# DAMPIER TO BUNBURY NATURAL GAS PIPELINE

# PROPOSED ACCESS ARRANGEMENT UNDER THE NATIONAL ACCESS CODE

## Additional Paper 2: Secondary Market Issues
## 16 June 2000

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# 1. Introduction

1.1 Eleven of the submissions to the Western Australian Independent Gas Pipelines Access Regulator ("the Regulator") on the proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline ("the DBNGP") raised issues concerning Epic Energy's proposal for a Secondary Market in which unused pipeline capacity could be traded.

1.2 These issues require more extensive comment than could be made in submissions on the DBNGP Access Arrangement that Epic Energy has already lodged with the Regulator. Epic Energy indicated in its Submissions 4 - 9 that, where it was unable to provide detailed comment on issues raised, or had not provided comment in earlier submissions, it would endeavour to deal with those issues in further papers to the Regulator. In Submission 6, Epic Energy noted that it would provide more detailed and considered comment on Secondary market issues.

1.3 Epic Energy's more detailed comments on Secondary Market issues are made in this Additional Paper 3.

# 2. Issues Raised in Submissions

2.1 Those raising issues arising from Epic Energy's proposal for a Secondary Market, and the issues they have raised are listed below.

2.2 Worsley Alumina:

> " . . . *the proposed Secondary Market terms and conditions are restrictive and do not promote the efficient use of the pipeline. The terms are effectively for a Firm Service for one day. It is take or pay for the day and not interruptible. Under the GTRs the AT3 service was 'pay for what you get' and interruptible*." [1]

2.3 WMC Resources:

> " . . . *the proposed Rules for the Secondary Market are lacking necessary detail and confer some privileges on the proponent. For example, it is far from clear as to the priority to be accorded to the holders of contracted capacity seeking to sell on the secondary market as against uncontracted capacity to be sold by Epic. Holders of existing contractual rights should be afforded priority in the sale process as they have entered into binding longer term commitments with large financial obligations.*
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> *For example, the price setting mechanism proposed to be used is a most important part of any Secondary Market, and needs to be well defined, understood and approved by OffGAR. To state that the price for Secondary Market Service will be the "prevailing market price" is far too imprecise*." [2]

[1] Worsley Alumina's Submission to the Office of Gas Access Regulation re Epic Energy's Proposed Access Arrangement for the DBNGP, 11 February 2000: section 3.5.
[2] WMC Resources, Submission on the Proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline: 4.

2.4 Robe River Mining Co Pty Ltd:

> "*There will be limited scope for trading capacity in the Pilbara Region (Zone 1(a)) as there are only two existing actual/potential shippers with actual or economically proximate Receipt Points within that Zone*." [3]

2.5 Wesfarmers Limited:

> "*We are concerned that the firm service proposed by Epic Energy is materially different to the T1 service in a range of key respects. The practical effect of these differences appears to be a significant increase in the effective transmission costs payable by pipeline users. This arises from:*
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> *. . .*
>
> *(b) an increase in incidental service costs charged by Epic Energy over and above the headline tariff. . . . Issues include:*
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> *. . .*
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> - *new restrictions to sell unused capacity to other users;*
> - *no provision for interruptible capacity . . . .*" [4]

2.6 Western Power:

> "*The GTR/DBPR services provide shippers with flexibility in acquiring additional capacity on a short term basis, by means of capacity trading between shippers, as an additional option to the interruptible capacity service.*
>
> *The proposed Firm Service however, does not have either of these flexibilities, because only firm capacity can be procured on a day to day basis, through the proposed Secondary Market Service. It appears that shippers with GTR contracts will not have the same trading entitlements as Firm Service shippers in the Secondary Market*." [5]

2.7 Western Power:

> "*Western Power questions how Epic Energy can provide access to spare capacity to shippers with GTR contracts, while operating the Secondary Market for eligible shippers.*
>
> *Western Power submits that Epic Energy should not be allowed to implement the proposed market trading regime, which effectively removes the rights of shippers to have access to daily interruptible capacity, unless the GTR shippers are eligible to purchase and sell capacity in the Secondary Market, and the secondary market rules are less restrictive.*

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[3] Robe River Mining Co Pty Ltd, Submission on Epic Energy's Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline dated 15 December 1999: 10.
[4] Letter to OffGAR dated 16 March 2000: section 4.
[5] Letter to OffGAR dated 16 March 2000, Epic Energy Access Arrangement for the DBNGP, Western Power Submission Number 4, T1, T2 & T3 Equivalent Reference Services: 6.

