

IN THE DISPUTE RESOLUTION PANEL AT MELBOURNE

(Constituted for a determination as to compensation under rule 226 of the National Gas Rules)

BETWEEN

IPOWER 2 Pty Limited & IPOWER Pty Limited
(trading as **Simply Energy** - ABN 67 269 241 237)

(**Simply Energy**)

and

Australian Energy Market Operator Limited (ABN 94 072 010 327) (**AEMO**)

JOINT SUBMISSION TO THE DISPUTE RESOLUTION PANEL

A. Glossary

1. A number of terms and acronyms are used throughout this submission.
2. Many of the terms used in these submissions are defined in the National Gas Rules (Version 4) (**NGR**).¹ For ease of reference these terms are italicised. Unless the context dictates otherwise, terms defined in the NGR have the same meaning in this submission as in the NGR.
3. A reference to a 'rule' followed by a number means a provision in the NGR.

B. Application

4. Australian Energy Market Operator Limited (**AEMO**) investigated whether an *unintended scheduling result* occurred on 29 June 2010 in accordance with rule 218(1)(b) and has determined that it did so occur. Compensation may be payable from the *Participant compensation fund* (**PCF**) as a consequence of this *unintended scheduling result*.
5. Simply Energy is and was, at all material times, registered in the Victorian wholesale gas market as a *Market Participant*.
6. Under rule 218(4), Simply Energy may apply to the Dispute Resolution Panel (**DRP**) for a determination as to compensation as a consequence of the *unintended scheduling result*. The matters to be determined by the DRP are:
 - (a) whether an *unintended scheduling result* occurred;
 - (b) whether compensation is payable to Simply Energy;
 - (c) if so, the amount of compensation to be paid to Simply Energy for its loss; and
 - (d) the manner and timing of payment of that compensation from the PCF.²

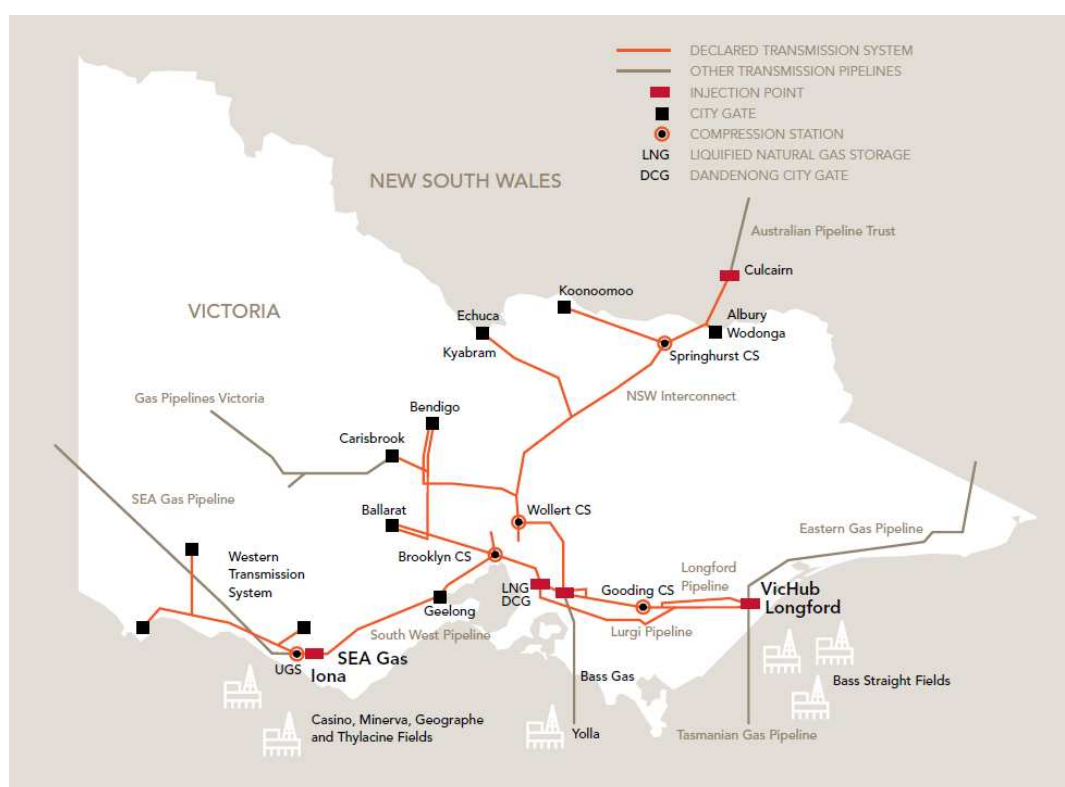
¹ Being the applicable version at all material times.

