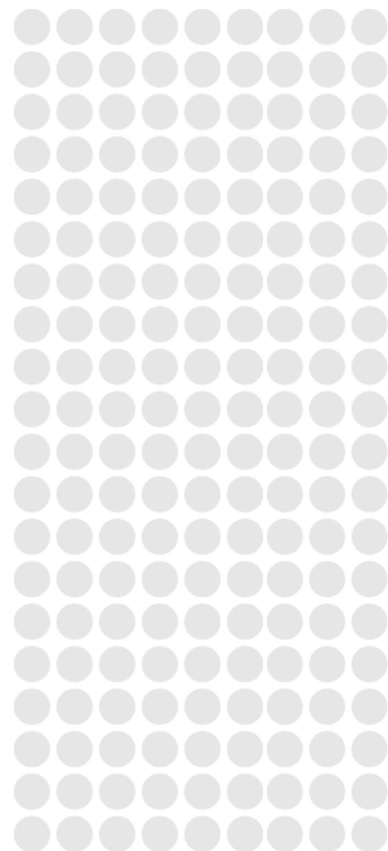
13 April 2017

gas pipeline information disclosure and arbitration framework

apa response to options paper



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1 Submission summary

APA considers that the options endorsed by the Gas Market Reform Group (GMRG) as the 'preliminary view' in the *Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper* (the *Options Paper*) could not be reasonably expected to achieve the outcomes sought by Dr Vertigan. In fact, the preliminary view options can be expected to deliver the following outcomes:

- Reliance by shippers on arbitration instead of commercial negotiation
- Reductions in investment, in particular in relation to spare capacity that would be subject to arbitration risk
- Slowing of innovation in the development of new services, growing the market or finding cost efficiencies as these are returned to shippers immediately through arbitration based on actual costs
- Pervading risk of arbitrator error raising the general risks (and costs) of the pipeliner
- A move towards voluntary coverage of pipelines to avoid many of these risks.

The reasons for these outcomes are discussed below.

Achievement of regime targeted to support commercial negotiation

While Dr Vertigan sought to create a regime that incentivised the parties towards commercial negotiation, the *Options Paper* instead creates a regime that offers virtually no incentives for shippers to negotiate. This is because it creates virtually no risk for the shipper from arbitration beyond the cost of arbitration as they are not bound by the outcome of the arbitration, yet offers high rewards from an outcome that sets prices at the absolute bottom of the range of prices that they could expect from any commercial negotiation.

This outcome bears no relationship to what a shipper would expect from a negotiation in a reasonably competitive market, where the outcome of negotiation can fall within a range, and still be considered acceptable by both parties.

Avoiding deterring investment and innovation

The recommended cost of service arbitration approach will undermine incentives for investment and innovation, contrary to outcomes sought by Dr Vertigan. In fact, the incentives for investment and innovation arising from the preferred options are significantly worse than those available under full regulation.

The continuous arbitration process will engender responses from shippers such as contractual 'most favoured nation' clauses that ensure that they can avail themselves at all times of the lowest possible tariff arising from the next arbitration, and ensure that all benefits from market growth or cost savings are passed to shippers immediately. Incentives to seek out cost savings, develop new services or invest in spare capacity are thereby confiscated by the operation of the arbitration scheme.

By contrast, conventional regulation allows the pipeliner to keep the benefits of outperformance for the duration of each regulatory decision, typically five years, and in doing so delivers some benefits to the pipeliner from effort and growth. Even these limited rewards are not available under the cost of service continuous arbitration regime envisaged under the *Options Paper*.

Lack of consideration of the risk of arbitrator error

While the theoretical outcome of the proposed preferred arbitration approach is to deliver a price for pipeline services that reflects the cost of service, the regime itself delivers enormous risks to the economy. These risks lie in the cost of arbitrator error, where prices delivered under the arbitration regime are in fact below the cost of service. This has obvious implications for incentives to invest. No protection against arbitrator error is available under the proposed scheme.

Regime cannot deliver a timely decision without significant risk of error

Where the scheme seeks to apply a cost of service approach (the 'preliminary view'), the information and decision-making demand on the arbitrator will be high. The *Options Paper* fails to recognise the necessary trade-off between choosing arbitration based on cost of service, and the resulting time and costs that need to be dedicated to that arbitration.

Cost of service arbitration cannot be completed within 3 months[1] on limited papers – to do so would effectively guarantee substantial decision-making error that will have profound impacts on the energy sector and the economy as a whole. The risks for pipeliners of a short, uninformed, cost of service arbitration far exceeds the risks for pipeliners of regulation, which at least provides for decision-making time, rules for decision, procedural steps including draft decisions, and rights for review (judicial and merits). None of these protections are available under the regime

[1] The *Options Paper* suggests that this time can only be extended to a maximum of 5 months with the agreement of both parties. That means the shipper can block the arbitrator's request for more time to consider the matter in dispute, even where the arbitrator considers it needs more time.

contemplated in the *Options Paper* to apply to pipelines *to which no case for regulation has even been made*.

The Options Paper risks substantial over-regulation

The 'preliminary view' option set out in the *Options Paper* applies prices-setting to all pipelines and all services without meaningful distinction as to whether services should be regulated. This approach ensures over-regulation rather than avoids it, and the chilling effect of the scheme will impact all pipelines, even where no arbitration process has yet been called, as the threat of arbitration will impact contracting behaviour of shippers and with that, pipeliners.

Even where no arbitration is called, the universal and uncertain application of the regime influences decisions over investment and services for every pipeline.

The arbitration regime as formulated in the *Options Paper* is not a regime that sits within a spectrum of regulation suitable for pipelines that do not meet the coverage test. It is instead a regime designed to do the same thing as the coverage test and full regulation, but is applied to all pipelines, and all services indiscriminately without any of the checks and balances set out in regulatory regimes that recognise the property rights that they remove, and which are designed to ensure that some incentives for investment and innovation are maintained.

APA considers that a more targeted and nuanced scheme is required that is directed at addressing perceived uneven bargaining power (not necessarily market power) to ensure that cost of service arbitration is not applied in circumstances where regulation is not justified.

Alternative model targeted to address negotiating imbalance

Amongst the options described in the *Paper*, there is an alternative model that may lead to the outcomes the GMRG is seeking (outcomes which cannot be achieved by the GMRG's 'preliminary view').

This model involves public disclosure of the following information on pipeliners' websites to support commercial negotiation:

1. Details of all services available on each pipeline
2. Details of the terms and conditions of access for each service, in the form of executable contract terms relevant to each service
3. The prevailing tariff being charged to shippers using firm service(s) where relevant
4. Pricing principles setting out how tariffs have been derived for each service, including the basis of derivative tariffs and how they have been calculated

5. A description of every pipeline, including technical attributes of the pipeline relevant to access such as metering requirements, gas specification and pipeline pressures.
6. How a shipper can seek access to the pipeline, including contact details and high level details on the process involved.

Supporting this disclosure is a right to binding commercial arbitration for shippers, however this arbitration is directed towards the prices paid by shippers for comparable services, with scope for the arbitrator to adjust those prices to take account of the specifics of the service sought under arbitration.

APA considers that this approach will support commercial negotiation by addressing uneven bargaining power for smaller shippers, and provide confidence to the market that they are not receiving a tariff that is out of step with that paid by other shippers for a similar service. Alternatively, if the policy concern is market power leading to monopoly prices, then the coverage regime provides the mechanism to address this issue.

Responses to questions put in the Options Paper

The *Options Paper* poses questions in respect of the scheme, and the preliminary views put in the paper. Section 4 of the submission addresses these questions.

2 Assessment of proposed information disclosure and arbitration framework against stated objectives

2.1 Objectives of COAG Energy Council agreed information disclosure and arbitration framework

Dr Michael Vertigan's report *Examination of the current test for the regulation of gas pipelines* (the *Examination*) investigated conclusions made by the ACCC in their *Inquiry into the east coast gas market*, that the coverage test, as it is currently formulated, does not address pipeline market power and required revision.

Dr Vertigan concluded that the market failure that required addressing was a different one, namely uneven bargaining power between shippers and pipeliners that is hampering shipper faith and trust in commercially negotiated outcomes. Dr Vertigan then set out a regime to address this issue. Specifically, Dr Vertigan's regime has two main parts:

- Enhanced information disclosure targeted at supporting commercial negotiations; and
- Binding commercial arbitration, where commercial negotiations fail.

The vision underpinning this framework was that binding commercial arbitration would provide a credible threat to both parties that would drive them towards successful commercial negotiation. In this vision the commercial arbitration mechanism was to be the backstop, not the main mechanism, for reaching agreement between the parties.

Importantly, Dr Vertigan's approach was intended to achieve these improved negotiation outcomes without the costs and risks seen to arise from regulation. The expected positive outcomes and attributes of Dr Vertigan's scheme, as described in the report, were:

- Avoidance of the costs of regulation

  …the effectiveness of commercial negotiations needs to be addressed in a manner which avoids the time delays and high costs usually associated with formal regulatory processes.[2]

[2] Dr Michael Vertigan AC 2016, Examination of the current test for the regulation of gas pipelines: Report, 14 December, p 91

- Avoid overregulation

  [In respect of discussion of option 5] This option would create considerable uncertainty, with little legal principle or precedent available to interpret the test likely to increase the legal and administrative costs associated with coverage determinations. Further, consultation suggests that this option risks over-regulation, discouraging investment and innovation.[3]

- Supportive of continuing investment and innovation

  The credibility of the threat needs to be appropriately balanced to avoid deterring pipeline investment and innovation.[4]

  and,

  The proposed solution should avoid any 'chilling' effect on investment.[5]

- Speediness

  This option has the potential to facilitate efficient commercial outcomes while avoiding the time, cost and uncertainty associated with regulatory processes.[6]

This framework was endorsed by the COAG Energy Council.

APA supports these aims and considers they are achievable.

Unfortunately, the Gas Market Reform Group's (GMRG's) 'preliminary view' of a preferred option, if implemented as described in the *Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper* (the *Options Paper*), would put in place a regime that could not be reasonably expected to achieve these aims. In fact, the preliminary view options can be expected to deliver the following outcomes:

- Reliance by shippers on arbitration instead of commercial negotiation
- Reductions in investment, in particular in relation to spare capacity that would be subject to arbitration risk
- Slowing of innovation in the development of new services, growing the market or finding cost efficiencies as these are returned to shippers immediately through arbitration based on actual costs

[3] Vertigan 2016, Examination of the current test for the regulation of gas pipelines: Report, p 97
[4] Vertigan 2016, Examination of the current test for the regulation of gas pipelines: Report, p 79
[5] Vertigan 2016, Examination of the current test for the regulation of gas pipelines: Report, p 91
[6] Vertigan 2016, Examination of the current test for the regulation of gas pipelines: Report, p 91

- Pervading risk of arbitrator error raising the general risks (and costs) of the pipeliner
- A move towards voluntary coverage of pipelines to avoid many of these risks.

These issues are discussed in the remainder of this chapter, and where relevant in response to questions in chapter 4 of this submission.

2.2 Achievement of regime targeted to support commercial negotiation

The *Options Paper* sets out a number of options to implement Dr Vertigan's framework, and indicates a 'preliminary view' on those options.

In doing so, however, the *Options Paper* appears to have lost sight of the intent of the framework which is to support commercial negotiations by addressing an imbalance in bargaining power between pipeliners and shippers. Instead the paper appears to seek to resolve the initial problem put to Dr Vertigan as described by the ACCC – reducing prices affected by market power where coverage is assumed to be an ineffective tool.

The *Options Paper* proceeds on the assumption that prices offered by pipeliners in a commercial negotiation are impacted by market power, and that arbitration is the only mechanism available to address this issue. It proceeds as if the market power of pipeliners was absolute and the coverage regime did not exist.

The *Options Paper's* assumption that the regime is to be designed to address monopoly pricing as opposed to supporting commercial negotiation is shown very starkly where considerable effort is put into making sure that the arbitration will deliver the 'correct', cost-based price for services in an environment where a pipeliner is assumed to be charging monopoly prices, rather than effort put into the information and negotiation part of the framework with the arbitration regime as the threat that pushes the parties towards commercial resolutions.