*Epic Energy seeks to have a dual role in the Secondary Market. It proposes to operate and manage the market, and it may also supply uncontracted capacity into the market, thus influencing the market depending on the time of offering capacity. Western Power submits that these two roles should be, at least, ring fenced.*

*Furthermore, because (as is appropriate) the Access Arrangement places no restriction on Epic Energy contracting with shippers for interruptible capacity on flexible terms, Epic Energy has the ability to by-pass the Secondary Market by selling flexible interruptible capacity in a way that undercuts shippers, who are compelled by the Secondary Market rules to offer only firm service capacity."* [6]

2.8 CMS:

"[The Secondary Market's] *inclusion by Epic appears to be an attempt to entrench a monopolistic position. Certainly Epic's own surcharge arrangements (especially the Nominations Surcharge) provide a strong incentive for Shippers to use the Market for fiscal relief.*

*. . . The wording of the text is both inadequate in detail and incomplete in substance. It is not clear just who is empowered to post for sale capacity which is contracted but un-nominated. Definitions are generally vague or omitted (eg. the definitions of a "Stand-in-the-market" bid, and the term "Converted Amount", respectively). The descriptions of process are at best unclear but also appear to be in some cases unworkable (eg. the timing and determination process of a sale for a Stand-in-the-market bid as described under Section 4.7(a)(i) & (ii)*." [7]

2.9 North West Shelf Gas:

"*The AA documents do not provide sufficient detail to allow reasonable assessment of the costs and practicalities of the proposed Secondary Market to be made. In particular, the details on how full haul capacity entitlements might be translated into part haul entitlements to facilitate capacity trading are not explained in the AA.*

*There is a concern that Epic Energy proposes to be both market organiser, participant and information broker/provider. It is difficult to see how these multiple roles are consistent with a well informed and balanced market for daily pipeline capacity. In our view, if Epic Energy is to be involved as a trader in such a capacity market, then such a secondary market needs to be formed and organised by a third party and there be rules to allow for prompt distribution of information to all market participants*." [8]

2.10 Treasury and Office of Energy:

"*Given that such a market has not been in existence before, there is uncertainty as to how the market would develop and whether it would be an effective and efficient means of optimising the use of the DBNGP spare unutilised capacity. There may be a need for a trial period to provide parties with experience with the rules and to allow identification of potential deficiencies and improvements to the rules. There may*

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[6] Letter to OffGAR dated 16 March 2000, Epic Energy Access Arrangement for the DBNGP, Western Power's Submission Number 5, Other Reference Service Issues and Policies: 10.
[7] Epic DBNGP System Proposed Access Arrangement, Public Submission by CMS, March 2000: 8.
[8] Submission by North West Shelf Gas Pty Ltd to the WA Independent Gas Pipelines Access Regulator Regarding the Proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline: 13.

*also be a need for an effective consultation process, involving the Regulator, that would oversee the operation and the rules of the secondary market. It may not be seen appropriate for Epic Energy to determine the rules of a secondary market if it is proposing to participate as a player in it. The Regulator may wish to consider the possibility of classifying the capacity posted in the secondary market as a "market carriage pipeline" and the desirability for the Regulator to approve any amendments to the secondary market rules proposed by Epic Energy.*" [9]

2.11 AlintaGas:

"*The proposed Secondary Market is inflexible, and provides for Firm capacity only. The T1 service permits flexible informal capacity dealing directly between users (through use of each other's nominations, including at non-contracted delivery points) and incorporates an AT3 interruptible service for daily spot capacity*." [10]

2.12 AlintaGas:

"*AlintaGas submits that the Secondary Market appears to be complex and inflexible. Epic Energy will gain most from an inflexible Secondary Capacity market because users will not be able to sell or buy Secondary Capacity in an effective manner. Some users will have an excess of unused firm capacity whilst other users will have purchased overrun capacity from Epic Energy. In both cases, Epic Energy benefits at the expense of the interests of users.*

*AlintaGas also submits that it is inappropriate for Epic Energy, which stands to gain most from the Secondary Market, to be able to unilaterally change the Secondary Market rules without the Regulator's approval.*

*There is sufficient flexibility within the T1 service for a user to get access to additional capacity and to sell that capacity to other users. . . .*

*This capability to trade capacity is possible because of the right the user has in the T1 service to deliver gas to Delivery Points at which the user does not have contracted capacity. . . .*

*Rather than providing an interruptible service and Delivery Point flexibility, Epic Energy is proposing a Secondary Market. . . .*

*AlintaGas contends that users do not want a Secondary Market that provides users with firm capacity. Rather, users would benefit, both in the sale and purchase of capacity, if there were an interruptible service combined with Delivery Point flexibility. . . .*

*Furthermore, because Epic Energy is free to negotiate interruptible non-Reference Services with users and prospective users, but is not making such flexibility available to users wishing to sell capacity on the Secondary Market, Epic Energy will be in a position to undercut any user selling capacity on the Secondary Market.*

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[9] Dampier to Bunbury Natural Gas Pipeline – Treasury and Office of Energy Submission on the Proposed Access Arrangement: 18.

[10] AlintaGas's Second Submission to Regulator on Epic Energy's DBNGP Access Arrangement: 2.

