



Book-Build – Reliability Requirement

Issues Paper

Introduction

The purpose of this paper is to facilitate discussions with Jurisdictions and the Technical Working Group (TWG) on the detailed design elements of the book-build. Following the Senior Committee of Officials (SCO) Reference Group and TWG meetings, a more detailed technical working paper will be developed. The technical working papers and draft final design document will be available for public consultation in mid-June.

High level design

The Energy Security Board (ESB) has agreed that this element of the Guarantee would operate as follows:

- If the reliability obligation is triggered, liable entities may be expected to demonstrate future compliance with the reliability obligation by securing sufficient qualifying contracts to cover their share of system peak demand.
- To facilitate competitive market outcomes and provide liable entities with sufficient optionality in addition to the traditional contracting processes, the Australian Energy Market Operator (AEMO) will conduct a voluntary 'book-build'. AEMO would call for an expression of interest for parties to participate in a voluntary 'book-build' process to help match buyers of contracts with developers of new resources to incentivise closing of the identified reliability gap.
- The process is expected to create new bilateral contracts, such as over-the-counter (OTC) swaps and caps, between parties. Any contracts secured by market participants through the 'book-build' would qualify for compliance under the reliability requirement. The successful parties will be expected to enter new bilateral contracts and AEMO will not take on any financial exposure. Contracts secured through the 'book-build' will qualify for compliance under a reliability obligation, subject to a framework for qualifying contracts.
- If a reliability gap continues to persist, AEMO could re-run the voluntary book-build two years before the gap is forecast to occur.

Detailed design elements for TWG input

1. How should AEMO conduct the book-build process?
2. Development of contracts under the book-build
3. How should contract issues between parties matched through the book-build be addressed?
4. Who should be able to participate and what assurances should they be required to provide to do so?
5. Public reporting of 'book-build' results

Issues for discussion

1. How should AEMO conduct the book-build process?

The 'book-build' is intended to address any information and/or resourcing barriers which could lead to suboptimal levels of contracting to reduce a forecast reliability gap. AEMO would effectively operate as a facilitator, matching buyers (including potentially groups of small retailers or large customers) and sellers on a voluntary basis to provide an incentive for new investment in the market (and potentially additional liquidity) in a cost-effective manner.

The process could provide broad flexibility for the products bought and sold or be more prescriptive. A flexible approach could allow the terms of the contract type (swap or cap), duration, MW, time periods etc. to vary for each participant and where combinations could be matched then parties would proceed to the agreement of contracts. Alternatively, a prescriptive approach could be based on standardised specifications for the product in which buyers and sellers could bid or offer.

The cost of running the book-build is expected to be minimal – it would most likely involve a commitment of a small number of staff from AEMO for the duration of the process (with costs recovered through AEMO's levy arrangements). Costs associated with participation would depend on the nature and scope of participation rules, including prudential requirements. The intent is that it would reduce cost barriers for small retailers.

Questions for the TWG:

- How should AEMO conduct the book build process?
- What oversight/controls are required to provide confidence in the process?
- Would AEMO be operating as a broker and are there any applicable licensing requirements?

2. Development of contracts under the book-build

Standardised contracting in the energy market is commonplace; however, contracts that involve the build and commissioning of resources will typically have bespoke elements. Many contracts that have a physical linkage can transfer some of those physical uncertainties to the buyer, particularly during the initial period of commissioning.

It is envisaged that certain types of contracts will be excluded from qualifying under the reliability guarantee (e.g. where the incentive to operate at high prices is not always present). The detailed design of the Guarantee should have regard to whether the book-build could allow minor deviations from any criteria established for qualifying contracts for the benefit of delivering additional physical plant. However, this would need to be balanced against the need to financially incentivise dispatch when reliability is needed and should not unnecessarily favour the book-build over other paths for contracting.

The design of book-build contracts may also benefit from some level of standardisation to minimise the execution risk following a book-build process and ensure consistency with the qualification requirements of the Reliability Requirement.

Questions for the TWG:

- Is there benefit in book-build contracts being standardised?
- What criteria are important to the design of book-build contracts?
- Will book-build contracts require flexibility beyond standard caps and swaps to encourage investment in new resources?

3. How should contract issues between parties matched through the book-build be addressed?

A key issue that could arise through the book-build process is that once book-build participants are matched they could find themselves unable to deal with each other due to a range of issues e.g. lack of ISDA Master Agreements, lack of credit support etc.

Questions for the TWG:

- How should credit issues be handled post the book-build?
- What obligation should be placed on book-build participants to come to agreement?
- Should pre-qualification be considered to ensure that the execution risk for matched participants is minimised?

4. Who should be able to participate and what assurances should they be required to provide to do so?

The primary benefit of the book-build is to provide Liable Entities with voluntary options to manage their compliance and further support competitive market outcomes by reducing information barriers in a cost-effective manner.

Consideration should be given to any limitations that should be placed on parties participating in the book-build with a view to supporting competitive market outcomes, increasing the certainty that qualifying contracts are delivered and facilitating the development of new resources.

Questions for the TWG:

- What information should AEMO require from prospective book-build participants before they can participate in the book-build?
- Should AEMO be able to limit participation to sellers of resources with certain physical characteristics or location? How should this be specified?
- Should non-liable parties be able to participate on the demand side?

5. Public reporting of 'book-build' results

If successful, the book-build will lead to new contracts being created which will help to partially underwrite investment in new resources to close an identified, material reliability gap. It is likely that successful sellers in this process will wish to announce the new projects that have been brought into the market. Successful buyers however may be less willing to disclose information about their contract position.

In creating the Book Build consideration should be given to what information is required to be disclosed. Given the main objective of the Reliability Requirement is to facilitate investment in dispatchable capacity, the disclosure requirements should be framed in a way that does not deter parties from participating in the book-build. The outcome of the book-build could be that only one or two parties are successful in creating contracts so commercial confidentiality needs to be taken into account.

Questions for the TWG:

- What public reporting requirements should there be for the 'book-build' results?

Interdependencies with other elements of the Guarantee

- Qualifying contracts
- Forecasting Methodology and Accountability
- Compliance