

Victorian Gas Industry Market and System Operations Rules applied as a law of
Victoria by the Gas Industry Act 2001 (Victoria)

IN THE DISPUTE RESOLUTION PANEL AT MELBOURNE

Between

AGL Sales Pty Ltd ABN 88 090 538 337

Applicant

and

Victorian Energy Networks Corporation

Respondent

DECISION OF THE DISPUTE RESOLUTION PANEL

(Sir Anthony Mason AC KBE, Mr R Merkel QC and Mr G H Thorpe)

Background

1. A dispute between AGL Sales Pty Ltd (**AGL**) and Victorian Energy Networks Corporation (**VENCorp**) was referred under Version 28 of the Market and System Operation Rules (**the MSO Rules**) for determination by the Dispute Resolution Panel (**the DRP**). The dispute related to the failure of VENCorp's market clearing engine software (**the MCE**) to pro-rate the minimum daily quantity bids of AGL and other wholesale gas market participants for gas supplied from the Longford plant on 10 days during March and April 2007 (**the dispute days**). AGL claims that the failure of the MCE to pro-rate its minimum bids on the dispute days constituted a scheduling error for which it is entitled to compensation under the MSO Rules. The compensation claimed was based on the

- 2 -

higher spot market prices paid by AGL for the gas that was not pro-rated to it on the dispute days.

2. The gas industry in Victoria is regulated by the Gas Industry Act 2001 (Vic) (**the Act**). The MSO Rules have statutory force under Pt 4 of the Act. Section 52 of the Act states that the purpose of the rules is the regulation of the operation of the market for gas, the regulation of the activities of the participants in that market and achievement of the market objectives set out in s 52(3). The objectives are to establish a competitive, reliable and efficient market for gas:
 - (a) *in which market participants can choose with whom they trade;*
 - (b) *in which third parties were granted access to the gas transmission system;*
 - (c) *in which, to the extent practicable, the trading of gas from different sources is not differentiated;*
 - (d) *in which prices are governed as far as practicable by commercial and market forces rather than regulation;*
 - (e) *in which efficiency is encouraged.*
3. VENCORP developed and utilised the MCE to discharge its obligation under the MSO Rules to schedule injections and withdrawals of gas from the gas transmission system and to set market prices for that gas.
4. The dispute relates to the nature and extent of VENCORP's obligations under the gas scheduling procedures set out in Ch 3 of the MSO Rules and specified in more detail in Version 5.1 of the Gas Scheduling Procedures (**the GS procedures**), being the version in force on the dispute days. The GS procedures are binding on VENCORP and are required by, but are subordinate to, the MSO Rules (see cl 3.1.1 of the

- 3 -

Rules and cl 5.2 of the procedures). The MSO Rules and the GS procedures each require such fair large and liberal interpretation as will best achieve their intent and object both generally and in any specific case (see cl 10.1 of the Rules and cl 5.1 of the procedures).

5. Clause 3.1 of the MSO Rules requires VENCORP to operate the transmission system in accordance with the GS procedures and the MSO Rules. Clause 3.1.1(a) requires VENCORP to operate the transmission system by scheduling injections of gas into and withdrawals of gas from it in accordance with bids. Clause 3.1.2 requires market participants to submit bids in accordance with cll 3.1.5 and 3.1.7. On the dispute days those clauses authorised participants to put in minimum quantity bids for injections and withdrawals in relation to the day to which the bid relates (see cll 3.1.5(f)(4) and (7)).
6. Clause 3.1.11 provides that where two or more bids are equally beneficial for scheduling then VENCORP must 'as far as practicable' apply the principles set out in the clause which, in substance, require the 'equally beneficial' bids to be 'scheduled to the same extent'. It is common ground between the parties that when cl 3.1.11 is applied to minimum injection and withdrawal bids that are equally beneficial the bids are to be pro-rated. On the dispute days supply from the Longford plant was constrained and, as a consequence, the minimum bid requirements of all of the market participants (including AGL) could not be satisfied. As those bids were equally beneficial, cl 3.1.11 required that VENCORP pro rate the bids 'as far as practicable'. Thus, as far as practicable, each of the bidders was to receive proportionately less than their respective minimum bids.
7. However, VENCORP's MCE software did not allow that to occur. In the result, the MCE assigned to AGL gas produced from other sources of

