Response to the GMRG Information Disclosure and Arbitration Framework Initial Draft Rules – July 2017

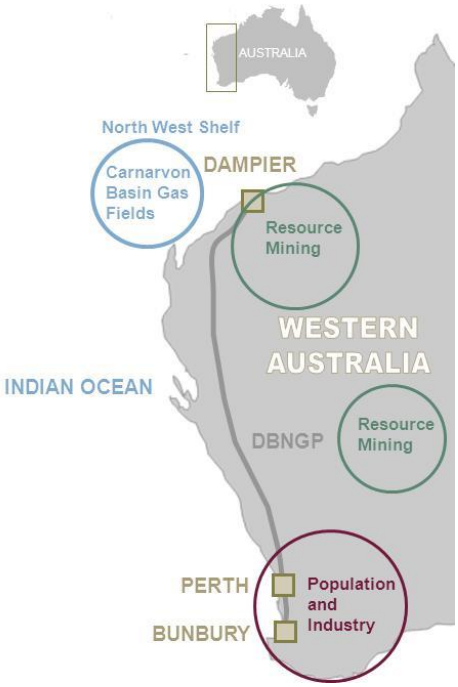
Date Submitted: 20/07/2017

DBP Transmission (DBP) is the owner and operator of the Dampier to Bunbury Natural Gas Pipeline (DBNGP), Western Australia's most important piece of energy infrastructure.

The DBNGP is WA's key gas transmission pipeline stretching almost 1600 kilometres and linking the gas fields located in the Carnarvon Basin off the Pilbara coast with population centres and industry in the south-west of the State.

DBP Development Group (DDG) is the group of entities that builds owns and operates new gas transmission pipelines and other associated infrastructure leveraging off the world class pipeline engineering and operating skills of DBP's management team. Since its inception in 2011, DDG has invested more than $300m in the construction of three new transmission pipelines

AGN is one of Australia's largest natural gas distribution companies and owns approximately 25,000 kilometres of natural gas distribution networks and 1,100 kilometres of natural gas pipelines, serving over 1.2 million consumers in South Australia, Victoria, Queensland, New South Wales and the Northern Territory.



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1. INTRODUCTION

DBP Transmission (**DBP**) is the owner and operator of the Dampier to Bunbury Natural Gas Pipeline (**DBNGP**), Western Australia's most important piece of energy infrastructure. The DBNGP is WA's key gas transmission pipeline stretching almost 1600 kilometres and linking the gas fields located in the Carnarvon Basin off the Pilbara coast with population centres and industry in the south-west of the State. Since acquiring the DBNGP in 2004, DBP has expended over $1.8bn in expanding the capacity of the DBNGP, resulting in a 60% expansion in capacity over that time.

DBP Development Group (**DDG**) is the group of companies that builds owns and operates new gas transmission pipelines and other associated infrastructure leveraging off the world-class pipeline engineering and operating skills of DBP's management team. Since its incorporation in 2011, DDG has already invested approximately $300m in constructing three uncovered, open access gas transmission pipelines in the Pilbara, being:

- The Wheatstone Ashburton West Pipeline, a 123km pipeline which connects the Chevron operated Wheatstone Domestic Gas Processing Plant with the DBNGP. Construction of this pipeline was achieved in February 2015;
- The Fortescue River Gas Pipeline, a 274km pipeline which allows for the delivery of gas from the DBNGP, initially to Fortescue Metals Group's iron ore operations at the Solomon Hub. Construction of the FRGP was completed in March 2015; and
- The Ashburton Onslow Gas Pipeline, a 30km pipeline which will allow for the delivery of gas from both the Wheatstone gas plant or the DBNGP to generate electricity for the town of Onslow. Construction of this pipeline was completed in June 2016.

Australian Gas Networks (**AGN**) is one of Australia's largest natural gas distribution companies. AGN owns approximately 25,000 kilometres of natural gas distribution networks and 1,100 kilometres of natural gas pipelines, serving over 1.2 million consumers in South Australia, Victoria, Queensland, New South Wales and the Northern Territory.

DBP, on its own and on behalf of DDG and AGN, appreciate the opportunity to respond to the Gas Market Reform Group's (**GMRG**) *Gas Pipeline Information Disclosure and Arbitration Framework Initial National Gas Rules* (**Draft Rules**). DBP has been an active participant in the consultative process with respect to the review

DBP notes that on Friday 14 July, the Federal, State and Territory energy Ministers agreed to implement the information disclosure and commercial arbitration reforms and for these reforms to take effect on 1 August 2017, a month ahead of what was already a very ambitious implementation date. Gazettal and implementation will come only days after stakeholders have the opportunity to make submissions on the draft rules. We think there are matters to be addressed in the draft rules as they currently stand and hope that speedy implementation does not get in the way of proper process.

