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Submitted by email: Electricity.Roadmap@dpie.nsw.gov.au

Re: Long-Term Energy Service Agreement design consultation paper

The Australian Energy Regulator (AER) welcomes the opportunity to comment on the NSW Government's consultation paper (the paper) on the design of Long-Term Energy Service Agreements (LTESAs), a key feature of the NSW Electricity Infrastructure Roadmap.

We understand that LTESAs will form part of the Infrastructure Safeguard. Under the Infrastructure Safeguard, an independent Consumer Trustee has been appointed to run competitive tenders to offer LTESAs for generation, long-duration storage and firming capacity. LTESAs will be option contracts that give each project optional access to a competitively set minimum price for their energy service.

LTESAs take the form of a put option where, when exercised, the Scheme Financial Vehicle agrees to buy energy from the generator/storage at an agreed price and volume. The put option can be exercised by the generator/storage when they consider future market conditions warrant that protection. We understand that the policy intention is for these fixed price and volume instruments to provide sufficient income for a project to meet its debt service covenants, but not its targeted equity return.

In the event that the generator/storage proponent considers that the spot price forecast is below the strike price for the LTESA option the Scheme Financial Vehicle would be exposed to the difference between the spot and contract strike prices – thereby exposing NSW consumers to contract payments.

One of the objectives of the NSW Electricity Infrastructure Roadmap is to lower energy prices for consumers. If spot prices are depressed for an extended period, then we would expect that contract prices traded in the wider energy market will also fall, as retailers seek to avoid paying out to support other higher-priced contracts. While this may benefit consumers, it could increase the challenge for new entrant projects to realise sufficient earnings without LTESAs.

Therefore, in designing LTESAs it will be important to consider the impact that they could have on trading in the wider contracts markets and their interaction with the national energy market. Balancing the NSW scheme objectives, the LTESA terms and conditions, the volumes and technologies tendered and purchased, and the flow on impact on market mechanisms such as the Retailer Reliability Obligations (RRO) will be challenging.

While the form of the future RRO has not yet been determined, the ability to manage the risk to NSW consumers from the LTESAs would appear to warrant consideration of developing a structure that is conducive to the secondary trading of derivatives that can be readily traded and encourage capacity development that supports future reliability. Further, a fixed shape/fixed volume contract would be preferred to a variable generation following contract, as it would remove the volume risk borne by the Scheme Financial Vehicle on behalf of NSW consumers. A contract of this form would also provide a firm volume, based on the contracted shape, for either a physical or financial RRO. The AER considers that the most appropriate form for LTESA contracts, that will minimise the risk to NSW consumers, are those where their formulation is firm.

The AER has observed that the decisions of government bodies can impact market supply and demand and result in unintended distortions to regional and national markets, particularly where they result in excess generation. We recommend that the NSW Government test the efficacy of the scheme by conducting targeted reviews on LTESAs, technology mix, and network development. This is most important after the first round of tenders has been accepted to assess that the contracts selected are in the long-term interests of NSW electricity consumers.

We support the points raised in the Australian Competition and Consumer Commission's submission.

Should you have any queries, or wish to discuss our submission, please contact Kami Kaur on 02 9230 9163 or kami.kaur@aer.gov.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'CS', with a long horizontal flourish extending to the right.

Clare Savage
Chair
Australian Energy Regulator