² Rule 226(1).

C. AEMO and the Victorian Wholesale Gas Market

7. The Victorian wholesale gas market started in March 1999 and was designed to:
 - manage gas supply, demand and linepack of the Victorian Declared Transmission System (DTS);
 - allow *Market Participants* to buy and sell gas; and
 - set a daily gas price (ex post) for all trades.
8. The Victorian wholesale gas market was redesigned to an ex-ante market commencing February 2007 where gas prices are set at 6am, 10am, 2pm, 6pm and 10 pm.
9. The Victorian wholesale gas market covers the DTS, which is depicted in Figure 1.

Figure 1: Declared Transmission System



10. AEMO performs a number of functions in the Victorian wholesale gas market, including the following:
 - operate the DTS and operate and administer the market in accordance with the National Gas Law and the NGR;
 - establish and update system security standards for the DTS; and
 - operate the DTS so as to minimise the threats to system security.

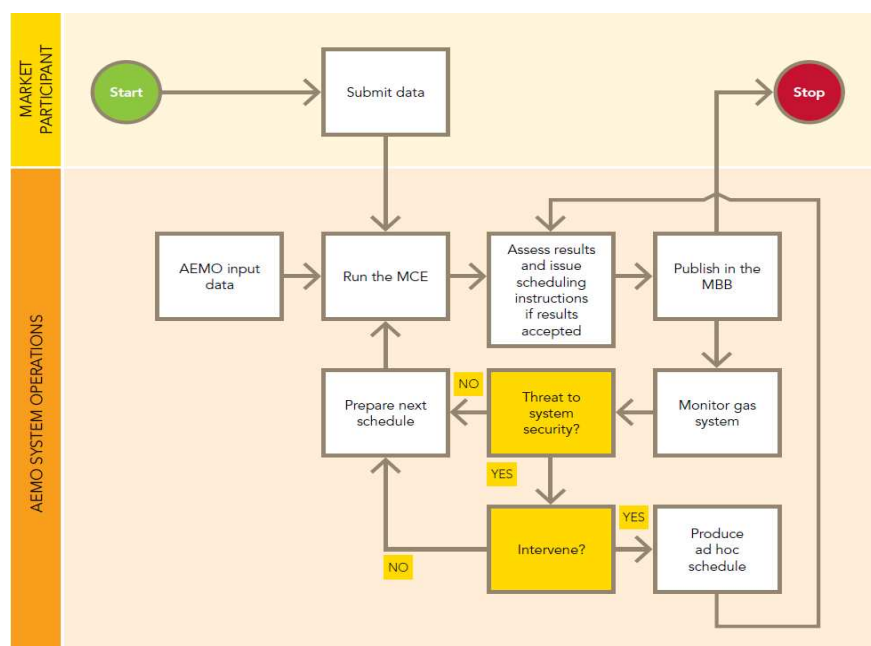
D. The Regulatory Framework

11. The NGR governs access to natural gas pipeline services and broader elements of natural gas markets. As applied in Victoria, this includes the operation of the Victorian wholesale gas market.
12. The NGR:
 - facilitates an efficient, competitive and reliable market;
 - regulates the operation and administration of the market;
 - regulates activities of participants in the market; and
 - provides for access to the DTS in a way that ensures its security.
13. Participants can be directly or indirectly involved in the Victorian wholesale gas market. Those who are registered to trade gas, that is, to inject gas into, or withdraw gas from, the DTS are called *Market Participants*.

E. Operation of the Victorian Wholesale Gas Market

14. On any given gas day, *Market Participants* trade in the Victorian wholesale gas market based on the imbalances in the gas withdrawn by their respective customer loads and the gas injected into the DTS by each of them.
15. Gas scheduling is a process that AEMO conducts a number of times each gas day to provide hourly injection schedules for each *Market Participant* and schedules for any controllable withdrawals. The market clearing algorithm (also known as the “Market Clearing Engine” or “**MCE**”) used in optimising each operating schedule minimises the cost of supplying gas to meet the forecast gas demand within the pipeline system security limits. Figure 2 highlights the key steps in this scheduling process.

