

# Hydro Tasmania: Submission on the GMRG Information Disclosure and Arbitration Framework Implementation Options Paper

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## 1. Introduction

The following submission has been prepared by Hydro Tasmania in response to the request for stakeholder input into the Gas Market Reform Group's (GMRG) Information Disclosure and Arbitration Framework Implementation Options Paper dated March 2017 (Options Paper). Hydro Tasmania has previously made a submission to GMRG on the National Gas (South Australia) (Pipeline Access-Arbitration) Bill 2017 (2017 Bill) and attended a roundtable discussion about the Options Paper with other large gas users.

Overall, Hydro Tasmania considers that work carried out by the GMRG to date represents significant movement towards achieving the objectives of timely and effective commercial negotiations with efficient physical operations and fair cost outcomes. Hydro Tasmania is highly supportive of the achievements of the GMRG and secretariat in the work it has undertaken to date – especially given the very short timeframe available.

Having said this, Hydro Tasmania considers that there are a number of areas through which these objectives and outcomes could be better achieved. Following the Options Paper, Hydro Tasmania presents its comments and suggestions in four sections:

- Information Disclosure
- Arbitration Mechanism
- Pricing principles
- Timelines and Transitional Arrangements – Confidential Section Provided Separately

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## 2. Information Disclosure Requirements

### 2.1 Hydro Tasmania believes that Option 3 should be adopted

The Options Paper considers a wide range of information that pipelines could be required to provide on websites in order to reduce the very significant information asymmetry between pipelines and shippers. All options considered by the Options Paper include a base level requirement (as set out in Table 3.4 of the Options Paper), and Hydro Tasmania agrees that such base level requirements are appropriate and should be published by pipeline operators on their website. Hydro Tasmania considers that providing and regularly updating this information will allow some of the issues relating to definition and availability of services and cost of standard services to be initially addressed.

However, while the base level requirements will help a shipper to ascertain what standard services are likely to be available and the standing offers for such services, it provides little or no information about whether the standing offers are reasonable and also what it would cost for the shipper to get the service it requires, if this is not a standing service offering as described by the pipeline. For example, if the standing offer for a GTA is five years for a particular pipeline, and the shipper is seeking a shorter term, the information provided in the base level requirements will not allow a shipper to get an indication of what an appropriate cost should be for this service. The base level requirements also do not address the reasonableness of the associated terms and conditions for the services.

Hydro Tasmania believes that the most appropriate information disclosure option to adopt is Option 3, which includes base level requirements, financial reports and more detailed cost, demand and financial information, for the following reasons:

- A summary of information related to relevant pipeline revenues and costs as well as demand for each service and average tariffs paid for each service over recent history (say 5 years) may assist shippers to assess reasonableness of service pricing against costs and average prices paid historically.
- While it might be useful to have comparisons against average prices for similar standard services on other pipelines, Hydro Tasmania agrees with the Options Paper that such comparisons should eventually be available for standing offers and may not be particularly illuminating as pipeline circumstances vary so widely.
- Prior to seeing the guidelines for financial reporting to be developed as part of the Framework process, it is impossible to know whether the financial information to be reported will be practically useful in allowing shippers to assess the reasonableness of prices offered by the pipeline. Given that so much of a pipeline's costs relate to return on, and of, the asset base of the pipeline, Hydro Tasmania considers that the values and methodology used to determine the capital base and depreciation are liable to significant interpretation issues and gaming and thus need to be in the public arena and subject to scrutiny. Such information should be provided under Option 3, but not necessarily under Option 2.
- At the roundtable discussions there was discussion about whether the financial information would require the provision of annual revenues and annual demand for each service by pipeline. The provision of this information going back over a period of 5 years is important, as it will allow an initial assessment of average (as opposed to standing offer) payment for each service over the past few years. The provision of such information is specifically contemplated under Option 3 (whilst it is debateable under Option 2).

## **2.2 Provision should be made in the Rules for information disclosure in response to a legitimate access request for information**

Hydro Tasmania considers that there is scope for another level of required information disclosure to be specified, which is not covered by the base level information and financial and cost information under Option 3, but which is legitimate information for a shipper to request, and will only need to be prepared in response to a bona fide access query. Hydro Tasmania notes:

- That there is a practical limit to how much information needs to be provided and routinely updated on websites. For example, it is not clear that the base level, financial, cost, revenue and demand information provided on the website will be useful for shippers who need to better understand the opportunities for expanding capacity or extending a pipeline. Information on how an expansion would be developed, the likely cost and required and prospective demand for such an expansion, is important for a shipper that is considering such an expansion or extension, but is not information that needs to be included on a website and routinely updated.
- That provision could therefore be made in the Rules for information disclosure in response to a legitimate access request for information. Such information might then be included on the website as a response to a specific access query, but need not be updated.
- That there would need to be mechanisms to ensure that the requests are not frivolous or request confidential information, that response times are reasonable and potentially that the pipeline operator's costs in providing such information are recoverable. Such a level of information disclosure could then be specified within the Negotiating Framework for each pipeline.

