KUTH Energy Submission on CEFC questions

8 December 2011

Questions/Answers

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

    - The key space that the CEFC needs to find is the space where existing commercial investors be they equity or loan investors are not prepared to enter.
    - Mezzanine finance facilities, subordinated loans, equity and quasi equity instruments will be an important part of the investment mix from the CEFC.
    - The money is needed at the front end of the projects and in particularly in the case of geothermal (very capital intensive) the exploration risk is the challenging part to fund.

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

    - Innovative funding will be essential in the renewable energy space if there is going to be a determined effort to find base load alternatives to coal/gas. *Seeing is believing* and the geothermal industry is at a standstill and will remain in that space unless a working model can be established.
    - Australia's abundance of coal assets, the long term low cost of electricity that consumers have enjoyed make the benchmark price for renewable energy by comparison to coal very high. The long term structural change to the energy market and innovation in the renewable sector will address this in due course and memories of distant low cost coal fired power will be forgotten (reference Origin Energy Annual Report for 2011 showing the average return to power generators amounting to $40MWh). In the immediate future the projections made by geothermal companies for returns per MWh in the $150MWh range (to justify viability) will not be uncommon and CEFC will need to take a long term vision that such pricing will become more efficient as innovations are delivered across the geothermal development chain. This will affect the type of lending instruments that will need to be tailored for the sector. It may be possible in some cases for CEFC to look at securitising the carbon credits /REC's as part of the debt repayment process.

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3. *What are the opportunities for the CEFC to partner with other organisations to deliver its objectives?*
    - This has got to be a good idea and one that should be pursued aggressively. Can CEFC find a way to provide its funding subordinated in some cases to identified private sector funds so that this acts as a lever to open up greater investment $$ into the sector . I see this as a key role for the CEFC in its attempt to identify space that unlocks the private sector funding.
    - Such instruments as Redeemable Preference Shares , Convertible notes with trigger buy-out clauses may be instruments to be considered in this area.

4. *How could the CEFC catalyse the flow of funds from financial institutions?*
    - Early stage funding mechanisms will need to be developed
    - Early equity and quasi equity instruments alongside promoters to move the projects down the risk curve (with commensurate returns to CEFC to recognise their additional risk) will be important levers of private sector funding

5. *What experiences have firms in the clean energy sector had with trying to obtain finance; have term, cost or availability of funds been the inhibitor?*

    - The industry has suffered from great uncertainty in the political arena with the on-off nature of the climate change debate and the various initiatives such as CEFC that have been announced. In theory such announcements should be very positive for the sector and in 2007 that would have been the case but investors have become very cautious, very cynical and very risk averse when it comes to forecasts for the sector. In the case of geothermal this has been further perpetuated by lack of progress and success in industry projects.
    - Speaking for the geothermal sector I believe that “availability of funds” in sufficient quantum to implement these high, front end capex “proof of concept” projects has been the major barrier. Funding “on-market” has been limited by the market capitalisation value of the companies and off market an absence of industry aligned JV partners – certainly with the deep pockets to rapidly progress the EGS/HSA projects identified.

6. What non-financial factors inhibit clean energy projects?
    - Regulatory issues can cause delays
    - The biggest being the instability of the political sector in respect to “certainty” of Carbon pricing , renewable support initiatives (such as the CEFC) and the longevity of the government of the day. The recent announcements are positive – the opposition attack has been detrimental. All this leads to investor uncertainty and when combined with nervous public markets, an international debt crisis and possibly riper pickings in other markets this makes for the perfect storm. This needs to be broken if there is truly going to be a cohesive/structured investment environment

7. Are there special factors that inhibit energy efficiency projects?
   No comment

8. How do you see the CEFC fitting with other government initiatives on clean energy?
   The CEFC will be an important complementary body for other government programs. In the case of geothermal the upfront risk of very early stage projects will unlikely meet the investment criteria set by the CEFC Board. Grant programs will presumably come from the ARENA stable for merit based projects and a follow on CEFC pathway would be a natural progression if success criteria is met AND .....the private sector funding is not available. In reality may well be that as the market conditions improve , stability around the carbon price and support initiatives is achieved that there will be a return of private sector funding to follow ARENA successes and it would be important to make sure that CEFC money does not replace this but rather fills the gaps.

APPENDIX A – TERMS OF REFERENCE

Scope of the Review

Reporting to the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP and the Minister for Finance and Deregulation, Senator the Hon Penny Wong, by mid-March 2012, the Chair and Review members are requested to:

1. Develop an implementation plan for the establishment of the CEFC. No comment

2. Develop and recommend a proposed investment and operating mandate for the CEFC, with the mandate reflecting: No comment

2.1. the market area in which the CEFC will operate, including broad guidelines for how the corporation would invest and manage risk; No comment

2.2. how it will approach the intention that funding be divided into two streams:

- There should be flexibility to CEFC board on this point so that good projects in either category are not locked out because of some rigid dividing line in funding availability.

2.2.1. a renewable energy and enabling technology stream which will have one half of the funding allocated; and

2.2.2. an energy efficiency and low emissions technologies stream which will have half of the funding allocated and will be able to fund renewable energy projects in addition to the dedicated stream.

2.3. how the CEFC is positioned within the broader objectives of the Government's Clean Energy Future Package. No comment

3. Consistent with statutory requirements and the guidance set out in Governance Arrangements for Australian Government Bodies, suggest appropriate governance principles and mechanisms, including: No comment

3.1. responsibilities, powers and statutory duties of office holders including the Board, Chair and Chief Executive Officer;

3.2. appropriate Board structure, representation and skills;

- Some skill base from the key renewable initiatives without that representation having a bias.
- Technology / start-up / commercialisation experience will be a key skill that will benefit the board.

3.3. reporting obligations of the Board; No comment

3.4. relationship between the Board and responsible Ministers; and No comment

3.5. duties No comment

Yours sincerely

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