Figure 2: Gas Scheduling Process



F. Events of 29 June 2010

16. On 29 June 2010, there was an increase in forecast demand to the highest level for that winter. In the 2pm reschedule, maximum hourly flow Supply Demand Point Constraints (**SDPCs**) were applied to the Iona and SEA Gas injection points in accordance with the Gas Scheduling Procedures. These SDPCs were applied to limit the aggregate flow in the South West Pipeline (**SWP**) to its maximum transportation capacity and were applied to ensure the correct flows from each injection point.
17. Gas injection bids at 2pm and 6pm for both Iona and SEA Gas were such that only injection bids priced at \$0/GJ were scheduled within the applied SDPCs.
18. It was found that the Market Clearing Engine did not respond as expected, or as intended. Different response times specified in the accreditation of *controllable quantities* applying to *gas bids* for the SEA Gas injection point from different *Market Participants* caused a quantity of *gas* that was offered on an equally beneficial basis at \$0GJ in the 2pm *schedule* to be *de-scheduled*, while other equally-priced *gas* was *scheduled* to continue flowing. At 6pm another quantity of a *gas bid* at \$0/GJ and supported by *AMDQ credit certificates* on an equally beneficial basis as other *gas* that was *scheduled* was not *scheduled*. Under the tie-breaking provisions of the NGR, where there are *gas bids* of an equally beneficial basis, such *gas bids* which are supported by *AMDQ credit certificates* (as was the case with Simply Energy) receive injection priority.
19. The MCE takes account of constraints that apply to gas bids and offers, including how quickly the flow of *gas* can be increased or decreased in response to a scheduling instruction (known as “**ramp rate**”). In this case, the ramp rate that applied to Simply Energy’s *bid* was such that the *scheduled gas* flow could be available in full at any time from the time the *scheduling instruction* applied, which in this case was 6.00pm, however, the ramp rates applied to other *gas* flows that were *scheduled* prior to 6.00pm were such that it would have taken some time for those flows to be reduced to make pipeline capacity available for the Simply Energy *gas* to flow. Rather than allowing for the displaced *gas* flows to be reduced and the Simply Energy flow to be ramped up over a corresponding time period, the MCE incorrectly interpreted the constraint on the Simply Energy *bid* to be such that if the full *gas* flow could not be accommodated at 6.00pm, it was not to be *scheduled* at all.
20. AEMO investigated these events in accordance with rule 218(1)(b) and prepared a detailed report titled 'Unintended Scheduling Result Gas Day 29 June 2010'. A copy of the report is reproduced in **Schedule 1** of this submission.
21. AEMO determined that an *unintended scheduling result* occurred on 29 June 2010 with financial impacts in the 2pm, 6pm and 10pm schedules.

G. Participant Compensation Fund

22. AEMO is not liable for an *unintended scheduling result*. Compensation for affected *Market Participants* is paid out of the PCF.³
23. AEMO is required to maintain the PCE under rule 225. The purpose of the PCF is to compensate *Market Participants* following an *unintended scheduling result*.
24. The current balance in the PCF is \$3,208,150.

³ Rule 227(2).

25. AEMO is required to replenish the PCF with fees collected from *Market Participants* in accordance with rules 225(3)-(6). For each *financial year*,⁴ the funding requirement for the PCF is the lesser of:
 - \$500,000; and
 - \$1,000,000 minus the amount AEMO reasonably expects to be the balance at the end of the relevant *financial year*.⁵
26. In making a determination as to compensation, a DRP must take into account the matters detailed in rule 226(1), which are:
 - which *Market Participant* is to receive compensation;
 - the amount of the compensation for each *Market Participant*; and
 - the manner and timing of payments from the PCF.