*Finally, since only users with a contract for firm service are to be permitted to market capacity on the Secondary Market, users with grandfathered T1 capacity will be excluded unless Epic Energy agrees to such users marketing capacity on the Secondary Market*." [11]

2.13 A number of themes run through the issues listed above. They are:

- the Secondary Market terms and conditions are restrictive and inflexible (Worsley Alumina, Wesfarmers, Western Power, AlintaGas);
- there is no interruptible service, and shippers are restricted to acquiring firm service on a daily basis (Worsley Alumina, Wesfarmers, Western Power, AlintaGas);
- the Secondary Market terms and conditions are lacking necessary details (WMC Resources, CMS, North West Shelf Gas);
- Epic Energy has conflicting roles as a Secondary Market participant and as market operator (WMC Resources, Western Power, CMS, North West Shelf Gas, Treasury/Office of Energy, AlintaGas);
- the Secondary Market should be conducted as a market carriage pipeline (Treasury/Office of Energy);
- shippers with GTR contracts will not have the same trading entitlements as Firm Service shippers (Western Power, AlintaGas); and
- there is limited scope for trading capacity in the Pilbara (Robe River Mining).

# 3. Epic Energy's Response to the Issues Raised

## 3.1 The Secondary Market terms and conditions are restrictive and inflexible

3.1.1 The view that Epic Energy's Secondary Market proposal is inflexible because shippers can no longer enter into capacity trading arrangements between themselves, and can no longer enter into capacity trading arrangements that have durations longer than one day, is incorrect.

3.1.2 Section 3.10 of the *National Third Party Access Code for Natural Gas Pipeline Systems* ("the Code") requires that the trading policy included in an access arrangement comply with the following principles:

(a) a user must be permitted to transfer or assign all or part of its contracted capacity without the consent of the service provider if:

- the user's obligations under its contract with the service provider remain in full force and effect after the transfer or assignment; and
- the terms of the contract are not altered as a result of the transfer or assignment (a bare transfer);

(b) where commercially and technically reasonable, a user must be permitted to transfer or assign all or part of its contracted capacity other than by way of a bare transfer with the consent of the service provider; and

[11] AlintaGas's Third Submission to Regulator on Epic Energy's DBNGP Access Arrangement, Initial Capital Base, WACC, Tariff and Other Issues, Submission dated 17 March 2000: 32-33.

(c) where commercially and technically reasonable, a user must be permitted to change the delivery point or receipt point from that specified in any contract for the relevant service with the prior written consent of the service provider.

3.1.3 Paragraph 11.1 of Epic Energy's Access Arrangement for the DBNGP expressly permits bare transfers in accordance with section 3.10 of the Code. Accordingly, it expressly permits shippers entering into capacity trading arrangements between themselves, and entering into capacity trading arrangements that have durations longer than one day, provided those arrangements are bare transfers. It also permits arrangements, provided they are bare transfers, whereby:

- a shipper agrees to use its nominations on behalf of another shipper; and
- the capacity traded is subject to interruption by the transferor.

3.1.4 To the extent that delivery point MDQ can be relocated in accordance with Clause 3.5 of the Access Contract Terms and Conditions, and receipt point flexibility is permitted in accordance with Clause 3.3, a bare transfer provides flexibility to change the delivery point or receipt point from that specified in any access contract. The Access Contract Terms and Conditions, in fact, provide the delivery point flexibility which AlintaGas suggests is absent from Epic Energy's proposals and is desired by shippers. The issue of delivery point flexibility was dealt with more fully in Epic Energy's Submission 9.

3.1.5 Epic Energy notes that Paragraph 11.1 of the DBNGP Access Arrangement does not make reference to transfers of capacity between shippers other than by way of bare transfers. It does not deal explicitly with the requirement of section 3.10(b) of the Code that an access arrangement permit, subject to prior written consent being given by the service provider, other transfers of capacity where these are technically and commercially reasonable.

3.1.6 This was not an intended consequence. If the Regulator were to require an amendment to Paragraph 11.1 of the DBNGP Access Arrangement, whereby Epic Energy would permit a transfer of capacity in accordance with section 3.10 of the Code (removing the requirement that transfers to limited to bare transfers), Epic Energy would not oppose such a requirement.

3.1.7 The flexibility that Western Power and AlintaGas claim is absent from the DBNGP Access Arrangement will, in fact, be available through the Trading Policy contained in Paragraph 11 of the Access Arrangement.

3.1.8 Epic Energy's Secondary Market proposal complements its Trading Policy.

3.1.9 Through the Secondary Market, shippers not wishing to incur the costs of negotiating directly with others, or seeking to address an expected capacity surplus or shortfall which has arisen at short notice, will have the means of making their unused capacity available to potential users, or acquiring the additional capacity they require.

