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Australian Energy Regulator
Retailer Reliability Obligation
Public consultation process

By email - RRO@aer.gov.au

18th June 2019

Renewable Energy Hub submission to the AER on the Draft Interim Contracts and Firmness Guideline

Renewable Energy Hub's submission to the Australian Energy Regulator (AER) addresses the specification of standard and non-standard qualifying contracts, and the process by which these products and associated bespoke firmness methodologies are approved by independent auditors.

Under the Retailer Reliability Obligation (RRO), liable entities are required to provide their net contract position (NCP), assessed one year before the reliability gap period, to the AER by reporting day. When reporting to the AER, liable entities must adjust their contract position to reflect how effective they are at limiting exposure to volatility in the wholesale electricity spot price (firmness adjustment).

Our interpretation of the draft Guidelines is that liable entities are responsible for obtaining auditor sign off on bespoke firmness methodologies for any non-standard qualifying contracts as part of the submission of their NCP report and ultimate compliance with RRO requirements.

This approach exposes liable parties to the risk that the firmness factor they have applied to non-standard qualifying contracts in their NCP report may be modified during the audit process, thereby reducing the quantity of firmness adjusted MWs they have contracted. This has the potential to expose liable entities to compliance shortfalls, and we believe will strongly incentivise them to use standard qualifying contracts as the primary means of compliance.

We anticipate that the lack of up front certainty regarding non-standard products will dampen liable entity interest in entering into more flexible and potentially lower cost hedging arrangements, as well as stifle the growing interest in alternative hedging contracts that are better suited to variable renewable generators and new sources of clean dispatchable capacity such as batteries.

Liabe entities are more likely to utilize different contracts if they can determine *prior to entering into those contracts* how they will be treated in the context of compliance under the RRO. A lack of certainty regarding eligibility, firmness or other factors will act as a disincentive for liable entities to utilize anything other than current standard qualifying contracts.

To avoid this uncertainty, and unintended bias towards the current suite of standard contracts, we propose that the AER supplement the Guideline with an additional (and optional) approach to determining firmness factors for non-standard qualifying contracts, as per the diagram below.

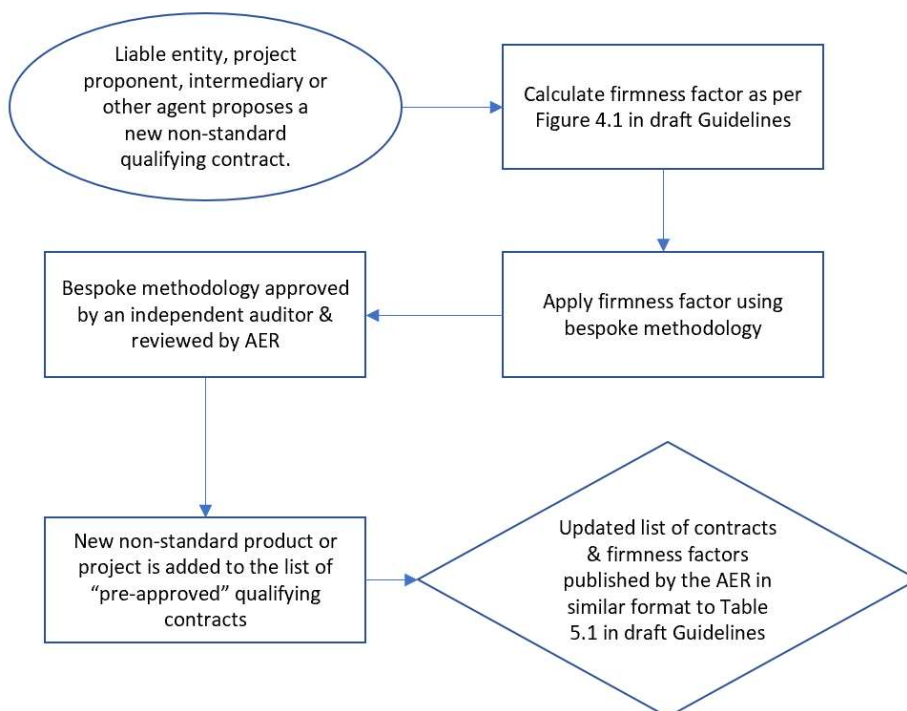


Figure 1. Proposed approach to creating pre-approved non-standard qualifying contracts

The AER should specify the process by which non-standard qualifying contracts can be added to the Guidelines (at Section 5 in the draft Guidelines provided for consultation). Where a non-standard qualifying contract, and associated bespoke firmness methodology, has been approved by an auditor it should be added to the Guidelines so that all liable entities have sufficient confidence to enter into those contracts prior to an assessment of their NCP report by an auditor.

Please note that we are not suggesting that this pre-approval process be the only option for liable entities or other parties. The option for the liable party to pursue a bespoke firmness methodology with an auditor, as set out in the draft Guideline should also apply.

The pre-approval process would essentially mirror the process for developing bespoke firmness methodologies for non-standard qualifying contracts outlined in Figures 3.1 and 4.1 of the draft Guidelines, however, liable entities or other parties could initiate this process *prior* to holding the contracts and submitting them as part of their NCP report.

The AER itself acknowledges the importance of market confidence in relation to contract firmness, noting on page 20 of the draft Guideline the need for liable entities to have confidence in order to enter into contracts:

“To give liable entities the confidence to enter into contracts under the Interim Guideline, the Rules allow liable entities to continue to use the methodology specified in the interim guideline for contracts entered while the interim guideline is in effect.”