This is a very significant flaw of the *Options Paper* – commercial negotiation is relegated to the background where Dr Vertigan had sought to bring it to the forefront.

2.3 Creation of incentives for both parties to reach a commercially negotiated outcome

There is very limited focus in the paper on the mechanisms of commercial negotiation, and in particular the aspects that make a good commercial negotiation.

When working effectively, commercial negotiation is two-sided. It is a process of finding the space between the supplier's costs and the buyer's value where a commercial deal will be struck which is to the benefit of both parties.

It is very important for the binding arbitration scheme to retain incentives towards the parties reaching commercial agreements, by providing them with additional bargaining power, while not forcing pipelines to accept sub economic prices that cannot be sustained in the long term.

The scheme as described in the *Options Paper* (the preliminary view option for arbitration principles in particular) creates a one-sided arbitration model that closely resembles a regulatory arbitration approach. This form of arbitration removes incentives for commercial negotiation by removing the risk for both parties that would exist in a two sided arbitration that the arbitrator will pick a point in the range between pipeliner costs and shipper value that puts one of the parties at a disadvantage compared to the outcome achieved through negotiation.

Instead, the preliminary view option of arbitration creates a known 'ceiling' to prices from arbitration at the cost of service. This approach creates no incentives for the shipper to negotiate with a pipeliner as the arbitrator's outcome matches the pipeliner's 'floor' in a negotiation – the shipper can assume that the pipeliner will not agree to a price below this point in a commercial negotiation. As a result, the shipper will always test the arbitration to confirm that the pipeliner is offering prices at cost of service (and no more).

The problem is further exacerbated by the fact that the shipper is not bound by the outcome of arbitration[7], such that the shipper faces virtually no risk associated with arbitration – the shipper knows the basis of an arbitrated price is set at the pipeliner's floor and can walk away from an arbitrated outcome. In this way arbitration effectively replaces commercial negotiation as the most rational option for a shipper when seeking a new service. The regime therefore creates no incentive to negotiate for the shipper.

2.4 Avoiding deterring investment and innovation

The preferred approach for arbitration is to set prices based on the cost of service. The rationale for this, as set out in the *Options Paper*, is that other options do not address issues with monopoly pricing.

The arbitration regime establishes a practice where prices can be set at actual costs at any time. There is no period of fixed prices, as would occur under standard contracts or regulation, where the pipeliner has the opportunity to outperform benchmarks assumed in existing tariffs, for example by reducing costs or growing the market. APA refers to this as 'continuous arbitration'.

[7] National Gas (South Australia) (Pipelines Access-Arbitration) Amendment Bill 2017, section 216Q(2)

The 'continuous arbitration' approach will undermine commercial incentives to invest by creating significant risks on any spare capacity as part of an investment. This is because the arbitration regime creates uncertainty over the tariff that will apply to spare capacity, and how the costs of delivering that capacity will be calculated. This uncertainty affects both the foundation shipper and the pipeliner and influences their decisions on the size of investments, tariffs and contractual arrangements. This is best shown by working through how the properties of the cost of service option will impact on decision-making in a commercial negotiation as set out in Box 2.1 below.

Box 2.1 - Incentives to invest – impact of applying continuous arbitration based on cost of service

Incentives to invest – impact of applying continuous arbitration based on cost of service

A shipper seeks to invest in a new pipeline, extension or expansion. There is competition to deliver the new capacity – a number of pipeline operators could build the new capacity, or expand existing capacity to meet the shipper's needs.

As the foundation shipper for new investment, that shipper needs to commit for a relatively long time at tariffs that make the investment profitable for both parties. The foundation shipper is prepared to commit to this capacity for a reasonable amount of time, on a firm basis.

In determining the foundation tariff for the new investment, all the competing pipeline operators will include costs associated with their view of the construction, financing and execution risk associated with the project. As an example, construction risk is related to the final costs of the construction, and the risk that there will be time overruns (and contractual penalties).

Under the proposed new framework, a shipper can seek access to spare capacity on that pipeline soon after through arbitration. The arbitration will look at the cost of service of the pipeline, including the actual costs incurred in developing the pipeline. Those costs will reflect the derisked costs, not those faced by the competing pipeliners when the foundation tariff was set. Further, the tariff will also take account of the new demand (on which the pipeliner took market risk to build), driving that third party shipper's tariff lower.

The secondary shipper has no incentive to negotiate with the pipeliner in these circumstances as it knows that the pipeliner will likely offer a tariff down to the foundation shipper tariff as that tariff included the risk of construction and the market risk associated with spare capacity – that is, the pipeliner's costs included in the foundation tariff. But the arbitrator may view the costs as lower, and therefore determine a lower tariff. At least the third party shipper can have a high degree of confidence that the arbitration outcome will not take the tariff higher than the foundation tariff. The shipper identifies the bounds of arbitration outcomes as capped at the foundation tariff.

As a result, through arbitration the new shipper has a good chance of gaining access to the pipeline at a lower tariff (and with less commitment to long term capacity) than the foundation shipper, with low risk of getting an outcome at the foundation tariff. This impacts the incentives for the foundation shipper to enter into a contract for the construction of new capacity.

> The rational response for the foundation shipper in this environment is to require a Most Favoured Nation (MFN) clause in the contract to immunise itself against the risk that a later shipper will get a better price from arbitration.
>
> The rational response for the pipeliner, faced with an MFN and no ability to ensure that future prices are set such that the MFN clause is not triggered in respect of spare capacity, is not to build spare capacity into new investments.[8] This protection is limited, however, where a pipeliner can be forced to expand a pipeline and this may lead to spare capacity do to the lumpiness of these investments.

The continuous arbitration approach has similar impacts on incentives for the pipeliner to innovate by finding cost savings or introducing new services.

Under the current market arrangements, a shipper will enter into contract for a new service involving a new pipeline, extension or expansion. In determining a tariff for that service, the pipeliner will consider its costs and determine a tariff for the term of the contract. This includes a forecast of the longer term operating costs for the pipeline. For the duration of the contract, the pipeliner has an incentive to find efficiencies and thereby reduce its costs (without undermining the service requirements under the contract) compared to those assumed in the foundation tariff.

At the same time, the pipeliner also has incentives to grow the market by developing and offering new services as these are largely not impacted by MFNs or revenue sharing arrangements.

Conventional regulation also provides some incentives for efficiency and innovation, though they are not as strong as applying in an unregulated environment. A standard regulatory term sets prices every five years on the basis of forward looking costs. In doing so, it sets prices for a period and therefore rewards actions that lead the pipeliner to outperform those benchmarks in the period. This includes incentives to grow the market (beat demand benchmarks), find efficiencies (beat cost benchmarks) and develop new services (derive additional revenue from unregulated services).

Under the proposed new framework, there is no period where tariffs are fixed. Continuous arbitration based on cost of service will mean a continual resetting of tariffs for services (including firm services) for new shippers based on a snapshot of costs and demand at the time. This means that a later shipper can seek access to spare capacity on a pipeline through arbitration, and be granted a tariff that is less than the benchmark set for a foundation shipper because it takes into account

[8] Under the existing coverage regime, the risk of the regulator setting a lower tariff than the foundation tariff is managed by clauses that exclude regulated tariffs from the operation of the MFN.

efficiency savings made since that original contract, growth, including the demand of the new shipper, as well as revenue earned from other services.

A rational response to this risk is for a shipper to seek an MFN clause in each contact to immunise itself against the risk that a later shipper will get a better price from arbitration.

The result for the pipeliner is that it has no incentive to seek efficiencies, grow the market or develop new services as these are all confiscated by shippers through the operation of each arbitration outcome flowing through MFN clauses to reset all tariffs. As a result, the incentives for the pipeliner for innovation and cost efficiencies flowing from the continuous arbitration regime are in fact poorer than under full regulation.

2.5 Lack of consideration of the risk of arbitrator error

While the theoretical outcome of the proposed preferred arbitration approach is to deliver a price for pipeline services that reflects the cost of service, the regime itself delivers enormous risks to the economy. These risks lie in the cost of arbitrator error, where prices delivered under the arbitration regime are in fact below the cost of service. This has obvious implications for incentives to invest.

The discussion in the *Options Paper* on the conduct of arbitration, in particular information and time available to the arbitrator to make a decision, demonstrates a complete lack of recognition or understanding of the significance of the decision being made by the arbitrator to the pipeline business, and to the economy. The *Options Paper* includes no consideration of the risk of arbitrator error.

The legislation establishing the arbitration regime removes the right for a pipeliner to set its own tariffs for services on pipelines for which it has risked shareholder capital to build. The removal of this right, as applies under formal access regulation for many sectors, is bounded by significant checks and balances and due regard to the risks that the regime creates.

None of these protections are available under the proposed scheme. It is critical that the party charged with the role of setting prices has the time and resources it needs to conduct its work. Limiting those resources substantially undermines the ability of that party to reach an appropriate decision. The less informed the decision, the more likely that it will be impacted by material error which will have considerable impacts on investment and through that the economy as a whole.

APA considers that the scheme design must instead be recast to address the problem as described by Dr Vertigan, not seek to replicate a regulatory regime though a significantly curtailed one-sided arbitration process.

2.6 Regime cannot deliver a timely decision without significant risk of error

Where the scheme seeks to apply a cost of service approach, as is recommended, the information and decision-making demand on the arbitrator will be high. The *Options Paper* fails to recognise the necessary trade-off between choosing arbitration based on cost of service, and the resulting time and costs that need to be dedicated to that arbitration. Instead it suggests that the parties would be 'gaming' the arbitration process if it provided the arbitrator with a lot of information.[9]

Cost of service arbitration cannot be completed within 3 months[10] on limited papers – to do so would effectively guarantee substantial decision-making error that will have profound impacts on the energy sector and the economy as a whole. The AER, when asked to do the same task for covered pipelines, takes at least 11 months, employing teams of experienced people, and applying bounded and well understood rules. These levels of resources, time and experience are not available to the arbitrator. Even prior to submission, pipeline businesses typically take 12 months to develop proposals.

The timeframe for arbitration and the scope of arbitration are inextricably linked – you cannot choose cost of service regulation/arbitration and then unreasonably limit the time to reach a decision. The threat of such a regime is sufficient to halt investment in the sector.

While APA considers that some cost of service disputes might be able to be resolved in this time, most will be complex, and involve setting tariffs for very long term contracts involving tens of millions of dollars a year. Some will even involve forcing investment in new infrastructure.

In this environment, it is unacceptable to constrain the ability of the arbitrator to give the matter due consideration as the risk of error on the pipeliner, and the shipper in the longer term, will be profound. It is worth remembering that a shipper does not find itself needing long term capacity (particularly capacity that may require an expansion) suddenly. The circumstances in which long term contracts are struck are twofold:

- Negotiation of terms for recontracting after expiry of a contract; or

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[9] Gas Market Reform Group 2017, Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper, March, p 114

[10] The *Options Paper* suggests that this time can only be extended to a maximum of 5 months with the agreement of both parties. That means the shipper can block the arbitrator's request for more time to consider the matter in dispute, even where the arbitrator considers it needs more time.

- Access to pipeline services (new or expanded) to match an upstream or downstream investment.

Both of these cases involve long lead times for the shipper where the shipper knows that it will need to negotiate for capacity. The parties are aware of the need to contract long before contract expiry, and any upstream or downstream investment for the shipper will have financial commitment and investment lead times that means that a shipper can invest time in negotiation.

In these circumstances, it should be up to the shipper to ensure it engages in commercial negotiation with the pipeliner in time such that if those negotiations fail, an arbitration process can properly consider the complex matters that may arise. The scheme as proposed, with a hard deadline for decisions and a basis on cost of service instead incentivises the shipper to wait until near contract expiry to create a sense of urgency, and then use short arbitration processes to force decisions.