3.1.10 To ensure that shippers have maximum flexibility, capacity can be sold or purchased in the Secondary Market at any time during the day, and capacity which has been purchased can be resold. In addition, the Secondary Market Rules allow shippers to post capacity for sale not only on the day ahead, but also on future days. Provided it has been offered, capacity can be purchased in advance for use in the future. Furthermore, shippers selling and requiring capacity can stand in the market with or for that capacity.

3.1.11 To facilitate the short term trading of capacity, and to permit all Firm Service shippers to be able to trade capacity irrespective of the locations of their delivery points, the proposed Secondary Market Rules define a "standard commodity" which can be traded. That standard commodity is Firm Service at the Secondary Market Point, a point on the DBNGP at Kwinana Junction.

3.1.12 Capacity which Epic Energy offers for sale in the Secondary Market will also have the characteristics of Firm Service. The Secondary Market Rules (in Clause 4.5) restrict Epic Energy to posting uncontracted capacity for sale on any day. A shipper will therefore have certainty that capacity it purchases from Epic Energy in the Secondary Market will not be interrupted during the day. Under the access regimes of the *Gas Transmission Regulations 1994* and the Access Manual of the *Dampier to Bunbury Pipeline Act 1997* ("the GTR/AM regimes"), Epic Energy could sell as AT3 capacity shipper's contracted, but unutilised capacity. If during a day, a shipper increased its nomination, using more of its contracted capacity, Epic Energy may have had to interrupt (without penalty) users of AT3 if that capacity were being provided from contracted but previously unutilised capacity.

3.1.13 Although the "commodity" traded in the Secondary Market is Firm Service, the Secondary Market arrangements provide a degree of flexibility not otherwise available with Firm Service. A shipper can purchase or sell capacity in the Secondary Market at any time during the day. It can, therefore, delay purchase until the capacity is needed, and can offer for sale at any time capacity surplus to its requirements. This is a more flexible arrangement that the arrangements for purchase of AT3 capacity under the GTR/AM regimes. Under the GTR/AM regimes, AT3 capacity had to be acquired at the times of nomination. Furthermore, there was a requirement to pay for AT3 capacity acquired and not used if Epic Energy could have sold that capacity to another shipper.

3.1.14 Requiring that the traded commodity be Firm Service recognises that the unused capacity shippers will have to offer on the Secondary Market is capacity provided under contracts for Firm Service. It also permits a simple contracting regime to operate at short notice. Once a purchaser in the Secondary Market is notified that its bid has been successful, a Secondary Market Service Contract is deemed to come into existence. The terms of that Secondary Market Service Contract are set out in the Secondary Market Terms and Conditions. They are, effectively, the terms and conditions for access to Firm Service.

3.1.15 In developing the proposed Secondary Market Rules, Epic Energy recognised that shippers with delivery points located outside Zones 9 and 10 would have very limited opportunities for the trading of capacity. Most opportunities to sell unused capacity would be opportunities in Zones 9 and 10. The proposed Rules therefore make provision for any capacity offered in the Secondary Market to be converted into, and offered as, an equivalent quantity of capacity at the Secondary Market Point (at the boundary between Zones 9 and 10). All purchases in the Secondary Market are then purchases of known, equivalent quantities of capacity at the Secondary Market Point. These equivalent quantities of capacity are referred to as Secondary Market Quantities. Trading in Secondary Market Quantities allows prospective purchasers to directly compare posted prices for a standard "commodity".

3.1.16 Capacity traded in the Secondary Market can be relocated in accordance with the delivery point flexibility provisions of the DBNGP Access Contract Terms and Conditions, enabling capacity to be used upstream of Kwinana Junction without Epic Energy's consent. However, if capacity is to be relocated downstream of Kwinana Junction, Epic Energy must be advised to ensure that capacity in Zone 10 is actually available for the delivery of gas.

### 3.2 There is no interruptible service

3.2.1 Epic Energy's Secondary Market Service is not interruptible; it is a form of Firm Service. Nevertheless, because capacity can be traded at any time during the day, Secondary Market Service has some of the flexibility of an interruptible service, but with greater certainty of supply. Epic Energy is, therefore, of the view that shippers will not be disadvantaged by not being able to purchase an interruptible service.

3.2.2 However, three issues appear to be of concern to shippers:

- because it is not interruptible, Secondary Market Service might command a price higher than the price applying to an interruptible service;
- shippers using Secondary Market Service might pay more than they would pay for an interruptible service because Secondary Market Service is effectively take-or-pay, whereas an interruptible service would usually be provided on a "pay for what you use" basis; and
- Epic Energy's not making available an interruptible service may result in the inefficient use of DBNGP capacity.

Epic Energy responds to these issues as follows.

