

ESEM Contract Co-Design Consultation feedback

Submission details	
Organisation	Acciona Energy
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Question	Response
Q1. Is the proposed contract structure suitable for a range of bulk energy technologies?	The proposed RRPPA contract has strong potential to be workable for these projects. The RRPPA contract structure has significant advantages over the previously proposed ex-post DWA swap. However workability will be subject to the final design of the critical terms around negative pricing, cap and FM, discussed below.
Q2. Does a cap on spot price exposure aligned to the strike price of the firming product (e.g. \$600/MWh) appropriately balance risks for sellers and buyers?	Under the proposed RRPPA design renewable generators continue to be exposed to some basis volume risk when they underperform relative to the regional index group. This risk particularly could arise from grid constraints and grid/generator outages impacting just one/few generator/s during extreme or prolonged high pricing events. Without an appropriate cap on the floating price, even a relatively modest volume mismatch to the reference index during an extreme price event can translate into a significant financial exposure, potentially materially impairing project financial performance. From the sellers perspective, capping the RRPPA floating price can significantly limit tail risk in these circumstances. From the buyer's perspective, it has coverage up to \$600, and for coverage of >\$600 prices the opportunity to buy the proposed firming product of the cap with \$600 strike provides a neat solution. It makes sense to align the cap under the bulk energy product and the firming product strike. But further analysis will be necessary to determine how much risk is mitigated by the \$600 cap and whether renewable energy projects with this basis volume risk/price exposure will be bankable.
Q3. Is a negative price provision required for the proposed contract, noting it is	Careful consideration of the approach to settlement during negative pricing is critical. The key issues are

settled against the Reference Fleet's performance and LGCs/REGOs are not included in the swap? If so, is a volume knock-out (no settlement during negative price periods) or a \$0 price floor more preferable?	driving economically efficient market outcomes through appropriate risk allocation and generator bidding incentives. The extent to which each approach could result in adverse dispatch outcomes resulting from highly concentrated volume clustering of generators bids should also be considered. Generally a \$0 floor would be preferable to renewable energy generators as it is likely to result in less earnings volatility than a volume knockout below \$0 approach. The volume knockout approach would result in a binary revenue on/off switch. Alternatively, the revenue resulting from a \$0 floor PPA is sensitive to the depth of negative pricing, which is a gradation and non-binary. Consequently, the volume knockout transfers materially more risk associated with negative-price-duration to the seller. This seller-risk can – and does - get priced-in to such contract structures, but this is unlikely be the most efficient risk allocation. So the \$0 floor is generally the preferred structure. However under the proposed RRPPA each contract will settle against an index based on the reference fleet actual generation, not the seller's actual production. This raises the prospect of misaligned incentives between individual generators which are incentivised to turn off to avoid the negative price exposure and still settle on the regional index generation. If all generators followed this incentive generator behaviour would default to a 'volume-knockout-like' outcome with all generators bidding at their negative-marginal LGC value. However, if contract strike prices were not initially based on expectation of the lower volume/higher dispatch-weighted outcomes associated with this approach, then generators would be undercompensated. The incentive to turn off for all generators could be addressed by using an index volume for settlement that is not based on actual dispatch, as has been considered by the working group. But we agree with the working group that the use of UIGF data to create the reference index is problematic, particularly its exclusion of physical grid conditions limiting dispatch of potential generation. In conclusion, both approaches have challenges which require further analysis and careful consideration. Other approaches could be considered, such as a hybrid of a \$0 floor with a volume knock-out at the negative LGC (or REGO) price.
Q4. Does the proposed design of the Reference Production Index	Appropriately balanced

appropriately balance risks for sellers (primarily basis risk) and buyers (long-term value of the product)?	<i>Additional comment:</i> The proposed contract structure in its current design generally strikes a good balance in risk allocation between buyers and sellers. As a seller, the regional reference PPA is much simpler and more preferable to the ex-post DWA swap. Although sellers retain basis risk, this is to a more correlated reference index rather than to firm volumes. On the buyer side, the current design enables buyers to purchase a slice of wind or solar generation in a particular region while not being exposed to the physical dispatch risks associated with any one individual project. The ultimate test of the contract will be whether it is bankable/investable for renewable projects. This will depend on several key terms yet to be determined, including the use of a \$600 (or other) cap, negative price provisions and Force Majeure. Furthermore, we would stress the importance of adequately testing the bankability of the final RRPPA design based on modelling and discussion with financial institutions.
Q5. Does the proposed approach to determining charge/discharge periods on a day ahead basis, using residual demand calculation, appropriately balance operational risks/simplicity with long-term value?	No comment
Q6. Does the use of AEMO's forecast data to determine shaping periods result in any material risks to the useability of this contract over the long-term?	No comment
Q7. Does the proposed approach of determining nominations at 4pm on a day ahead basis pose any material operational risks?	No comment
Q8. Does the proposed Daily Shaping Period that commences at the Trading Interval ending at 09:05 and finishes at the Trading Interval ending at 09:00 the	No comment

following day pose any material operational risks?	
Q9. Is a \$600 cap, in comparison to a \$300 cap, appropriate to support the entry of new firming assets? If not, why?	No comment
Q10. Are there any concerns with the proposed weekly settlement approach, aligned to the AEMO settlement calendar?	No comment
Q11. Are alternate approaches to manage Force Majeure risk exposure (outside of the contracts) required to support the entry of new assets?	ESEM contracts will provide no asset-specific FM relief. The consultation paper cites the position from the NEM Review Final Report that while proponents will have no physical FM cover, they will have the ability to buy back their sold positions in market or from the ESEM administrator. The paper then asks whether this will be sufficient. We expect that this will fall well short of the level of protection required by investors for bankability. We would strongly endorse a broader mechanism for FM management, such as via pooled insurance and/or parallel bilateral agreements between sellers and the ESEMA, which are separate to the fungible contracts.
Q12. Do the proposed contract structures achieve the Working Group's Terms of Reference and perform well against the identified evaluation criteria?	No comment
Q13. Are there any concerns with the ability of the contract structures proposed to be subject to a Market Making Obligation (MMO) in the future?	No comment
Q14. Will the proposed contract structures, in conjunction with other risk management contracts, such as flat swaps, evening peak swaps or caps, be	No comment

effective for buyers (e.g. retailers, large loads, etc.) to manage financial risks?	
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