

7 September, 2001

Professor T Parry  
Chairman  
Independent Pricing and Regulatory Tribunal of NSW  
PO Box Q290  
QVB NSW 1231

Dear Professor Parry

**DRAFT ASSOCIATE CONTRACT GUIDELINES**

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We attach a submission from AGL in response to the Tribunal's draft guidelines in relation to approval of associate contracts under the National Gas Code. The submission is made on behalf of both AGL's retail and network businesses.

We would be happy to meet with officers of the Tribunal to discuss the issues identified in our submission and to answer any queries the Tribunal may have regarding the submission. Should you have any queries on this submission, please do not hesitate to contact Sandra Dureau on 99228513.

Yours faithfully

B A Connery  
General Manager Regulatory Affairs  
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## **ASSOCIATE CONTRACTS UNDER NATIONAL GAS CODE RESPONSE TO DRAFT GUIDELINES**

### **Introduction**

The Tribunal has prepared draft guidelines in relation to the approval of Associate Contracts under the National Gas Code. The stated intention of the Guidelines is to provide information and guidance to Service Providers and other interested parties, and also to provide an indication of the matters which may be considered by the Tribunal in considering approval of an Associate Contract.

Guidelines can be a useful tool to facilitate timely and efficient consideration of applications and in this respect, AGL welcomes the Tribunal's proposal to clarify the matters it considers significant and to outline its processes.

To be most effective, guidelines should reflect the following principles:

1. guidelines can not alter or add to the obligations and rights existing under the relevant law,
2. they should provide a high degree of certainty as to the processes and requirements of the decision-maker in exercising its discretion under the law, particularly in relation to "standard" applications. This includes providing a meaningful indication of the Tribunal's current thinking on substantive matters, and
3. they should reflect the statutory intent behind the relevant obligation and also any relevant factual circumstances.

While the guidelines reflect these principles in many areas, some parts of the guidelines fail to do so and accordingly require revision.

The final part of this submission addresses several other matters not specifically relevant to these principles.

(Note: the term "contract" is used in this submission to include arrangements and understandings as well as formal contracts.)

## 1. INCONSISTENCY WITH STATUTORY OBLIGATIONS

There are several areas where the guidelines appear to be seeking to impose additional criteria or requirements over those in the Code, or to be relying on an interpretation inconsistent with the Code. These areas are:

- (i) pre-requisites for an application,
- (ii) time limits and requests for additional information,
- (iii) determination of what is an Associate Contract,
- (iv) definition of an arms length transaction.

This is inconsistent with one of the fundamental principles for development of effective guidelines, and we submit that the guidelines should be amended to rectify this.

### *Requirements for acceptance of an application*

The guidelines include an extensive list of information which is specified as a minimum requirement for the Tribunal to accept an application for approval of an Associate Contract. Mandating inclusion of this information as a pre-requisite to lodging an application goes beyond the scope of the Code and confuses the making of the application with the provision to the Tribunal of the information which it requires to make its determination.

The Code does not include any minimum requirements for an application and imposition of detailed information requirements as a pre-requisite for lodging of an application is beyond the Code. There is no basis to interpret the Code as requiring an application to comprise anything more than details of the parties to the proposed Associate Contract, the contract terms, and a formal request for approval. Provided the application satisfies this threshold, the Regulator is bound to accept the application – it is then a separate matter whether the Regulator has sufficient information to be able to make its determination. Accordingly, in so far as section 5.1 of the guidelines suggests that the Tribunal would refuse to accept an application which was not accompanied by the specified information, the guidelines fail to recognise the regime under the Code.

Clearly, it will expedite consideration of an Associate Contract if information is provided to the Tribunal as early as possible, and AGL supports the development of guidelines which outline the information which will typically be required by the Tribunal. However, provision of that information cannot be made a pre-requisite to acceptance of an application.

AGL submits that the guidelines should recognise properly the information which must be included as part of an application, and then set out separately an indication of the information which the Tribunal considers it will normally require to assist it to assess the impact on competition of a proposed Associate Contract. Such additional information could be included in the “supporting submission” contemplated in section 6 of the guidelines.

