



**8 December 2011**

Ms Jillian Broadbent  
Chair  
Clean Energy Finance Corporation Expert Review  
C-/ The Treasury  
Langton Crescent  
PARKES ACT 2600

By email to [cefc@treasury.gov.au](mailto:cefc@treasury.gov.au)

Dear Ms Broadbent,

AGL Energy welcomes the opportunity to comment on the *Clean Energy Finance Corporation Expert Review Request for Submissions*. AGL Energy (AGL) is the leading investor in renewable energy in Australia. AGL operates across the supply chain and has investments in coal-fired, gas-fired, renewable and embedded electricity generation and electricity retailing. AGL is Australia's largest private owner, operator and developer of renewable generation in Australia with 1,205 MW of renewable capacity (at 30 June 2011). AGL is also a significant retailer of energy with over 3 million electricity and gas customers.

This submission outlines AGL's views across four key aspects related to the *Request for Submissions* paper: current impediments to investment; principles for the Clean Energy Finance Corporation (CEFC) which would guide investment decision making; other policy reforms which are required to overcome investment barriers; and specific transmission policy principles to guide potential investments in transmission. It is critical that the CEFC be established in a competitively neutral manner so as not to distort existing and future private sector investment decisions.

### **Current impediments to investment**

AGL notes that the objective of the CEFC is, 'to overcome capital market barriers that hinder the financing, commercialisation and deployment of renewable energy, energy efficiency and low emissions technologies.' As both an investor in small and large scale low emissions generation (such as cogeneration and wind farms), AGL is well placed to comment on current capital market barriers and believes that these can be separated into supply-side and demand-side barriers. These are discussed in further detail below:

#### *Supply-Side*

The electricity and gas supply industries have significant capital investment requirements over the coming decade. The total capital requirements for generation and network businesses participating in a recent esaa survey were expected to total \$95.1 billion over the five years to June 2016<sup>1</sup>. Nearly half is required for refinancing existing generation and network assets (\$47.3 billion), with the rest intended as investment in both new and existing assets. In this environment, it is important to note that there are capital market

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<sup>1</sup> Esaa, Capital Markets Survey, 2011

efficiency losses currently being experienced by market participants through ongoing uncertainty in relation to carbon pricing<sup>2</sup>.

A recent study by Simshauser and Nelson (2011)<sup>3</sup> demonstrated that Australian power generation project financing spreads remain elevated compared to global markets. Furthermore, tenors are also smaller compared with global markets with the maximum tenor in Australia now only 7 years. As such, a key impediment to investment relates to the terms for debt financing of both thermal and renewable investments.

The other most significant impediments to large supply-side investments are related to perverse outcomes associated with Australia's Federal system of government and overlapping responsibility for energy and climate change policy. In particular: complementary State-based environmental policies which distort renewable and wholesale energy markets; and ongoing retail price regulation represent the largest impediments to long-term investment decision making in new renewable and low-emission generation.

#### *Demand-Side*

AGL notes that one of the most critical issues relates to the responsiveness of electricity and gas demand to higher prices. Unfortunately, the biggest impediment to demand side response is the ongoing regulation of retail tariffs and flat tariff network regulation. AGL has completed a number of research projects on how the introduction of Time-of-Use (ToU) pricing would deliver societal benefits. In particular, a working paper by Simshauser and Downer<sup>4</sup> examined how the introduction of dynamic pricing would impact on electricity demand (particularly at peak times). The study demonstrated that an 8.2 percentage point improvement in the load curve could be achieved with the introduction of dynamic pricing. The paper's modelling showed that a flattening of the household load curve from 38.5% to 50%, indicated a reduction in unit costs of about \$32/MWh, and if applied unilaterally across the four primary NEM states, a reduction in costs of some \$1.6 billion pa in the household sector alone.

However, in this context it is important to distinguish between regulated and non-regulated activities in the context of demand side participation. AGL is concerned that businesses which operate primarily as regulated network operators are increasingly engaging in activities that are contestable. Where appropriately ring-fenced, this is not likely to create significant concerns. However, at present it is unclear that regulated income is not being used to fund business development activities in these emerging contestable markets. AGL firmly believes that only contestable businesses should be in contact with customers to provide demand side participation services. Regulated businesses by definition provide a monopoly service and have no need to be in contact with the customer in relation to new products and services. AGL strongly believes that any funding for businesses with regulated revenues is appropriately ring-fenced from any activities that require 'involvement' with the customer.

### **Principles for the Clean Energy Finance Corporation**

AGL believes that the CEFC should establish a set of principles under which all investments will be made:

- Investments made by the CEFC should not distort existing markets. In other words, projects financed by the CEFC should be 'price takers', not 'price makers' in wholesale energy markets and the market for Large Scale Renewable Energy Certificates (LRECs).
- Funding should only be made available to overcome capital market barriers that affect all participants equally. Funding should not be made available on preferential terms to participants because of their unique circumstances. To ensure that markets

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<sup>2</sup> It should be noted that uncertainty will continue to be problematic until there is bipartisan support for a broad overarching climate change policy mechanism.