H. Liability to pay Compensation

27. Rule 226 requires that the occurrence of an *unintended scheduling result* be confirmed either by agreement or determination in accordance with the dispute resolution processes in the NGR.
28. The parties submit that the *unintended scheduling result* has occurred as a result of the application of rule 217(1)(a), namely, that equally beneficial *bids* were not *scheduled* to the same extent.
29. The parties also submit that none of the exceptions detailed in rule 217(2) apply.
30. The exceptions in rule 217(2)(a) provide for expected impacts on schedules and market outcomes arising from physical or contractual constraints on gas flows and other matters. Such constraints are routinely applied in the scheduling and operations processes and no compensation is applicable.
31. Rule 217(2)(b) does not apply as no *Market Participant* has been paid compensation for this event.
32. Rule 217(3) is not relevant because no error was made in determining the *market price* on the day. The *pricing schedule* process worked correctly without error.
33. The parties submit that rule 217(4) is also not applicable, as the claim from the affected *Market Participant* exceeds the minimum thresholds set out in that rule.
34. The affected *Market Participant* is Simply Energy.

I. Calculation of Simply Energy's Loss

35. The magnitude of the lost *Market* revenue by Simply Energy as a result of this *unintended scheduling result* is \$26,033 (GST inclusive).
36. The detailed calculations of Simply Energy's lost *Market* revenue are contained on page 6 of AEMO's report contained in **Schedule 1**.⁶ At 6pm, Simply Energy should have been *scheduled* to inject 5TJ over the remainder of the *gas day* but were scheduled for zero which, at a price of \$5.9112/GJ, results in lost *Market* revenue of \$29,556. At 10pm, Simply Energy was *scheduled* to inject 1.552TJ over the remainder of the day at a price of \$2.27/GJ resulting in a payment of \$3,523 for that period. Had it been *scheduled* correctly at 6pm and 10pm, the

⁴ *Financial year* is defined as a period commencing on 1 July and terminating on the following 30 June.

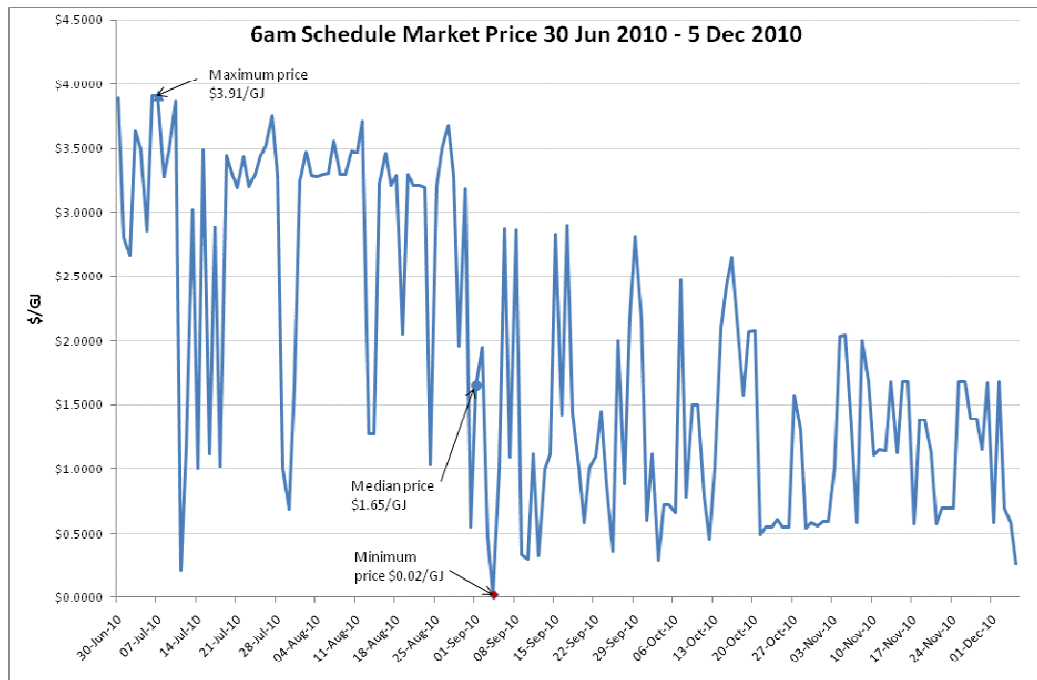
⁵ Rule 225(2).

⁶ Simply Energy is referred to as participant "B" in Tables 2 & 3 of that report.