### *Time limits and requests for additional information*

In relation to the processes where the Tribunal seeks further information, paragraph 6.6 of the guidelines appears to misconstrue the Code. Under section 7.4(b) of the Code, the relevant period of time for approval is extended where the Regulator requires additional information – the period of the extension is equivalent to the time taken by the Service Provider to provide the required information. However, the guidelines propose that the Tribunal could undertake a two-part extension process whereby it would “stop the clock” by asserting that it requires further information, and would subsequently inform the Service Provider of the actual information

required. This proposal is inconsistent with the proper interpretation of section 7.4(b), is unnecessary and is also unfair.

There is no basis for interpreting section 7.4(b) as creating a two-part notification process. If the Code intended that the Regulator could undertake a two-part notification process, it could be expected that this would have been provided for in the Code, including specification of a period within which the Regulator is to issue details of the required information.

The intention of section 7.4(b) is to provide a mechanism for extension of the time period in section 7.4(a) by the time taken by the Service Provider to provide the requisite information. An interpretation consistent with this intention is to be preferred to any other, and the interpretation consistent with this intention is that the time for approval is extended from the time at which the Regulator gives notice of the additional information which is required.

Practically, under the guidelines' proposed approach, there would be no remedy to the Service Provider or Associate if the Tribunal issued a notice that it wanted more information but then failed to provide details of the requested information, or provided details of its requirements a significant time later. In that case, under the guidelines, the time for approval would stop or be significantly delayed with no mechanism available to the Service Provider or the Associate to bring the approval process to a close. This is clearly inconsistent with the nature of section 7.4 which provides for deemed approval in the absence of a contrary decision within the specified time. It would also be unfair to the Service Provider, the Associate and the end-customer as the transportation service under the Associate contract could not be provided.

Similarly, paragraph 6.8 misinterprets the Code – under section 7.4(b), the relevant period is extended from the date of notification of the additional information requirements until the date that information is provided. It is incorrect (and administratively cumbersome) to seek to develop a process where the period is extended until the Tribunal gives a written acknowledgment that the information has been provided. The relevant date is the date on which the Tribunal receives the information, not when it notifies the receipt of the information. While the giving of such notice will remove uncertainty as to whether there are outstanding information requirements, it cannot extend the time period established under the Code.

Paragraph 5.4 suggests that the Tribunal will issue a notice “once it considers that a full application has been provided” recording the date of receipt, and this will be the date of receipt for the purposes of the Code. Provided that the application gives details of the parties to the Associate Contract and the contract terms, the period for consideration commences on the day on which that application is received. If the guidelines are suggesting there could be some other view of when the time period commences, they would seem to be attempting to extend the operation of the Code.

#### *Determination of what is an Associate Contract*

The guidelines refer to an expectation by the Tribunal that all contracts which are “potentially” Associate Contracts will be forwarded to the Tribunal for consideration (paragraph 2.4). While it may be desirable for a Service Provider to seek the Regulator's view on whether the Regulator considers a particular contract to be an Associate Contract, it is not appropriate for the Regulator to purport to determine, as a matter of law, whether a particular contract is an Associate Contract. In line with other obligations under the Gas Pipelines Access Law and generally, it is for the Service Provider to form its own view on the meaning or application of the law, and to bear the consequences if that view is incorrect.

As written, paragraph 2.4 seeks to create some obligation on the Service Provider to submit for consideration by the Tribunal every document which is potentially an Associate Contract. We would submit that paragraph 2.4 would be better worded as permissive rather than mandatory.

Additionally, it may be beneficial if the informal notification process under the guidelines extended to cover discussion regarding contracts where there is uncertainty as to whether they are or are not within the definition.

