NATIONAL GENERATORS FORUM

Clean Energy Future Corporation Expert Review Panel
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Dear Clean Energy Future Corporation Review Panel

Clean Energy Finance Corporation – Expert Review

The NGF welcomes the opportunity to provide input into the Expert Review Panel consultation on the establishment of the Clean Energy Finance Corporation.

Introduction

The NGF is the national industry association representing private and government owned electricity generators. NGF members operate all generation technologies, including coal-fired plant, gas-fired plant, hydroelectric plant and wind farms. Members have business interests in all States.

The NGF was surprised by the announcement that the Government will fund, through a new Clean Energy Finance Corporation, public investment in private, commercial projects.

The Government proposes to borrow $10 billion over five years to establish the Clean Energy Finance Corporation. The cost to the budget of this initiative, over the forward estimates, is estimated at $944 million. This $944 million includes administration, the cost of non-commercial loans (i.e. loans where the rates are not reflective of the risks associated with the investment) and equity investments. There is no indication of what public benefit returns are expected from this investment of public funds.

Despite the intention to commit almost $1 billion of public funds to this new corporation, very little has been announced about the priorities or governance of this new government bank. The background documentation for the Expert Panel Review provides no additional information on the CEF. The generation sector is perplexed as to why such a major new initiative, which will impact on investment and production decisions in our sector is going ahead with no prior discussion, analysis or any real explanation as to the motives and impacts of this program.

The *Securing a Clean Energy Future* document indicates that the corporation will:

- Invest in commercialization and development of renewable energy and enabling technologies, energy efficiency and low emissions technologies; and
- Invest in the transformation of existing manufacturing businesses to refocus on meeting demand for inputs for these sectors.

Funding is to be split evenly between “a renewable energy stream” and “a general clean energy stream … [which] will be able to fund renewable energy projects”. It is unclear how these two streams differ. Carbon capture and storage is excluded from support by the corporation.

The corporation will commit public funds through loans, loan guarantees and equity investments. The Government has indicated that it will announce further details on the operation of the corporation in early 2012.

The NGF is disappointed that such a substantial commitment of public funds, with potentially significant implications for competition and investment in electricity markets, has been made without consultation with generators. The NGF urges the Government to engage in early, genuine consultation with the generation sector on the design of the corporation.

Given the lack of information on key aspects of the corporation, the NGF can only offer general comments. The NGF is very concerned that the Clean Energy Finance Corporation marks a fundamental shift in government policy which will:

- Disadvantage viable low emission generation projects including renewable energy projects;
- Distort competition in electricity markets; and
- Expose governments to significant project risks.

The Commonwealth has two broad sets of policies to support the growth of renewable energy.

Firstly, competitive grants, the R&D tax concession, and public research funding support early stage innovation. This support is premised on the risk that private investment will not occur in new technology and the prospect of spill over benefits to the community. Support is available from basic research through to large scale demonstration projects.

Secondly, after the pre-competitive stage, the Government provides substantial support to renewable energy investments. The most obvious subsidy is delivered through the Renewable Energy Target (RET) which reserves 20 per cent of the electricity market to renewable generation. Under this scheme, renewable energy generators can receive a subsidy of up to $92 per MWh (post tax).

From 1 July 2012, a high and rising carbon price will also apply, conferring a further cost advantage on renewable generation. With a commencing price of $23 a tonne, the carbon price will add more than $25 per MWh to the cost of generation from brown coal-fired plant, more than $20 per MWh for black coal-fired plant and about $10 per MWh for gas-fired plant. At the starting price of $23 per tonne, about $20 per MWh might be expected to be passed through to retail electricity prices. As the carbon cost passed through to consumers rises, the relative competitiveness of renewable generation will improve.

Technology Neutrality

It is important to note that the RET does not discriminate between different types of renewable technologies or projects: the distribution of subsidies is decided in the market by retailers. Competition within the renewable energy segment promotes lowest cost outcomes. The Government has long made clear its preference for such ‘market-based’ approaches.

Despite these measures, the Government appears to have decided that further policy interventions are needed. For the first time, the Government seems intent on becoming an active investor in commercial projects. The Clean Energy Finance Corporation marks a shift from allowing the market to select the best mix of renewable projects to government intervening to pick winners.

The justification for the Clean Energy Finance Corporation would appear to be that project finance may not be available for an unknown number of renewable projects with major technology or commercial risks. While eligible for the RET subsidy and benefiting from the carbon price, these projects fail because other renewable projects are more competitive. The Clean Energy Finance Corporation will provide concessional finance to these marginal projects.

The NGF is concerned that underwriting marginal projects will undermine viable projects. A simple substitution is likely to occur, with higher cost, higher risk projects displacing more competitive projects. There would be no net increase in renewable generation: the RET determines the amount of renewable energy supplied to markets. Such an intervention raises serious equity and efficiency concerns.

Conflict of Interest

The NGF is also concerned that such direct government intervention in the market creates a new source of investor uncertainty.

Over the last twenty years, energy market reform has created open, competitive markets. Competitive markets have delivered unprecedented investment in new generation capacity and stable wholesale electricity prices. There are no major barriers to new entrant generators. Until recently, consumers have enjoyed reliable supply at falling real prices.

Competitive neutrality has been essential to this success. There is an obvious risk of conflicts of interest when governments compete in markets they regulate. Public investment can crowd out private investment. A lack of confidence in the openness and transparency of the market can deter private investors, creating barriers to entry. Since the mid 1990s, State governments have addressed this problem by winding back their direct commercial involvement through privatization and corporatization.

