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Director, Renewable Electricity Markets
Department of Climate Change
GPO Box 854
Canberra, ACT, 2601

19 February 2008

Email RET@climatechange.gov.au

Dear Sir / Madam

Re: Exposure Draft Renewable Energy Target (RET) Legislation and supporting regulations

The Clean Energy Council is the peak body representing Australia's clean energy and energy efficiency industries.

Its priorities are to:

- Create the optimal conditions in Australia to stimulate investment in the development and deployment of the world's best clean energy technologies;
- Develop effective legislation and regulation to reduce energy demand and improve its efficient use; and
- Work to reduce costs and remove all other barriers to accessing clean energy.

The Council advocates policy development on behalf of its members at the Federal and state government level. It also promotes understanding of the industry and its potential through forums such as industry events, forums, conferences, newsletters and publications.

The "clean energy" industry includes generation of electricity using wind, hydro, solar, biomass, geothermal and ocean energy as well as the emerging technologies and service providers in the energy efficiency sector including solar hot water and cogeneration.

The Council appreciates being given the opportunity to provide comments on the Exposure Draft Renewable Energy Target Legislation and supporting regulations.

Correctly drafted legislation will be an important complementary measure in the government's climate change strategy. Its primary objective should be to develop a dynamic and internationally competitive clean energy industry in Australia. Its success will be demonstrated by its ability to stimulate investment and innovation to exploit our abundant suite of world-class clean energy resources, fostering accelerated development of emerging technologies and driving down costs in those already proven.

The Council believes the draft legislation as currently proposed will fall significantly short of delivering the government's stated objective of deploying 20 per cent of Australia's stationary energy generation from renewable sources. The Council cannot support the legislation in its current form.

Scheme design and trajectory

The Council in its submission to the Council of Australian Governments (COAG) Working Group on Climate Change and Water's paper titled *Design Options for the Expanded National Renewable Energy Target Scheme*, suggested that the current MRET was working well and called for only a minimal set of amendments to the existing MRET legislation. In summary these amendments were:

- extend the scheme to 2030;
- start the new trajectory 1 Jan 2009;
- increase the target linearly to 45,000GWh in 2020;
- maintain the target at 45,000GWh from 2020 to 2030; and
- increase the penalty price level to support the needed investment.

The Council notes the exposure draft legislation has heeded recommendations and is only proposing a minimal set of changes to the legislation. Most of the ideas flagged in the options paper have been abandoned in favour of a series of mostly simple amendments. This is welcomed.

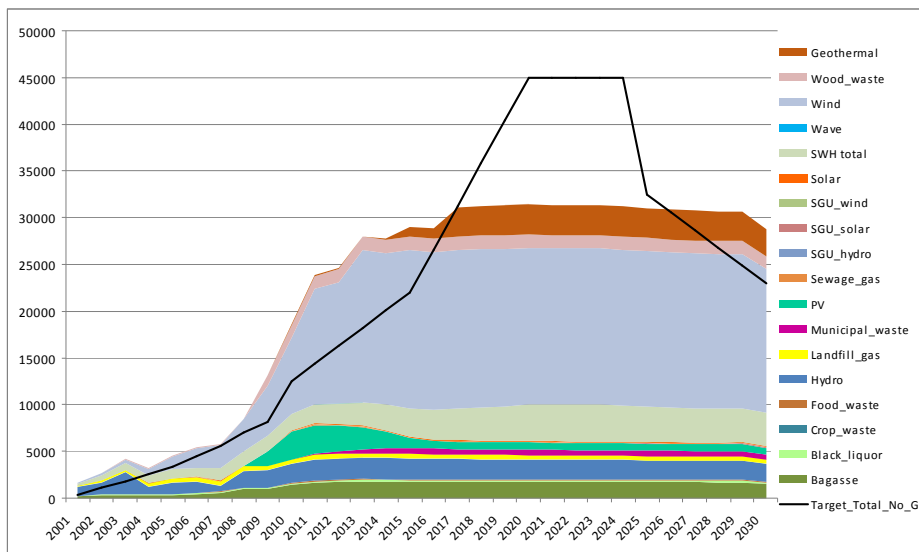
However, the Council is concerned that some proposed amendments will compromise the legislation's intended objectives. The current trajectory proposed in the draft RET design will not deliver the desired investment in new and emerging technologies. Crucially, it proposes the trajectory for the RET be steadily reduced after 2024. This regulated over supply will have the effect of collapsing the price of renewable energy certificates (RECs) from 2024. This will in effect bring forward to that date the working life of the scheme and the window in which investments in renewable energy projects must be made.

To determine the likely impacts of the proposed design, the Council commissioned economic modellers Intelligent Energy Systems (IES) to model the results of a range of different legislation designs, including that proposed by the draft legislation.

The IES modelling revealed the proposed trajectory combined with other proposed rules will drive an accelerated rush to deploy proven technologies in the early years of the scheme. The modelling predicts that most of the generation needed to meet the cumulative target for the scheme will be built by 2013. This will be at the expense of other emerging technologies such as geothermal and ocean. The implicit volatility in this outcome will undermine the industry’s evolution towards a low cost, zero emissions mainstream component of Australia’s stationary energy industry.

