (e.g. through a joint venture)? If so, what process do you suggest is used to identify the service provider responsible for publishing pipeline financial information?

For the situation where the pipeline is operated under a joint venture, GLNG considers there is limited value for shippers in their preparations for negotiations in having the Pipeline Financial Statements prepared by one entity, particularly where there are multiple parties with a material interest in the pipeline.

GLNG recommends given the key elements for negotiation are gained from the income statements, these could be developed based on the total of the parties with an interest in the pipeline.

The balance sheet information is more challenging due to separate entities treatment of the asset and funding mechanisms utilised. GLNG's recommendation is that the balance sheet is not a mandatory reporting item for joint venture operated pipelines due to the limited value in individual reporting and the secondary value of the information to shippers.

- ***Section 4 Pipeline Financial Statements – Financial Metrics: Limited benefits if operated by Joint Venture, hence total of all parties***

  GLNG maintains that similar to Pipeline Financial Statements where a Joint Venture operates the pipeline, there is limited value in completing Financial Metrics on a single entity basis where there are multiple parties with an interest in the pipeline. Hence GLNG recommends that Financial Metrics are only completed on the Pipeline Financial Statements where these are based on a total of all parties.

- ***Section 4 Pipeline Financial Statements [Box 4.3] – Financial Metrics: Only return on assets***

Qu23.Should the pipeline statements (performance metrics) show the return on equity for the pipeline, or is it sufficient to show the return on assets only? What benefit could shippers derive from understanding a pipeline's return on equity?

The return on equity calculation for a joint venture operated pipeline would be distorted given that the participating owners deal with their tax matters separately and each would have differing tax circumstances. In this respect, the more relevant driver for negotiations on price and non-price terms will be Return on Assets (EBIT). Hence, GLNG suggests the key elements for negotiation are gained from the return on assets rather than return on equity, particularly with the complexities of a Joint Venture operated pipeline although in the case of Joint Venture the return on asset may require guidance as discussed below.

- ***Section 5 Asset valuation in accordance with rule 569(4) [Box 5.1]:***

Qu27. If estimates are permitted:

- How reliable do you think the estimates are likely be and is there a risk that this information could be misleading to shippers?

In consideration of the asset valuation methodology, GLNG highlights that in the case of joint venture ownership of a pipeline asset, particularly where this is a minor non-core part of its business and where the pipeline is primarily for own use, the Return of Capital calculation as it is currently provided will be difficult or impossible to apply. In a joint venture case where the pipeline is an incidental part of the business, specific tax and liabilities will not be possible to identify for the pipeline asset that are required for the Return of Capital calculation.

Further each joint venture partner may have differing Return on Capital requirements which will be based on their base business rather than the pipeline which may form a necessary part of their business but does not drive the overall risk profile and investment return requirements. Additionally it may be impossible to differentiate the actual return gained on that particular pipeline asset as the majority of the capacity may be for own use and not providing a revenue stream.

In the described circumstances the required Return on Capital and the tax liabilities may either not be relevant or may be impossible to calculate for the pipeline asset. Therefore the formula for Recovered Capital Method requires some key elements that are not available when the pipeline is operated under a Joint Venture arrangement and where the pipeline is a non-core asset ie within a balance sheet combined with other assets.

GLNG asserts that greater clarity is required from the GMRG/ AER as to how the Return of Capital calculation can be applied to broader pipeline ownership models including joint venture ownership, non-core incidental and largely own use cases. The GMRC and/ or the AER should develop and publish principles and potentially standard assumptions for use of the formula for Recovered Capital Method to assist pipeline owners under various circumstances including that described above.

GLNG considers that broadening of the application of Draft Guidelines to certain Entities Financial Statements beyond Pipeline Financial Statements where there are significant or multiple non-pipeline assets will not provide material benefit to the market.

GLNG maintains where the party is operated by a joint venture the Pipeline Financial Statements should be limited to Income Statements, where all Pipeline Financial Statements are based on a total of the entities with an interest in the pipeline. GLNG considers that the amendments recommended in this submission are consistent with National Gas Objective and the COAG Energy Council's Australian Gas Market Vision.

We would welcome the opportunity to discuss these recommendations ahead of the implementation of the Financial Reporting Guidelines. Please contact Vanessa Taylor from GLNG via email on Vanessa.taylor@glng.com or via telephone on (07) 3838 3009.

Yours sincerely,

Rod Duke
Chief Executive Officer
GLNG Operations Pty Ltd