APA considers that the timing for arbitrations should always target the 'ideal' of 50 business days, however this time needs to be able to be extended at the discretion of the arbitrator for long, complex or high value deals that can have profound impacts on the viability of pipeliners and shippers.

To be clear, the risks for pipeliners of a short, uninformed, cost of service arbitration far exceeds the risks for pipeliners of regulation, which at least provides for decision-making time, rules for decision, procedural steps including draft decisions, and rights for review (judicial and merits). None of these protections are available under the regime contemplated in the *Options Paper* to apply to pipelines *to which no case for regulation has even been made*.

APA considers this scheme would create an uninvestable environment and cannot deliver timely arbitrator decisions that are not impacted by substantial error.

2.7 The Options Paper risks substantial over-regulation

The 'preliminary view' option set out in the *Options Paper* applies prices-setting to all pipelines and all services without meaningful distinction as to whether services should be regulated. This approach ensures over-regulation rather than avoids it.

Even where no arbitration is called, the universal and uncertain application of the regime influences decisions over investment and services for every pipeline, as described above.

The arbitration regime as formulated in the *Options Paper* is not a regime that sits within a spectrum of regulation suitable for pipelines that do not meet the coverage test. It is instead a regime designed to do the same thing as the coverage test and full regulation, but is applied to all pipelines, and all services indiscriminately without any of the checks and balances set out in regulatory regimes that recognise the

property rights that they remove, and which are designed to ensure that some incentives for investment and innovation are maintained.

APA considers that a more targeted and nuanced regime is required that is directed at addressing uneven bargaining power (not necessarily market power) to ensure that cost of service arbitration is not applied in circumstances where regulation is not justified.

3 Alternative model targeted to address negotiating imbalance

Amongst the options described in the Paper, there is an alternative model for information disclosure and commercial arbitration that would incentivise commercial negotiation for all parties to a negotiation, while also supporting innovation and investment. This approach would provide for timely arbitration decision making, without significant risk of error, and as such ensures that arbitration remains a credible threat.

Most importantly, it would directly address the concern raised by Dr Vertigan in relation to uneven bargaining power between shippers and pipeliners, by developing a nuanced approach that recognises that this scheme operates in relation to un-covered pipelines, and there is in place an effective proven regime in place *economy-wide* to address market power arising from natural monopoly.

3.1 Existing legislative scheme applying to pipelines

As discussed above, APA considers that the preferred options set out in the *Options Paper* do not recognise the operation of the existing coverage regime, and the role it plays in addressing market power arising from natural monopoly. The options have instead been developed as if the coverage regime did not exist or was ineffective, and that the Vertigan Framework's primary role was to reset prices that are substantially impacted by monopoly power.

Put simply, the *Options Paper* appears to be trying to solve the initial problem put to Dr Vertigan, being the resolution of market power in an environment where the coverage regime does not work.

Good public policy is not based on perceptions of how legislation works but on how it actually works, as applied by experts and the judiciary. Good policy also avoids overlapping and unnecessary regulation, recognising that there are significant costs to regulation that can reach beyond the direct costs, by adversely impacting normal business operations to the detriment of the economy as a whole.

In this regard it was disappointing that the *Examination* did not acknowledge or refer to the expert advice of the National Competition Council (NCC), charged under National Gas Law with applying the coverage test (and matching National Access Regime Declaration criteria), where it stated emphatically (and in contradiction to the conclusions set out in the *Examination*) that:

> *… the ACCC has made a questionable assumption that these are circumstances in which the coverage criteria for gas pipelines in the NGL will not be satisfied.*

> *The current test in criterion (a) is already a test of market power. That was made clear in Re Duke Eastern Gas Pipeline Pty Ltd [2001] ACompT 2 at [116] - [118].*

The NCC went on to state:

> *The NCC considers that monopoly pricing that is persistent over the long term could generate circumstances that would meet the coverage criteria for gas pipelines in the NGL.*

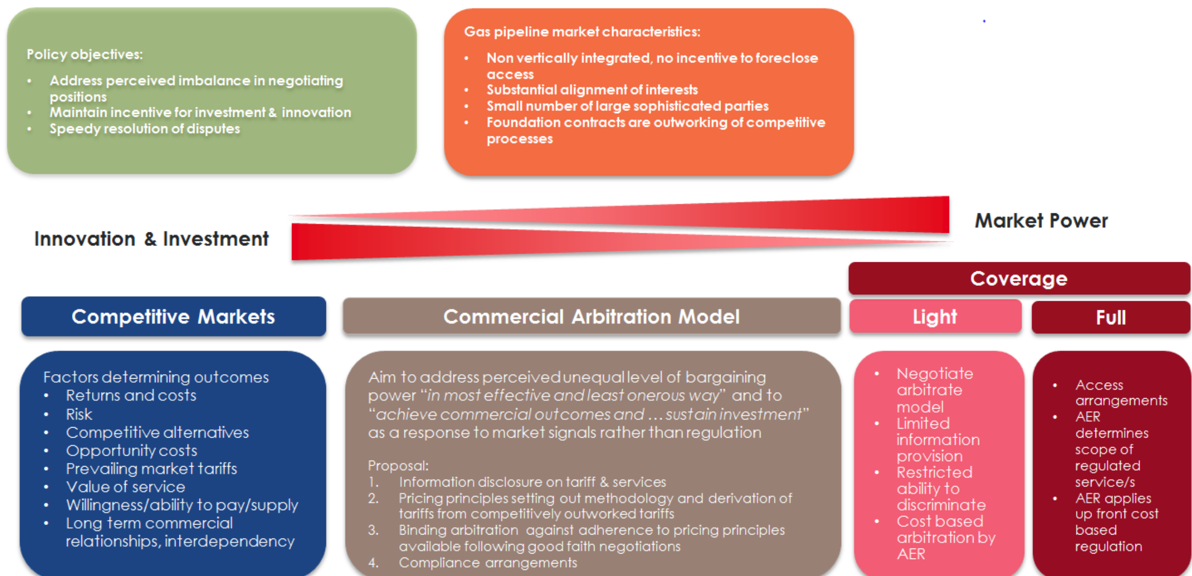
APA acknowledges that many shippers do not believe that the coverage test works to address market power. However, APA is of the view that where the perception of how a particular piece of legislation operates is incorrect, the most effective course for public policy is to correct the perception, and not to instead create a duplicative and inferior regime in response to those misguided perceptions.

The alternative model which APA sees as embedded in the options described in the Options Paper – the Commercial Arbitration Model – would proceed on the basis that the existing coverage regime is effective in dealing with persistent pipeliner market power that may lead to monopoly terms and conditions of service. This is the coverage regime's intention, and this is how practitioners that apply the test on a daily basis say that it operates.[11]

The Commercial Arbitration Model would then address the remaining issue, as identified by Dr Vertigan, which is uneven bargaining power between pipeliners and shippers that may undermine shipper confidence in commercially agreed outcomes. Diagrammatically, the APA's scheme sits within a spectrum of regulation as shown in Figure 3.1 below.

[11] It is worth noting that the ACCC, that initially raised issues with the application of the test, does not apply the coverage test (or the matching declaration test under the National Access Regime) as part of their functions. The ACCC has no involvement in decisions on the application of the test, and no practical experience in how it is applied. Despite suggestions to the contrary, they are not an expert body in the application of the coverage test. The body that does have this expertise is the National Competition Council.

Figure 3.1 – Placement of commercial arbitration regime in spectrum of regulatory interventions



3.2 Alternative model for information disclosure and arbitration

3.2.1 *High level framework of alternative model*

The Commercial Arbitration Model would create a relationship between information disclosure, pricing principles and arbitration that is arguably missing from the *Options Paper*. It is set out below. It matches elements of options set out in the *Options Paper*.

At a high level, the Commercial Arbitration Model would require – and APA would support - public disclosure of the following information on APA's website to support commercial negotiation.

1. Details of all services available on each pipeline
2. Details of the terms and conditions of access for each service, in the form of executable contract terms relevant to each service.[12]
3. The prevailing tariff being charged to shippers using firm service(s).[13]

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[12] Note that an executable contract with these details is already published on APA's website

[13] In some limited circumstances, the prevailing tariff may not be relevant to the provision of new services on the pipeline. As an example, it may reflect terms and conditions that are very specific to a single shipper on the pipeline, or capacity may be locked into a long term

4. Pricing principles setting out how tariffs have been derived for each service, including the basis of derivative tariffs and how they have been calculated.
5. A description of every pipeline, including technical attributes of the pipeline relevant to access such as metering requirements, gas specification and pipeline pressures.
6. How a shipper can seek access to the pipeline, including contact details and high level details on the process involved.

Supporting this disclosure is a right to binding commercial arbitration for shippers, however this arbitration is limited to considering the prices paid by shippers for comparable services, with scope for the arbitrator to adjust those prices to take account of the specifics of the service sought under arbitration.

APA considers that this approach will support commercial negotiation by addressing uneven bargaining power for smaller shippers, and provide confidence to the market that they are not receiving a tariff that is out of step with that paid by other shippers for a similar service, as described in section 3.3 below.

3.2.2 *Information disclosure*

In respect of information provision, the Commercial Arbitration Model matches Option 1, which is the disclosure of base level information, supplemented by a form of price reporting as suggested in Option 4. APA considers that the most effective form of price reporting would be the publication of a 'prevailing tariff' for firm services, as it addresses confidentiality concerns of shippers, while also giving strong guidance to the market as to the tariffs paid by other shippers on pipelines, where this price is at all relevant to services available on that pipeline.

APA considers that publication of the prevailing tariff is more powerful than just disclosing to prospective shippers what other shippers pay – it also provides the market with powerful evidence to support an application for coverage if that prevailing tariff is out of step with a shipper's view of the costs of operating that pipeline.

In this way this disclosure regime supports commercial negotiation, but also strengthens the existing regime for coverage by providing information to shippers that is relevant to a coverage application and decision.

contract and therefore may not be available without augmentation. In these cases, APA would publish as alternative tariff reflecting standard services on the pipeline.

3.2.3 *Arbitration mechanism*

APA supports a conventional commercial arbitration approach as the arbitration mechanism, in line with Option 1. This approach gives the most discretion to the arbitrator as to how the arbitration is run, and what information is needed, without constraining (through Rules or guidelines) the ability of the parties to give the arbitrator information relevant to the dispute at hand. Under this approach, APA notes that the arbitrator can still choose to constrain information, but that decision rests with the arbitrator.

APA has concerns with the design of all the options in relation to the firm deadline for an arbitration decision, in the context of completing complex cost of service arbitrations in the 50 day time limit (even with extension).

APA's other key concerns with the proposed Option 3 are the suggestion that the rules would constrain what information is provided to the arbitrator. APA considers that the arbitrator should be free to determine information requirements for a particular arbitration. Further, APA is concerned that the involvement of the AER to assist the arbitrator would skew the arbitration towards regulatory rather than commercial matters. APA has no concerns with aspects of Option 3 associated with confidentiality.

3.2.4 *Arbitration principles*

APA considers that a threshold question for arbitration is whether a service is provided in a competitive market. Where it is, APA considers that there is no place for arbitration. Therefore, a threshold consideration for the arbitrator should be the level of competition for the provision of the service.

This consideration would cover the price and other terms and conditions of any competing or substitute services, including whether the level of competition for the service, or the availability of competitive benchmarks, mean that the arbitrator should not proceed with the arbitration, and that the arbitrated price or terms should reflect the available competitive benchmarks.

Where there is no competition or competitive benchmarks available, APA considers that an information disclosure and arbitration regime based on the pricing principles and consideration of the tariff charged to other shippers for similar services will support commercial negotiation as it places in the public domain all the elements that the arbitrator might take into account when reaching a decision. In doing so, the approach also provides space for commercial negotiation around that tariff to take account of the specifics of the service. The parties will be driven to commercial negotiation to resolve these matters as the scope for disagreement is more bounded, also making the cost of an arbitration more manageable for a shipper where there is disagreement.

