



COAG  
Energy Council

**ENERGY SECURITY BOARD**  
**National Energy Guarantee**  
**TECHNICAL WORKING PAPER**

**Book-Build**  
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## Executive Summary

- The Energy Security Board (ESB) has agreed to further consider a voluntary book-build approach that is intended to facilitate competitive market outcomes and provide liable entities with additional optionality to the traditional contracting processes in meeting their obligations under the reliability requirement.
- Given the preferred approach highlighted in the qualifying contracts paper is to implement a Market Liquidity Obligation, the ESB, when finalising the detailed design, will consider whether there is still a need for a voluntary book-build if the Market Liquidity Obligation proposal is adopted.
- If there is to be a voluntary book-build, then the process would be run by AEMO three years out from a forecast gap if the reliability requirement has been triggered. The book-build process may be run again two years out if the gap persists.
- AEMO would call for an expression of interest for parties to participate in the voluntary book-build. The process aims to match buyers of contracts with the developers of new resources which would help to close the identified reliability gap.
- The contracts delivered through the book-build will qualify for compliance under the reliability obligation. The book-build process would result in the delivery of qualifying contracts which are backed by the development of new physical capacity. Sellers of book-build contracts would be obliged to ensure that the contracts sold meet the firmness test outlined in the qualifying contracts framework and therefore provide the financial incentive to deliver new capacity.
- AEMO would not take on any financial exposure or credit risk under the book-build, all risks (including development risk) would be borne by the participants.
- The detailed methodology for how AEMO would conduct the book-build would be consulted on and determined following the completion of the detailed design.
- Reporting of contracts developed out of the book-build process would need to be consistent with reporting under the proposed qualifying contract framework.

## 1 Introduction

On 20 April 2018, the Energy Security Board (ESB) presented the COAG Energy Council with a high-level design proposal for the National Energy Guarantee (the Guarantee). The COAG Energy Council agreed that the ESB progress the detailed design of the Guarantee for determination by the Council at its August 2018 meeting.

As part of the development process, the ESB convened Technical Working Groups to advise on certain detailed design elements of the Guarantee. The Technical Working Groups were comprised of a broad range of stakeholders with relevant expertise from more than 30 organisations.

The purpose of this paper is to outline options and preferred approaches relating to the voluntary book-build process under the reliability requirement of the Guarantee.

In the event of a forecast reliability gap being material and the AER triggering the reliability obligation, AEMO could run a book-build process at the three-year mark to help match buyers of contracts with new capacity coming into the market. The process is intended to support competitive market outcomes (particularly in relation to supporting smaller retailers and large non-market customers that are liable) and contract liquidity while incentivising the delivery of new physical resources that could assist in closing the forecast gap. If the gap persists, the voluntary book-build process may be run again by AEMO two years out.

Given the preferred approach highlighted in the *Technical Working Paper on Qualifying Contracts* to implement a Market Liquidity Obligation, the ESB, when finalising the detailed design, will consider whether there is still a need for a voluntary book-build if the Market Liquidity Obligation proposal is adopted.

This paper provides additional detail and context to the [Draft Detailed Design Consultation Paper](#). Interested parties are encouraged to lodge a submission to the consultation by **13 July 2018** for consideration by the ESB prior to the publication of the final design of the Guarantee.

## 2 Overview of High-Level Design

If the reliability obligation is triggered, liable entities may need to secure sufficient qualifying contracts to cover their share of system peak demand in order to be compliant with the reliability obligation.

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) could conduct a voluntary 'book-build' three years before the forecast gap. 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 book-build process is expected to create new bilateral contracts, such as over-the-counter (OTC) swaps and caps, between participants. Contracts secured through the book-build will qualify for compliance under the reliability obligation, subject to being consistent with the proposed framework for qualifying contracts.

If a reliability gap continues to persist, AEMO may re-run the voluntary book-build two years before the gap is forecast to occur.

## 3 Book-build design and the Guarantee

### 3.1 The role of the book-build

The book-build is proposed as a voluntary market mechanism to be conducted by AEMO with the objective of incentivising the delivery of resources into the market to address the identified reliability gap. The outcome of the book-build will be a commitment to develop new resources and financial contracts that will help to underpin the proposed physical resources.

The buyer of the qualifying contracts will be able to use the new contracts to satisfy their obligation under the reliability requirement. The benefit of the book-build is that it could provide an opportunity for liable entities to secure contracts that are linked to the physical delivery of resources. The book-build could also provide additional contracting options for liable entities, in particular, small retailers and large customers, in the event that there is a lack of liquidity in the traditional market. The seller of the qualifying contracts will be able to lock in a firm contract to support its proposed investment.

