16 December 2011

Expert Review Panel
Clean Energy Finance Corporation
Submitted via email: cefc@treasury.gov.au

Dear Review Panel

Clean Energy Finance Corporation: Expert Review

Loy Yang Marketing Management Company (LYMMCo) welcomes the opportunity to comment on the $10 billion commercially orientated Clean Energy Finance Corporation (CEFC) – which forms part of the Commonwealth's Clean Energy Future Package.

LYMMCo trades the largest privately-owned generator in the National Electricity Market (NEM). In total, LYMMCo trades in excess of 2,200 MW which is approximately one third of Victoria's electricity needs and more than 8% of the total generation for the south-east of Australia.

The stated objective of the CEFC is to overcome capital market barriers – that hinder commercialisation and deployment – for renewable energy, energy efficiency and low emissions technologies. LYMMCo considers that capital market barriers typically exist because capital markets view such activities, and investments, as far riskier than other possible investment options. In the case of energy efficiency, entrenched barriers also exist[1]. Further, it is intended that the CEFC be commercially orientated and make a positive return on investments.

LYMMCO's submission focuses on the scope of the operation of the CEFC and potential National Electricity Market (NEM) impacts. However, LYMMCo considers that the Panel should, because of their applicability, give detailed consideration to the following pieces of recently completed work:

- The Auditor General, Audit Report No.26 2009–10, *Performance Audit: Administration of Climate Change Programs*[2];
- The Australian Government Prime Minister's Task Group on Energy Efficiency: *Report of the Prime Minister's Task Group on Energy Efficiency* July 2010[3]; and

[1] Entrenched barriers are well documented and include; split incentives, long pay back periods and apathy.
[2] At: http://www.anao.gov.au/uploads/documents/2009-10_Audit_Report_26.pdf
[3] At: http://www.climatechange.gov.au/~/media/submissions/pm-taskforce/report-prime-minister-task-group-energy-efficiency.pdf

ABN 19 105 758 316
LOY YANG MARKETING MANAGEMENT COMPANY PTY LTD
PO BOX 565 COLLINS STREET WEST, MELBOURNE VICTORIA AUSTRALIA
Tel +61 3 5173 2777 Fax + 61 3 9612 2222

www.lymmco.com.au

- Garnaut Climate Change Review: *Update Paper 7 Low Emissions Technology and the Innovation Challenge*[4].

LYMMCo considers that this work offers clear insights, and useful commentary and analysis into:

- the performance of historic climate change programs (e.g. the $400M Greenhouse Gas Abatement Program (GGAP));
- barriers to investment in energy efficiency; and
- important elements regarding the design of research, development and deployment schemes.

Furthermore, it is evident to LYMMCo from this material that subsidy programs run by government:

Commonly struggle to 'pick winners'

Although still capable of failing, private sector investments are more efficient as proponents have a greater understanding of the market, face competitive financing requirements and are exposed to risk/reward pressures which are not faced by government.

Will not always deliver against objectives

The Auditor General found that the GGAP program delivered only 30 percent of planned emissions abatement and that 9 out of 23 approved projects did not actually eventuate[5].

Require frequent monitoring and assessment

Without an effective audit program the potential clearly exists for the program to fail against objectives.

Additionally, the Garnaut update review articulates that such measures should allow for little bureaucratic discretion or political interference.

Potential National Electricity Market impacts

The following commentary relates to the potential impact of the CEFC on the NEM.

If the CEFC is to fund renewable energy generation capacity that contributes to electricity supply in the NEM this capacity will need to receive an additional subsidy in order to cover their total costs of production. This is because the NEM dispatches generators based on their marginal cost of production which is typically below the total cost of renewable generation capacity.

The nature of the operation of the NEM and the difference in marginal and total costs of production between renewable and fossil fuelled generation capacity is a key reason for the implementation of the Renewable Energy Target (RET)[6]. An alternative to a renewable energy target would be a feed-in tariff (FiT). The following

[4] At: http://www.garnautreview.org.au/update-2011/update-papers/up7-low-emissions-technology-innovation-challenge.html
[5] op cit 2 pg.17
[6] The RET provides a renewable energy certificate (RECs) for eligible renewable energy generation capacity thereby bridging the difference between their costs of production and the NEM wholesale price.

material outlines what the potential impacts would be on the NEM if CEFC projects also received RECs.

If CEFC renewable energy generation projects received RECs the following outcomes are highly plausible:

- CEFC funded generation projects depress wholesale pool prices as excess new generation investment is forced into the NEM – the revenue of all incumbent generators would decline contributing to investor uncertainty (both potential and existing)[7]. This is already occurring in the NEM because of the RET.
- the value of RECs diminishes as new investment is forced into the REC market – the diminishing value of RECs undermines historical RET investments;
- non-CEFC renewable energy projects are crowded out (predominantly wind farms) – financial institutions are more likely to be attracted to CEFC backed projects, depending on loan terms and conditions, than non-CEFC projects; and
- transmission and distribution network costs increase to bring new capacity to the market and in response to intermittent renewable energy supply and reliability issues.

The decline in the wholesale pool price and decline in REC prices will also diminish the capacity of any CEFC funded projects to make a positive return on investment. In effect, the CEFC could potentially self-sabotage.

Although, the implementation of a carbon price will substantially increase the wholesale pool price it may not be sufficient to greatly improve the economics of CEFC funded renewable energy generation projects given the significant disparity in costs.

An option that could potentially address the adverse impacts of CEFC projects on the NEM would be to restrict investment until NEM reserve requirements fall below a set percentage. However, such an approach would likely crowd out other – non CEFC – investments. Another option to minimise NEM impacts could include only funding technology research and development – to drive down the economic costs of specific technologies thereby improving their competitiveness in the NEM.

LYMMCO notes that the other renewable energy programs identified in the Paper i.e. the $3.2 billion Australian Renewable Energy Agency and the $1.2 billion Clean Energy Technology Program will, aside from the incursion of additional administrative and transaction costs, potentially compound the issues identified by LYMMCO above.

In conclusion, LYMMCO encourages the Review Panel to:

- seek to structure the CEFC so as to minimise the impact of the scheme on NEM market outcomes. LYMCO has identified two options in this submission however other alternatives could be worked through;
- ensure that the CEFC does not crowd out private sector investment in the NEM – which is already being adversely affected by regulatory uncertainty;

[7] Wholesale pool prices would also fall if a FiT was implemented instead of the RET.

- address issues raised by the Auditor General, the Prime Minister's Task Group on Energy Efficiency and the Garnaut Review Update in framing the scheme.

Please do not hesitate to contact me on (03) 9612 2236 if you wish to discuss issues raised in this submission.

Yours sincerely

Simon Camroux
Manager Regulation and Market Development