



AER submission

**Gas Pipeline Information
Disclosure and Arbitration
Framework**

Implementation Options Paper

April 2017

Contents

1. Introduction	2
1.1 Certainty in arbitration outcomes	2
1.2 Asset valuations	3
1.3 Timeliness of implementation	4
1.4 Consistency with current regulatory regime	4
2. Information Disclosure.....	5
3. Arbitration Mechanism.....	8
4. Arbitration Principles	13
5. Transitional Arrangements	13

1. Introduction

In August 2016, the COAG Energy Council directed Dr Michael Vertigan to conduct an 'Examination of the current test for regulation of gas pipelines' (the Examination).

Dr Vertigan reported his findings in December 2016 and stated 'that it is clear that pipeline owners do have market power'.¹ In the Examination two principal issues were identified: 'the information asymmetry between parties in negotiations and the superior negotiating position of the pipeline operators'.² As a result, Dr Vertigan recommended 'that the information and transparency of pipeline services costs, pricing and contract terms and conditions be greatly enhanced and a framework for binding arbitration be introduced'.³

In March 2017 the Gas Market Reform Group (GMRG) released an implementation options paper as the next step in this process. The options paper considers in detail a number of design options for the three key elements of the framework, being the information disclosure requirements, the arbitration mechanism and the arbitration principles.

The AER considers that the options paper is a useful next step in this process of operationalising Dr Vertigan's recommendations.

The AER supports the overarching objectives outlined in the options paper, which are 'to facilitate timely and effective commercial negotiations between shippers and the operators of non-scheme pipelines by reducing the imbalance in bargaining power that shippers face and posing a constraint on the exercise of market power by pipeline operators'.⁴ These objectives and the GMRG's preferred design are consistent with Dr Vertigan's recommendations in the Examination.

The AER considers that the GMRG's discussion of each preferred option appropriately considers the relevant trade-offs between the alternative designs. On the whole, the AER considers that the preliminary views of the GMRG present a targeted framework to encourage negotiation between parties, while minimising costs.

In providing comments the AER is mindful that the proposed framework is intended to be different from the forms of regulation currently administered by the AER under the National Gas Rules (NGR).

The AER comments in this submission are aimed at supporting the GMRG to implement its preliminary views in the most effective manner possible.

1.1 Certainty in arbitration outcomes

The GMRG states clearly that commercial negotiation will continue to be the principal means by which access terms and conditions are determined. The arbitration mechanism is intended only as a backstop, with the threat of arbitration sufficient to encourage parties to reach a commercial agreement.⁵

When two parties negotiate in a context in which either party can seek binding arbitration, the negotiated outcomes will be heavily influenced by the outcome the parties expect to obtain through arbitration. The greater the scope for both parties to predict the outcomes of

¹ Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, p.12.

² Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, p. 3.

³ Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, p.4.

⁴ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.5.

⁵ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p. 5.

the arbitration process upfront, the more likely this is to facilitate negotiated outcomes without recourse to arbitration.

In this sense it is critical that the information disclosure requirements, arbitration principles and arbitration mechanism elements work together in an integrated way.

The arbitration principles will be critical in guiding the arbitrator and setting expectations around arbitration outcomes to inform negotiations. The AER notes that the arbitration principles proposed by the GMRG would require the arbitrator to assess the reasonableness of the offer by reference to the cost of service.

The AER strongly supports this proposed standard. The lack of competitive pressures in the market more generally means that reference to other pipeline operators' tariffs will not provide an indication of whether an offer is reasonable.

To facilitate negotiated outcomes there should be a clear alignment in the type of information that is publicly available and the type of information that would likely be utilised by an arbitrator in the case of a dispute. The GMRG has indicated that it prefers Option 2 for information disclosure. This involves the disclosure of verified financial information and demand information (on an individual pipeline basis).