The link to an identified project is what distinguishes the book-build approach from a standard broking service that facilitates the matching of market participants who require financial contracts.

Once the contracts are in place, the seller will have the incentive to make sure that the resources are developed to meet the gap, ensuring that they can defend their sold contract position. The liable entity will have contracted in a way that is consistent with meeting their obligation under the reliability requirement.

If the book-build proposal proceeds, the preferred approach is that any seller participating in the book-build would be required by the buyer to develop and deliver a new physical resource to the market.

#### **The role of the book-build**

- The outcome of the book-build is a commitment by the seller to deliver new resources to reduce the reliability gap and provide financial contracts that can be used by liable entities to satisfy their reliability obligation.

### 3.2 Design of the book-build

There are a number of options in terms of how AEMO could conduct the book-build process. This could include, but is not limited to, a broad reverse-auction style process or a tailored matching service between parties.

The aim of the book-build is to close as much of the reliability gap as possible in the most efficient manner. The exact methodology does not need to be determined at this stage of the design process but AEMO would be expected to consult with key stakeholders in developing a set of guidelines and procedures that detail how the overall process will be conducted.

#### **The book-build design**

- AEMO should engage with industry participants and other stakeholders to develop a set of guidelines and procedures outlining how it will conduct the book-build process.

### 3.3 Timing of the book-build process

The role of the book-build is to deliver new resources to reduce the reliability gap and provide contracts that can be used by a retailer or large customer to satisfy their reliability obligation.

The opportunity exists for the book-build to operate in the window between the reliability obligation being triggered at T-3 years and the reliability gap disappearing or the Procurer of Last Resort commencing at T-1 years.

The preferred approach is that AEMO will be able to conduct the book-build once the reliability obligation has been triggered. If a gap remains at T-2 years, AEMO could rerun the book-build to give participants a further opportunity to contract under the book-build and provide another opportunity for the market to resolve any gap prior to potentially utilising the Procurer of Last Resort safety net.

#### **Book-build timing**

- AEMO will be able to conduct the book-build at T-3 years if the reliability obligation has been triggered. AEMO could run a further book-build at T-2 years if the reliability gap has not disappeared.

### 3.4 Impact on the reliability gap

If the book-build is successful in securing a commitment to deliver new resources this will need to be factored into the assessment of the reliability gap. When the reliability obligation was triggered, if AEMO had identified a (material) gap of 500 MW in a region and the book-build, in combination with mechanisms outside of the book-build resulted in a commitment of 500 MW of new resources, then AEMO will update its forecasts and would not need to conduct a subsequent book-build or use the procurer of last resort mechanism.

Until the resources committed under the book-build meet AEMO's criteria for recognising projects and factoring these into their ESOO forecasts, the reliability gap will remain. AEMO's involvement

in facilitating the book-build will provide insight into the likelihood of the resources being delivered in the projected time frames and the gap will be updated when the resource commitments meet AEMO's criteria for recognising new resources.

This could be achieved through AEMO's forecasting processes identifying the gap.

#### **Impact on reliability gap**

- AEMO should explicitly recognise projects that have been underpinned by contracts through the book-build in its assessment of the reliability gap and reflect the likelihood of the resources being delivered.

### **3.5 Contract risk**

There is the potential that counterparties matched through the book-build process may find they are unable to contract with each other due to credit issues or a range of other issues.

AEMO will not be involved in mitigating or managing any risks related to the delivery of the new resources, including credit. Counterparties will be expected to manage these risks themselves.

The book-build process is intended to match willing participants to facilitate the delivery of new investment in the form of new resources to the market. However, AEMO will not take on any financial exposure at any stage of the process.

The preferred approach is to allow participants to manage their own credit, counterparty, development and contractual risks throughout the book-build process.

#### **Contract risk**

- Participants will manage their own risks throughout the book-build process and AEMO will not be exposed to any of these risks.

### **3.6 Reporting of book-build contracts**

Any reporting requirements should be consistent with the reporting of all qualifying contracts as required under the contract framework. The preferred option is that contracts developed out of the book-build process will be reported in a manner consistent with the qualifying contracts framework.

#### **Public reporting of book-build contracts**

- Any contracts developed out of the book-build process will need to be reported consistently with the proposed qualifying contracts framework.

## **A**      **Abbreviations and defined terms**

AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
COAG	Council of Australian Governments
ESOO	Electricity Statement of Opportunities
ESB	Energy Security Board
Guarantee	National Energy Guarantee
MW	Megawatt
OTC	Over-the-counter

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