The modelling predicts that the early overbuild of generation will bank sufficient renewable energy certificates (RECs) to meet the prescribed target without ever producing 45,000GWh of new renewable energy in any year. In fact, the maximum annual generation is predicted to be around 31,000GWh, giving the percentage of renewables in 2020 of about 15% rather than the government’s stated aim of 20%.

Figure 1: IES modelling of exposure draft legislation



Source IES 2009

The Council has reviewed and noted the economic modelling on the design of the draft RET scheme commissioned by the government and prepared by McLennan Magasanik and Associates (MMA). This modelling appears to have influenced the proposed trajectory design as outlined in the exposure draft legislation.

The Council would make the following observations in relation to key aspects of this analysis.

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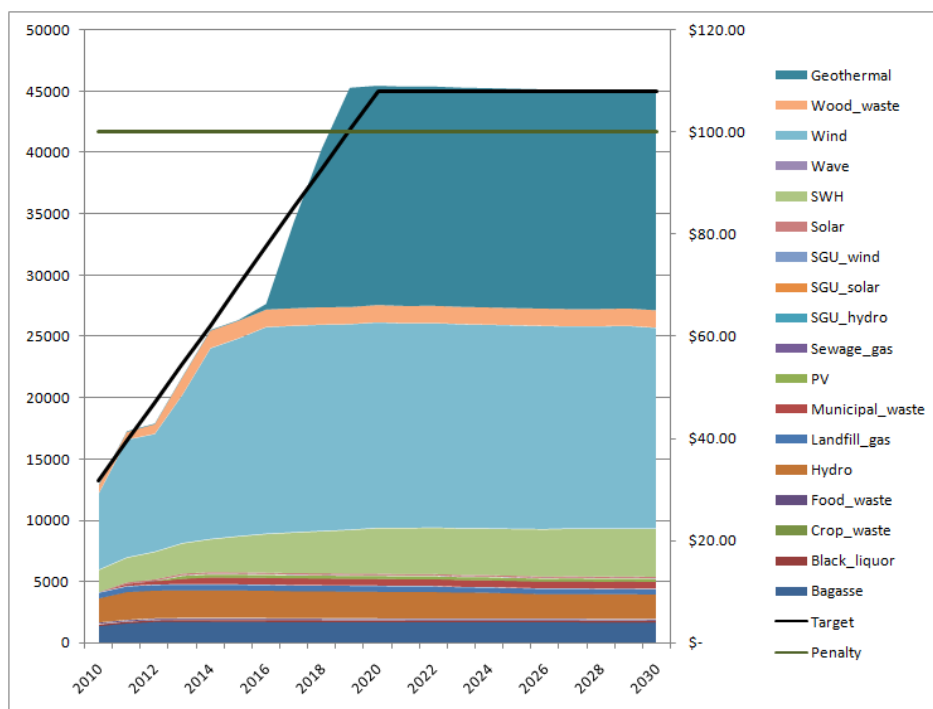
MMA assumes a linear trajectory for the value of renewable energy certificates which starts at \$70 per certificate in 2009 and falls steadily to around \$20 by 2030. This assumes a relatively stable and predictable carbon price in Australia and internationally over the next decade. This assumption has no underpinning research to support it and is not consistent with leading analysis about the key determinants of a future carbon price. There is growing evidence a major determinant for a medium term global carbon price will be the price of oil, as a proxy for the cost of switching from coal fired generation to gas fired generation. As such the real world carbon price is likely to be much more volatile, which means the real value of RECs will also be much less predictable.

The modelling also assumes perfect future knowledge by investors, predicting with full knowledge the entry point of existing and new technologies and their costs and full future knowledge of carbon and REC prices, often up to ten years or more in the future. This is the same as assuming investors are able to correctly predict the future value oil prices. Such foresight would be genuinely remarkable.

Because MMA has assumed a perfect linear price path for RECs and assumes perfect future knowledge of carbon and REC price trajectories by investors, they assume there will be effectively no impact in reducing the scheme trajectory after 2024. By inference their model assumes investors in 2014 can invest at that time with the full confidence that the carbon price will continue to override the RET scheme.

In reality the uncertainty created by this proposed post-2024 trajectory will stall investment from around 2014. It's possible the future carbon price will make the scheme redundant and transfer the full cost of transforming the energy market to a world carbon price. But investors cannot act on possibilities. The purpose of the RET is to provide this investment certainty. It is indeed possible, even likely, that the scheme will add no extra cost to the energy market by around 2020. But without it investment in Australian lowest-cost renewable energy technologies will stall until the carbon market is sufficiently robust and prices high enough.

Figure 2: RET Trajectory as proposed by Clean Energy Council



Source: IES 2008

The modelling proposed a simple solution to amend this design flaw. Holding the trajectory at 45,000GWh for the period 2020 to 2030 would encourage a more gradual and sustained development of new renewable energy projects with a mix of the current technologies and the new technologies currently being investigated. This trajectory will also ensure the government honours its election promise of deploying 45,000GWh of renewable generation by 2020.