This submission does not intended to debate the GMRG's final design now endorsed by the Standing Council of Officials. DBP does however see that there are a number of drafting related issues that it wishes to bring to the attention of the GMRG. These include:

- Uncertain relationship with the proposed objective, the National Gas Objective and operation of the pricing principles;
- The need for the regulator's significant discretions in providing exemptions, the ability to prescribe methods and approaches in the financial reporting guidelines and the lack of guidance given to the regulator in maintaining a pool of suitably qualified commercial arbitrators;

- Other issues including the requirement to reserve capacity subject to an arbitration, the lack of clarity for service providers who may be required to fund augmentation and potential for inconsistences to arise between the timing agreed for further investigations and the requirement to make an offer;
- Interpretation of the transitional provisions and the ability to request information that the service provider has not been afforded sufficient time to prepare.

2. OVERARCHING ISSUES

This section of the submission contains our key concerns with the proposed Draft Rules and provides some recommended solutions. Where we have suggested solutions we have done so with the express aim of implementing the GRMG's Final Design in a way that seeks to avoid unintended consequences.

The proposed objective and pricing principles

Draft National Gas Rule (**NGR**) 546 sets out the proposed objective of Part 23 of the NGR. This objective is to be taken into account by the arbitrator when determining an access dispute.[1]

What is unclear is how this objective is to operate in a manner that is consistent with the National Gas Objective (**NGO**) in section 23 of the National Gas Law (**NGL**). The latter objective is much more focussed on the achievement of efficient outcomes resulting in the lowest possible prices for end consumers. Such an objective would appear to be potentially inconsistent with the proposed objective in rule 546 which seeks to achieve "reasonable" outcomes which would permit service providers to earn a commercial rate of return.

In order to achieve the objective of setting a price that reflects the outcomes of a workably competitive market, the primary pricing principle the arbitrator is to take into account is set out in NGR 569(2)(a). The price for a pipeline service is to reflect the cost of providing that service, including a commercial rate of return that is commensurate with the prevailing conditions in the market for funds and reflects the risk the service provider faces in providing the pipeline service. The arbitrator is required to determine the value of any assets in the provision of the pipeline service having regard to asset valuation techniques consistent with the objective set out in NGR 546(1).

This requirement introduces four separate concepts, being:

- cost of providing the service;
- commercial rate of return;
- prevailing conditions in the market for funds; and
- risks faced by the service provider.

These concepts give rise to some difficulties, including:

- What is the relevant measure of cost that will be adopted when ascertaining the cost of providing the service?
- What is meant by a commercial rate of return?
- The prevailing conditions in the market for funds will underestimate what the service provider is likely to assess as being the risks it faces which it ought to be compensated for.

Having said that, it is relatively clear that the price of the service will not be the short run marginal cost of providing the service, and is more likely to reflect the owners long run marginal costs. If there is uncertainty that this is the outcome that is sought to be achieved, the issue should be clarified.

DBP favours the alternative version of paragraph (a) of NGR 569(2) so as to provide the arbitrator with greater guidance as to how to apply the pricing principles.

[1] *Rule 569(1) of the NGR.*

Operation of the Pricing Principles

Draft NGR 569 contains the proposed pricing and other principles. As it is currently drafted, NGR 569 sets the pricing principle as the primary focus by specifying those principles as matters that the arbitrator must take into account (subrules (2) and (3)) and then specifying other factors to which the arbitrator may also have regard (subrule (4)).

Subrule (4) also states that the arbitrator may have regard to the matters set out there in "where not inconsistent with subrules (1) to (3)".

This drafting approach is quite peculiar. It is difficult to see how having regard to something could be seen to be inconsistent with an earlier provision. This is particularly the case, where the latter provision merely permits the arbitrator to "have regard to" the specified matters. Having regard to something does not require the arbitrator to make a determination that is consistent with those matters. For example, it is unlikely that an arbitrator could make a determination that both achieves "the legitimate business interests of the service provider" as well as "the interests of all persons who have rights to use the pipeline".

Further, the current drafting would allow the arbitrator to make a determination that is inconsistent with the operational and technical requirements necessary for the safe and reliable operation of the pipeline.

For these reasons, and to ensure the rule is consistent with similar provisions in other regulatory contexts,[2] DBP would recommend rule 569(1) - (4) be redrafted as follows:

(1) When making a determination under this Division the arbitrator must take the following matters into account:

(a) the objective of this Part;

(b) the pricing principles in subrules (2) and (3) where the price of access to a pipeline service on a non-scheme pipeline is in dispute;

(c) the legitimate business interests of the service provider;

(d) the interests of all persons who have rights to use the pipeline;

(e) the value to the service provider of any extension or expansion of the pipeline the cost of which is borne by another person;

(f) the value to the service provider of interconnections to the pipeline the cost of which is borne by another person; and

(g) the operational and technical requirements necessary for the safe and reliable operation of the pipeline.