- 4 -

- supply instead of a pro-rated share of gas from the Longford plant. Under the MSO Rules, AGL was required to pay for the gas it was instead allocated from other sources at the prevailing spot price, which was higher than the price it would have paid for a pro-rated share of gas from the Longford plant.
8. The problem arose because the MCE was not configured to pro-rate the minimum bids when the constraint on supply did not allow all of the bids to be satisfied. Instead the MCE allocated the available gas on the random basis of last bid in first served. That had the consequence of the other market participants, receiving gas AGL sought pursuant to its minimum bids. The agreed facts state the consequence as being that on the dispute days AGL's minimum daily quantity bids were scheduled to a lesser extent than the minimum daily quantity bids of the other market participants and to a lesser extent than if tie-breaking had applied.
 9. VENCORP sought to negotiate with the other market participants to retrospectively reallocate the minimum bid quantities but no agreement was able to be reached. AGL has now sought compensation pursuant to the MSO Rules for the loss suffered by it. VENCORP disputes AGL's claim on the ground that the MSO Rules do not provide for compensation in the circumstances of the present case. In order to determine the dispute it is necessary to consider the specific rules and procedures ultimately relied upon by the parties.
 10. The GS procedures specified certain requirements in respect of VENCORP's scheduling instructions. Clause 7.2(d) of the procedures provided that, in specifying the quantities of gas the participants are required, in accordance with the MSO Rules, to inject or withdraw, VENCORP must attempt, to the extent practicable, to satisfy the following objective:

- 5 -

Minimise the cost of satisfying demand for gas taking into account:

- *operating schedules;*
- *injection and withdrawal bids by Market Participants;*
- *.....*

11. Scheduling errors are provided for in cl 3.1.14, which provides:

(a) If either:

- (1) the dispute resolution panel determines under clause 7.2 that VENCORP has failed to follow the gas scheduling procedures for the purpose of issuing scheduling instructions; or*
- (2) VENCORP declares that it has not complied with the gas scheduling procedures for the purpose of issuing scheduling instructions,*

a scheduling error will be deemed to have occurred and a Market Participant may be entitled to compensation in accordance with clause 3.3.3.

(b) A scheduling error does not include an error made in determining a market price or a pricing schedule

The Glossary in the MSO Rules define the gas scheduling procedures as the scheduling procedures which VENCORP is required to develop, document and make available to market participants in accordance with cl 3.1.1(d) of the MSO Rules.

12. VENCORP was not prepared to declare that it did not comply with the gas scheduling procedures for the purpose of issuing scheduling instructions on the dispute days. Accordingly, the DRP is required to determine whether VENCORP failed to follow the gas scheduling procedures for the purpose of issuing scheduling instructions on the dispute days. If there

- 6 -

has been non-compliance a scheduling error will be deemed to have occurred (see cl 3.1.14(a)) and cl 3.3 of the MSO Rules authorises the DRP to determine that an amount of compensation is to be paid to a market participant for the scheduling error out of the participant compensation fund.

13. The question for the DRP is whether, on the dispute days, VENCORP failed to follow the gas scheduling procedures for the purpose of issuing scheduling instructions.
14. It was an agreed fact that on the dispute days the MCE failed to provide for AGL to receive a pro-rated quantity of gas pursuant to its minimum daily bids because the MCE had no feature to pro rate the bids when the total minimum daily quantities the subject of the bids exceed the supply available from the Longford plant to satisfy the bids.
15. At the hearing, AGL's primary contention was that on the dispute days the random selection procedure followed by the MCE (ie last in first served) necessarily meant that, contrary to the requirement in cl 7.2(d), VENCORP made a scheduling error because it failed to take into account in any real or meaningful sense the minimum bid requirements of AGL on those days. AGL also relied on other provisions in the MSO Rules and the GS procedures to support its claim that VENCORP was obliged, but failed, to pro rate the minimum bids of all of the market participants on the dispute days and therefore made a scheduling error for which AGL was entitled to compensation.
16. AGL contended that, on a proper construction of the relevant MSO Rules and the GS procedures upon which it relied, VENCORP's obligations in respect of AGL's minimum bids were not qualified by practicability

- 7 -

considerations. Put another way, it was said that it is not open to VENCORP to claim that it was only required to follow the relevant gas scheduling procedures 'so far as practicable' (see cl 3.1.11 of MSO Rules) or 'to the extent practicable' (see cl 7.2 of the GS procedures).

