



# Response to Consultation Paper

National Gas Amendment (Pipeline operator cost  
recovery processes) Rule 2012: GRC0017

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## Introduction

APIA, the national peak body representing the Australian transmission pipeline industry, welcomes the opportunity to comment on the Consultation Paper for the National Gas Amendment (Pipeline operator cost recovery processes) Rule 2012 proposed by the Australian Energy Regulator.

APIA has six main issues with the proposed rule change which need to be considered during the AEMC's deliberations:

1. The introduction of the concept of 'efficiency' to replace 'reasonable' as the test for appropriate costs to be recovered will be measured.
2. The proposed timeframes substantially extend the maximum period pipeline operators may have to wait for payment of invoices.
3. The introduction of burdensome information requirements at the cost estimate stage.
4. The suggestion in the commentary that information provided to the AER to justify invoices will be published.
5. The proposed drafting requires the creation of identical sections in two separate parts of the NGR. It is more efficient to have a single cost recovery section that can be referenced as necessary.
6. Improvements can be made to the objection mechanism to increase the efficiency of the assessment process. This is an area not addressed at all in the proposed rule change.

These issues are addressed in more detail in APIA's responses to the AEMC's questions, set out below.

For more information on APIA's responses, please contact APIA's Policy Adviser, Steve Davies, on (02) 6273 0577 or [sdavies@apia.asn.au](mailto:sdavies@apia.asn.au).

## 1. General

*(a) What would be the impacts (costs and benefits) on pipeline operators and other STTM participants if the MOS allocation service cost recovery process was amended in line with the proposed rule?*

APIA does not consider there are any real impacts on STTM participants, other than pipeline operators, created by this proposed rule change. The affected parties are pipeline operators, the AER and AEMO.

With respect to pipeline operators there are no benefits accruing from the proposed rule change. There are some relatively small costs, such as deferred interest, arising from longer statutory periods available to the AER to make its decision. Depending on whether there is, in fact, a difference between "reasonable" costs and "efficient" costs, it is also possible that the proposed rule change

will reduce the ability of pipeline operators to recover the costs incurred in performing the MOS allocation service. This is obviously of concern to pipeline operators and APIA.

Also of great concern to APIA is the intention (discussed in the rule change proposal but not explicit in the proposed new rule) to publish information provided to the AER by pipeline operators to justify invoices. This is not necessary and has the potential to expose commercially sensitive information to both market participants and contractors providing services (such as IT) to pipeline operators.

The remainder of the impacts from the rule change seem to affect the AER and AEMO.

It appears to APIA that the actual effect of the rule change proposed will be relatively minor. The experiences of the first two financial years operation of the STTM and the MOS cost recovery process have led to changes in the information presented by pipeline operators at the invoicing stage that mean the proposed rule change has little impact on them. As noted by the AEMC in the consultation paper, while problems were encountered in the very first year of MOS cost recovery, the issues experienced by AEMO and the AER during the second practical application in 2012 did not reoccur. As such, it seems that the problems which this rule change intends to address were simply teething issues.

*(b) The rule change request seeks to improve the efficiency and operation of the assessment process for MOS allocation service costs, and BB aggregation and information costs, incurred by pipeline operators. Are there alternative means of achieving this objective which may prove more appropriate?*

APIA considers there is little overall improvement in efficiency resulting from the rule change as it is currently proposed. APIA considers there are several improvements that can be made to the proposed rule change that will improve its efficiency.

### **1. Drafting efficiency**

The proposed rule change calls for the same assessment process to be applied to costs incurred by pipeline operators in providing MOS services and BB services. It calls for the same changes to be made to the sections of the NGR covering MOS and BB services. It would be more efficient to create a new section of the NGR titled (for example) 'Cost recovery for services provided by market participants'. This section could then be referenced in the relevant MOS and BB sections.

A new, single section covering the cost recovery and assessment process offers the following efficiency improvements:

- a. Future changes to the assessment process would require change to one section of the NGR rather than two or more.
- b. The single section could readily be applied to future services provided by pipeline operators or other market participants. It is apparent that the Gas Supply Hub may require services from pipeline operators. With the ongoing development of gas markets in Australia it seems likely new, currently unforeseen services will arise in the future.