(2) The pricing principles are that the price of access to a pipeline service on a non-scheme pipeline must:

[2] For example, see section 44X(1) of the *Competition and Consumer Act 2010* (Cth).

(a) reflect the cost of providing that service, including a commercial rate of return that is commensurate with the prevailing conditions in the market for funds and reflects the risks the service provider faces in providing the pipeline service; and

(b) be no higher than the price that the service provider has offered for providing the pipeline services and no lower than the price that the prospective user has offered to pay for use of the pipeline service, each pricing having been specified in the applicable statement given under rule 567(3).

(3) For the purposes of paragraph (2)(a):

(a) the value of any assets used in the provision of the pipeline service must be determined as if the pipeline were a covered pipeline, with the asset value to be determined as follows:

(i) if the non-scheme pipeline was commissioned before 1 July 2008, in the manner provided for in rule 77(1)(a);

(ii) if the non-scheme pipeline was commissioned after 1 July 2008, in the manner provided for in rule 77(1)(b); or

(iii) if the non-scheme pipeline has previously been subject to an access arrangement, in the manner provided for in rule 77(3).

(b) when applied to a pipeline service that when used affects the capacity of the non-scheme pipeline available for other pipeline services and is priced at a premium or a discount to the price for a firm haulage services on the relevant non-scheme pipeline - the premium or discount must:

(i) take into account and opportunity cost or benefit to the service provider of providing the pipeline service, having regarding to any effect on the cost of providing firm haulage services or the capacity of the non-scheme pipeline; and

(ii) be consistent with the price for the pipeline service providing a reasonable contribution to joint and common costs.

Shipper incentives created by draft rule 569(3)

Draft NGR 569(3) requires that the arbitrator choose a tariff between the offer of the service provider and the offer of the shipper, with the former being the upper and the latter being the lower bound.

From an economic perspective, this is inconsistent with how efficient prices are found in a workably competitive market. An efficient price will lie between the willingness to pay on the part of a shipper as an upper bound and the willingness to supply on the part of the pipeline as a lower bound, which can be shown as a demand and supply curve.

Noting that each shipper is likely to have different levels of willingness to pay, and the price of the marginal consumer matches the marginal willingness to serve on the part of the shipper, then economic efficiency would be achieved. The point between the supply curve and each shipper's willingness to pay (i.e. – where it sits on the demand curve) at which each price sits represents how the consumer and producer surplus is divided, all points being efficient. Since efficiency is what workably competitive markets are supposed to determine, this would be in keeping with the objectives of the Draft Rules but inconsistent with the drafting of NGR 569(3) which constrains the arbitrator to only consider a price which can be supported by a cost of service model.

If the net effect of NGR 569(3) limits the scope of the objective in NGR 546 then we are of the view that this is likely to cause gaming and provides an incentive for shippers to offer the lowest conceivable tariff under the new framework (and probably for the pipeline operator to do the opposite). The effect will be that commercial arrangements will not be reached and arbitration will become the norm. DBP recommends that subrule (3) of NGR 569 be omitted. We however acknowledge the GMRG's Final Design has concluded that the arbitrator's price determination is required to be cost reflective.

Discretions afforded in providing exemptions

Division 6 of the Draft Rules sets out the rules relating to the application of the exemptions under the Chapter. The Draft Rules provide for an exemption regime that encompasses the following elements:

- a service provider for a non-scheme pipeline must apply to the AER for the relevant exemption (i.e. Category 1 - 3);
- the AER may grant an exemption where the applicant service provider has demonstrated to the reasonable satisfaction of the AER that the non-scheme pipeline satisfies the applicable exemption criteria and the AER is otherwise satisfied that in all the circumstances the exemption should be granted;
- the AER will establish, publish and maintain a register of exemptions and exemption revocations;
- a service provider for a non-scheme pipeline for which an exemption has been granted must notify the AER of any change in circumstances affecting the non-scheme pipeline's eligibility for the exemption;
- any exemption granted by the AER may be granted subject to conditions as determined by the AER and such conditions may be varied, including at the AER's own initiative; and
- the AER may revoke an exemption where in its reasonable opinion, the relevant exemption criteria is no longer satisfied.

The proposed exemption regime is needlessly complicated and unnecessary. It establishes an intrusive regime by imposing additional obligations and costs on both service providers and the AER.

The same intended result is far more easily achievable by drafting the rules in the usual manner of imposing the relevant statutory obligation on a person and then providing that the obligation does not apply to a person in certain specified circumstances. It is then up to the person to determine whether the statutory obligation applies to them or whether they fall within the relevant exemption. To the extent that the primary statutory obligation (i.e. to disclose relevant information or participate in a prescribed negotiation/arbitration process) is classified as a conduct provision under the NGR, pipeline operators will have a clear incentive to comply with the rules.