#### *Definition of arms length transactions*

In respect of the discussion in paragraph 4.2, AGL concurs that the proper interpretation of the Code is whether the *transaction* is arms length – this is consistent with paragraph (b) of the definition of Associate Contract in the Code. Similarly, the guidelines are correct in recognising that it is a question of fact whether or not a transaction is arms length.

However, the discussion in paragraph 4.3 errs in suggesting that the test for whether a transaction is arms length is whether the transaction “was one that was the product of real bargaining between the parties”. To the extent that this suggests that a transaction can only be arms length where there is equal bargaining power between the parties it is incorrect. The key to whether a transaction is arms length is whether the terms of the transaction were influenced by a relationship between the parties to the transaction (or associates of those parties), not whether both parties have “real” bargaining power. In the context of a gas distribution network, for example, an agreement for a reference or negotiated service will be arms length transaction even where the customer has no alternative to the use of natural gas as long as the terms of the transaction were not influenced by a commercial or other relationship between the Service Provider and the customer (or associates of those parties).

In relation to the last sentence of paragraph 4.3, we note that this applies to all Associate Contracts, not just contracts which are Associate Contracts because they benefit an Associate.

#### *Proper test for approval*

While it is presumably a matter of tone rather than substance, paragraphs 10.6 and 10.7 appear to reflect a pre-determination by the Tribunal that Associate Contracts could not be approved unless, in every case, the Service Provider gives an undertaking of the sort described in the guidelines. We suggest that this should be rectified in the final version of the guidelines.

Additionally, the guidelines could lead to an inaccurate understanding of the test in the Code – under section 7.1 of the Code, the Regulator must approve an Associate Contract unless the Regulator considers that the contract would have, or would be likely to have, the relevant effect on competition. The Code does not start with the presumption that Associate Contracts will have such an effect and that they should normally not be approved – instead, the Code clearly creates a regime under which, in the absence of evidence that the Associate Contract will have the effect, the Contract is to be approved. However, the guidelines appear to suggest that the Service Provider must affirmatively demonstrate that an Associate Contract will not have the relevant effect (paragraphs 10.6) – it would be preferable for the guidelines to properly reflect the test in the Code.

## **2. SCOPE FOR GREATER CONTRIBUTION TO CERTAINTY**

In many areas, the guidelines will contribute to the certainty and transparency of the Tribunal's processes in assessing the impact of an Associate Contract. However, there are several areas where revision of the guidelines would provide a greater level of certainty and transparency without compromising the Tribunal's role and ability to assess each Associate Contract on its merits.

These areas are:

- (i) informal notifications
- (ii) definition of “market” and “substantial lessening”
- (iii) treatment of confidential information

### **Informal notification**

The guidelines propose a process of “informal notification” to assist the Tribunal to identify the information it may require to assess the impact on competition of an Associate Contract and the process which will be undertaken.

There may be significant benefit in an informal notification process similar to those in other regulatory processes where the decision-maker identifies not only the processes which are to be observed, but also the decision-maker’s views on the substantive issues raised by the application. Some processes also extend to the decision-maker providing a level of certainty on the outcome of the formal process, subject to there being no matters subsequently brought to the decision-maker’s attention which would warrant reconsideration of the issues. Such a process can contribute positively to the consideration of applications.

However, the process under the guidelines is designed only for very limited purposes – to identify (in addition to other provisions of the guidelines) the information the Tribunal may require to assess an Associate Contract and the process proposed by the Tribunal. The possible benefit of this limited process is further reduced by the significant qualifications in section 7.3 on what might be provided by the Tribunal – if there is “sufficient information” the Tribunal may provide “some guidance as to the extent” of the information and consultation requirements.

Accordingly, AGL submits that the guidelines should provide for a more certain and extensive informal process.

In any event, and regardless of the outcome of any informal notification process, it is important that the guidelines do not purport to make such notification mandatory, and decisions are not influenced by whether or not the Service Provider engaged in informal notification.

### **“Market” and “substantial lessening”**

In early 2001, the Tribunal published its decision on an Associate Contract affecting the AGL distribution network. In that decision, the Tribunal considered and reached a conclusion on the matters discussed in sections 8, 9 and 10 of the guidelines. It is unclear why this is not reflected in the guidelines .