In order to assess the reasonableness of offers against a cost of service standard, it will be important for shippers and the arbitrator to have the requisite cost information readily available, particularly on the key topics of asset valuation and cost allocation. It is therefore imperative that the proposed financial statements information under the proposed information disclosure requirements and the supporting guidance are fit for this purpose. This approach will facilitate commercially negotiated outcomes as well as assisting the timely resolution of any access disputes by a commercial arbitrator.

1.2 Asset valuations

The GMRG should ensure there is appropriate guidance and clarity, both for the arbitrator and negotiating parties around key pieces of cost information. There are certain types of cost information that will play a pivotal role in helping parties assess the reasonableness of an offer under a cost of service standard.

Given the capital intensive nature of pipelines, the reporting of asset values will be a critical input into the estimation of price by both shippers in undertaking negotiations and the arbitrator. The options paper also identifies that the starting asset values may be a source of dispute and there may be benefit in providing further guidance and assistance to an arbitrator on this matter.⁶

The AER considers that giving pipelines full discretion as to how they report asset values over time would limit the ability of the framework to achieve its stated objectives. In particular this approach would create a high level of uncertainty for industry participants that would be likely to lead to a greater level of reliance on arbitrations. It will also greatly complicate the matters that an arbitrator will need to consider within the proposed three month processes, thus affecting the timeliness of outcomes.

The AER considers there is a spectrum of options to provide guidance to the arbitrator on asset values.

⁶ GMRG, Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper, 21 March 2017, p. 132.

One option would be for the GMRG (with expert advice or another body) to estimate starting asset values for pipelines subject to the framework and prescribe the starting asset values in the NGR. This will likely have three advantages. It could:

- expedite the arbitration process,
- be used by parties during negotiations and help minimise the need for arbitration, and
- prevent asset revaluations over time.

This option does however limit the discretion of the arbitrator to estimate asset values, and would run the risk of being unduly prescriptive.

Another option could be to include guidance on how the starting asset values are estimated in either the NGR or in a binding guideline. If this direction is provided in a guideline, it could be included in the guideline proposed for supporting the public disclosure of financial and demand information. The guidance could replicate the direction for estimating asset bases, currently in the NGR.⁷ However, the guidance provided for pipelines built prior to the commencement of the Gas Code that have not had an initial asset value determined is very broad. As the GMRG notes, consideration would need to be given to narrowing the scope of factors to be considered when setting opening asset bases for such pipelines.⁸

This approach would be consistent with a cost based standard to be considered by an arbitrator and shipper during negotiations. Such guidance could provide adequate detail to guide the arbitrator and provide some certainty in arbitration outcomes to promote negotiations, but also maintain a degree of discretion for the arbitrator. While the guideline would require pipelines to report the requisite cost information in a specified way, the arbitrator would not be bound by the guideline in making an arbitration determination and would be able to depart from it on a case by case basis if the arbitrator considers this to be appropriate.

Irrespective of the form in which the guidance on asset valuations is provided, the framework should prohibit asset revaluations over time. Continued asset revaluations will undermine a shipper or arbitrator's ability to estimate a reasonable price for the service. Based on the AER, and ACCC's experience, prescription around consistent reporting of asset values over time will greatly enhance the overall efficacy of the framework.

1.3 Timeliness of implementation

In order to facilitate timely operation of the guideline to support negotiations and the arbitrator, the AER supports the GMRG's option to accelerate the development of the information disclosure guideline by commissioning the assistance of an expert financial reporting consulting firm to work closely with the GMRG and AER in developing the guideline. The AER looks forward to working with and assisting the GRMG in developing this element of the framework.

1.4 Consistency with current regulatory regime

The framework presented in the options paper focuses on reducing the imbalance in bargaining power and potential exercise of market power by non-scheme pipelines.

At some stage this framework will operate alongside the current regulatory framework for gas pipelines under the NGR, which includes pipelines subject to light regulation and full

⁷ NGR, r. 77.