The only other circumstances under the NGL where a service provider might apply for an exemption from the application of the law is where:

- a service provider applies to the AER in accordance with section 146 of the NGL for an exemption from the ring fencing requirements imposed under sections 139 - 141 of the NGL;
- a service provider applies for a 15-year no-coverage determination under Chapter 5, Part 2 of the NGL; or
- a service provider applies for a price regulation exemption under Chapter 5, Part 3 of the NGL.

However, those circumstances could hardly be said to be similar to what is proposed here under the draft rules. In two of the cases highlighted above, the service provider makes their application to the National Competition Council which then makes a recommendation to the relevant Minister as to whether the application should be granted. The Minister then makes the decision on the service provider's application.

It has not been sufficiently demonstrated why a service provider should be required to apply for an exemption, particularly, where the AER is given a broad discretion to refuse to grant an exemption even if the non-scheme pipeline otherwise satisfies the relevant exemption criteria. The Explanatory Note suggests that it is necessary for the AER to maintain a residual discretion on the granting of exemptions to address the concern that pipeline operators might be able to circumvent the new framework by restructuring their business and only selling transportation services to related parties who then supply end users.[3]

There is no reason why a residual discretion is necessary in order to safeguard that sort of conduct occurring. Even in relation to the ring fencing exemption referred to above, the AER is not provided with any residual discretion. Rather, it is required to grant the application for an exemption where the relevant criteria is satisfied.[4] Instead, the rules can expressly set out the circumstances in which a pipeline operator of a non-scheme pipeline will be exempt from complying with the relevant information disclosure or other obligations. Such rules could be drafted so as to prevent pipeline operators that enter into the contemplated arrangements from being able to rely on the relevant exemption.

Financial Reporting Guidelines

The financial information for a non-scheme pipeline is required to be published on the service provider's website under NGR 555(1)(a) and must be in a form and contain the information specified in the financial reporting guidelines.

Page 25 of the Explanatory Note states that the once an asset value has been set by the arbitration the GMRG expects that the financial guidelines will require the financial information provided by the service provider will need to reflect the determined asset value (of which there will be transparency of in accordance with NGR 581 and be updated annually). Further, we note that on page 35 of the Explanatory Note the GMRG comment that the financial reporting guidelines will be binding on service providers, but the arbitrator will not be bound to have regard to the information or methods used by the service provider. This may create a tension where the AER requires a certain asset base methodology prescribed in the financial reporting guidelines but the service provider is also required to report the asset value handed down by an arbitrator who is not bound by the methods prescribed by the financial reporting guidelines.

Rule 556(2)(ii) and (iii) allows the AER to determine the methods, principles and inputs concerning those matters specified. Whilst the Arbitrator would not be bound to follow those methods or principles, no doubt the Guidelines will considerably influence the Arbitrator. We are of the view that this will likely lead to further regulatory practices being applied to non-scheme pipelines. As the guidelines are intended to be binding and act more like rules rather than guidelines we suggest it more appropriate for the AEMC to review rather than the scheme regulator.

We are also of the view that while the AER will be required to follow the standard consultative procedure under NGR 8 this will only be required to be followed for amendments. While we acknowledge that the GMRG is on a very compressed timeline for the new framework to be adopted we support the AER following the standard consultative procedure in the first instance. As the reporting guidelines are key to informing the reasonableness of the information, the development process should not be rushed,

[3] *GMRG, Gas Pipeline Information Disclosure and Arbitration Framework: Initial National Gas Rules Explanatory note for stakeholder consultation, June 2017, p 33.*

[4] *See rule 31 of the NGR.*

particularly where the outcome of the first arbitrations carry significant weight given the GMRG has decided to publically publish asset values decided by the arbitrator.

If the alternative more detailed drafting of rule 569(2)(a) is adopted, rule 556(2) will need to be amended, to some extent, as the method of determining the value of assets will be specified in the rules.

Finally, we are of the view that the publication of asset value determined by the arbitrator is an unnecessary requirement considering it will be calculated and audited consistently with the binding AER financial reporting guideline.

3. OTHER ISSUES

Reservation of capacity subject to arbitration

At the bottom of page 29 of the Explanatory Note the GMRG states that the service provider will need to manage the risks associated with selling capacity that is the subject of an access dispute during the course of the access dispute. This position is said to be consistent with the existing arbitration process with Section 216N of the NGL for regulated pipelines which protects capacity contracts with other users only if they are in force before the access dispute notice is given. We note that proposed National Gas Law 216N protects existing contractual rights but does not explicitly allow a pipeline operator to sell the capacity subject to arbitration.