APA considers that arbitration pricing principles should be based on tariffs paid by shippers for comparable pipeline services. In reaching a decision, however, the arbitrator should also have discretion to vary those tariffs, if the arbitrator deems this is needed, to take account of the circumstances of pipeliner and shipper in terms of the matter in dispute.

In applying this discretion, APA considers that the arbitrator should be guided by high level principles similar to those set out in the *Options Paper* on page 137, however these principles require some amendment as follows:

- *the prices paid by shippers for similar services, including the terms and conditions relevant to those services, and the characteristics of the shipper;*
- *the legitimate business interests of the pipeline operator, and the pipeline operator's investment in the pipeline;*
- *the value of service to the shipper;*
- *the interests of all persons who have rights to use the service; and*
- *the operational and technical requirements necessary for the safe and reliable operation of the facility.*

APA does not support the proposed principles related to extensions, expansions and interconnections[14] as they undermine the principles set out earlier in the *Options Paper* that pipeliners should not be required to risk capital where they are forced to invest in an expansion. The operation of these clauses would have the effect of directing the arbitrator to form a view on the value of those expansions or interconnections to the pipeliner, and discounting that amount from the funding required from the shipper for that investment. This is an unacceptable risk for the pipeliner that should not be part of this regime that applies to non-covered pipelines.

Derivative services

APA agrees with the *Options Paper* that there should be additional pricing principles for derivative services. APA supports the principles set out in the *Options Paper* for derivative services are appropriate. These are:

The prices for a derivative service should:

[14] They are as follows:

- the value to the provider of extensions including expansions of capacity and expansions of geographical reach whose cost is borne by someone else;
- the value to the provider of interconnections to the facility whose cost is borne by someone else;

- *take account of opportunity cost / benefit of the derivative service relative to the main pipeline service, having regard to any effect on cost and / or capacity, and*
- *be consistent with the derivative service delivering a reasonable contribution to joint and common costs.*

In practice, derivative services include short term services or services that do not have a capacity payment element, as well as pipeline storage services.

In applying this approach, APA envisages publishing the relevant factors for each pipeline used to set derivative tariffs, and calculations that led to that factor. The intent is that these would be transparent calculations.

Managing pipeline expansions

In respect of expansions, APA considers that these could be managed through the conduct of regular open seasons for all pipelines for expansions to test market demand. This would be extended to also conducting an open season when looking to expand a pipeline for a particular proponent. This would allow smaller shippers to effectively join in to a larger expansion and take advantage of the economies of scale, and negotiating power, available to larger shippers.

Under the pricing principles, the tariff charged to those smaller shippers would be commensurate with that applying to the larger foundation shipper for the expansion. This approach directly addresses uneven bargaining power available to smaller shippers in respect of expansions without assuming that the tariff for expansions is impacted by market power and therefore requires regulation.

APA does not consider that it is appropriate to require pipeliners to invest in new capacity through this scheme. This is a scheme directed at pipeliners for which no case for regulation has been made. Directing investment is a very heavy handed regulatory response that is not called for in the circumstances.

As noted in the *Options Paper*, the ACCC's review found that pipeliners had responded well to the rapidly changing market through investment in infrastructure and the provision of new services.[15] It is unclear what problem the *Options Paper* is seeking to solve by forcing pipeliner to invest. Indeed, given the incentive for pipeliners to invest where they can gain an appropriate return, the regime would only need to force pipeliners to invest where the cost of capital arising from an arbitration were insufficient for the business. This should give policy-makers reason to

[15] Australian Competition and Consumer Commission 2016, Inquiry into the east coast gas market, April. p 93

pause and consider whether the outcome of the arbitration that requires investment to be forced is forcing an investment that should not in fact occur.

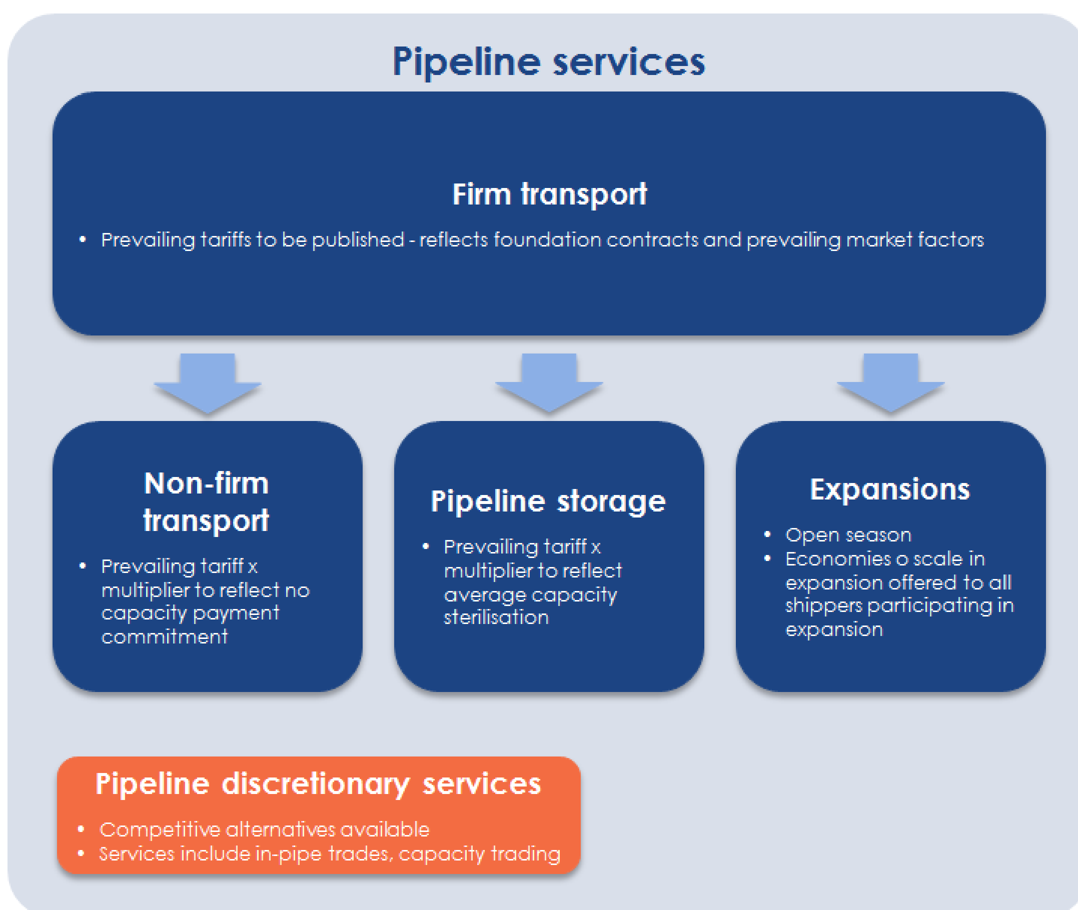
Other services

There are very few other services that are not firm services or derivatives of those.

APA considers that it would be appropriate for pipeliners to post prices for other pipeline services that are effectively discretionary for shippers such as capacity trading and in pipe trades. These services would be charged at a standard rate for all shippers.

This scheme for pricing principles is set out in Figure 3.2 below.

Figure 3.2 – APA proposed pricing principles for pipeline services on APA pipelines



This alternative approach to the arbitration principles most closely matches option 3a in the *Options Paper*.

In the detail application of this option, it applies a number of considerations to setting prices for the arbitrator, effectively in the following order:

- If there are market factors such as direct competition or competitive benchmarks that can be used to determine pipeline prices, these should be used; or, alternatively
- Prices paid by existing shippers for similar services.

Where adjustments are required in respect of those tariffs, the arbitrator would apply other factors such as the legitimate business interests of the pipeline operator, the interests of other users of the pipeline, and the value of the service to the shipper.

Pricing principles would also apply for derivative tariffs, requiring the arbitrator to take account of the opportunity cost / benefit of the derivative service relative to the main pipeline service, having regard to any effect on cost and / or capacity, and to be consistent with the derivative service delivering a reasonable contribution to joint and common costs.

3.3 Addressing the objectives for Dr Vertigan's framework

This section discusses how the proposed approach addresses the objectives set out be Dr Vertigan for this scheme.

3.3.1 Addressing uneven bargaining power

The published prevailing tariff reflects the prices paid by other shippers on that pipeline for a similar service. This information provides a clear starting point for negotiation, as well as allowing smaller shippers to take advantage of the negotiating power of larger shippers.

APA considers that this approach directly addresses the problem identified by Dr Vertigan in his *Examination*. Smaller shippers are most likely to be affected by uneven bargaining power, and have the least access to information (or levels of meaningful capacity) to develop their own cost models for pipeline access. This is recognised in the *Options Paper* where it states:

> *The negotiations will also vary depending on the size of the shipper. For example, retailers that have a portfolio of gas supply and transportation contracts are likely to have increased bargaining power as a result of their size, understanding of the market and their needs relative to smaller parties. They would also have more resources to devote to the negotiation process.*[16]

[16] GMRG 2017, Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper, p 59

The approach to information disclosure in the Commercial Arbitration Model allows smaller shippers to very effectively take advantage of the resources available to the larger shippers to do these analyses as well as the countervailing power of large shippers in a commercial negotiation.

Addressing concerns that prevailing tariffs reflect market power

In discussing the potential to use prices paid by other shippers to support commercial negotiations, the *Options Paper* raises concerns that these prices may be impacted by market power.[17]

The ACCC made limited findings in respect of pipeliner market power, and most examples put forward are historic anonymous anecdotes to which pipeliners have not had opportunity to respond. This is not a basis on which to regulate an entire sector.

What the ACCC did find was that foundation contracts can be expected to reflect competitive outcomes. APA notes that foundation contracts by their very nature, would have the strongest weighting in any prevailing tariff calculation, passing on this benefit to later shippers that were not part of the initial negotiation.

Addressing concerns over changing demand over time impacting the tariff

Another concern raised in the *Options Paper* for this approach is that it would not take account of changing demand on the pipeline. This concern is fundamentally misconceived.

Foundation contracts, as confirmed by the ACCC, and the *Options Paper*[18], are arrived at through competitive processes. Some include 'most favoured nation' clauses and others do not. Some may also include some form of revenue or cost sharing where new shippers come to use spare capacity on the pipeline at a later date.

Whether the foundation contracts contain these types of provisions as an outcome from commercial negotiation. Where they do not include these clauses, the foundation tariff will be lower as they allow the pipeliner to keep the benefits of growing the market – often they mean that the pipeline is built with spare capacity for this purpose. These arrangements are therefore struck on the assumption that foundation tariffs are not reduced in line with increased demand on the pipeline. Importantly, these arrangements are not a function of market power but a risk

[17] GMRG 2017, Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper, p 127

[18] GMRG 2017, Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper, pp 60-61

sharing arrangement between the foundation shipper and the pipeline operator struck in a competitive negotiation.

By contrast, where foundation contracts do contain these clauses they reflect a desire on the part of the shipper to manage the risks that a competitor may access the pipeline that they have committed to use over the longer term on better terms (lower rates or with less long term contracting risk) than the foundation shipper could at the time of negotiation because of the scale required to support new investment. This is a legitimate concern for the shipper that they can manage through these clauses, but the trade-off is that they cap future growth returns for the pipeliner on the pipeline for the duration of that contract meaning that the foundation tariff is likely to be higher.

The results for the appropriateness of using a foundation tariff in light of changing demand are therefore as follows:

- The foundation tariff reflects a contract without future restrictions and therefore the foundation tariff has been set with the pipeliner having the opportunity for future growth in revenues in mind – changing demand should not impact that tariff as to do so would undermine the pipeliner’s incentive to invest in spare capacity; or
- The foundation tariff reflects revenue sharing of future use of pipeline (and therefore has or will be driven lower by increased growth) or has been reset by the operation of an MFN.

In each of these cases, changing demand is already embedded in the prevailing tariff, and should not be a factor in determining the appropriateness of that tariff.

As an aside, contractual utilisation of a pipeline, particularly where there is significant spare capacity on a pipeline, can be a good indicator of the negotiating power the shipper. This information is now readily available on the Gas Market Bulletin Board in the form of a 12-month outlook of spare firm capacity.