The same principle applies to non-standard qualifying contracts using bespoke firmness methodologies. Liable entities need confidence regarding the treatment of non-standard contracts in order to include them within their portfolio of contracts for the purposes of compliance under the RRO.

Importantly, the process of determining a new firmness factor and bespoke methodology should be able to be initiated by any party, not just a liable entity. For example, a renewable energy generator selling PPAs may choose to engage an independent auditor to approve a bespoke methodology and firmness factor associated with its project. This would enable potential offtakers from the project to incorporate this factor into their determination of price/value in the context of an RRO instrument being issued.

The cost and efficiency benefit of this approach is not insignificant. Without the option of pre-determining the firmness factor to apply to a specific project or non-standard contract, different liable entities risk duplicating the process of methodology determination multiple times for the same contract type, or even an individual renewable energy project with multiple offtakers. There is also a risk of inconsistent methodologies being approved by different auditors for the same, or similar, projects and hedge contract types.

The emergence of non-standard contracts

Renewable Energy Hub is leading the market in innovation in new standardized hedging contracts tailored for variable renewable energy generators, and new providers of clean dispatchable capacity. In 2018 we launched Australia’s first solar shape and inverse solar shape swap contracts to specifically address the growing market need for new hedging arrangements as renewables increasingly come to dominate the generation fleet in the NEM.

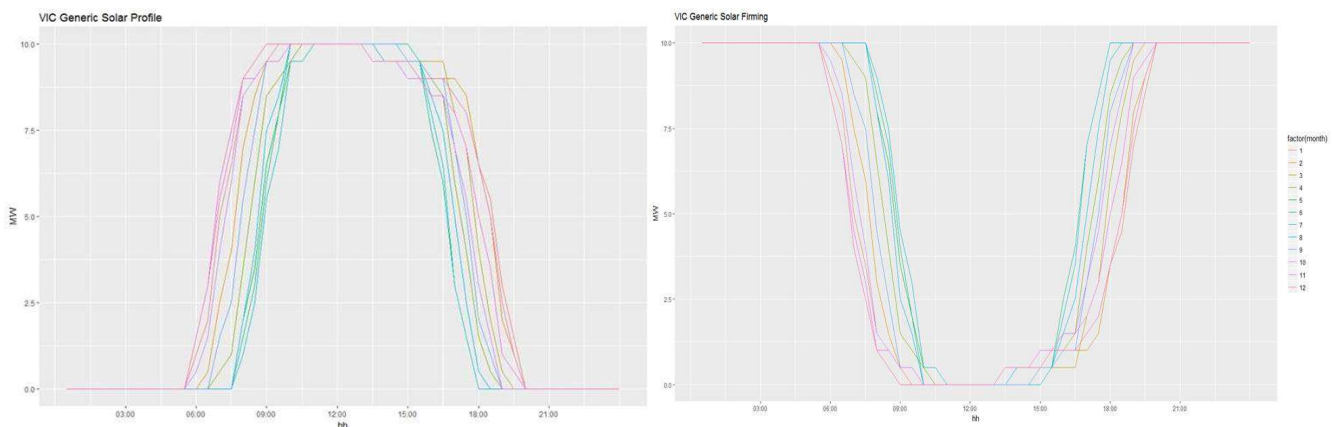


Figure 2. Renewable Energy Hub’s solar and inverse solar swap contract shapes

We would expect that solar shape and inverse solar shape contracts would have a firmness factor equal to 1 as they are fixed price and volume contracts. However, without confirmation of this treatment prior to entering into contracts, liable entities may be reluctant to utilize these contracts for compliance purposes, or apply a pricing discount because of the “audit risk” related to the final determination of a firmness factor in their NCP report. Under the “pre-approval” mechanism proposed above (see Figure 1), this risk would be efficiently dealt with and would encourage utilization of new and innovative hedging instruments, creating additional liquidity for both generators and liable entities.

Further, it is expected that new and more complex hedging products may emerge which will have firmness factors of less than 1. Ensuring certainty regarding their treatment under the Guidelines will be important to creating an efficient and cost effective hedging market for liable entities.

The team at Renewable Energy Hub would be pleased to provide further information to the AER on our submission at any time.

Yours sincerely

Philip Cohn
Head of Corporate Development
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About Renewable Energy Hub

Established in 2017, Renewable Energy Hub is a platform for wholesale renewable energy projects, to transact with corporate energy buyers, firming market participants, consultants, and energy retailers. The aim of the platform is simple: to standardise and drive wholesale renewable energy and firming market options to energy buyers.

Our expert team present a range of PPA solutions that have been developed with wholesale energy market participants - solutions that are best suited to our clients’ preferences, and provide the opportunity to unlock dramatic energy cost savings.

Renewable Energy Hub is a part of TFS, Australia’s market leading wholesale energy and environmental markets team. Together we form part of the global Tradition Group of companies. Tradition is one of the largest interdealer brokers in over-the-counter financial and commodity related products. Represented in over 28 countries with over 2,300 employees, we are listed on the Swiss stock exchange.

About TFS Green Australia

Through its long-term commitment to the Australian Energy & Environmental Markets, and its global experience in the carbon markets, The Global TFS Green team is a market leader providing a complete range of broking services from wholesale trading, to structured primary deals, along with a full suite of

local enviro-market consultancy and data provision services. TFS Green Global encompasses teams in London, New York, Santiago, and experts from our 28 country offices.

TFS Green, is part of Tradition Financial Services (TFS), which is an established service provider in the brokerage of financial and non-financial products. The company covers a range of commodity markets including currency options, equity derivatives, freight and much more.

TFS Green assists clients to source, or bring their projects to market, and offer pricing structures and alternatives geared to the production of environmental certificates and clean energy generation.