However, the practical effect is likely to be that pipeline operators will be required to reserve or quarantine the capacity subject to arbitration. Where a pipeline is close to being fully contracted, that is likely to be problematic and could allow shippers to game the process by blocking competitors from access to capacity noting that the result of an arbitration process is not binding on the shipper.

While in the case of pipelines with spare capacity over and above the requirements of prospective shippers this is not likely to be a problem, DBP is of the view that there may be instances where it is in the legitimate business interests of the service provider to enter into a contract for capacity that is subject of arbitration. The Arbitrator should in this instance have the discretion to either terminate the arbitration process or proceed on the basis the capacity requires augmentation or expansion of the pipeline. This would be consistent with the objective which speaks of a commercially-orientated arbitration process and pricing principles that include the legitimate business interests of the service provider.

Inconsistency between NGR 559 and 560

DBP is of the view that there is inconsistent drafting between NGR 559(6)(c) where the service provider and shipper can in good faith agree to terms and conditions on which further investigations are to be carried out and the requirement to make an offer. As it is conceivable that both parties could agree to investigations that may take longer than 60 days it therefore seems unreasonable and inconsistent to require the service provider to make an access offer within 60 days of receiving the access request under NGR 560(1)(b), particularly where that provision is classified as a civil penalty provision. Further, NGR 560(3)(b) allows for the service provider to decide not to make an access offer where after further investigations are required (which if agreed by both parties can be longer than 60 days) and can result in no offer being made if the service provider has concluded that it is not technically feasible or consistent with the safe and reliable operation of the pipeline to provide the pipeline service requested.

Qualifications of the arbitrator

There are no criteria as to the qualifications a commercial arbitrator must have in Rule 583(1). Specific guidance should be given to the AER on what a suitably qualified and experienced commercial arbitrator is within the final version of the rules.

Shipper funded activities referred to in NGR 570(d)

The rule should make clear that the shipper must fund the activity up front, without recourse to the service provider. If the intent of NGR 570(5)(b) is that the activities listed in NGR 570(3)(d) will not proceed unless funded upfront by the user unless agreed by the service provider it should be made clear. We note that existing NGR 104(3) expressly excludes the service provider from the requirement to provide funds for work involved in making an extension or expansion on regulated pipelines unless it agrees.

4. TRANSITIONAL ISSUES

The arbitration mechanism is to commence on 1 September 2017[5], 5 months before any information is required to be disclosed by the pipeline owners. Due to the lack of financial information that will be available in the transitional period, GMRG is proposing that the arbitrator be empowered to "request parties to provide **any additional information** that it requires to apply the pricing principles and making a determination, including cost and financial information".

The Explanatory Note (footnote 27 on page 35) states that "*while the pipeline operator may not be in a position to provide information specified in the AER's guideline, it should still be in a position to provide the arbitrator with the information it requires to apply the pricing principles*".

In the Explanatory Note the GMRG foreshadows the following process/transitional rights to be granted during the transition phase:

- a fast track arbitration could apply, which would waive the requirement for shippers and pipeline operators to comply with any requirements in Stages 1 and 2 of the framework;
- The arbitrator would likely be required to request potentially significant additional information from parties to apply the arbitration principles in the absence of the information published in Stage 1 and the exchange of cost and other relevant information in Stage 2; and
- More time may also be required for the determination to be made.

The term "any additional information" is extremely broad. We assume however, that this is qualified by footnote 27, and should read down to "*information the arbitrator reasonably requires to be able to apply the pricing principles*".

There is much uncertainty around the proposed transitional framework. DBP proposes that while applications for arbitration may be submitted from commencement of the legislation on 1 September or earlier, no arbitrations should be heard until after the base level information is first published on 1 February 2018. This is because:

- There is a great deal of uncertainty as to the level of information that the arbitrator has the power to request;
- The GMRG acknowledges that the information that could be requested by the arbitrator could be "potentially significant", accordingly:
    - there could be disputes about the extent of information requested by the arbitrator if, in the view of the pipeline operator, this goes beyond what is required for the pricing principles;
    - pipeline operators will need to ensure that they comply with confidentiality obligations to their existing customers in responding to requests for such information;
    - Dealing with responses to information requests in an arbitration will divert resources from preparation of the information required to be presented at 1 February 2018;
    - If the extent of the information required by the arbitrator during the transitional phase is the same as that to be produced as at February 2018, it is likely that collation the information required by the arbitrator will take a reasonable amount of time, potentially months to put together;

[5] *As outlined by the Explanatory Note however we note that the COAG Energy Council as mandated the rules are required to commence 1 August in a recent communique. We are unclear if this is possible but would further acerbate identified transitional issues.*

- 5 months is a relatively short timeframe in a dispute resolution process. Should an application for access to a pipeline be made on or after 1 September 2017, the intervening period gives the parties time to reach a commercial resolution without the need for arbitration, with the threat of arbitration commencing on and from 1 February should the parties fail to negotiate mutually acceptable arrangements prior to that time.
- There is no timeframe for the arbitration to take place within during the transitional phase and the pipeline operator is likely to need time to collate the information requested;

It is unreasonable to expect that a pipeline operator will have all the information ready to properly participate in an arbitration on the pricing principles from 1 August or 1 September 2017.