Addressing concerns over the bespoke nature of contracts

APA believes that concern over the bespoke nature of contracts is significantly overstated and may reflect circumstances of a generation ago before standardisation. In practice, pipeline services are defined by a small number of factors:

- Location – pipeline services on which pipeline between which points?
- Duration – long term contract or short term (e.g. seasonal) contract?
- Amount – how much capacity is being contracted? and

- Scheduling priority (degree of firmness).

Other aspects of the contract may be subject to variation, however they are very unlikely to materially impact the tariffs under the contract. In fact, as APA has developed and implemented a standard form contract, these variations are very limited indeed.

APA believes that it is possible to develop a supportable and meaningful benchmark for the prevailing firm tariff for each pipeline.

3.3.2 *How this approach ensures timely decision making*

An approach that directs the arbitrator towards tariffs applying to other shippers for similar services is likely to require less time than one that seeks to determine the cost of service.

Even where the arbitrator has discretion to vary those tariffs for the specific circumstances of the pipeliner and shipper, this consideration is constrained because it is anchored at a reference point, and the parties' arguments will be limited to variations from that point.

As set out above, the arbitrator would have guidance on matters to consider, however the arbitrator would still determine the weighting of those matters to the dispute at hand.

3.3.3 *How this approach avoids distorting investment and innovation*

An approach that references the outcomes of arbitration to tariffs paid by other shippers is unlikely to distort investment in pipeline services or undermine incentives for innovation as it effectively retains the incentives that are embedded in long term contracts for finding cost efficiencies and growing the market. At the same time, this approach ensures that smaller shippers in particular can take advantage the negotiating power of larger shippers with very limited costs from engaging in a lengthy negotiation or pursuing arbitration.

3.3.4 *How this approach avoids over-regulation*

This approach does not seek to set prices for all services on all un-regulated pipelines at the cost of service. In doing so, it recognises that the application of pricing restrictions on services has both direct and indirect costs, and is not appropriate in respect of many services offered by pipelines.

For the economy as a whole, the appropriate threshold for this type of regulation has been set as the declaration/coverage criteria. These criteria have been reviewed on numerous occasions and confirmed to be appropriate, with minor revision, mostly to

make sure that they do not apply to assets for which the cost of regulation (direct and indirect) is not justified.

Extension of cost of service regulation to assets that are not covered would be over-regulation by the standard set by the National Competition Policy. This is avoided in the Commercial Arbitration Model.

4 Responses to questions in *Options Paper*

GMRG question	APA response
Information disclosure	
1. Are there any other information disclosure options that you think should be considered? If so, what is the option and why do you think it should be considered?	The information disclosure options in the paper effectively build levels of disclosure above option 1. The alternative Commercial Arbitration Model involves a different mix of the existing options including option 1 'base level' information, with disclosure of a measure of the prevailing tariffs paid by shippers for each pipeline for firm services (part of option 4). APA considers that disclosure of this information directly addresses the concern as expressed by Dr Vertigan, being uneven bargaining power between shippers and pipeliners. APA considers that the focus on cost of service reflects the initial concern over monopoly pricing from the ACCC, where this recommendation arose, rather than a regime focused on addressing the concerns raised by Dr Vertigan.
2. Do you agree with the base level of information that pipeline operators would be required to provide if Option 1 was to be implemented, or is there other information you think should be disclosed to enable shippers to make an informed decision about whether to seek access?	APA has no concerns with publishing the base level of information as described under Option 1. APA notes that it already publishes the majority of the listed information on its website. APA considers that the base information could be further supported by information on the prevailing tariff applying for each non-scheme pipeline for firm services.
3. Do you think there is value in requiring pipeline operators to provide shippers with information that could assist with their assessment of the reasonableness of the prices offered?	APA considers that publication of the prevailing tariff applying to firm services for each non-scheme pipeline would support shippers to assess the reasonableness of the prices offered, including prices for expansions.
3(b) (i) Do you think that	Cost information is only relevant in the context of setting

cost and other financial information should be reported? • If not, why not? • If so, do you think it is sufficient for shippers to be able to access the pipeline's financial reports and a breakdown of demand information, or is more detailed cost, demand and financial information required?	regulated prices and in the absence of other market mechanisms to determine an efficient price. This is not the case for pipelines that have not met the coverage test. APA does not believe that the disclosure by APA of pipeline specific financial reports will be relevant information for a shipper to determine the cost of service. APA prepares group level accounts only. Many costs, such as debt and equity costs, tax and corporate costs, are incurred at the group level and are either not allocated to specific assets, or their allocation does not bear a relationship to how those assets drive those costs. Therefore, as a base measure for determining costs for each pipeline, these key building blocks will lead to a misleading picture of each pipeline's actual level of costs. Further, it is not possible to develop a more 'meaningful' allocation for each asset – this is likely to involve considerable discretion such as to undermine the intent of the measure. As an example, allocation of group level debt and equity costs by revenue driver would not reflect the debt/equity position and risk of the asset. Also, it is unclear if or how group level economies of scale should be allocated to individual assets. APA considers that the publication of prevailing tariffs (where they are applicable) would be a better alternative measure to the publication of cost information. The publication of a prevailing tariff, coupled with Bulletin Board information on pipeline capacity and available firm capacity would give a reasonable indication to shippers as to revenues earned from firm services for each pipeline. As firm services represent the vast majority of revenues, this is also a good indicator of total revenue earned. This is a factor of currently published information, coupled with the proposed publication of a prevailing tariff. As such, there is no need to add an additional cost reporting requirement. Cost reporting is likely to be quite costly, involve significant compliance and monitoring arrangements, and ultimately, in APA's case, deliver reporting that is not indicative of underlying costs of individual assets because of the relatively arbitrary allocation of group costs.
3(b)(ii) Do you think the prices actually payable by shippers should be reported?	APA considers that the prices payable by shippers are important information to assist other shippers, in particular smaller shippers, to bargain with pipeliners on non-scheme pipelines.
— If so, do you think the anonymity of shippers needs to be protected, or	APA understands that shippers may not wish that their particular tariffs be published, including the terms and conditions of their arrangements, notwithstanding that this would be very powerful

do you think all prices should be disclosed? — If you think anonymity needs to be protected, please explain why and how you think prices could be aggregated?	information to support commercial negotiations. As an alternative, APA considers that publication of a prevailing tariff, as a measure of the tariffs paid by existing shippers for firm services on a particular pipeline would present a reasonable compromise to address shipper confidentiality concerns.
— Given the differences in terms and conditions that can affect price in the underlying contracts, do you have any concerns about aggregating prices?	APA believes that concern over the bespoke nature of contracts is significantly overstated and may reflect the circumstances of a generation ago before standardisation. In practice, pipeline services are defined by a small number of factors: • location – pipeline services between which points? • duration – long term contract or short term (eg seasonal) contract • amount – how much capacity is being contracted for, including flexibility such as MHQ that impacts the total capacity reserved under the contract; and • Scheduling priority (degree of firmness). Other aspects of the terms and conditions may be subject to variation, however they are very unlikely to materially impact the tariffs under the contract. In fact, as APA has developed and implemented a standard form contract, these variations are very limited indeed. APA believes that it is possible to develop a supportable and meaningful benchmark for the prevailing firm tariff for each non-scheme pipeline to support negotiations.
3(b)(iii) Is there any other information that pipeline operators could be required to disclose?	As described above, APA considers that pipeliners should disclose the base information as described under option 1, coupled with details of prevailing tariffs for each non-scheme pipeline. In addition, APA considers that pipeliners should publish pricing principles setting out details of how 'derivative' tariffs have been determined, including relevant calculations.
4. Do you think that an exemption mechanism should be incorporated into the information disclosure requirements?	Yes, the information disclosure requirements impose additional obligations and costs on pipeliners, and therefore there should be exemptions where the benefits of that disclosure do not outweigh the costs.

(i) Do you agree that it would be appropriate to provide for an exemption from all the disclosure requirements if the pipeline is not providing third party access; or is a single shipper pipeline? (ii) Do you think an exemption from the cost, demand and financial information reporting requirements should be granted to pipelines that are smaller than the minimum reporting threshold? If so: • Do you think the exemption should be absolute, or should it just mean that the pipeline operator doesn't have to provide information unless it is requested to do so? • Do you agree with the 10 TJ/day reporting threshold, or do you think a different threshold would be more appropriate? (iii) Do you think there are any other exemptions that should be provided for, such as in relation to: – non-scheme distribution pipelines? – pipelines subject to a 15-year no-coverage determination?	Dedicated pipelines servicing a single shipper, such as connection assets, should not be subject to any type of reporting requirement. These assets do not, and will not, provide third party access to other shippers. Applying this regime to these pipelines will deliver no benefit in respect of supporting commercial negotiations. The broad category of 'non-scheme pipelines' will capture industrial users that own their pipeline connection assets into this scheme. These pipeline owners have not been involved in this policy process and are very likely unaware that it is even happening. It would not be appropriate to include these pipelines in this scheme. The lack of recognition of these pipeline owners in the *Options Paper* reflects on the poor level of actual consideration and due diligence that has gone into developing this scheme to date. These issues would have been expected to be picked up in a Regulation Impact Statement in the normal course of policy development. The abandonment of these elements of good government in this process has meant that the regime, as already introduced into the South Australian Parliament, could have far reaching and unintended consequences and costs that have not even been identified as risks in this process to date. APA considers that far more consideration needs to be given to the scope of this regime than the cursory consideration given in the *Options Paper*. For example, does it apply to embedded distribution networks? How would an embedded distribution network even comply? These and other impacted stakeholders have not been part of this policy process, yet they will find themselves non-compliant by mid-year with legislation (the NGL) that has never applied to them. How are they to be identified and informed of their obligations? Have their costs of compliance been considered? This is an important matter that needs to be addressed before this regime commences.
4(c) If an exemption mechanism is to be adopted, do you think the	The AER is the appropriate body to oversee exemptions, however it is unclear how the AER will identify all impacted stakeholders that may be appropriate for exemption, or what rules it would

AER is the most appropriate body to oversee the mechanism, or is there another option?	apply.
5. Do you agree that the new information disclosure requirements should be classified as a civil penalty provision in the NGR? If not, why not?	The decision as to whether to classify these requirements as a civil penalty provision should be made within the context of other similar rules, and how they are treated.
6. Do you think there would be any value in also classifying the information disclosure requirements as a conduct provision in the NGR? If so, why?	The decision as to whether to classify these requirements as conduct provisions should be made within the context of other similar rules, and how they are treated. As this is a general reporting requirement, and conduct provisions involve the ability of individuals to themselves enforce compliance and seek remedy for non-compliance where they have been harmed, it would appear inappropriate under the existing NGL scheme of compliance for these obligations to be conduct provisions.
7. Do you think there would be value in including a reporting standard in the information disclosure requirements in the NGR? (a) If not, why not? (b) If so, what form do you think it should take?	APA supports *in principle* the reporting standard discussed in the *Options Paper* that published information must not be knowingly false or misleading. Noting APA's comments above in relation to cost reporting of group-incurred costs, APA does not believe that reporting of these costs is likely to be particularly meaningful for shippers in determining actual pipeline costs. The costs of compliance with any information disclosure increase significantly as the standards of accuracy or timeliness increase. For example, a requirement to regularly publish information (such as daily by a particular time) to a high level of accuracy will impose system costs to ensure everyday compliance. This includes backup systems and processes for the validation and transmittal of information. By contrast, a 'best endeavours' requirement, with the ability (and potentially an obligation) to correct any errors if they are found would impose significantly lower costs of compliance. The appropriate standard to apply to these information requirements will depend of the nature and use of the information. As the information discussed in the *Options Paper* is more in the nature of 'standing' information, and would not be used to make short term transactions (such as would be required of information supporting the Short Term Trading Market for example) then the reporting standard should reflect this.