The Tribunal has already received submissions on these issues, including Service Providers and retailers, and has considered those submissions and the implication of the Code test in the context of a New South Wales distribution network and there seems to be little benefit in guidelines which propose that the Tribunal will consider the matter afresh for every Associate Contract which is lodged. The guidelines would better fulfil their intended role if they reflected the Tribunal’s findings, with the Tribunal undertaking further investigation if a particular Associate Contract raises issues which have not already been canvassed and determined.

## **Confidential information**

It is likely that, particularly in relation to non-reference service Associate Contracts, information which is confidential or commercially sensitive may be provided to the Tribunal. Unfortunately, while the guidelines contain reasonable detail regarding the Tribunal's ability to obtain information, and the discretion as to release of information, there is no guidance given as to the Tribunal's general view as to disclosure of information. It would contribute to a better understanding of the Tribunal's processes if the guidelines contained an indication of the Tribunal's general intention in relation to publication of information.

Additionally, the guidelines could address whether the Tribunal, as a matter of course, would normally intend to give the parties to the Associate Contract an opportunity to respond to issues raised by submissions made in confidence or which are not published on the Tribunal's web-site.

## **3. REFLECTION OF POLICY BACKGROUND AND RELEVANT FACTUAL CIRCUMSTANCES**

### *Policy background to section 7.1*

There is no reflection in the guidelines of the statutory objective underpinning the obligation for the Service Provider to obtain regulatory approval of agreements with associates. Section 7.1 of the Code is complementary to the ringfencing obligations in section 4 which are, in turn, part of a regime designed to promote the development of a competitive market through establishment of a "level playing field" for all retailers. This should be recognised in the guidelines to give a meaningful context to the obligation and the Tribunal's processes.

Rather than recognising the basis for the obligation, the guidelines seem to be affected by an implication that, generally, Associate Contracts will have an undesirable effect on competition and this is why they are regulated – for example:

- the assertion in paragraph 10.1 that "Associate Contracts have the potential to confer a competitive advantage on the parties involved, resulting in a substantial lessening of competition" suggests that other contracts do not also have this potential.
- paragraph 10.6 states the test for approval in such a way as to suggest that the starting point of the Tribunal is that an Associate Contract would be likely to have the relevant effect.
- similarly, paragraph 10.18 emphasises the possibility of an Associate Contract having an adverse effect on competition where there is a high level of vertical integration, without recognising that it is because of this very circumstance that regulatory approval is required.

### *Relevant factual circumstances*

Retailers generally pass through to their end-customers the terms and conditions of their arrangements with the distribution network. It is suggested that recognition of this in the guidelines would be of assistance to participants in the consultation process as this fact will have an impact on the effect on competition of an Associate Contract.

## 4. GENERAL

### *Information*

It is recognised that the Tribunal must have the information which is necessary to enable it to determine whether the proposed contract will have the relevant effect on competition. Additionally, there are benefits to all participants in review processes if there is clear understanding of the information required by the Tribunal as this should assist in expediting consideration of Associate Contracts. While provision of this information can not be made a pre-requisite for acceptance of an application, it is recognised that there is a general body of information which will generally be required by the Tribunal to enable the Tribunal to reach its determination.

At the same time, the information required by the Tribunal should be limited to information which is relevant to the question of whether the Associate Contract will have the relevant effect on competition, and information which is needed for the Tribunal to assess that effect.

Against this background, and the fact that the Tribunal is always able to seek more information if required, the proposed information requirements in paragraph 5.1 of the guidelines appear to be unduly detailed. We have set out in the annexure to this submission our comments on specific items in paragraph 5.1.

### ***Sanctions for non-compliance***

The discussion in section 13 of possible sanctions for breach of the Code does not appear to be relevant to the stated aims of the guidelines.