3.2.3 That Secondary Market Service is not interruptible does not immediately imply its price will be higher than the price of an interruptible service. The prices at which capacity will be traded in the Secondary Market will be determined by demand and supply conditions in that market from day to day, and during each day. From its observations on daily demand for capacity, and capacity availability, since it acquired the DBNGP in March 1998, Epic Energy expects the prices at which Secondary Market transactions would take place would be relatively low for most of the time. Days on which all shippers seek capacity additional to their contract entitlements, and Epic Energy is unable to supply uncontracted capacity because of compressor unit outages, are infrequent. (During 1999, there were only 16 days on which shippers' capacity requirements exceeded the total capacity nominally available. The capacity nominally available exceeded the total requirement, including the requirement for AT3 capacity, by, on average, 55 TJ/day.) Accordingly, high Secondary Market prices are likely to be relatively infrequent.

3.2.4 Secondary Market Service is effectively take-or-pay, rather than "pay for what you use". However, this does not necessarily imply higher charges for capacity obtained through the Secondary Market. Shippers can reduce the cost of using Secondary Market Service by managing their Secondary Market transactions. As noted in paragraph 3.1.10 above, provided capacity is offered for sale through the Secondary Market, it can be purchased at any time during the day. Furthermore, provided there are buyers in the market, a shipper that has purchased Secondary Market Capacity earlier in the day can, on finding that capacity surplus to its requirements, resell the capacity. There is no requirement for a shipper to purchase Secondary Market Capacity before the start of a day and to hold that capacity for the full day.

3.2.5 Epic Energy notes that, under the GTR/AM regimes, a shipper requiring additional capacity could acquire that capacity from another shipper as traded capacity, in which case it was take-or-pay. Alternatively, it could obtain, from Epic Energy, capacity not utilised by other shippers as AT3 capacity, but only in accordance with an inflexible nominations process. AT3 capacity was interruptible, but where it was unutilised contracted capacity, Epic Energy was effectively selling the capacity twice. Under its Secondary Market proposal, Epic Energy does not have the right to sell unutilised contracted capacity, and does not sell capacity twice.

3.2.6 Epic Energy's not making available an interruptible service does not imply the inefficient use of DBNGP capacity. If demand exists, Epic Energy will make available, at least on a short term basis, whatever capacity it can, up to the maximum capacity of the DBNGP at the time, to meet that demand. It is in Epic Energy's commercial interest to do so. In the past, when demand for pipeline capacity was high (because, for example, industrial disputes prevented the use of coal fired power plant) DBNGP capacity was made available to meet that demand by postponing scheduled maintenance for short periods, and manning remotely operated compressor stations to minimise the time compression plant was out of service. The availability of an interruptible service is irrelevant to the efficient use of DBNGP capacity. Capacity required will still be made available, but it will be made available through the Secondary Market at a price determined in that market. The key issue is a set of operating arrangements in which Epic Energy has incentives to supply the capacity required by shippers, up to the maximum available. The proposed Secondary Market is part of such a set of operating arrangements. Furthermore, in contrast to the GTR/AM regimes, under the proposed Access Arrangement shippers will ultimately benefit from additional capacity sold by Epic Energy through the rebate mechanism of Paragraph 9.

3.2.7 Epic Energy's Secondary Market proposal precludes the inefficient use of capacity that is possible through the arrangements for interruptible capacity in the GTR/AM regimes. Under those regimes, shippers can contract long term for interruptible capacity with no obligation to pay unless that capacity is used. Interruptible capacity can be "tied up" through an ST3 contract, with the shipper holding but not using the capacity having no incentive to make it available to another party.

3.2.8 Neither the DBNGP Access Arrangement nor the proposed Secondary Market Rules prevent shippers from entering into capacity trading arrangements between themselves, and entering into capacity trading arrangements that have durations longer than one day. These arrangements may provide for a shipper shipping on behalf of another, and may provide for capacity traded to be interrupted by the transferor. Epic Energy will not have a monopoly on the supply of interruptible capacity. It will not, as AlintaGas and Western Power assert, be able to sell interruptible capacity and undercut shippers who are compelled to take Firm Service capacity through the Secondary Market. There is no compulsion on shippers to use the Secondary Market.

3.2.9 To assert, as CMS has done, that the Secondary Market arrangements entrench Epic Energy's monopoly position because the nominations surcharge forces shippers to use the Secondary Market, is misleading. The imposition of a nominations surcharge would not be the routine matter implied by CMS. A nominations surcharge may be levied only if Epic Energy, as a reasonable and prudent pipeline operator, believes that a shipper is not making nominations in good faith. Before the surcharge can be applied, a variation notice must be given by Epic Energy. Once a variation notice is issued, the shipper has 21 days within which to adjust its nominations. Even then, a surcharge cannot be applied unless the quantities of gas received or delivered vary by more than 10% from the relevant nomination. The purpose of the nominations surcharge is not, as CMS suggests, to force use of the Secondary Market. It is to deter extreme behaviour which could result in Epic Energy being unable to meet its obligations to other shippers, or which would lead to the inefficient operation of the DBNGP. CMS has neglected to mention that, under the

GTR/AM regime, there is also an obligation to nominate in good faith. A shipper who fails to comply with that obligation is in breach of contract, and its contract can be terminated.