8. Do you agree that the information to be published by pipeline operators should be published on their website?	This information should be published on the individual pipeliner's website. This information relates to primary capacity transactions – they are transactions between pipeliners and shippers and do not involve third party platforms. Publication of this information on another platform would increase compliance costs for no benefit.
8(b) Are there any other issues that the GMRG should consider in relation to the manner and form in which information should be published?	The GMRG should consider the role of the scheme and what it is trying to achieve. It is not trying to emulate a regulatory price setting process. It is intended to support commercial negotiations. The nature of information to be published, and its form, should be commensurate with this aim.
9. Do you agree that the AER should prepare a guideline on how financial reports or detailed cost information is to be prepared? If not, why not?	No. AER involvement in setting standards for information disclosure is likely to drive the scheme towards regulatory concerns rather than commercial ones. Assistance in developing appropriate guides may be a role for the AEMC in line with their other market development roles.
10. Do you have an alternative view on the frequency with which information should be published by pipeline operators from that set out in section 3.4.6.3?	The base information should be kept up to date with any changes reflected in the published information within a reasonable period. In respect of APA's proposal to publish details of the prevailing tariff, this can be updated annually. This would provide an appropriate balance between compliance costs and the degree to which contracted capacity on a pipeline changes. APA does not believe that financial information should be reported. Significant demand information is already reported to the Bulletin Board on a daily basis.
11. Do you think a confidentiality mechanism should be included in the information disclosure requirement? (a) If not, why not?	APA does not consider that a confidentiality mechanism is required under the proposed information disclosure framework of the Commercial Arbitration Model. Noting that the regime already anticipates the exemption of single shipper pipelines from the information disclosure requirements, this exemption would mean that tariff information relevant to a single shipper would also be protected.
12. If a shipper's access application reasonably	Yes, the pipeline operator should be able to recover these costs. Rule 112 applying to scheme pipelines explicitly states that these

requires further investigation by the pipeline operator, do you think a pipeline operator should be able to recover the direct costs of this investigation work? If not, why not?	costs should be recoverable. There is no reason why different considerations should be applied to non-scheme pipelines. These provisions, amongst other things, protect pipeliners from non-serious requests for access, generally referred to as tyre-kicking. Pipeline operators should not be exposed to the risks of non-genuine requests for access (where the pipeliner is obliged to respond as envisaged by this scheme) as this could be subject to significant gaming by prospective shippers as a fact finding/cost transfer exercise rather than a genuine request for access at a particular site.
13. Are there any other circumstances in which a pipeline operator should be able to recover the costs it incurs in providing information?	As a general rule, businesses should be able to recover the costs of compliance with new obligations from customers. APA will vary tariffs under existing contractual change of regulatory obligation rights to recover any additional costs arising from this scheme.
14. Do you agree with the GRMG's preliminary view that Option 2 should be implemented? If not, please explain why this is the case and if there is another option that you think would be more appropriate?	No. This option includes the disclosure of significant revenue and cost information that is not appropriate for the purpose of the scheme. The information proposed to be disclosed would not assist a shipper to reach a meaningful conclusion as to an appropriate tariff for services such that it would assist in reaching a commercially negotiated outcome. The assumption that disclosed information should allow this calculation is misconceived. APA prepares group level accounts only. Many costs, such as debt and equity costs, tax, as well as corporate costs, are incurred at the group level and are either not allocated to specific assets, or their allocation does not bear a relationship to how those assets drive those costs. Therefore, as a base measure for determining costs for each pipeline, these key building blocks will lead to a misleading picture of each pipeline's actual level of costs. Further, it is not possible to develop a more 'meaningful' allocation for each asset – this is likely to involve considerable discretion such as to undermine the intent of the measure.
15. What costs are pipeline operators likely to incur complying with this option?	The costs to APA of this approach would be very significant. APA currently prepares accounts at a group level only, with auditing costs reflecting this level of detail. Option 2 would require pipeline level accounts, and associated auditing requirements at this level, which APA estimates would approximately double current auditing costs.

	APA owns and operates a large number of pipelines and other assets such as gas-fired generators, wind farms, gas production facilities and storage facilities. APA does not gather information or allocate its group costs on an individual pipeline or non-regulated asset basis. In addition, APA does not record its revenues on this basis, in particular as between services provided to each shipper on a pipeline such that APA could accurately report revenue by service by pipeline. It is worth noting that even full regulation pipelines are not required to report revenues to the regulator as they are not relevant to setting tariffs based on costs. In addition to direct auditing costs, the amount of support that APA would need to provide to audits would increase dramatically. With very small assets requiring individual treatment, this will drive audit investigations to individual minor transactions to get appropriate levels of certainty. This dramatically increases staff costs to support the audit. Further, APA would need to revise its account systems to develop these reports. It would also need to develop methodologies for the manual allocation of costs incurred at a group level, and then to perform those allocations effectively outside of the accounting system. This is would be a very resource intensive process that is still unlikely to deliver meaningful 'asset by asset' costs because of the nature of the group level costs (such as debt and equity costs) being allocated.
16. Do you think that the benefits of implementing this option will exceed the costs?	A requirement of the kind set out in the preliminary view would require significant increase in APA's direct and indirect auditing costs, as well as reconfiguration of APA's financial reporting structure, and additional manual data handing costs. These costs would be completely out of step with any possible benefit that could be derived from disclosing this information as this information will necessarily involve some level of allocation of group level costs that will not reflect the underlying drivers of those costs. This disclosure, given the limitations, is likely to lead the shipper to make incorrect assumptions, and therefore lead shippers into dispute rather than support commercially agreed arrangements.
17. Do you agree with the GMRG's preliminary view on how the implementation issues should be dealt with (see Table 6.3)? If not, please	APA has discussed many of the implementation matters set out in table 6.3 in response to questions above. These include: • Exemptions – see response at 4 • Compliance – see responses at 5, 6 and 7 • Manner, form and frequency – see responses at 8, 9 and 10

explain why.	• Confidentiality – see responses at 3(b)(ii) and 11 • Costs – see responses at 12, 15 and 16
Arbitration mechanism	
18. Do you agree with the GMRG's proposed approach to dealing with the following matters as set out in sections 4.4.1 and 4.4.3: 19. If not: (a) What concerns do you have with the proposed approach/s? (b) Are there other approaches that you think would be more appropriate? If so, please explain why this is the case.	
(a) access proposals?	APA agrees that requests for access should be made in accordance with the pipeliner's negotiating framework.
(b) protecting existing contractual rights?	APA believes that the discussion in the *Options Paper* in relation to the impact of the arbitration regime on contracts containing MFN clauses is self-serving. It does not consider the impact of MFNS on pipeliners in light of the new arbitration regime. Pipeliners only agree to MFN clauses in respect of pipelines and investments where they consider that there is a very low risk of economic regulation. Indeed, many MFN clauses do not apply to regulated tariffs. This is because pipeliners must manage their risks in relation to MFNs by being able to decide on prices paid by other shippers for similar services. This new arbitration regime removes that right for pipeliners and will have a fundamental impact on returns in respect of those pipelines.
(c) safeguards to avoid distorting investment?	As discussed in section 2.4 of this submission, APA believes this scheme will fundamentally undermine incentives for investment. This is achieved through the indiscriminate application of a continuous arbitration scheme based on cost of service, and how that scheme will impact on shipper contracting behaviour through the imposition of MFNs, and the inability of pipeliners to then manage that risk, leading to an uninvestable environment. Where the *Options Paper* does discuss safeguards to avoid distorting investment, it is in the context of forcing investments in new capacity. While a protection ensuring that pipeliners are not forced to fund an expansion is welcome, this provision is undermined by the proposed pricing principles where the arbitrator is invited to consider the value of such expansions to the pipeliner in setting tariffs. These pricing principles must be removed if the protection discussed above is to be meaningful. These pricing principles exist in the CCA in respect of regulated

	assets. The expectation is that the value of these expansions for the infrastructure operator, as determined by the regulator, becomes part of an asset on which the infrastructure operator can recover costs from other users. This principle does not apply in respect of the arbitration regime and should be removed – the pipeliner would have full risk that any unfunded part of an asset is stranded in the future with no protection that costs would be recovered through other shippers. There is no group recovery associated with these investments from other users that can be assumed – the user requiring the investment should therefore pay the full costs of any expansion forced under the scheme. Further, APA considers that the *Options Papers* does not at all consider the circumstances where a pipeliner may be forced to invest. Open access pipeline operators across Australia are not vertically integrated. They have no incentive to block access to a pipeline or not complete an economic expansion. The real risk of the power to force expansion is to distort investment towards an expansion that is not economic. No consideration is given to this risk in the *Options Paper*. The risk is created by the cost of service arbitration approach, and avoided under the Commercial Arbitration Model. APA agrees that pipeline extensions should be excluded from the regime as they are provided on a competitive basis. It is puzzling why the *Options Paper* does not consider that this argument applies to some other services provided by pipeliners, such as capacity trading services that are discretionary services that make transactions easier, but are not necessary in order to trade capacity.
(d) the role of the AER?	The AER's role should be limited to compliance and enforcement in line with its powers in respect of markets. APA is concerned with the creep throughout the paper to seek to rely on the AER's 'expertise' to develop relevant guidelines and to support the arbitrator. The AER has no expertise in relation to commercial negotiations or arbitrations. The involvement of the AER will bring with it a regulatory overlay and assumptions that the *Options Paper* states it is trying to avoid.
(e) selection of the arbitrator?	APA considers that the arbitrator/s selected for a dispute must have experience in commercial business negotiations and commercial dispute resolution, reflecting the nature of the decisions that the arbitrator would make under this scheme. This scheme is quite different from other arbitration schemes

	where the arbitrator is stepping in to resolve disputes related to an agreement, which are more of a more legal nature, and the parties are seeking to avoid going to court. The types of decision this scheme would be determining are pre-agreement matters, and are not those that would go to court as they relate to reaching a decision for the provision of services, not the interpretation of terms within a service. This requires a different set of skills that are not legal or regulatory in nature. Further, APA considers that there would be value in appointing a panel of arbitrators (at least 2) to consider matters under dispute. This would provide a number of benefits, such as a diversity of experience, ability to manage workload and backup if a particular arbitrator was not able to complete an arbitration.
(f) the binding nature of the access determination?	The most profound shortcoming of the regime as set out in the legislation introduced to the South Australian Parliament is the removal of the binding nature of the arbitration on shippers. This change from the draft legislation consulted on with industry fundamentally undermines the ability of the regime to deliver the outcomes sought by Dr Vertigan as it has the effect of substantially removing incentives for a shipper to reach a commercially agreed outcome with a pipeliner. For the regime to support commercial negotiation, it needs to provide incentives for both parties to reach a negotiated agreement. Where one party can trigger arbitration, yet not be bound by the outcome, the risks of arbitration for the shipper are fundamentally diminished – only one party is incentivised to avoid arbitration. When this right to walk away is coupled with an arbitration based on cost of service, the incentives for the shipper to do anything other than complete the steps before seeking arbitration are completely eroded. A 'cost of service' approach sets arbitration outcomes at the lowest end of the range of outcomes that a shipper could expect from a commercial negotiation. As a result, the shipper will always test the arbitration to confirm that the pipeliner is offering prices at cost of service (and no more). Importantly, the shipper will do this even if the pipeliner is offering tariffs at this floor as the risks of arbitration are very low for the shipper and arbitration becomes a process to confirm that prices offered are at the floor. In this way arbitration effectively replaces commercial negotiation as the most rational option for a shipper when seeking a new service. The scheme therefore creates negative incentives to negotiate for the shipper.