### **2. Objection Mechanism**

In both the existing and proposed cost recovery provisions, the assessment process is triggered only in the event of an objection from a market participant. As there are no barriers to objection or need for an objecting party to provide any justification for their objection frequent and unnecessary objections are probable.. An objection triggers a process that consumes AER, AEMO and pipeline operator resources, delays payment to pipeline operators and accordingly cannot be considered

inherently efficient. In APIA's view, the objection process, for both the current and proposed provisions, can be improved in the following ways:

- a. Introduction of cost to objection – if there is no cost to an objector, objections will always occur. Options to address this include:
  - A fee to be paid by objector – this at least means the objection is likely to go through an internal approval process and prevents an overzealous or enthusiastic STTM participant making an objection on behalf of an organisation without appropriate approval.
  - In the event an invoice is approved in full (or near full) after an objection, a pipeline operator should be allowed to add administrative costs associated with responding to the objection to the final invoice. This is particularly relevant if a pipeline operator has a track record of full or near full payment of invoices. This additional cost could be borne by the objector to provide further disincentive to frivolous objections.
- b. Removal of blanket objection – currently a single objection applies to all pipeline operators in a hub. This is not appropriate. Objections should be on an invoice by invoice basis. The blanket objection means the track record of a pipeline operator is not a factor and both an operator and AER must expend resources to examine an invoice that may be of no concern to market participants.
- c. An objector should be required to provide justification of its objection. There must be a reason for an objection, such as inconsistency between estimated and final costs or poor track record or a substantial deviation from the average invoice.
- d. Track record should matter. If a pipeline operator has a history of accurately estimating costs and having invoices paid it should not be forced into the potentially burdensome assessment process without good reason.

APIA's strong view is that improvements must be made to the objection mechanism to increase the threshold at which an objection will occur. It cannot be efficient to have a process that will routinely lead to objections and a full assessment process for every invoice.

### **3. Timeframe of full process**

APIA is of the view that the proposed time frame is excessive. If all phases are carried out to their longest extent, the payment of invoices will take 6 months. Standard commercial terms on invoices requirement payment in 30 days, after which interest is charged. If such an extended time frame is to remain in a new rule, pipeline operators should be allowed to charge interest on payments.

*(c) Are the costs associated with conducting the proposed MOS allocation service cost recovery process proportional to the costs that could be claimed by pipeline operators?*

In the current environment of relatively new STTM hubs and associated system upgrades, it seems the proposed process is proportional. In time, as systems and the STTM itself are bedded in, it is likely the cost of invoices will drop significantly and become more constant year on year. Presumably as the magnitude of invoices drop the potential for objection will also, but as outlined above APIA considers it highly likely that a zero-cost objection mechanism will be over-used.

*(d) Will the proposed rule contribute, or be likely to contribute, to the achievement of the NGO? Please explain your view.*

As proposed, APIA believes the proposed rule does not contribute to the NGO. The substantial proposed increase in the duration of the process could be considered to decrease the efficiency of the market, which detracts from the NGO. Further, if the proposed assessment process is so resource intensive it required 60 to 90 days for the AER to make a decision, it is unlikely its benefits outweigh its costs.

APIA believes the improvements to the proposed rule change outlined in this submission would improve the efficiency of the process which could then be considered to contribute to the NGO.

*(e) Do any other reviews that AEMO is currently undertaking have implications for this rule change request?*

No.

*(f) The proponent requested that the proposed rule be made by June 2013 and apply to costs incurred during 2012-2013. What are the implications of applying the rule retrospectively? Do you have any views on when the rule change should commence, if it is made?*

Where the intention of the rule change is that a different category of costs is recoverable (ie all “reasonable” costs as compared to the “efficient” costs), APIA strongly objects to the rule change being made retrospectively. Pipeline operators have been incurring costs throughout the current financial year, and keeping record of those costs, based on their understanding of what is claimable based on previous years’ experience. It would not be appropriate to retrospectively change the rule such that expended amounts are no longer recoverable.

If, however, the intent is not to change the category of costs claimable, but is instead only procedural (ie changing the decision maker to the AER and extending the relevant time frames), then APIA does not have a strong view on this.

However, APIA does believe that retrospectivity of rule changes should be applied consistently by the AEMC, particularly as it relates to costs already incurred. APIA understands the AEMC has made a decision in relation to the Economic Regulation of Service Providers rule change that has introduced ex-post capex review for electricity service providers. The same retrospectivity that applies in that case should apply here.

## **2. Efficiency of costs**

*(a) What are some examples of the types of costs incurred by pipeline operators in providing the MOS allocation service? To what extent can pipeline operators influence the type and level of these costs?*

The main categories of cost incurred by pipeline operators in providing the MOS allocation service are:

1. IT costs, which can be broken down to contractor costs and internal costs;
2. Operating costs including daily data processing, management review, process development, auditing etc.;
3. contract modification costs; and

4. implementation costs arising due to rule and procedure changes.

With regard to these costs, APIA asserts it is appropriate to assumed they are incurred under the same prudent commercial decision making processes under which all costs are incurred. For it to be otherwise would be for the Board of a pipeline operator to be derelict in its duty.

It should also be noted that other market participants have the ability to influence contract modification costs through their behaviour during the modification of contracts.