3.2.10 Epic Energy's Trading Policy, its Access Arrangement Terms and Conditions, and its Secondary Market proposal provide a flexible scheme for the transfer of unused capacity to shippers requiring additional capacity. Epic Energy expects that its proposed Secondary Market arrangements will facilitate additional capacity being made available, at market determined prices, to those who require it. This should be of particular benefit to shippers who have unused capacity available for short periods, or who have available only small quantities of unused capacity. They will not need to incur the costs of seeking out and contracting with trading partners. It should also be of benefit to those who require additional capacity at short notice. More importantly, through Epic Energy's creation of an effective Secondary Market, shippers should expect to see prices for unutilised capacity that are significantly lower than the price of AT3 capacity under the GTR/AM regimes.

### 3.3 The Secondary Market terms and conditions are lacking necessary details

3.3.1 Submissions have asserted that the proposed Secondary Market Terms and Conditions are lacking necessary details, but only seven specific instances of deficiency have been cited. These are:

- the priority to be accorded to the holders of contracted capacity seeking to sell against uncontracted capacity offered for sale by Epic Energy is not clear (WMC Resources);
- the price setting mechanism is not clear, and to describe the price for Secondary Market Service as the prevailing market price is far too imprecise (WMC Resources);
- who has the right to post for sale contracted but unutilised capacity is not clear (CMS);
- the definition of Stand in the Market Bid is not clear (CMS);
- the definition of Converted Amount is not clear (CMS);
- the description of the timing and determination process of a sale for a Stand in the Market Bid is not clear (CMS); and
- details of the way in which full haul capacity entitlements are converted into part haul capacity entitlements to facilitate capacity trading are not provided (North West Shelf Gas).

3.3.2 Epic Energy acknowledges that the Secondary Market Rules do not accord a priority to the holders of contracted capacity seeking to sell against uncontracted capacity offered for sale by Epic Energy. No such priority has been assigned. The Secondary Market is intended to be a market served by multiple competing sellers, one of whom would be Epic Energy. To the extent that this is not clear from the existing structure of the Secondary Market Rules, Epic Energy is prepared to include a specific provision in the Rules indicating that there is no priority accorded to sellers offering capacity for sale in the Secondary Market.

3.3.3 Epic Energy points out that it has an important role to play as an active participant in the Secondary Market. The number of shippers selling capacity through the market is, initially, likely to be small, and Epic Energy's participation as a competitor in the Secondary Market should assist in driving prices down. Moreover, if the Secondary Market Rules were to accord a priority to shippers holding contracted capacity, there would be no competitive pressure on the price for uncontracted capacity at the time Epic Energy could offer that capacity in the market.

3.3.4 Epic Energy does not agree with the view that the price setting mechanism is unclear, although it would accept that its description of the price for Secondary Market Service as "the prevailing market price" (DBNGP Access Arrangement, Paragraph 11.3(e)) is an abbreviated description of the Secondary Market price setting process. In the Secondary Market, as in other auction markets, there is no set market price. A separate price is established, through the operation of the market clearing mechanism defined in the proposed Secondary Market Rules, for each transaction that takes place. That price is determined from the prices bid by the sellers and buyers transacting in the market. It is simply a function of supply and demand, and cannot be defined or described in any other way.

3.3.5 Only shippers have the right to sell contracted but unutilised capacity in the Secondary Market. This is implied by the form of the access contract that a shipper would enter into under the proposed DBNGP Access Arrangement. More importantly, it is stated explicitly in Clause 4.5 of the Secondary Market Rules:

"*Epic Energy will only be able to post for sale on the Secondary Market, Capacity that is uncontracted capacity*."

The shipper's (and not Epic Energy's) right to sell contracted but unutilised capacity seems clear. Epic Energy is therefore not sure whether, in raising this issue, CMS is seeking to make some other point which has not been made explicit.

3.3.6 Two types of bids can be made in the Secondary Market. One is a Stand in the Market Bid, which can be either for the sale of capacity, or for the purchase of capacity. The second type of bid is not given a specific name but leads to Otherwise – Purchase (Clause 4.7(b) of the proposed Secondary Market Rules), or Otherwise – Sale (Clause 4.7(c)). The fundamental differences between the two types of bids are:

- a Stand in the Market Bid must specify a closing time for acceptance of the bid; there is no closing time required for the second type of bid; and
- a Stand in the Market Bid from a seller must specify the minimum price acceptable; the second type of bid must specify the price the seller requires for the capacity.

Epic Energy acknowledges that the Secondary Market Rules require careful reading, but believes the definition of Stand in the Market Bid is clear.