17. VENCORP disputed AGL's contention, claiming that its scheduling obligations in respect of minimum bids were not unqualified as AGL contended but, rather, were qualified by the practicability limitations set out in the relevant clauses.
18. The DRP does not accept AGL's construction of the relevant rules and procedures. Clause 7.2 of the GS procedures qualifies VENCORP's obligation to satisfy the objectives set out in the clause by stating the obligation to be one of attempting 'to the extent practicable' of achieving those objectives. Further, the GS procedures are subordinate to the MSO Rules and cl 3.1.11, which provides for the scheduling of minimum bids to be pro-rated, expresses VENCORP's obligation in that regard to be an obligation to apply the relevant principles 'as far as practicable'.
19. The practicability limitations on VENCORP's obligations are consistent with the objectives set out in s 52 of the Act (see s 52(3)(c) and (d)). Accordingly, there is no reason to depart from the ordinary and natural meaning of the relevant clauses which, in terms, qualify the relevant obligations by such limitations.
20. It follows from the foregoing discussion that the critical question is whether VENCORP followed the required procedures in respect of the minimum bids to the extent practicable or so far as practicable. That raises two factual questions which, if either is answered in the positive, will mean there was a scheduling error. However, if both questions are answered in the negative that will mean that the DRP cannot be satisfied that there was a

- 8 -

scheduling error. The first question is whether, on the evidence and material before the DRP, it is satisfied that it was practicable for the MCE, or for the algorithm employed by the MCE, to pro rate the minimum bids on the dispute days. The second question is whether, on that evidence and material, the DRP is satisfied that it was practicable for another algorithm or process to have had a feature that would enabled VENCORP to pro-rate the minimum bids on the dispute days.

21. AGL contended that subsequent changes advanced by VENCORP to the MSO Rules to remove the ability for market participants to submit minimum bid quantities (by deletion of cll 3.1.5(f)(4) and (f)(7)) demonstrated that it was practicable to avoid the adverse outcome experienced by AGL. A paper to the Gas Market Consultative Committee (GMCC 07-014-02), which explained the reasons for the change, stated that the use of minimum daily quantity constraints in the bid information not only prevent tie-breaking, but also prevent the AMDQ feature of the tie-breaking facility from working and lead to infeasible solutions in some cases of the market schedule. The problem with AGL's argument is that the changes removed the minimum daily bid quantity constraint in the bid information because there was no compelling case for maintaining it and it gave rise to the problems identified above. That is not a basis for concluding that it was practicable for the MCE to make the minimum bid quantity requirements work correctly in the circumstances that arose on the dispute days.
22. It was common ground that the circumstances that gave rise to the failure to correctly pro rate the minimum bid quantities on the dispute days had not occurred previously and were unexpected. However, that fact throws no light on whether it was practicable for the MCE to achieve the correct pro-rating on the dispute days.

- 9 -

23. Although, the relevant bids were not pro rated on the dispute days, the DRP is not satisfied on the evidence or other material presented to it that it was practicable for the MCE to pro rate the minimum bids in the circumstances that arose on the dispute days.
24. The second question relates to whether the DRP is satisfied that it was practicable for another algorithm or process to have had a feature that would have enabled VENCORP to pro-rate the minimum bids on the dispute days. As the evidence and other material is silent on this issue the DRP is not satisfied that it was practicable for VENCORP to have employed another algorithm or process to pro-rate the minimum bids.
25. Accordingly, the DRP is not satisfied that VENCORP has failed to follow the gas scheduling procedures on the dispute days and therefore no scheduling error is deemed to have occurred. It follows that AGL's claim must fail.
26. The outcome of AGL's claim might be seen by some to be anomalous in that AGL did suffer loss as a result of an unintended scheduling outcome that occurred on a random and unexpected basis. However, it is appropriate for the DRP to emphasise that no evidence or material was placed before it to demonstrate that the intended tie-breaking outcome was practicable in the circumstances that arose on the dispute days. Rather, AGL sought to put its claim the basis (not accepted by the DRP) that, relevantly, VENCORP's obligations were not qualified by the practicability limitations described in these reasons.
27. AGL submitted that should a scheduling error be deemed to have occurred it should be awarded compensation, which included interest. VENCORP argued interest is not claimable as compensation. As the DRP


- 10 -

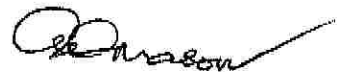
has not determined that there was a scheduling error it is not necessary to consider this question.

28. VENCORP has submitted that each party should bear its own costs irrespective of whether the DRP finds that a scheduling error occurred. VENCORP's reasons were stated as follows:

- *this is the first scheduling error dispute to be determined under the MSOR and the arguments of the parties have raised a number of issues that concern the interpretation of the Gas Scheduling Procedures and MSOR that have not previously been the subject of guidance from a Dispute Resolution Panel;*
- *neither party has raised arguments that were untenable or has engaged in conduct that unduly prolonged the hearing or the proceedings leading up to it; and*
- *both parties have conducted the hearing and the proceedings leading up to it in an expeditious manner.*

29. The DRP accepts that the reasons put forward by VENCORP, cumulatively, warrant the course suggested by it and therefore does not make any determination under cl 7.2.8 of the MSO Rules allocating the costs of the parties to the dispute.

DATED  JUNE 2008



Sir Anthony Mason AC KBE
Chairman