*(b) How would the application of an 'efficiency test' differ from the current test of 'reasonableness'?*

The difference between a "reasonable" cost and an "efficient" cost is not obvious to the APIA or to pipeline operators. It is also not clear how the application of the "efficiency" test would differ from the current test of "reasonableness". It would be appreciated if this would be clarified before any rule change is made changing this concept.

Importantly, as outlined below in APIA's response to 2(c), the proposed rule change's identified 'most substantive change from adopting the efficiency test' does not actually arise from the introduction of the efficiency test. It arises from changes to the information requirements.

In APIA's view, both the existing concept of 'reasonable costs' and the proposed concept of 'efficient costs' are high level. Regardless of which is used, the concept appears vague and potential for dispute remains.

**APIA considers a guideline on appropriate costs, and appropriate information for justification, will increase the efficiency of the cost recovery and assessment process and lower the potential for dispute.**

*(c) Is an 'efficiency test' appropriate given the type and level of MOS allocation service costs incurred by pipeline operators? If not, is there another framework or test that may be more appropriate?*

As stated above, the difference between an 'efficiency test' and a 'reasonableness test' is not clear to APIA. Efficiency in regulation tends to be applied when considering allowable revenue for monopoly infrastructure, having regard to a hypothetical benchmark efficient firm and economic concepts such as rate of return and cost of debt.

In this case, STTM facilities have a requirement under the rules to do something and the industry has agreed that the cost of getting it done should be recoverable. The pipeline operators involved have different systems, different resources and different in-house capabilities. There is no benchmark for comparison.

**APIA believes the test should be whether the costs have been incurred under prudent commercial processes, taking into account specific circumstances of the business.** For example, where external services have been engaged, evidence that the market for those services was tested may be appropriate. The AER itself notes, in its letter to AEMC dated 23 August 2012, "... the relevant circumstances of the pipeline operator would be taken into account in each case."

The AER also states in the same letter that:

*The most substantive change from adopting the 'efficiency test' in the proposed rule is that the onus would be on the pipeline operator to provide supporting evidence to show that its invoiced costs are efficient ... there is an incentive for service providers to provide appropriate information at the outset in support of their proposals – rather than an onus on the AER to request specific pieces of the information it needs to complete its assessment.*

APIA has two problems with this statement. Firstly, it is not correct that that the adoption of an 'efficiency test' creates the onus for the pipeline operator to prove its costs are efficient. This is done by changing the requirements on information supporting the invoice. The AER has characterised this as 'the most substantive change from adopting the efficiency test' when in fact it has nothing to do with the efficiency test. If the test was one of 'reasonableness', the new information requirements would place the onus on the pipeline operator to prove the 'reasonableness' of costs.

Secondly, the statement implies that the pipeline operator must provide evidence to demonstrate that every component of the invoiced amount is efficient, irrespective of the amounts involved and when only some components might be contentious. This is a very onerous requirement if any aspect of the invoice that is not substantiated at the outset may be disallowed or adjusted. APIA accepts that an invoice should be supported by appropriate detail and explanatory material but not at the level of detail implied by the AER. A framework that focuses on and resolves contentious issues; that provides for the pipeline operator to produce additional information on request; and that takes account of materiality, would be more practical and efficient.

### **3. Information requirements – justification of costs**

*(a) Is the proposed rule likely to result in improvements in the information provided by pipeline operators to AEMO to justify the costs incurred in providing the MOS allocation service?*

In APIA's view the experience of the first two cost recovery processes has already improved the information provided by pipeline operators to AEMO. The proposed rule formalises these improvements.

APIA does have concerns with the proposed changes to rule 424(5).

1. It is not clear if the information justifying the invoice will be published. The proposed rule is not explicit on this, referring only to the publication of the invoice. The rule change proposal does refer to the additional information leading to 'improved consultation', which may mean the objection phase of the assessment process. This implies it will be available to market participants.

The information submitted with the estimate and invoice is necessary for the AER to make a decision but it is not necessary for market participants and others to have access. It is very likely the supporting information will include commercially sensitive information that pipeline operators do not wish to share with the broader gas market. This will include payment for services to IT and other specialist vendors, which is information pipeline operators do not wish to share with each other or potential IT and specialist vendors themselves.

In terms of justifying any market participant objection to the payment of invoices, APIA has outlined some justifications for objections above that do not rely on access to commercially sensitive information.

2. The proposed changes to rule 424(5) create the same information requirements for the cost estimate and the final invoice. A requirement, as proposed, to provide justification of efficient costs at the cost estimate stage is excessive. The cost estimate is not a formal quote or contract. Pipeline operators have sufficient incentive to provide an accurate estimate, if the estimate and final invoice are in alignment it reduces the likelihood of an objection occurring (provided changes are made to the objection process). APIA accepts that some level of justification might be relevant to the estimate, but the wording of a new rule should explicitly reflect that it is a lower level than for the final invoice.