3.3.7 The term "converted amount" is not defined in the Secondary Market Rules. It is used, as an undefined term, in the definition of Secondary Market Quantities. The effect of paragraph (a) of that definition is to enable a conversion of the contracted capacity being offered in the market by a shipper to be converted to capacity at Kwinana Junction (that is, at the Secondary Market Point). This is necessary if the capacity being sold is upstream of Kwinana Junction. Epic Energy intends to develop an automatic conversion model to calculate the physical effect of shifting capacity from an upstream delivery point downstream to Kwinana Junction. That is covered by subparagraph (i). It is also important that the "value" to be paid for the capacity be reflected at where the shipper is able to sell. This is the purpose of subparagraph (ii). The intent is to reflect the value paid for take-or-pay charges compared to those which would have been paid for Zone 9 quantities. In other words, if such capacity is in Zone 9, it will remain the same quantity. However, if the quantity was in Zone 8, the Secondary Market Quantity would be multiplied by 0.8308 and divided by 0.9515 (that is, 1 TJ in Zone 8 would be equivalent to 0.8826 TJ of Secondary Market Quantity). The ultimate Secondary Market Quantity is therefore the lesser of the "technical" equivalent and the "value" equivalent. Paragraph (b) of the definition of Secondary Market Quantities covers the problems of dealing with the translation of quantities downstream of Kwinana Junction given that the DBNGP effectively becomes a number of lateral pipelines.

3.3.9 The timing of a capacity sale in accordance with a Stand in the Market Bid is determined by the closing time specified in the bid. At the closing time specified, Epic Energy's Secondary Market System will determine the bid or bids with the highest price at or above the minimum price specified in the Stand in the Market Bid, and deem those to be accepted by the Stand in the Market Bid, starting with the bid with the highest price and working down until the quantity bid for is met. The seller and the buyer or buyers are then notified in accordance with Clause 4.2(e) of the proposed Secondary Market Rules.

3.3.10 Epic Energy has not, as North West Shelf Gas correctly asserts, provided details of the way in which capacities at delivery points are to be converted into Secondary Market Quantities to facilitate capacity trading. A conversion model is still to be developed by Epic Energy. Development of the model will require a series of pipeline flow modelling studies under different operating conditions. This modelling requires considerable effort and will only be undertaken if the Regulator's Draft Decision warrants Epic Energy's continuing with its Secondary Market proposal. Once it has been developed, Secondary Market participants will be advised of the principles behind the conversion model for the Secondary Market System.

### 3.4 Epic Energy has conflicting roles as a Secondary Market participant and as market operator

3.4.1 A number of submissions to the Regulator have drawn attention to Epic Energy's dual role as organiser of the Secondary Market, and as market participant. They have argued that Epic Energy has a privileged position and may use this position to influence the market. Western Power and North West Shelf Gas go further and propose that Secondary Market organisation and operation be placed with a separate, ring fenced business. The Treasury and the Office of Energy propose classifying the Secondary Market as a "market carriage pipeline" and, along with others, have raised the issue of the Regulator approving amendments to the proposed Secondary Market Rules.

3.4.2 Epic Energy points out that the proposed Secondary Market arrangements are additional to the capacity trading arrangements required in an access arrangement under sections 3.9, 3.10 and 3.11 of the Code. Epic Energy has no obligation to develop the Secondary Market, and could leave shippers to make their own capacity trading arrangements in accordance with provisions in the DBNGP Arrangement that implement the requirements of section 3.10. However, it has put forward details of the Secondary Market to assist shippers and prospective shippers in understanding and appreciating the benefits Epic Energy currently proposes to bring to the new access regime.

3.4.3 Epic Energy believes that there are benefits for both shippers and Epic Energy from an active secondary market. Those benefits will only be realised if Epic Energy takes the initiative in organising the Secondary Market. It is readily understood that some shippers, who have a vested interest in the current arrangements, may oppose Epic Energy taking the initiative in this manner.

3.4.4 The gas transportation service provided through the Secondary Market is not separate from Epic Energy's provision of the DBNGP Reference Service. The two types of service are provided within the same pipeline system. While the market is in its infancy, Epic Energy is the logical party to organise and operate the Secondary Market. Epic Energy would, however, be happy for a totally independent party to operate the market once it has been set up. Epic Energy has proposed, and will continue to develop, rules so as to ensure, wherever possible, that it cannot gain an advantage while it is both the operator of and a participant in the Secondary Market.