10pm *schedule* for injections over the *gas day* would have remained unchanged at 5TJ, which means that its *Market* revenue would also have remained unchanged at \$29,556. Hence, the net lost *Market* revenue for the day was $\$29,556 - \$3,523 = \$26,033$.

37. Simply Energy submits that, as a result of the *unintended scheduling result*, there was 3.448TJ of gas that had not been *scheduled* for injection but had nonetheless been paid for by Simply Energy under an upstream gas supply agreement (the **Upstream GSA**). In determining the amount of any intrinsic value in the volume of the *gas not scheduled*, Simply Energy notes that the Upstream GSA contains maximum daily quantity restrictions, an annual volume limitation and a 100% 'take or pay' obligation. The impact of the restrictions in the Upstream GSA means that the 3.448TJ volume of gas which was not correctly *scheduled* on the 29 June 2010 *gas day* will be rescheduled for injection into the *Market* during a period when Simply Energy has significantly lower retail demand (and hence significantly lower price) for this gas (in order to appropriately manage its 'take or pay' obligation). Simply Energy considers it is not possible to accurately and precisely determine the intrinsic value of the volume of unscheduled gas. However, Simply Energy estimates that the value of the unscheduled volume of *gas* during the lower demand period would be between \$0.50/GJ and \$1.00/GJ, resulting in the intrinsic value of the unscheduled value of gas lying in the range from \$1,724 to \$3,448. Hence, the net loss suffered by Simply Energy, after taking intrinsic value into account, would range from \$24,309 ($\$26,033 - \$1,724$) (assuming a \$0.50/GJ gas price) to \$22,585 ($\$26,033 - \$3,448$) (assuming a \$1.00/GJ gas price). Simply Energy submits that the mid point of \$0.75/ GJ represents the intrinsic value of the gas not scheduled, resulting in a loss of \$23,447 ($\$26,033 - \$2,586$).
38. AEMO submits that it is not in a position to comment on the constraints on Simply Energy arising out of the Upstream GSA as gas supply agreements are confidential bilateral arrangements. As the market operator, however, AEMO can verify what the market prices were in the post-30 June 2010 period. Figure 3 is a chart indicating the 6am schedule prices for this period. These prices are depicted because they have the greatest impact on Market Participants' imbalance payments. Figure 3 indicates not only each such price, but the minimum, maximum and median prices, as well.

Figure 3: 6am Schedule Price between 30 June 2010 – 5 December 2010



J. Payment of Compensation

39. Rule 227(1) also requires that the aggregate amount of compensation paid each year from the PCF must not exceed the balance that would have been available at the end of that year had no compensation payments been made that year and therefore the DRP must, when making a determination, take into account the following requirements:
 - the aggregate amount of compensation determined under rule 226 must not exceed the balance of the PCF at the time the determination is made, less any amount not yet paid from the PCF in respect of any previous determinations; and
 - the aggregate amount of compensation payable from the PCF at any time is limited to its balance.
40. Since the commencement of the *Market* there have been a total of two claims made from the PCF resulting in payments totalling \$74,599.65.
41. There are no other claims made or anticipated to be made against the PCF.
42. The *Adviser* issued a notice on 21 December to the DMC contacts regarding the receipt of a claim against the PCF in respect of this *unintended scheduling result*. No further claims were notified.
43. If the compensation was paid for the full amount of Simply Energy's claimed losses, the balance in the *Participant compensation fund* would be \$3,182,117 (GST inclusive).
44. Accordingly, full payment of Simply Energy's losses is appropriate taking into account the current balance of the *Participant compensation fund* and the low likelihood of any further actual liabilities being incurred this financial year.

K. Interest

45. Simply Energy does not seek payment of interest on its losses as part of this application.

M. Costs

46. The parties submit that the costs of this process (other than the legal costs of the parties) should be borne equally by them and that each of them should bear its own legal costs. It is submitted that the DRP should not exercise any discretion it may have under rule 135JA to allocate costs on a different basis as neither Simply Energy, nor AEMO, has unreasonably prolonged or escalated a dispute or otherwise increased the costs of the DRP proceedings.

DATED: 3 February 2011

**IPOWER 2 Pty Limited & IPOWER Pty Limited (trading as Simply Energy)
Australian Energy Market Operator Ltd**

SCHEDULE 1