#### 4. Appropriate decision maker

*(a) Is it more appropriate for the AER, rather than AEMO, to assess cost invoices and determine the appropriate amount payable to pipeline operators for the provision of the MOS allocation service?*

It does seem to APIA that AEMO, as the party responsible for developing and maintaining the systems that run the STTM, would have a good understanding of the obligations on pipeline operators to provide MOS allocation services and the costs that would be incurred in doing so.

#### 5. Time allowed for assessment of invoiced costs

*(a) Is the proposed timeframe for the assessment of MOS allocation service costs by the AER appropriate? Does this timeframe reflect the action undertaken by the AER? If not, what would be a more appropriate timeframe?*

The proposed timeframe of 60 business days with option to extend a further 30 days seems excessive for the task. The proposed statutory timeframe is longer than many of those the AER has to conduct its decision making powers in far more complex matters of economic regulation of service providers.

If the AER requires 60 – 90 days to make this decision, then the resources required and the cost of making the decision must be such that they outweigh the benefits of this rule change proposal or any assessment of pipeline operator invoices and lower the efficiency to the gas market.

A 30 business day timeframe is a doubling of the existing timeframe and should be sufficient for this relatively minor matter.

*(b) Is the proposed timeframe for the payment of MOS allocation service costs by AEMO appropriate? Does this timeframe reflect the action undertaken by AEMO? If not, what would be a more appropriate timeframe?*

30 days for the payment of invoices is standard, which is the equivalent of 20 business days. The proposal is for 30 business days. Further, standard commercial practices are not preceded by such onerous assessment processes.

In light of the proposed rule change shifting the decision for payment from AEMO to the AER, it is APIA's view that 10 business days is appropriate for AEMO to pay invoices.

APIA is also concerned with the timing of the phases for publishing of invoice and referral to the AER. Both of these are to be completed 'as soon as practicable' under the current and proposed rules.

With regard to the first phase, in 2012 invoices were provided to AEMO by all pipeline operators within the statutory timeframe of 20 business days from the start of the financial year. The invoices were published on 15 August 2012, 33 business days after the start of the financial year and 13 business days after the latest acceptable day for invoice submission. APIA considers 13 business days to be an excessive period to complete the act of publishing invoices. APIA proposes a 5 business day statutory time limit apply to both the acts of publishing of invoices and the referral to the invoices to the AER.

*(c) Would the assessment process benefit from a 'stop the clock' mechanism for the AER?*

No, this is not a complex process. The rule change proposal requires justification of invoices at both the estimate stage and the invoice stage. This requirement, combined with the experience of the two completed processes in 2010/11 and 2011/12, should ensure the AER does not require very much, if any, additional information during the assessment processes.

## **6. Clarity of definition of MOS allocation service costs**

*(a) Will the proposed amended definition of 'MOS allocation service costs' provide more clarity on the types of costs that can be recovered by pipeline operators in respect of MOS allocation service costs? If not, why not?*

By explicitly excluding certain costs the proposed rule can be considered to increase clarity on the types of costs that can be recovered. Unfortunately, pipeline operator systems are not readily separable into 'MOS allocation systems' and 'STTM systems'. MOS allocation processes utilise existing systems and functionality and have the potential to impact existing systems and functionality. A level of discretion will always be present and the potential for dispute as to what comprises a 'MOS allocation service cost' will always remain.

## **7. Bulletin Board**

*(a) Is there benefit in having a consistent approach to the recovery of MOS allocation service costs and BB aggregation and information service costs, by pipeline operators? Please explain your view.*

The approach should be consistent. As outlined above, APIA believes this consistent approach should be detailed in one section of the NGR and referenced in the relevant MOS allocation service costs and BB sections.

*(b) Will the proposed definition of 'aggregation and information service costs' provide more clarity on the types of costs that can be recovered by pipeline operators in respect of BB aggregation and information service costs? If not, why not?*

No, the definition does not provide any more clarity; it simply moves the reference to “costs incurred in providing aggregation and information services” from the rule itself into the definition. It does not provide any additional information or explanation of what those costs might be. It appears to be a stylistic change only.

*(c) Are the costs associated with conducting the proposed BB aggregation and information service cost recovery process proportional to the costs that could be claimed by pipeline operators?*

No. As mentioned in the Consultation Paper, no pipeline operator has made a claim for its costs in providing the aggregation and information service. APIA understands that this is because pipeline operators are of the view that, given the relatively low value of those costs, it is not worth going through the NGR process to recover those costs.

*(d) Will the proposed changes to the BB aggregation and information service cost recovery process contribute, or be likely to contribute, to the achievement of the NGO? Please explain your view.*

APIA's view on these questions is consistent with our view on MOS allocations service costs and process.