This is of high consequence as the first arbitration on each pipeline will have the additional requirement of forcing the first publication of asset valuation by arbitration. Whilst the asset valuation may be subject to change in the future, the published value will have extra weight.

In addition, the commencement of the new rules from 1 August 2017 will cause the requirement that pipeline operators publish the following information for non-scheme pipelines to be brought forward one month from 1 February 2018 to 1 January 2018:

- pipeline information specified in rule 553(2);
- pipeline service information specified in rule 553(3); and
- standing terms specified in rule 554.[6]

DBP is concerned that the bringing forward of the date (by one month) of when pipeline operators of non-scheme pipelines will be required to publish this information will not allow pipeline operators sufficient time in which to have their internal arrangements in place in order to comply with the new rules from that date onwards. In the circumstances, DBP does not consider that postponing these publication requirements by one month, to 1 February 2018, will cause any material detriment to prospective access seekers, particularly as they were until only recently proposed to commence on that date.

[6] Rule 552(2) of the NGR.

5. RESPONSE TO QUESTIONS

The following provides our response to the GMRG's specific questions set out in Section 2.8 of the Explanatory Note.

1. **Are the information disclosure obligations of service providers in Division 2 sufficiently clear and can they be complied with by both transmission and distribution pipelines? If not, what changes could be made to clarify the information disclosure obligations?**

We make the following observations in regards to the requirements of Division 2:

- The requirements for monthly service information is too onerous. DBP asks the GMRG to consider the benefit of this information being made available on a monthly frequency. Similarly, the requirement for monthly updates for service availability for the forward 36 months is unnecessarily onerous. We note that these obligations far exceed what is required for fully regulated pipelines, where a spare capacity register is required to be published and updated whenever changes occur. Prospective shippers can also understand the utilisation of pipelines from the National and WA Gas Bulletin Boards.
- We note that nameplate rating (referred to in NGR 553(2)) is not a relevant term of distribution pipelines which is a matter discussed elsewhere in this submission;
- NGR 557(1)(b) requires that the service provider disclose the inputs used by the service provider to calculate the weighted average price. This requirement would defeat the purposes of providing a weighted average price, which is intended to deal with the confidentiality of individual shipper tariffs.

2. **Given the potential for the capacity of a pipeline to be affected by the assumption made about gas specification, should the draft rules require the daily capacity and the primary pipeline capacity to be measured using the gas specification set out in AS 4564-2011 (as amended or replaced from time to time)?**

DBP agrees that it would avoid confusion if a standard could be used as the basis for the assumptions required to be made when determining nameplate capacity. However, the standard gas quality specification for gas transmission pipelines in Western Australia is prescribed in the *Gas Supply (Gas Quality Specifications) Regulations 2010*[7] rather than an Australian Standard.

Further, the standard specification as prescribed in WA provide for a range rather than a point assumption i.e. higher heating value (HHV) is given an acceptable range from 35.1MJ/m^3 to 42.0MJ/m^3; The HHV can have a significant impact on the capacity of a transmission pipeline.

DBP proposes that the GMRG could adopt a similar approach used by the AEMO for the WA Gas Bulletin Board. We note there is a relatively simple definition of nameplate capacity, which does not rely on referencing Australian Standards and or reference specification. The following appears in the *Gas Service Information Rules (2013)*[8]:

"Nameplate Capacity means—for a Transmission Pipeline, the maximum quantity of natural gas that, under normal operating conditions, can be delivered through the pipeline on a Gas Day"

[7] https://www.slp.wa.gov.au/pco/prod/filestore.nsf/FileURL/mrdoc_29469.pdf/$FILE/Gas%20Supply%20(Gas%20Quality%20Specifications)%20Regulations%202010%20-%20%5B01-b0-01%5D.pdf?OpenElement

[8] https://www.slp.wa.gov.au/pco/prod/filestore.nsf/FileURL/mrdoc_31082.pdf/$FILE/Gas%20Services%20Information%20Rules%20(2013)%20-%20%5B00-00-00%5D.pdf?OpenElement

3. The obligation to provide access negotiation information when requested during negotiations is not currently assumed to be classified as either a civil penalty or conduct provision. Do you think there would be any value in classifying the obligation to provide this information as:

- a civil penalty provision – if a provision is classified as a civil penalty provision then the AER may issue an infringement notice to the relevant party, or institute civil proceedings in the Federal Court seeking an order that the penalty be paid; and/or

- a conduct provision – if a provision is classified as a conduct provision then persons other than the AER that suffer loss or damage as a result of the conduct of another person that was done in breach of a conduct provision can seek to recover the amount of the loss or damage by action against that person in court?