⁸ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.133.

regulation. The AER encourages the GMRG to openly discuss how it considers its preliminary views, or other package options, will sit within the context of this broader regulatory environment. Such consideration will minimise the potential for unintended outcomes when the new framework is implemented.

The remainder of this submission provides specific comments on each element of the framework:

- Information Disclosure
- Arbitration Mechanism
- Arbitration Principles
- Transitional provisions.

2. Information Disclosure

Purpose of provisions

To reduce the information asymmetry shippers can face in negotiations and, in so doing, facilitate more timely and effective negotiations.

To limit the reliance that needs to be placed on the arbitration mechanism.⁹

The GMRG has expressed a preference for Option 2:¹⁰

Non-scheme pipeline operators would be required to disclose on their website:

A base level of information that shippers require when considering whether to seek access to a pipeline, such as technical characteristics of the pipeline.

Verified financial reports for each pipeline (prepared on an individual pipeline basis), and a breakdown of demand (by service). This information would need to be published on an annual basis four months after the end of the financial year.

The verified financial reports would include:

- **an income statement with revenue broken down by service type and expenditure by major categories;**
- **a statement of comprehensive income;**
- **a statement of changes in equity;**
- **a statement of cash flows; and**
- **notes to the financial report, which, amongst other things, should include information on the methodologies or principles the pipeline operator has used to determine the value of the assets, the depreciation allowance and cost allocation.**

The AER supports the purpose of the information disclosure.

The AER supports the disclosure of cost based information to enable shippers to determine a cost-reflective price of transportation. The AER view is that anything less than cost

⁹ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p. 143.

¹⁰ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p. 40.

information is unlikely to support the findings (monopoly pricing) and recommendations of the Examination.¹¹

While the AER understands the rationale and motivation of the GMRG in selecting Option 2, there is a considerable step in translating the proposal and the list of financial reports to be disclosed into a workable arrangement that meets the objective - to empower shippers to be able to determine an efficient cost of transportation services in their negotiation with pipeline owners.

Further, to be effective, parties need to have some certainty regarding arbitration outcomes to incentivise them to reach a commercial agreement, as opposed to seeking an arbitrated outcome. This will only happen if the information disclosure meets its stated objective, and there is clarity on how the arbitrator will determine prices, and use the arbitration pricing principles. To do this the information disclosure regime should match the information used by the arbitrator in the arbitration process.

The AER believes that the disclosure regime will be strengthened by the inclusion of at least a minimum year ahead operational information. This disclosure will entail little extra cost, but provide shippers with a broader outlook on the direction of prices. All commercial businesses make forecasts for operational purposes. For this reason, forecast capital expenditures, operating expenditures, expected demand and revenues should be part of the regime and at a minimum for the following year. This information will be useful to explain the outlook of the pipeline business, and the direction of prices.

The GMRG has sought comment on whether maintaining accounting separation for each pipeline represents a significant burden.¹²

Under Option 2, information will be required to be published annually four months after the end of the financial year (on the pipeline operator's website). The information published is to be verified, and prepared in accordance with the relevant Australian Accounting Standards.¹³

The Examination found that an uneven bargaining relationship around the transport of gas existed. The Examination argued that downward pressure will be placed on prices through mandating greater disclosure and transparency of pipeline services and pricing.

In order for the GMRG's proposed model to be effective and achieve its objectives, information must be both accessible and consistent. This only comes about via separate accounts that are in an accessible format, and which can be compared year on year. The AER's view is that the maintenance of accounting separation for each pipeline is unlikely to pose a significant cost burden.

The AER is therefore supportive of the efficiencies that come with a standardised format.

The AER considers that information disclosed by pipeline operators should be verified. The AER is of the view that independent auditing should be considered, and that pipeline operators should be required to make any audit report available both to the arbitrator and to the AER. An audit report may be of assistance in assessing whether the disclosed information is false or misleading.

¹¹ Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016.

¹² GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.36.

¹³ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.40.