<sup>3</sup> <http://www.aglblog.com.au/wp-content/uploads/2011/04/No-26-Toxic-Debt-II-FINAL1.pdf>

<sup>4</sup> <http://www.aglblog.com.au/wp-content/uploads/2011/03/No.24-Limited-Form-Dynamic-Pricing.pdf>

are not distorted, the analysis of project and counterparty risks should reflect those standards applied by project banks and institutional investors

- All market participants should have access to CEFC funding, but as is the case with privately financed projects, risk assessments should be carried out in relation to technology risk, counter-party risk and the like. In this context, expected returns to the CEFC should be risk adjusted.
- A clear, transparent and concise methodology should be established if the CEFC is to finance projects for purposes other than financial returns (e.g. emissions reductions).

### **Other policy reforms required to overcome investment barriers**

As discussed above, there are a number of policy reforms which would assist the CEFC in overcoming investment barriers:

- *Clarification of responsibilities for renewable energy policies in a Federalist system of government.* Energy policy within Australia often suffers due to a lack of coordination between the States and the Commonwealth. This is not unsurprising given our Federalist system of government. However, the CEFC could play a significant role in highlighting through the Ministerial Council on Energy the perverse outcomes that occur when policies are implemented without mutual consideration or coordination. The growth in incentives for small scale solar PV generation in recent years is a crucial example of how uncoordinated policy can lead to perverse policy outcomes. In a recent paper, Nelson, Simshauser and Kelley (2011)<sup>5</sup> highlighted the regressive nature of Feed-in Tariffs and IPART<sup>6</sup> in its recent draft pricing determination highlighted the problems associated with multiple support mechanisms for solar PV leading to higher overall electricity prices. In this context, AGL believes that renewable energy policy should be the responsibility of the Commonwealth and State Governments should gradually remove support mechanisms such as State-based Feed-in tariffs.
- *Removal of retail price regulation where competition has been demonstrated to be effective and the introduction of price monitoring.* The continued regulation of retail pricing is a barrier to four key macroeconomic objectives: economic growth; innovation; environmental outcomes and new investment. AGL believes that the CEFC has a role in highlighting to the Ministerial Council on Energy (MCE) the real and non-trivial costs associated with the continued regulation of retail prices where competition has been demonstrated to be effective.

### **Transmission policy**

AGL understands that some stakeholders may seek to access funding for large scale transmission investment to connect remote areas with renewable resources to the existing electricity grid. In this context, AGL prepared the following principles as part of the Australian Energy Market Commission's *Scale Efficient Network Extensions* (SENE) rule change proposal. These principles are considered to be consistent with the objectives of the National Electricity Rules and provide for a competitive market.

1. Transmission policy should deliver efficient transmission prices which incentivise generation proponents, all other things being equal, to locate their investments as close to load centres as possible.
2. All parties that connect to the network, after meeting minimum technical requirements, should benefit from any savings that they can provide to the network and contribute the full cost of any additional costs they create on the network. These costs and benefits should be provided to the connecting parties at the time investments in plant are determined.

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<sup>5</sup> [http://www.eap-journal.com/archive/v41\\_i2\\_01-nelson.pdf](http://www.eap-journal.com/archive/v41_i2_01-nelson.pdf)

<sup>6</sup> Available at: [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)

3. Extensions of transmission networks should be financed solely by the benefiting entities. Only where existing infrastructure is upgraded to the benefit of other participants as well as connecting entities can the costs be appropriately shared across all the benefiting parties. Impacts of additional charges on existing generators should be minimised unless those generators are the proponents of the augmentation.
4. The risks and returns of developing infrastructure should be appropriated on the same entities. In other words, policies that ensure economic returns flow to generation proponents and transmission network service providers (TNSPs) for investments made should ensure that the risks of failure are apportioned towards these same entities. The risks apportioned to connecting parties should be identified and agreed at the time of connection
5. Electricity customers (through electricity tariffs) and/or taxpayers (through the CEFC) should not be required to underwrite the development of transmission services as customers do not receive any share of the profits, should the investments generate economic returns. In other words, policy settings should not privatise profits and socialise losses.

### **Conclusion**

In this submission AGL has outlined: current barriers to investment; principles by which the CEFC could establish its investment parameters; other policy reforms required to overcome investment barriers; and specific transmission investment policy principles. Should you have any questions in relation to this submission, please contact me at [tanelson@agl.com.au](mailto:tanelson@agl.com.au) or on (02) 9921 2516.

Yours sincerely,



Tim Nelson  
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