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## **3. Arbitration Mechanism**

Overall, Hydro Tasmania considers the likely outcomes and balance achieved by the preferred Arbitration Mechanism option to be well considered and appropriate to the circumstances. While setting a tight

timetable, the preferred option allows the arbitrator to be proactive and prescriptive in setting out the procedure to be adopted and specifying information requirements and timing. We also consider it beneficial that the option allows (but does not require) the arbitrator to seek administrative or technical support as required from the AER.

We note that consideration was given to limiting the scope of arbitration to price and directly price related issues only but that this is not the currently preferred option. Hydro Tasmania supports the preferred option which allows arbitrators to consider both price and non-price issues.

A key issue to Hydro Tasmania is one of timing of the implementation of the Framework and how this interacts with contracts which are currently under negotiation. As we understand it, arbitration cannot be used to overturn provisions in existing contracts under any of the options considered. This means that onerous terms and conditions under contracts which are signed prior to the Framework being implemented cannot be overturned.

Hydro Tasmania believes that a significant opportunity for the gas market to benefit from the proposed changes could be missed if contracts, which are currently being negotiated, are not able to benefit from the reforms purely because the expiry date of the contract falls prior to the arbitration mechanism commencing on 1 January 2018 (as proposed). The GMRG should investigate avenues under which those contracts which have been negotiated since the COAG Energy Council agreed to the implementation of the Framework in March 2017 should be able to access the benefits of the reforms contained within the Framework. While it is unclear whether there will be any recourse available to contracts actually signed before the new Rules are implemented, contracts which have not been signed on the date when the new Rules come into effect (currently anticipated to be 1 August 2017) should be able to benefit from the reforms.

Hydro Tasmania believes that the Rules should include transitional provisions to cater for such a possibility. One possible avenue might be to automatically allow arbitration to be invoked as soon as the Rules are approved with continuation of supply according to existing tariffs, terms and conditions unless the pipeline can demonstrate that it cannot continue to provide such temporary access.

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## 4. Arbitration Principles

The Options Paper has focused on the arbitrator deciding whether a pricing offer made by a pipeline is “reasonable” as assessed against the “actual costs” incurred by the pipeline in providing the service. As reasonable and actual costs are open to wide and vested interpretations, a number of other principles and considerations could supplement the pricing principles.

While use of an actual cost basis may be reasonable in some, or indeed many situations, it raises the possibility of significant anomalies and uncertainties in some cases, for example:

- Is the “actual cost” the cost of building the pipeline, or the cost at which it was later sold, or is it the replacement cost?
- How is the possibility of capital redundancy to be taken into account?
- How to handle significant price increases if demand reduces?
- Should shippers bear the costs of bad decisions taken by pipelines or due to loss of demand from other users?

It is Hydro Tasmania’s belief that assessing the reasonableness of costs and conditions based almost exclusively on the “actual cost” principle as proposed may result in outcomes that many would consider unreasonable. Part of the solution may be to include other principles which an arbitrator should consider in the test of reasonableness.

That said, in Hydro Tasmania’s submission the overriding principle for the resolution of an arbitration should be that there is a commercial outcome that is achieved. An expert arbitrator should have sufficient

guidance on overall approach but the principles should not be so restrictive that it becomes a quasi-regulatory approach.

In its Executive Summary, the Options Paper states that while the objective of the new framework is not economic efficiency, the expected improvements to the timeliness and effectiveness of commercial negotiations and the behaviour of pipeline operators can be expected to result in “*the prices charged for pipeline services better reflecting the cost of service provision and the prices that would prevail in a workably competitive market*” (page v). In order to assist in ensuring that the prices reflect those prevailing in a workably competitive market, Hydro Tasmania suggests that this be included as a principle to be taken into account by the Arbitrator.

A further consideration in assessing “reasonableness” is that in a workably competitive market, shippers should have the right to expect that their particular requirements will be catered for unless this is not technically or commercially feasible. Any additional charge that may be levied in moving from the standard service should need to be reflective of actual costs incurred by the pipeline (including opportunity costs). As an example, this would require a pipeline to justify any cost increases in moving from, say, a 5-year GTA offered by a pipeline labelled as “standard” to a user required 2-year GTA, or to justify any cost increases in allowing users in the same delivery zone to trade capacity.

Hydro Tasmania recommends that GMRG enhance the principles arbitrators need to consider in arriving at a decision to include those which add an element of competitive and efficiency considerations. Thus, some additional principles and considerations for the Arbitrator to take into account in an assessment of reasonableness might include:

- Prices that would prevail in a workably competitive market
- Prices paid historically on that pipeline
- Price and non-price terms and conditions on other Australian pipelines and prices paid historically on the relevant pipeline
- The actual cost to the pipeline (including opportunity cost) of moving from standard terms and conditions.