3.4.5 Epic Energy is best placed to initially organise and operate the Secondary Market. In these circumstances, the key issue becomes one of ensuring that its interests in developing the market are aligned with shipper interests. Epic Energy has sought to effect this alignment through making its provision of Secondary Market Service a rebateable service. This point has been overlooked in all of the submissions made to the Regulator. If Epic Energy is successful in making sales of Secondary Market Service against shippers sales of unutilised capacity, shippers benefit through the revenue sharing of the rebate mechanism. This alignment of interests may not be perfect, but it will provide benefits that will not be available if Epic Energy does not proceed with development of the Secondary Market. Epic Energy notes that the benefits to shippers available through the revenue sharing of the rebate mechanism are not available under the GTR/AM regimes. Under the GTR/AM regimes, all of the revenue from interruptible capacity sold under ST3 contracts, and all of the revenue from sale of AT3 capacity, irrespective of whether that capacity is sourced from shippers' unutilised capacity or from uncontracted capacity, accrues to Epic Energy.

3.4.6 A longer term perspective is also important in relation to concerns over Epic Energy's major involvement as a participant in the Secondary Market. Epic Energy has strong commercial interests in ensuring that all of the DBNGP Firm Service is always fully utilised. In the same way that it has an interest in having capacity used through the Secondary Market, Epic Energy has an incentive to have used as much of the capacity that is available as Seasonal Service as is possible. In these circumstances, Epic Energy would expect that it would have relatively small amounts of capacity available for sale as Secondary Market Service. In the longer term, most of the capacity traded in the Secondary Market will be unutilised capacity offered by shippers themselves.

### 3.5 Operation as a market carriage pipeline

3.5.1 Epic Energy can see no particular benefit in the Treasury and Office of Energy proposal that the Secondary Market be organised on a market carriage basis. The operation of some form of market carriage, on a pipeline that is a contract carriage pipeline would involve unnecessary complexity for both shippers and the pipeline operator.

### 3.6 Shippers with GTR contracts will not have the same trading entitlements as Firm Service shippers

3.6.1 Western Power and AlintaGas have made a number of comments concerning the trading entitlements of shippers who continue to hold transportation contracts entered into under the earlier GTR/AM regimes. These comments demonstrate a desire to "cherry pick", and to give Western Power and AlintaGas the best of both worlds for their grandfathered contracts. Western Power and AlintaGas ignore the already privileged positions they have relative to others through their having grandfathered contracts with options of picking up new, lower tariffs.

3.6.2 Issues raised in comments made by Western Power and AlintaGas are:

- Shippers with GTR contracts will not have the same trading entitlements as Firm Service shippers in the Secondary Market;

- How can Epic Energy provide access to spare capacity to shippers with GTR contracts, while operating the Secondary Market for eligible shippers;
- GTR shippers will be excluded unless Epic Energy agrees to them marketing capacity in the Secondary Market;

3.6.3 Epic Energy is aware that shippers with GTR contracts will not have the same trading entitlements as Firm Service shippers in the Secondary Market. The Regulator will note that the Government chose only to give the holders of grandfathered contracts the ability to pick up new tariffs, and not other terms and conditions. The trading entitlements of shippers with GTR contracts will be those of their contracts. These entitlements are derived from Part 9 of the GTRs. That this is a matter for concern, is an acknowledgment by Western Power and AlintaGas that, **despite their arguments to the contrary**, the capacity trading policy of the proposed DBNGP Access Arrangement, and Epic Energy's Secondary Market proposal, are superior to the capacity trading and AT3 arrangements of the GTR/AM regimes.

3.6.4 Shippers with grandfathered contracts will have their own regime for capacity trading and for short term access to capacity via the AT3 service. Western Power believes these arrangements are superior to the proposed Secondary Market. It is, therefore, curious that Western Power believes it should have access to the Secondary Market. Indeed, the Secondary Market Rules as they are currently structured (although this requires review), permit shippers with contracts entered into under the GTR/AM regimes to purchase capacity in the Secondary Market. They are, however, precluded from selling capacity in that market because the capacity they have to offer is provided on terms and conditions which are different from the terms and conditions of the Reference Service. Shippers like Western Power could gain full access to the Secondary Market by transferring to Access Arrangement contracts.

### 3.7 There is limited scope for trading capacity in the Pilbara

3.7.1 Some submissions argue that the trading policy of the proposed DBNGP Access Arrangement, the Access Arrangement Terms and Conditions, and the Secondary Market proposal should provide greater scope for trading capacity in the Pilbara than earlier access regimes.

3.7.2 Under the proposed Secondary Market Rules, trading in the Secondary Market will effectively be trading in Secondary Market Quantities. It is recognised that capacity in the Pilbara is essentially a unique commodity, and Epic Energy will therefore consider Zone 1a capacity as a separate commodity. That aside, clearly unused capacity at delivery points elsewhere on the DBNGP can be made available, through the Secondary Market, to shippers with delivery points in the Pilbara.

## 4. Full Development of the Secondary Market

4.1 Epic Energy is continuing to refine the principles of its Secondary Market proposal. However, development of the systems through which the proposal would be implemented will not proceed until Epic Energy is satisfied, through issue of the Regulator's Draft Decision, that this is appropriate in the context of the total Access Arrangement for the DBNGP.