In addition, while the actions discussed in paragraph 13.6 generally reflect the undertakings voluntarily provided by AGL Gas Networks in early 2001, it is not clear how the inclusion of this discussion is relevant to guidelines which are designed for general application to the future exercise of the Tribunal's powers in relation to all Service Providers in New South Wales.

The discussion in paragraph 13.6 may be misleading in so far as it suggests that the Tribunal has a right to recommend to a Court that the Court require the Service Provider to undertake certain actions.

### *Other matters*

- (a) Paragraph 12.3 suggests that a proposed variation can be an associate contract under the Code. However, while a variation to a contract can itself be an associate contract, it is not clear that a *proposed* variation could be an associate contract as this would be extending the definition to unconcluded negotiations. While this is presumably a minor drafting matter, it would be desirable if this were addressed in the final guidelines.
- (b) The discussion in paragraph 12.3 should also be extended to apply to information provided by any person to the Tribunal.
- (c) Paragraph 12.4 is unclear – is this intended to suggest that the Tribunal's exercise of its powers under section 7.12 of the Code and section 42 of the Gas Pipelines Access Law will somehow be constrained by the provisions of the Freedom of Information Act?

## **COMMENTS ON INFORMATION IDENTIFIED IN PARAGRAPH 5.1 OF GUIDELINES**



- the name, address and contact details of any end user customers named in the Associate Contract.

*This information will not always be meaningful or relevant to assessment of an Associate Contract, particularly for reference services. Additionally, for a reference service agreement for tariff customers, this would require the provision of names and addresses of hundreds of thousands of end-customers.*

*As a general matter, such information should only be routinely sought where the Associate Contract is for a non-reference service. Even then, the information should only be sought, and contact made with the end-customer, where contact with the end-user is required for the Tribunal to be able to inform itself as to the impact of the Associate Contract on competition.*

- a description of business carried on by all parties to the proposed Associate Contract.

*It is not clear why this will generally be relevant information for the consideration of an Associate Contract. We suggest that this information should not form part of the “standard” information requirements but should be obtained where relevant to the particular Associate Contract being considered by the Tribunal. In any event, through its role as Regulator under the Code, the Tribunal is already aware of the business carried on by the Service Providers which it regulates, and by the retail associates of those Service Providers.*

- a description of the proposed Associate Contract and its commercial rationale.

*It is not clear what is intended by this item and it is also not clear that this information will be meaningful or relevant to assessment of an Associate Contract, particularly for reference services.*

*Such information should only be routinely sought where the Associate Contract is for provision of a service other than at the reference tariff and even then, the information should only be sought if it is necessary for the Tribunal to understand the impact of the Associate Contract on competition.*

- a copy of any other documents or correspondence, e.g. letters of offer, which reduce any of the particulars of the Associate Contract to writing.

*It may be of assistance if the guidelines clarified that this requirement would apply to Associate Contracts which are not in the form of a formal contract.*

- an outline of any differences (and the rationale for the differences) in tariffs, terms and conditions between the Associate Contract and:
  - (i) tariffs, terms and conditions (if known) that might be negotiated by other parties in respect of similar contracts; and
  - (ii) reference tariffs, terms and conditions that may be applicable to other customers.

*It is not clear what information is intended to be provided under these categories, or how that information will be relevant to the assessment of the impact on competition of an Associate Contract.*

*In addition, the point is understood to require a comparison between the particular Associate Contract and the Service Provider's standard reference service agreement. If the request for such information is retained, it may be of assistance if the guidelines clarified that the information is only required where the Associate Contract is not for a reference service.*

*Additionally, having regard to the range of reference services that may be offered, and the numerous end-customers of a distribution network, it may also be of assistance if the guidelines clarified that the comparison under paragraph (ii) is a comparison against the reference service terms applicable to comparable end-customers.*

- an outline of any of the terms and conditions of the Associate Contract that were offered to other parties, and the names and addresses of these parties.

*It is not clear that this information will be meaningful or relevant to assessment of the impact on competition of an Associate Contract, particularly for reference services.*