Under the proposal the AER is likely to develop guidelines / reporting templates on:

- what information is to be reported and in what format; and
- any reporting principles to be employed.

The guideline would not require pipeline operators to use specified methodologies, for example in relation to appropriate asset valuation, rate of return or cost allocation. Rather, the guideline would require the pipeline operator to identify the methodology used to determine the asset valuation, rate of return and cost allocation reflected in the financial reports. The guideline would likely be developed by the AER.¹⁴

The experience of the AER (and the ACCC before it¹⁵) is that asset valuation, cost allocation and the rate of return are the most contentious elements in a cost of service framework in industries such as gas.

For example, asset valuation for the Moomba to Sydney gas pipeline (MSP) under the Gas Code was a key issue in contention between the pipeline operator, East Australia Pipeline Limited, and the ACCC as a part of the 2004-2009 Access Arrangement review. In its final decision on 2 October 2003, the ACCC rejected the valuation methodology applied by the pipeline operator. This decision was subject to protracted litigation. On 19 May 2005, the Australian Competition Tribunal rejected the methodology applied by the ACCC and endorsed an alternative depreciated optimised replacement cost (DORC) methodology that was proposed by the pipeline operator at the Tribunal stage. The ACCC then appealed to the Full Federal Court, who overturned the Tribunal's decision on the methodology for establishing the initial capital base of the pipeline. The pipeline operator subsequently appealed to the High Court, who found, on 27 September 2007, that the Tribunal had been correct in its construction and application of the relevant provisions of Gas Code.

The ACCC submission sets out its experience with airports, which has been that accounting values have included asset revaluations undertaken at the airport's discretion.

On this basis, the AER is of the view that the key elements and principles of the methodology to be applied in the asset valuation process must be clearly articulated, and that any discretion for pipeline owners to depart from this methodology should be very limited in scope.

Leaving pipeline owners to use different methodologies for calculating asset valuations and rates of return, or for determining cost allocations is too broad a discretion and creates the risk of continual asset revaluation and changes in methodologies. This creates uncertainty about arbitration outcomes and fundamentally undermines the information disclosure/transparency objectives of the regime. Limiting discretion is essential to ensure that the regime is underpinned by certainty regarding the opening value of the pipeline.

In order to have some certainty around arbitration outcomes and to maintain the desired credibility of the threat of arbitration – the information disclosure needs to be consistent with the arbitration principles and there needs to be clarity around how the arbitration principles will be applied in arbitration.

An exemption mechanism for information disclosure is to be incorporated into the regime where the costs of disclosure outweigh the benefits.

Exemption from all disclosure for the non-scheme pipelines.¹⁶

¹⁴ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.41.

¹⁵ The ACCC previously regulated the covered section of the Moomba to Sydney Pipeline (MSP) under the National Gas Code.

- **not providing third party access; or**
- **a single shipper pipeline and this is not expected to change for the foreseeable future; or**
- **the size of the non-scheme pipeline falls below a minimum reporting threshold (such as 10TJ/day).**

Two other possibilities are:

- **non-scheme distribution pipelines; and**
- **pipelines that are subject to a 15 year no coverage determination.**

The AER supports exemption provisions being part of the proposed arrangements so long as there is an authority making these determinations using clear criteria for the provision of an exemption.

The AER agrees, should circumstances change, that there should then be a mechanism to review the exemption.

Compliance framework

- **The NGL provides for the AER to have a role in monitoring and enforcing the reporting obligations.**
- **Civil penalty provisions.**

A reporting standard be included in the disclosure framework that as a minimum state that the information provided must not be knowingly false or misleading.

The AER supports the inclusion of civil penalty provisions given the reliance shippers and the arbitrator will place on the information disclosed. As explained above, the AER is of the view that the GMRG should consider an audit requirement as an additional confidence-building mechanism.

The AER also believes that an independent auditor be required to provide a declaration that the published information is true and correct.

