

ESEM Contract Co-Design Consultation feedback

Submission details	
Organisation	Nectr
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Question	Response
Q1. Is the proposed contract structure suitable for a range of bulk energy technologies?	Electricity retailers strive to provide lowest cost energy for customers. To do this, we need a wholesale energy market with sufficient liquidity for procurement. Thus, we are aligned with the intent of the ESEM to originate and then recycle bulk energy contracts back into the market. However, we are concerned that the proposed contract structure will result in high cost hedges due to the need to mitigate basis risk, particularly for wind generators. Generator basis risk is incurred as the production from a renewable energy asset is likely to deviate from the Regional Production Index (RPI) due to differences between the local wind/solar resource of the asset and the RPI; and/or due to asset curtailment; and/or due to declining MLFs; and/or due to Force Majeure. We envisage that wind farms will likely suffer from more resource variability and potential deviation from the RPI compared to solar farms. Banks will likely seek risk mitigation strategies to be baked in by ESEM sellers. The generator (the seller) may be compelled to buy outage insurance, firming, or tranches in other assets, in order to manage basis risk. They may need to adjust these risk mitigants through the tenor of the contract as the reference curve evolves with the introduction of new assets. While solar farms may be able to hedge through contracting or integration with a retail portfolio including rooftop solar, there is no such decentralised generation pool for wind assets. Auxilliary contracts add costs. It is not clear that the buyer benefits from a generator 'firming to the reference curve'. If the added costs do not bring commensurate value to the buyer, then the resulting contract may be

	out of the money in comparison to a run-of-meter PPA, especially for a wind farm. This risks the goal of warehousing contracts for a time before recycling back to the market.
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?	It's reasonable, provided the price of the contract is discounted accordingly. The cap costs the buyer less than it seems. Fleet VRE output tends to be low during high-price intervals, so the uncapped spike exposure on the index volume is modest. For the seller, though, the cap removes a significant basis-driven tail risk. Retailers (buyers) are still exposed above \$600 on the PPA volume. The cap only works if the \$600 firming cap is liquid and available alongside it. If it isn't, retailers will have to buy standard \$300 ASX caps and carry a \$300–\$600 band mismatch.
Q3. Is a negative price provision required for the proposed contract, noting it is 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?	Yes, preference volume knock-out as this mirrors typical run-of-meter PPA treatment of negative price periods.
Q4. Does the proposed design of the Reference Production Index appropriately balance risks for sellers (primarily basis risk) and buyers (long-term value of the product)?	The long-term value of the product depends on what the product contains. If the ESEM contract is composed of a bundle of products (asset offtake + risk management tools such as firming), it is desirable for the buyer to have the option to unbundle the product and manage any firming products as part of a firming portfolio. This could be considered as a kind of 'Exchange for Physical' process, whereby exchange trading participants elect to interact bilaterally for convenience.
Q5. Does the proposed approach to determining charge/discharge periods on a day ahead basis, using residual	The proposed ToD block assumes battery cycling once a day. But we know that value can be clustered seasonally and it might be more valuable to cycle a battery multiple

demand calculation, appropriately balance operational risks/simplicity with long-term value?	times a day in certain seasons, and not at all in other periods. Also, the assumption that intraday arbitrage is the only game is limiting: battery charge could be conserved across contract days to target renewable lulls. Retailers (contract buyers) would benefit more from a nominateable product.
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?	Methodology changes. AEMO revises its forecasting systems and demand definitions over time, such as the treatment of storage, scheduled loads and "operational demand" itself. A 10+ year contract needs change-management provisions that preserve the economic intent. Fallback provisions are needed for missing or delayed publications and system outages. Default windows could be based on historical averages for that month and day type. Systematic forecast bias transfers value between the parties. The WG should publish back-testing of forecast-determined windows against ex-post optimal windows so the gap can be priced.
Q7. Does the proposed approach of determining nominations at 4pm on a day ahead basis pose any material operational risks?	Traders on the sell side of these contracts will be incentivised to minimise payout while maximising earnings. The best way to do that is to bid up prices outside the fixed window so that contract buyers receive a minimal settlement amount, while having maximum exposure to high prices outside the nomination windows.
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 following day pose any material operational risks?	Manageable but not trivial, the issues are system and calendar misalignment: It differs from the NEM trading day (04:05–04:00) and from bid and settlement day conventions. Retailer ETRM, settlement and reporting systems key off the trading day, so a bespoke day definition means custom build and reconciliation effort. Boundary crossings: A Saturday 09:05 to Sunday 09:00 period straddles two AEMO settlement weeks. Month and quarter periods split in the same way, which affects settlement, accounting accruals and quarter-based hedge reporting. Clock differences: The NEM runs on AEST year-round while customer tariffs shift with daylight saving. This is minor, but it adds to the translation burden.

Q9. Is a \$600 cap, in comparison to a \$300 cap, appropriate to support the entry of new firming assets? If not, why?	Caps have traded at \$600 and \$1000 bilaterally but only via OTC. Liquidity becomes a concern if the market is split between caps at different levels.
Q10. Are there any concerns with the proposed weekly settlement approach, aligned to the AEMO settlement calendar?	Not really any concerns.
Q11. Are alternate approaches to manage Force Majeure risk exposure (outside of the contracts) required to support the entry of new assets?	From a buyer's perspective, seller force majeure tends to hit exactly when the hedge is needed, such as a battery or firming asset out during a tight period. A product that can fall away in those conditions is worth materially less to a retailer, and it becomes harder to trade under an MMO. If we consider the ESEM contract as a bundle of instruments, pricing FM risk through insurance and allowing unbundling allows buyers to adopt their own strategy and deploy firming or insurances as suits their portfolio.
Q12. Do the proposed contract structures achieve the Working Group's Terms of Reference and perform well against the identified evaluation criteria?	These contracts may be standardised but are not truly fungible. To be truly fungible, the product must have a clearing house, or initial margin. The contracts are bilateral agreements, where the asset owner likely remains the seller for the lifetime of the contract.
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?	Pricing difficulty. Long-dated, index-settled and path-dependent products are hard to quote tightly. An MMO on these products risks wide spreads, or concentrating risk on the few obligated parties.
Q14. Will the proposed contract structures, in conjunction with other risk management contracts, such as flatswaps, evening peak swaps or caps, be effective for buyers (e.g. retailers, large loads, etc.) to manage financial risks?	It seems that the ESEM contract will be more expensive than run-of-meter PPAs while not being noticeably better at hedging a retail load. Unless offtake prices can be minimised for the end buyer, the proposed contracts are unlikely to be used by retailers to hedge retail loads.