	As the legislation has been introduced in to the South Australian Parliament that provides for this outcome and therefore is very unlikely to be changed, it is critical that the basis of arbitration be separated from a cost of service approach, such that commercial negotiations can still be conducted in an environment where arbitration could deliver a potential range of outcomes, some of which may not be desirable for the shipper. Without this, the regime moves from one that supports commercial negotiation to one that applies real price regulation to pipelines and services on which no case for regulation has been made, and without any of the checks, balances or safeguards provided by the National Gas Law and National Gas Rules for regulated pipelines. This may lead pipeliners to seek full regulation of assets as an alternative. This is a key failure of the framework as conceived in the *Options Paper*, and one that must be addressed for the framework to deliver on its intent.
(g) the costs of the arbitration?	In the absence of a binding arbitration ruling on shippers, the only remaining incentives that shippers would have to reach a commercial outcome rather than rely on arbitration is the direct costs of arbitration. This is a very limited mechanism as the costs of arbitration, while they can be significant, are likely to be small in relation to the value of the contract in question for both parties. Given the scale of businesses seeking direct access to pipelines, and the assumption that these businesses are sophisticated enough to be participating in the gas market (presumably they have negotiated a deal for gas supply, for instance), APA is concerned that the *Options Paper* contemplates a situation where the costs of arbitration could be awarded in a manner that takes account of the financial circumstances of the parties or the value of the services sought. This appears to be a suggestion that the pipeliner would bear the costs of arbitration for small shippers. APA encourages the GMRG to seriously reconsider the assumptions behind this suggestion in a commercial negotiation framework. APA supports the suggestion that, where a shipper elects not to be bound by an arbitration, it must bear the full costs of the arbitration, including each party's reasonable costs in relation to the arbitration. In the absence of the arbitration being binding on the shipper, this may provide some incentives to negotiate.
(h) the termination of	An arbitration should be able to be terminated by the arbitrator,

arbitration by the arbitrator and/or access seeker?	or by agreement of the parties. APA considers that where the arbitrator or the access seeker terminates the arbitration, the reasons for doing so should be reflected in the allocation of costs associated with the arbitration. For example, if an arbitrator terminates a process because a shipper is not engaging in the process in good faith, the shipper should bear the full costs of the arbitration. APA notes that not all circumstances where a shipper terminates an arbitration would necessarily lead to the shipper appropriately bearing the full costs of the arbitration – the award of costs should therefore be at the discretion of the arbitrator.
(i) the process for correcting errors?	The process for correcting errors is appropriate.
20. Do you agree with the GMRG's proposal to allow shippers and pipeline operators to be able to access arbitration in the event of a dispute in relation to services that require the use of existing capacity or require further augmentation of the pipeline (excluding extensions)?	APA agrees that this the appropriate scope for arbitration. APA supports the position set out in the *Options Paper* that extensions to pipelines should be excluded from provisions under which the arbitrator can force the pipeliner to invest. This reflects that these services are subject to competition. APA believes that this provision would extend to negotiations to build a new pipeline, which may interconnect with an existing pipeline.
21. Do you think an exemption mechanism should be incorporated into the arbitration mechanism? (a) If not, why not? (b) If so, do you agree that it would be appropriate to provide for an exemption to non-scheme pipelines that are not providing third party access? If not, why not? (c) Are there other exemptions that should	APA's comments on the need for an exemption mechanism from information disclosure at question 4 apply similarly to the arbitration scheme.

be included, such as in relation to: (i) non-scheme distribution pipelines? (ii) pipelines subject to a 15-year no-coverage determination?	
22. If an exemption mechanism is to be adopted, do you think the AER is the most appropriate body to oversee the mechanism, or is there another option?	The AER is the appropriate body to oversee exemptions, however it is unclear how the AER will identify all impacted stakeholders that may be appropriate for exemption, or what rules it would apply.
23. If an exemption is adopted, what process should be in place under the Rules to obtain an exemption? For example, should parties be required to apply to the AER for an exemption?	The broad application of the term 'non-scheme pipeline' means that there is potential for significant numbers of parties to be captured in that definition in a way unintended by the scheme. This suggests that a case by case application process for exemption is not appropriate. Many parties would not even know they need an exemption and may find them themselves in unintended non-compliance with the legislation.
24. Are there other important design components that have not been identified in this paper? If so: (a) What design component/s have been overlooked? (b) What approach would you recommend the GMRG take in addressing these design issues?	The party that notifies that AER of a dispute should also have to notify the other party to the negotiation at the same time.
Arbitration options	
25. Of the options that have been identified, which options do you think provide the most a credible threat on	Resolution of disputes through speedy commercial arbitration will provide a credible threat of intervention. APA believes that conventional arbitration most closely resembles that used in commercial disputes. To ensure that

intervention? Why?	disputes can be resolved quickly, that arbitration should be guided by pricing principles. This approach creates a credible threat of arbitration for the pipeliner (in favour of the shipper) as it is speedy. Unfortunately, when this option is combined with cost of service pricing principles (the preliminary view), the incentives for shippers to agree to a commercially negotiated outcome disappears as prices will be set through arbitration at the floor of possible outcomes they could expect from a commercial negotiation. The result is a full threat of intervention for the pipeliner, but a situation where a shipper still seek out arbitration to confirm they have been offered a tariff at the bottom of the range.
26. Which option do you think appropriately balances the following and why: • providing for a commercially-focused arbitration framework; • avoiding unnecessary interference with investment and innovation; and • affording adequate protections to small shippers to effectively use arbitration in the event of a dispute.	APA considers that the Commercial Arbitration Model, involving conventional arbitration bounded by pricing principles where arbitration is based on the prices paid by other shippers, incentivises commercial negotiation and provides for commercially-focused arbitration as it derives tariffs based on outcomes that are an outworking of commercial processes. The preliminary view option of cost of service arbitration creates a regime of continuous arbitration and price setting that is devoid of incentives for investment and innovation by finding cost savings or introducing new services. Under the current market arrangements, a shipper will seek to enter into a contract for a new service involving a new pipeline, extension or expansion. In determining a tariff for that service, the pipeliner will consider its costs and determine a tariff for the term of the contract. This includes a forecast of the longer term operating costs for the pipeline. For the duration of the contract, the pipeliner has an incentive to find efficiencies and thereby reduce its costs (without undermining the service requirements under the contract) compared to those assumed in the foundation tariff. In return, the shipper has firm access to capacity and cost certainty. At the same time, the pipeliner also has incentives to grow the market by developing and offering new services as these are largely not impacted by MFNs or revenue sharing arrangements. This growth is made possible because the pipeliner has had an incentive to invest in spare capacity because it can keep additional revenue associated with providing new services. Conventional regulation also provides some incentives for efficiency and innovation, though they are not nearly as strong

	as applying in an unregulated environment. A standard regulatory term sets prices every five years on the basis of forward looking costs. In doing so, it sets prices for a period and therefore rewards actions that lead the pipeliner to outperform those benchmarks in the period. This includes incentives to grow the market (beat demand benchmarks), find efficiencies (beat cost benchmarks) and develop new services (derive additional revenue from new/innovative unregulated services). Under the proposed new framework, there is no period where tariffs are fixed. Continuous arbitration based on cost of service will mean a continual resetting of tariffs for services (including firm services) for new shippers based on a snapshot of costs and demand at the time. This means that a later shipper can seek access to spare capacity on a pipeline through arbitration, and be granted a tariff that is less than the benchmark set for a foundation shipper because it takes into account efficiency savings made since that original contract, demand growth, including the demand of the new shipper, as well as revenue earned from other services. A rational response to this risk is for a foundation shipper to seek an MFN clause in each contact to immunise itself against the risk that a later shipper will get a better price from arbitration. The result will be that the pipeliner has no incentive to seek efficiencies, grow the market or develop new services as these are all confiscated by shippers through the operation of each arbitration outcome flowing through MFN clauses to reset all tariffs. As a result, the incentives for the pipeliner for innovation and cost efficiencies flowing from the continuous arbitration regime are in fact poorer than under full regulation. Cost of service arbitration will also be expensive, and for it to avoid significant risk of error it will need to take more time than the allocated 3 months (extendable to 5 months only with the agreement of the shipper).
27. Are there any additional and more preferable options for the implementation of the arbitration mechanism not identified in this paper? If so: (a) What design components would make up this option or options?	APA considers that the Commercial Arbitration Model, involving disclosure of prevailing tariff(s) for each pipeline, pricing principles and arbitration based on the prices paid by other shippers incentivises commercial negotiation and provides for commercially-focused arbitration as it derives tariffs based on outcomes that are an outworking of commercial processes. Details of this approach, including the advantages of this approach, are set out in chapter 3 of this submission. In short, APA considers that the alternative model for information disclosure and commercial arbitration will incentivise commercial

(b) What are the advantages and disadvantages of this option? (c) Why is this option preferable to the five options identified?	negotiation for all parties to a negotiation, while also supporting innovation and investment. The Commercial Arbitration Model provides for timely dispute resolution, without significant risk of error, and as such ensures that arbitration remains a credible threat. Most importantly, it directly addresses the concern raised by Dr Vertigan in relation to uneven bargaining power between shippers and pipeliners, by developing nuanced approach that recognises that this applies in relation to uncovered pipelines, and there is in place an effective proven regime in place economy-wide to address market power arising from natural monopoly.
28. Do you agree with the preliminary view on the form the arbitration mechanism should take? (a) If not, is there another arbitration option that you think would be more appropriate? If so, please explain why this is the case?	APA believes that conventional arbitration most closely resembles that used in commercial disputes. To ensure that disputes can be resolved quickly, that arbitration should be guided by pricing principles. The form of the pricing principles will determine whether the arbitration regime incentivises commercial negotiation, and does not distort incentives for investment and innovation. The cost of service approach does not incentivise commercial negotiation, and distorts incentives for investment and innovation.
29(a) Do you think the pricing principles should provide the arbitrator with broad discretion to determine whether a pipeline operator's offer is reasonable? If so, why?	APA considers that the pricing principles applied by the arbitrator should reference the business interest of the pipeliner, other contracted shippers on the pipeline, and the value of the service for the shipper. Decisions should be limited to the dispute between the parties and information put forward by the parties, and should seek to reference the prices paid by other shippers for similar services. Where adjustments to tariffs are required to take account of specific circumstances, the arbitrator should have discretion to make those adjustments, in line with the pricing principles.
29(b) Do you think the pricing principles should specify the test the arbitrator is to use when assessing whether a pipeline operator's offer is reasonable?	If a pipeline operator's offer is not reasonable, that will be discovered (in commercial arbitration) through arbitrator decisions which closely accord with the outcomes sought by shippers.
(ii) If so, do you think the	Arbitration should be based on the prices paid by other shippers for similar services and other principles to determine derivative

test should be based on: • the prices payable for comparable pipeline services? If so, please explain why and also set out how you think the limitations set out in sections 3.3.2.2 and 5.1.1 would be overcome.	tariffs. This approach delivers a speedy approach to resolve disputes that addresses uneven bargaining power concerns of smaller shippers. The arbitrator would have discretion to make some adjustment to the tariffs applying to other users tariffs where this is appropriate under the other pricing principles. *Market power concerns* This concern appears to arise from an acceptance in the *Options Paper*, in contradiction to Vertigan's *Examination*, that the information disclosure and arbitration regime should be directed at addressing monopoly pricing rather than uneven bargaining power. The ACCC found that foundation contracts can be expected to reflect competitive outcomes. APA notes that foundation contracts by their very nature, would have the strongest weighting in any prevailing tariff calculation, passing on this benefit to later shippers that were not part of the initial negotiation. *Impact of changing demand on the tariff* Another concern raised in the *Options Paper* for this approach is that it would not take account of changing demand on the pipeline. This concern is fundamentally misconceived. Foundations contracts, as confirmed by the ACCC, and the *Options Paper*, are arrived at through competitive processes. Some include MFN clauses and others do not. Some may also include some form of revenue or cost sharing where new shippers come to use spare capacity on the pipeline at a later date. Whether the foundation contracts contain these types of provisions is a function of a commercial negotiation. Where they do not include these clauses, the foundation tariff will be lower as they allow the pipeliner to keep the benefits of growing the market – often they mean that the pipeline is built with spare capacity for this purpose. These arrangements are therefore struck on the assumption that foundation tariffs are not reduced in line with increased demand on the pipeline. Importantly, these arrangements are not a function of market power but a risk sharing arrangement between the foundation shipper and the pipeline operator struck in a competitive negotiation. By contrast, where foundation contracts do contain these clauses they reflect a desire on the part of the shipper to manage the risks that a competitor may access the pipeline that they have committed to use over the longer term on better terms (lower rates or with less long term contracting risk) than the

foundation shipper could at the time of negotiation because of the scale required to support new investment. This is a legitimate concern for the shipper that they can manage through these clauses, but the trade-off is that they cap future growth returns for the pipeliner on the pipeline for the duration of that contract meaning that the foundation tariff is likely to be higher.