3. Arbitration Mechanism

Purpose of provisions

The aim of the arbitration mechanism is to provide a credible threat of intervention in the event that commercial negotiations fail and to therefore encourage appropriate behaviour by pipeline operators during negotiation.¹⁷

The GMRG has expressed a preference for Option 3:

- **Conventional arbitration with enhanced procedural protections and partial transparency:**
- **Key design elements associated with this option are:**

¹⁶ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.45.

¹⁷ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.48.

- **Arbitration could be used to settle disputes in relation to all aspects of access to all types of services offered (excluding extensions).**
- **Documentation provided to the arbitrator must be directly relevant to the matter/s in dispute**
- **The arbitrator, at the commencement of the arbitration, must provide the cut-off date and time for provision of information.**
- **The arbitrator may also limit the amount of documentation provided and provide a list of questions for the parties to address.**
- **The arbitrator can seek administrative or technical support from the AER.**
- **Information on the existence of the arbitration would be published on the AER website.**

The AER accepts the introduction of a new arbitration¹⁸ framework for non-scheme pipelines as a way of addressing the power imbalance between shippers and pipeline operators, caused by the existence of market power and information asymmetries.

The AER broadly agrees with the choice of option 3, but would request the GMRG consider the design comments the AER has outlined below.

Interaction of design elements

The intention is that arbitration is a credible threat, but used only in the event of failure to reach a negotiated outcome. The more transparent the information disclosure provisions are, such that shippers are able to establish a price for the services they are seeking, the less frequent arbitrations will be. Frequency of arbitrations will also be diminished the more certainty there is around arbitration outcomes.

The arbitrator should consider all relevant matters in the dispute

The AER agrees that the arbitrator should consider all relevant matters in the dispute, not just price. The price of a service, for example, should not be considered in isolation as in practice, prices in GTAs are naturally influenced by the other terms of agreement. There are trade-offs between the negotiated price of services and the terms of the GTA.

The AER agrees with the proposed safeguards.

The arbitrator should have additional information gathering powers

The AER believes that the majority of necessary information should be available under the information disclosure arrangements. This reduces the need for the arbitration process, and the need for the arbitrator to obtain additional information with the potential for time delay.

Quite simply the arbitration framework will be more effective if parties to a dispute already have key information and are able to accurately predict the likely arbitration outcome. This is because parties will be more likely to reach agreement if their separate estimates of likely arbitration outcomes are similar. Having the bulk of necessary information already publically available to parties and the arbitrator ensures that parties can predict for themselves what the likely arbitration outcome will be.

¹⁸ The framework has attributes of commercial arbitration but will be provided for by a statutory instrument (NGL, NGR).

Noting the above points, the AER agrees that the arbitrator should have additional information gathering powers, in case the information that is required to resolve a particular dispute goes beyond that which has previously been made available under the earlier information disclosure provisions.

The AER agrees that disclosure should be directly relevant to the dispute,¹⁹ and limited by the arbitrator.²⁰ This should help to avoid disclosure of voluminous and unnecessary documents and extra legal costs. The AER agrees with the GMRG that if disclosure is not confined, excessive disclosure could be used as a tactic by a participant to slow down the process and to increase costs. Ineffective disclosure processes would discourage shippers to have recourse to arbitration and would reinforce the market power of the pipeline operator.

The arbitrator has 50 business days to resolve the dispute, which can be extended to 90 business days with the agreement of the parties.

The AER considers that it would be preferable that the arbitrator be given the discretion to extend the timeframe to 90 (or 70) business days.

The arbitrator, rather than the parties, will be in the best position to assess whether an extension is needed. One possible compromise would be to give the arbitrator the ability to exercise this discretion once, and once only, with any further extensions to be by agreement only.

Variation of access determinations

Dispute resolution process cannot be used to vary an access determination. Parties must rely on GTA terms instead.²¹

The GMRG is proposing that if parties would like a variation to an access determination, they need to apply to the AER in writing, with evidence of their agreement for the variation. If there is no variation, parties cannot seek arbitration under the NGL unless the variation relates to the provision of a new service.