The Government's decision to become an active investor in the generation sector reverses this trend.

Limit Project Eligibility

Assuming that the political settlement brokered in the Multiparty Committee on Climate Change cannot be amended, the NGF would urge the Government to limit the scope of the Clean Energy Finance Corporation to minimize market distortions and maximize public benefit returns.

Support should be limited to projects which can deliver significant technology advances. Projects should be selected on the basis of technology risks and returns. In the United States, the Department of Energy offers concessional finance to new technology projects, defined as technologies which are not used in "three or more commercial projects in the U.S". As this example suggests, support should be limited to 'first in kind' type projects. Technologies with limited potential for wider use should have a low priority.

Public funds should be directed to addressing the technology risk. As far as possible, there should be measures to ensure that any knowledge or expertise gained from the project is made accessible to other parties. These are the public benefit opportunities which the program should capture.

Public investment should be limited to a maximum share of project costs to ensure that proponents have a greater exposure to project risk than taxpayers. Private investors must have sufficient "skin in the game" so that they face sufficient commercial incentives. The Government should not become the majority owner of any company or project.

Request for Submissions specific questions

1. How do you expect the CEFC to facilitate investment?

The NGF is concerned that the CEFC will only facilitate investment that otherwise would have occurred anyway (because the CEFC is supposed to operate on a commercial basis), or it will invest in projects that are not commercial or are not the most cost-effective way to reduce emissions. As such, the CEFC will not facilitate efficient investment at all.

The CEFC aims to "facilitate the flow of funds into ... clean energy technologies." Away from what? That is, the CEFC aims to distort Australian financial markets in their allocation of capital. If the CEFC is successful in this aim, other economic activities, in any sector, will have less funding available than they otherwise would. By lowering the cost of capital for renewable projects, the CEFC introduces a new distortion to all Australian markets.

2. Are there principles beyond financial viability that could be used to prioritise investments, such as emissions impact or demonstration affect?

If a renewable energy project is financially viable, then it doesn't need the CEFC. The *Request for Submissions* is incorrect when it says that there are "capital market barriers that hinder the financing, commercialisation and deployment of renewable energy". There are no such barriers. If a project cannot obtain debt or equity financing, it is because it is not commercial.

Therefore, if the CEFC is going to invest in non-commercial projects (despite the intention that the CEFC "be commercially oriented and to make a positive return on investments"), the NGF believes that the CEFC's investment criteria should aim to maximise emissions reductions per dollar invested *without* substantially distorting the market and/or crowding out other activities.

Despite the merits of such a principle, investments in many technologies that offer significant emissions reductions per dollar are excluded from CEFC.

8. How do you see the CEFC fitting with other government initiatives on clean energy?

The CEFC duplicates other government initiatives. With a mandated market for renewable energy (RET) and a carbon price, there is no need whatsoever for the CEFC. The CEFC adds subsidy upon subsidy (although CEFC funds are not grants, they will significantly lower the cost of capital for investees).

Other issues

The *Request for Submissions* seeks responses to other issues raised in the review's Terms of Reference:

Investment and Operating Mandate

The NGF is concerned that it is intended that returns earned by the CEFC will not be returned to the CEFC's owners (the taxpayer) but rather will be channelled back into the renewable energy sector. If the CEFC is successful in earning positive returns, the taxpayer has a right to expect its money back. Otherwise, if this reinvestment continues in perpetuity, the CEFC is transferring wealth from the taxpayer to the industry. That is, the CEFC *is* a grant program.

Asking the taxpayer to bear commercial risks while the private sector keeps all the returns is not a principle the NGF agrees with. The CEFC must be structured such that the taxpayer can expect to obtain at least some of the returns. Therefore, the CEFC must give serious thought to how it will exit its investments and it must establish exit processes and procedures *before* making any investments.

Governance

The Terms of Reference for the review states that governance of the CEFC should be conistent with *Governance Arrangements for Australian Government Bodies.* Care needs to be taken that this is not in conflict with the CEFC's mission to be commercial. Governance of the CEFC should be at the best-practice standard of private and public equity investors.

As mentioned above, by taking equity positions in renewable energy firms, the CEFC creates conflict of interests for the Government. It will become both an owner and regulator of these businesses. As with normal private equity investments, one might expect CEFC officials to have seats on the boards of the firms it invests in. While this is good practice in the private sector, it creates conflicts for the Government.

Recommend a path to transition from current arrangements to arrangements which streamline support

The CEFC will be funded for five years. Will it be required to have exited all of its investments by the time it is wound-up. How will legacy investments be handled if they cannot be exited? Will the life of CEFC be long enough for it to earn a commercial return on its investments?

Relationship with Renewable Energy Target

As mentioned above, the NGF believes that the Renewable Energy Target (and the pricing of carbon) render the CEFC redundant. A market has been mandated for renewables. This demand ensures investment in renewable generation. Any project unable to obtain finance must be uncommerical even with the RET subsidy. It therefore should not receive tax-payer support. By funding such projects, the CEFC will distort the renewable energy market and ensure that Australia's renewable energy sector *does not* consist of the most efficient technologies available.

The RET lets the market determine the technology mix. The CEFC will do the opposite, by trying to pick winners – which governments and government bodies are notoriously bad at.

Thank you for your consideration.

Yours sincerely

PShields

Peter Shields

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