Please note that similar provisions in Part 11 of the NGR (see rule 107), have been classified as both civil penalty and conduct provisions.

The GMRG has suggested that a number of the proposed rules should be classified under the NGR as civil penalty provisions. These rules, in particular NGR 552, 558 and 560 impose obligations on service providers for non-scheme pipelines to publish certain information regarding their pipelines such as service and access information, standing terms, and the making of access offers to prospective customers.

In its Explanatory Note,[9] the GMRG notes that NGR 107 of the NGR is both a civil penalty provision and a conduct provision. That rule requires a service provider for a scheme pipeline to make accessible on the service provider's website the applicable access arrangement. Such a requirement is not considered to be unreasonable as the pipelines to which that requirement applies are covered pipelines. Hence, it is considered appropriate that the service provider for a regulated pipeline should be required to make readily available the access arrangement that sets out the approved terms and conditions on which an access seeker might seek access to the service provider's pipeline.

However, DBP considers it would be quite unreasonable for any of NGR 552, 558 or 560 to be classified as civil penalty provisions. No adequate justification has been provided as to why such provisions should be classified as civil penalty provisions.

It is in the interests of a service provider to make relevant information readily available to prospective customers so as to incentivise the negotiation of access agreements with such persons. Further, if a prospective customer is able to demonstrate their bona fides, then there is no reason why a service provider would not be prepared to offer them access to their pipeline.

If there is a genuine concern that service providers will be inclined not to comply with the aforementioned rules (which we do not consider there is any evidence to warrant such a concern), then the appropriate mechanism would be to classify the applicable rules as conduct provisions rather than as civil penalty provisions. To the extent a service provider might fail to comply with the relevant rules, there is no overriding public detriment which would warrant enforcement by the AER and the imposition of a civil penalty. Any loss or damage occasioned by the service provider's non-compliance will be strictly limited to the loss or damage suffered (if any) by a prospective user of the pipeline. Hence, only persons who have been so affected should have a right to seek compensation from the relevant service provider.

[9] *GMRG, Gas Pipeline Information Disclosure and Arbitration Framework: Initial National Gas Rules Explanatory note for stakeholder consultation, June 2017, p 36.*

4. Do the draft initial rules provide a credible threat of arbitration, whilst still incentivising commercial negotiation as the preferred approach for access to non-scheme pipelines?

We do consider that the framework provides a credible threat of arbitration. However, we are of the view that the design has not stuck the appropriate balance that will allow for commercial negotiation.

Our concerns which are briefly addressed in Section 2 as overarching concerns, have been discussed at length in prior submissions, are that a framework that overly focuses on a cost of service framework lacks the incentives for the shipper to genuinely enter into the negotiation phase and will likely result in routine arbitrations.

5. Are there any changes to the draft rules that you consider are necessary to ensure parties are unable to game or circumvent the framework?

We refer to Section 2 of this submission. DBP's view is that the effect of NGR 569(3) limits the scope of the objective in NGR 546 which has the aim of producing a workably competitive market and is inconsistent with how commercial-orientated agreements are reached. Simply put, the Draft Rules work in a way that provides the shipper with the highest possible price outcome (the price offered by the service provider which must be based on the cost of service) it therefore has little disincentive not to chance a better outcome through an arbitration.

From an economic perspective, an efficient price will lie between the willingness to pay on the part of a shipper as an upper bound and the willingness to supply on the part of the pipeline as a lower bound, which can be shown as a demand and supply curve.

Noting that each shipper is likely to have different levels of willingness to pay, and the price of the marginal consumer matches the marginal willingness to serve on the part of the shipper, then economic efficiency would be achieved. The point between the supply curve and each shipper's willingness to pay (i.e. – where it sits on the demand curve) at which each price sits represents how the consumer and producer surplus is divided, all points being efficient. Since efficiency is what workably competitive markets are supposed to determine, this would be in keeping with the objectives of the Draft Rules but inconsistent with the drafting of NGR 569(3) which artificially constrains the arbitrator to only consider a price which can be supported by a cost of service model.

Since the pipeliner's offer is still to be considered by the arbitrator, there is still a supply curve in this framework. However, with the shipper's offer being the lower bound, the demand curve is gone,[10] and thus half of the information in the market is lost. Since the shipper's offer has nothing to do with willingness to pay, the question must be asked what it does represent. This leads to an understanding of the incentives of the shipper in negotiations within this framework.

A shipper will know, given the information provision requirements, what the costs of the pipeline and how much demand it is likely to have, and thus, with some precision, what the likely cost-based price of the pipeline will be. This is known prior to the negotiation starting.