The AER notes that it is quite possible, particularly if the services that are the subject of the arbitration decision are to be provided over an extended period, that changes in circumstances after an initial arbitration decisions may make it appropriate to vary an arbitration decision at a later date. In these circumstances, it is not certain that the parties will be able to reach agreement on the terms of the variation. Thus, the AER considers that the preferable approach would be to allow for a new dispute to be lodged, and a new arbitration conducted, at least where there has been a significant change in circumstances or where the further dispute involves a new service.

Another option would be for the Rules to expressly empower the arbitrator, when making the initial arbitration decision, to determine an appropriate dispute resolution mechanism for inclusion in the relevant contract. The arbitrator should not be precluded from making a ruling on this as part of the initial arbitration.

¹⁹ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.117.

²⁰ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.118.

²¹ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.70.

Confidentiality

GRMG proposes that, whilst the fact of the arbitration will be made public, the outcome (including the arbitrator's reasons) will remain confidential to the parties and to the arbitrator.²²

The AER considers that it is appropriate not to disclose the outcome of the arbitration publically in order to protect the commercial interests of parties, the exemption being asset valuation determinations.

While this may decrease certainty in the outcome and arbitration process generally, the AER considers that if there is a strong framework and guidelines for the arbitration process, this will not be a factor that discourages shippers from seeking arbitration. Shippers will, for example, have some certainty about average timelines, as the GMRG has proposed that the timeframe of arbitration will be posted on the AER website. However, to enable the operation of the scheme to be monitored and evaluated, there should be a requirement to disclose the outcome, and accompanying reasons, to the AER. This is in line with the GMRGs view that the AER have 'oversight of the access dispute to ensure that the arbitration is conducted in accordance with the law and rules'.²³

In order to minimise repeat arbitrations on the same issue and the potential for divergence in decisions, asset valuation arbitration outcomes should be publically disclosed.

Cost limits for third party expert input as part of the arbitration must be agreed by both parties in advance.

To avoid deadlock, the AER considers that it would be more appropriate for the arbitrator to have the ability to make the final decision on this issue, having regard to the party's capacity to pay and to the likely significance of the input for the arbitrator's final decision.

Role of the AER

Contrary to the draft enabling legislation, the GMRG does not want the AER to have a role in determining whether there is a reason why the dispute should not be arbitrated (such as that the parties have not negotiated in good faith, or if the notification of a dispute is vexatious, or if the dispute is trivial, misconceived or lacking in substance). The GMRG would prefer that these matters be left to the arbitrator.²⁴

The GMRG proposes that the AER will have an administrative role in the arbitration mechanism framework.²⁵ It states that the AER will oversee and maintain the arbitration framework,²⁶ but does not want the AER to have a role in determining whether there is a reason why the dispute should not be arbitrated.

²² GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.107.

²³ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.63.

²⁴ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.64.

²⁵ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.63. The GMRG would like the AER to take on a 'scheme administrator' role as opposed to being a 'scheme regulator'.

²⁶ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.49.

The AER is of the view that a party's ability to refer a dispute to arbitration, without having to satisfy significant jurisdictional or procedural pre-requisites, is a key element of ensuring that the possibility of arbitration is seen by other parties as a credible alternative to a negotiated outcome. Accordingly, the AER's preferred position is that all disputes referred by a party should be arbitrated.

If an initial assessment is required, about whether a dispute should be arbitrated, as part of the overall arbitration framework, the AER believes that it would be preferable for the AER to act as the gatekeeper on these matters so that a consistent approach is adopted for all disputes. This will give pipeline operators and shippers / access seekers greater up-front certainty about whether the use of the dispute resolution process will be denied on these grounds. This will be an important consideration for each party in deciding whether to continue to pursue negotiations or to lodge a dispute (and run the risk of arbitration being refused on these grounds). Leaving these matters to the arbitrator would introduce uncertainty and unpredictability into the regime, as different arbitrators may have different views, for example, about what a failure to negotiate in good faith involves.