The results for the appropriateness of using an existing foundation tariff in light of changing demand are therefore as follows:

- The foundation tariff reflects a contract without future restrictions (no MFN or revenue sharing) and therefore the foundation tariff has been set with the pipeliner having the opportunity for future growth in revenues in mind – changing demand should not impact that tariff as to do so would undermine the pipeliner's incentive to invest in spare capacity that made up the original business case; or
- The foundation tariff reflects revenue sharing of future use of pipeline (and therefore has already been driven lower by increased growth) or has been reset by the operation of an MFN.

In each of these cases, changing demand is already embedded in the foundation tariff, and is not a factor in determining the appropriateness of that tariff.

As an aside, contractual utilisation of a pipeline, particularly where there is significant spare capacity on a pipeline, can be a good indicator of the negotiating power of the shipper. This information is now readily available on the Gas Market Bulletin Board in the form of a 12-month outlook of spare firm capacity.

Bespoke nature of contracts

APA believes that concern over the bespoke nature of contracts is significantly overstated and may reflect circumstances of a generation ago before standardisation. In practice, pipeline services are defined by a small number of factors:

- Location – pipeline services on which pipeline between which points?
- Duration – long term contract or short term (eg seasonal) contract?
- Amount – how much capacity is being contracted? and
- Scheduling priority (degree of firmness).

Other aspects of the contract may be subject to variation, however they are very unlikely to materially impact the tariffs under the contract. In fact, as APA has developed and

	implemented a standard form contract, these variations are very limited indeed. APA believes that it is possible to develop a supportable and meaningful benchmark for the prevailing firm tariff for each non-scheme pipeline that would support negotiations. *Confidentiality concerns* APA understands that shippers may not wish that their particular tariffs be published, including the terms and conditions of their arrangements, notwithstanding that this would be very powerful information to support commercial negotiations for other shippers. However, as an alternative, APA considers that publication of a form of a prevailing tariff for firm services on a particular non-scheme pipeline would present a reasonable compromise to address shipper confidentiality concerns if this is considered appropriate.
(ii) If so, do you think the test should be based on: • the costs incurred in the provision of services? If so, do you think the costs should be measured using the hypothetical new entrant standard, or the actual cost standard?	APA does not support a cost of service approach for arbitration as it provides no incentive for shippers to engage in commercial negotiations, and has very negative implications for incentives for innovation and investment. It also creates very significant risks of arbitrator error. The very fact that this is a question asked in the *Options Paper* is a clear indication that the paper has veered down the wrong path. The *Options Paper* states: *The arbitration process is not intended to emulate the AER regulatory process or provide for quasi-economic regulation. Parties may submit a coverage application to the National Competition Council (NCC) if they think a pipeline should be subject to economic regulation [page 61].* Contrary to these statements, these questions are effectively asking about which form of economic regulatory assessment under the NGR should be used to determine the opening asset base. These are economic regulatory questions that have no place in a commercial arbitration approach. APA also considers that cost of service arbitration cannot be completed within the timeframe set for arbitration. Where the scheme seeks to apply a cost of service approach, as is recommended, the information and decision-making demands on the arbitrator will be high. The *Options Paper* fails to recognise the necessary trade-off between choosing arbitration based on cost of service, and the resulting time and costs that need to be

	dedicated to that arbitration. Instead it suggests that a party would be 'gaming' the arbitration process if it provided the arbitrator with a lot of information. Cost of service arbitration cannot be completed within 3 months on limited papers – to do so would effectively guarantee substantial decision-making error that will have profound impacts on the energy sector and the economy as a whole. The AER, when asked to do the same task for covered pipelines, takes at least 11 months, employing teams of experienced people, and applying bounded and well understood rules. These levels of resources, time and experience are not available to the arbitrator. Even prior to submission, pipeline businesses typically take 6-12 months to develop proposals. The timeframe for arbitration and the scope of arbitration are inextricably linked – you cannot choose cost of service regulation and then limit the time to reach a decision. The threat of such a regime is sufficient to halt investment in the sector. To be clear, the risks for pipeliners of a short, uninformed, cost of service arbitration far exceeds the risks for pipeliners of regulation, which at least provides for decision-making time, rules for decision, procedural steps including draft decisions, and rights for review (judicial and merits). None of these protections are available under the regime contemplated in the *Options Paper* to apply to pipelines to which no case for regulation has even been made. APA considers this scheme would create an uninvestable environment and cannot deliver timely arbitrator decisions that are not impacted by substantial error. If the GMRG insists on continuing down its preferred path, any asset valuation must be based on the hypothetical new entrant test. As noted in the *Options Paper*, this test reflects a more commercial setting and is consistent with encouraging direct competition for infrastructure services. APA does not agree with the discussion in the paper on the difficulty of applying this test in practice, and in any case does not consider that the alternative valuation methodology, the actual cost standard, represents a less difficult or controversial path.
29(c) Do you think the pricing principles should provide the arbitrator with additional guidance on how to apply the relevant test, or should the	APA believes that conventional arbitration most closely resembles that used in commercial disputes. To ensure that disputes can be resolved quickly, that arbitration should be guided by pricing principles. The pricing principles should first direct the arbitrator to consider the level of competition for services under dispute. Where this is

arbitrator have discretion to determine how the test is to be applied? (i) If you think more guidance is required, please explain why and specify what additional guidance should be included in the pricing principles. (ii) If you don't think further guidance should be included in the pricing principles, do you think there would be value in getting the AER to prepare any guidelines on how the actual cost of providing the service could be measured by the arbitrator (including asset valuation techniques that could be used)?	not relevant the arbitrator should use the prices paid by other shippers for similar services and other principles to determine derivative tariffs. Where adjustments are required to those tariffs to take account of different circumstances, the arbitrator should have discretion to make those adjustments. APA does not support the idea that the AER should develop guidelines to assist the arbitrator under a cost of service approach. APA is concerned with the creep throughout the paper to seek to rely on the AER's 'expertise' to develop relevant guidelines and support the arbitrator. The AER has no expertise in relation to commercial negotiations or arbitrations. The involvement of the AER will bring with it a regulatory overlay and assumptions that the *Options Paper* states it is trying to avoid. Assistance in developing appropriate guides may be a role for the AEMC in line with their other market development roles if this is considered to be necessary. APA considers, however, that an ideal scheme would not require guides as the pricing principles would provide the direction (and the discretion) for the arbitrator.
29(d) Do you think the pricing principles should include separate principles to deal with derivative and ancillary services? (i) If not, why not? (ii) If so, do you think the test should be based on the approach set out in section 5.1.3?	Yes. The pricing of many services are in fact derivatives of the relevant firm service tariff. This approach is adopted to maintain incentives for shippers to operate within the bounds of their contractual arrangements (for example, imbalance charges are designed such that shippers do not seek to turn a transportation service into a storage service through imbalances). Tariffs for short term or day ahead services also reflect pipeline load factors to incentivise firm contracting that supports investment. APA has set out pricing principles of this type in section 3.2.4 of this submission. The high level principles set out in section 5.1.3 of the *Options Paper* appear to reflect this approach.
30. Are there any other pricing principles that you think should be included in the NGR that haven't been considered?	Yes, APA considers that the arbitrator should be directed to consider the value of the service for shippers. This brings the arbitration more in line with commercial arbitration which is two sided.
31. Do you think the	APA considers that more bounded discretion is appropriate

pricing principles should be supplemented with other principles? (a) If not, why not? (b) If so, do you think the principles set out at the end of section 5.2 are appropriate, or do you think further refinements are required?	which limits decisions of the arbitrator to first consider whether services are provided in a competitive market (in which case no decision on tariffs would be needed), and failing that, directs the arbitrator to consider the tariffs paid by shippers for similar services. Where the arbitrator does have discretion, for example in determining any adjustment to commensurate tariffs to take account of specific circumstances, it is appropriate to guide the arbitrator towards arriving at commercial outcomes that reflect the role of commercial arbitration as resolving disputes between parties, not tilting decision-making in favour of the shipper. Pricing principles to consider include: • the legitimate business interests of the provider, and the provider's investment in the facility; • the value of the service for the shipper; and • the interests of all persons who have rights to use the service.
32. Do you agree with the GMRG's preliminary view that the pricing principles should be based on actual cost of service provision (including a commercial rate of return) supplemented by a broad set of other principles (i.e. Option 2b)? (a) If not, are there other options that you think would be more appropriate? If so, please explain why this is the case.	The 'preliminary view' proposed cost of service approach will provide the least incentives towards commercial negotiation by virtue of the incentives it creates for shippers to defer to arbitration. APA does not support this approach.
(b) Should a supplementary factor be included in the pricing principles that allows an arbitrator to consider the prices struck in foundation contracts for comparable services in those cases where a pipeline has recently been	Yes, though APA does not see how this fits in the *Options Paper's* preliminary view based on cost of service. It would involve a (welcome) broadening of the consideration for the arbitrator to bring in market factors in play in determining tariffs such as competing pipelines and substitute services. In effect, it may be a promotion of the principle in section 5.2 of the *Options Paper* related to the level of competition for the provision of the service, including consideration of substitutes and other competitive benchmarks. This would involve a threshold decision on the part of the

constructed and there was competition for the development of the pipeline (i) If so, how would the limitations set out in Box 5.1 be overcome?	arbitrator as to whether the foundation tariff was arrived at through a competitive process and can be used in place of cost of service. This consideration should not be limited to foundation tariffs. Any existing tariff may have elements that allow it to be used to set prices depending on the circumstances in which it was negotiated. Competitive pressures can be brought to bear on negotiations at different times in a pipeline's life. An example would be negotiation for services on the Carpentaria Gas Pipeline where the rival was a new (government-subsidised) electricity line (CopperString). That process reset tariffs on the CGP midway in its life through a process that was arguably competitive.
Transitional issues	
33. Do you agree with the GMRG's preference to accelerate the development of the financial guidelines with the assistance of a suitable consulting firm and in consultation with the AER? (a) If not, why not?	APA considers that the financial reporting requirements need rethinking as this reporting is very unlikely to support commercial negotiation. For APA, many costs are incurred at a group level (debt and equity funding, tax, corporate) and are not allocated to assets by meaningful drivers. Any pipeline level accounts that APA derives are therefore likely to give non-meaningful information on actual costs by pipeline, which could lead to more rather than less arbitrations. Should the GMRG proceed with its proposal for financial reporting, APA does not consider that the AER should have a role in developing any guidelines. The AER does not have accounting expertise, and, in APA's experience, where the AER have attempted to gather financial information through regulatory processes (such as in relation to provisions), it has demonstrated the lack of understanding of basic financial accounting principles within that organisation.
(b) What timeframes do you believe are appropriate in relation to: (i) pipeline operators publishing the base level information required by shippers on their website? (ii) the development of a guideline on the preparation of financial reports? (iii) pipeline operators	Base-level information – APA believes that this information should be able to be reported by 1 February 2018. 1 January deadlines are difficult to implement and are unlikely to deliver any material benefit over a 1 February 2018 deadline. Financial reporting guideline- APA does not support the publication of financial reporting data. If the GMRG proceeds with this recommendation, it needs to be understood that APA does not prepare its accounts on a pipeline by pipeline basis, and the work involved to do so will be considerable. Publication of financial reports - The level of prescription in the guideline will fundamentally impact the time it will take to implement, and the costs. The proposed 2 months to amend reporting systems would be manifestly in adequate, even for the

publishing financial reports?	most minor change to system reporting, because of the profound impact this is likely to have on APA's current group level accounting.