Consider two types of shippers; one with a willingness to pay above the cost of service and one with a willingness to pay below the cost of service. For the first shipper, the entire process is essentially a game. There is, realistically, no price that the pipeline could credibly put forward which would be significantly above its cost of service, because the arbitrator is required to base prices on the cost of service. The

[10] *Technically, the demand curve could lie below the supply curve, but what this would mean is that there is no shipper willing to pay even the lowest supply price in the market, and thus there is no reason for the service to be provided at all.*

shipper thus has no real incentive to negotiate in good faith, and in fact has an incentive to put in an offer close to zero.[11]

Now consider a shipper whose willingness to pay is near or below the cost of service. This shipper has an incentive to play the arbitration game seriously. This is because, if it does not get a price at or below its willingness to pay, it will fail. Further, this shipper is not bound to the outcome of the arbitration so has little to lose. It therefore is likely to test whether the arbitrator will interpret the framework differently to service providers.

If the willingness to pay is less than the cost of producing the item, then society is better off if that item is not produced and sold, but rather, the resources that went into the production of the relevant good or service ought to be deployed elsewhere.

6. **Are the exemption categories and criteria sufficiently clear and can they be applied to both transmission and distribution pipelines? If not, what changes could be made to clarify the exemptions?**

   - One exemption criterion that has been identified as potentially problematic is the nameplate capacity criterion, which the GMRG has been informed may not be appropriate for distribution pipelines. If this is the case, what is an alternative criterion that could be used to achieve the same objective (i.e. to identify small pipelines)?

Our view is that the criteria in Division 6, while clear, due to the way NGR 585 is drafted service providers (both distribution and transmission) have no certainty that an exemption will be granted or if granted the nature of conditions that may be associated with it. That point is covered above.

Nameplate capacity criteria and its applicability to distribution pipelines is problematic as there is no nameplate capacity or rating assigned to distribution pipelines. In discussions with the GMRG we have suggested that a distribution system be granted an exemption if the average throughput (injections) into the system is less than 10TJ/day (based on average daily injections using annual injections). It is proposed that the averaging period be for a suitable length, either three of five years to smooth volatility. It is our view that using a one or two year averaging period may see distribution systems fall in an out of the criteria too frequently if they are operating around the 10TJ/day vicinity.

7. **Do you think the pricing principles should provide the arbitrator with:**

   - More guidance on how to determine the value of the assets used in the provision of services? If so, please explain why you think more prescription is necessary.

   - Greater discretion on how to determine the value of the assets used in the provision of services, subject to the caveat that the asset valuation techniques are consistent with the

[11] *The only situation whereby this would change is if there are multiple shippers bidding for the same capacity, such that not all can be served. Then the incentive is to submit higher bids. However, unless several shippers all put bids in at exactly the same time, it appears that this is unlikely to happen because, if a second shipper comes along whilst the negotiation process with the first shipper is still ongoing and offers a higher price, and the pipeline accepts it, the pipeline is still liable to find the capacity desired by the first shipper (see p29 of Explanatory Statement)*

workably competitive market objective? If so, please explain why you think greater discretion is required.

If you think more guidance on asset valuation is required, do you think the arbitrator should be required to employ the same techniques that would apply to scheme pipelines (as set out in rule 77 of the NGR), or are there are alternative approaches that you think are feasible and appropriate?

DBP favours the alternative version of paragraph (a) of NGR 569(2) so as to provide the arbitrator with greater guidance as to how to apply the pricing principles. DBP has also suggested a revised version of NGR 569 in Section 2 of this submission.

8. **Is there anything in the draft initial rules which may suggest that the expeditious resolution of the access dispute will not occur?**

No.

9. **Are any other transitional rules required? If so, what are they and why are they required?**

We refer to Section 4 of this submission.

10. **Section 83A(2)(e) of the Amendment Bill contemplates that the rules may provide for ring-fencing requirements, similar to those contained in Chapter 4, Part 2 of the NGL that apply to scheme pipelines. Are similar requirements necessary under the draft initial rules? Why/why not?.**

We do not consider that ring-fencing requirements similar to those that apply to regulated pipelines are required. We are not aware of any issue, problem or market failure that has been raised through the GMRG's process that requires addressing for non-scheme pipelines. Further, it was not something that was included in the endorsed GMRG's Final Design.

11. **Should anything in the rules be moved to the NGL in a future review?**

DBP considers that only one rule should at this time be moved or elevated to the NGL. That rule is rule 546 which sets out the objective of Part 23 of the NGR. If a question of interpretation arose relating to the interpretation of rule 546 vis-à-vis the National Gas Objective (Section 23 of the NGL), then as a rule, it would be considered subordinate to a conflicting provision of the NGL.