If the AER is not to have a "gatekeeper role" in deciding whether the dispute should be arbitrated,²⁷ the need for the dispute process to be triggered by notifying the AER is unclear. If this approach is adopted, notification should be to the other party, copied to the AER.

Exemptions

The only exemption that should be available from the arbitration mechanism is in relation to non-scheme pipelines that do not provide for third party access. This means that pipelines subject to a 15 year no coverage determination and non-scheme distribution pipelines would not be afforded an exemption, in and of, themselves but would be eligible for an exemption if they do not provide third party access.²⁸

The AER supports exemption provisions being part of the proposed arrangements so long as there is an authority making these determinations using clear criteria for the provision of an exemption.

The AER supports the GMRG's proposed approach that pipelines should only be eligible for an exemption from the arbitration if they do not provide third party access.

The AER is also supportive of the GMRG's proposed approach to exemptions from the base level and financial reporting requirements.

In principle, there is no reason to treat non-covered distribution pipelines any differently to non-covered transmission pipelines. To the extent that there is equality in bargaining power between a pipeline operator and shipper, this is something that the arbitrator should be expressly empowered to consider / take into account in arriving at any arbitration decision.

For single shipper pipelines, an exemption from the arbitration process should only be provided to the extent that there is no uncontracted capacity on the pipeline. If there is uncontracted capacity, this presumably reflects the fact that the foundation shipper did not consider that it needed access to that capacity as the quid pro quo for being the foundation shipper. It is also possible that the pipeline owner or operator may have expressly built at least some additional capacity into the pipeline to allow for additional users of the pipeline in

²⁷ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p. 63.

²⁸ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.110.

the future. The fact that there is only one shipper using a pipeline at a particular point of time should not be determinative.

The AER agrees with 15 year no-coverage exemptions for those pipelines with no third party access.

4. Arbitration Principles

Purpose of provisions

The arbitration principles should guide the arbitrator on the matters to be taken into account when making its decision. It is noted that well-specified principles provide more certainty as to the outcome of arbitration, and, in doing so, increase the likelihood of parties reaching a commercial agreement without recourse to arbitration.

The principles are to be based on actual cost of service (including a commercial rate of return) supplemented by a number of other factors (including principles on derivative and ancillary services, and a refined list of other criteria developed by the GMRG).

It would be left to the arbitrator to determine how to carry out the assessment and no further guidance is considered necessary.²⁹

The AER supports a cost of service approach, and the use of arbitration principles grounded in the cost of service approach to provide guidance to the arbitrator on the matters to be taken into account when making a determination.

As long as the pricing principles and other principles established under the rules adopt an appropriate cost of service approach, the AER agrees with the GMRG that there is no need for an additional requirement that the arbitrator have regard to the National Gas Objective in arriving at an arbitral decision.³⁰

As previously noted for parties to an access dispute to be able to independently determine the range of arbitration outcomes and to make commercial agreement more likely, a clear relationship is required linking the information provided by pipeline owners and how an arbitrator will apply the arbitration principles. Further in the absence of merits or judicial review options, there is a case for providing an arbitrator with a guideline on how the principles are to be applied to provide more certainty.

5. Transitional Arrangements

Transitional Issues:³¹

The GMRG is supportive of early implementation of the arrangements.

²⁹ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, pp.139 and 152.

³⁰ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, p.124.

³¹ GMRG, *Gas Pipeline Information Disclosure and Arbitration Framework: Implementation Options Paper*, 21 March 2017, section 6.2.

The AER supports development of guidelines by commissioning the assistance of a consulting firm with expertise in financial reporting requirements, who could work closely with the GMRG and the AER on the development of guidelines.

This will mean pipeline owners commence information reporting by 30 October 2018, rather than sometime in April 2019.