Recommendation: The trajectory be amended to a linear trajectory rising to 45,000GWh in 2020 and maintaining at 45,000GWh until the measure ends in 2030.

Solar multiplier

The draft legislation includes a new “Solar Credit” scheme to allow small generators such as domestic sized PV installations to create extra RECs (up to 5 times the energy that will be produced by the installation).

The multiplier will provide a short term transition from the current solar homes and communities rebate for residential deployment of solar PV systems, but will not provide the scale and longer term certainty needed to drive costs down to a level that will allow the technology to compete directly with other technologies.

In the short term, the industry will benefit by the broadening of the applicability to industrial and commercial sites, but the limitation of 1.5kW will still make it difficult to enjoy economies of scale and scope. This multiplier needs to be applicable to larger scale installations up to 200kW. At present only solar PV is able to deem 15 years of generation when RECs are created. The regulations should be amended to increase the period available to the other small generation units (small wind and micro hydro) to 15 years.

To ensure the integrity of the RET it is essential that the target is not compromised by the creation of excess “phantom” RECs because of the solar credit multiplier. It is essential that the target is topped up to ensure that the 45,000GWh target in 2020 is met.

The PV multiplier reduces to one in 2015. At that time the total number of phantom RECs that were created can be easily calculated and the target for the years beyond that point be increased slightly to maintain the integrity of the measure.

The industry’s long-term position is that solar PV and small scale generation in general, such as small wind and micro hydro, are best supported by a gross feed-in tariff (GFIT). The design of the multiplier does allow the government to transition smoothly from the current rebate scheme to a GFIT. The GFIT can be introduced at a lower level while the multiplier is in effect then ramp slowly up to the level needed to provide the long-term support the industry needs to continue to grow and develop. The Council is eager to work with the government in the planning and introduction of appropriate GFIT details and implementation strategies.

Recommendation: The limit for eligibility for the solar credit multiplier be increased to 200kW

Recommendation: The regulations should be amended to increase the maximum deeming period for small wind and micro hydro to 15 years.

Recommendation: The trajectory be amended to account for the additional RECs created by the multiplier to ensure that the target of 45,000GWh in generation in 2020 is met.

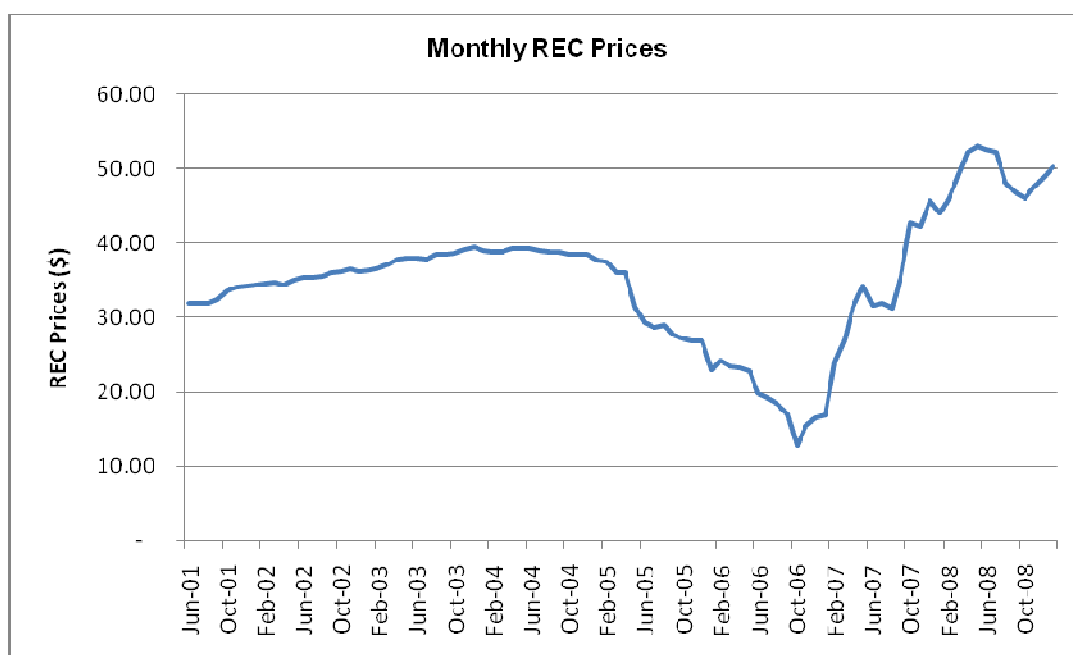
Recommendation: A transition mechanism be implemented to move from the multiplier to a gross feed-in tariff.

Penalty price

The draft legislation does not specify a shortfall charge, but indicates that this will be set at a level that will support the development of new technologies required to meet the target. The Council’s early analysis suggests that the shortfall charge needs to be in the range of \$80 - \$120 /MWh; however this figure needs to be confirmed in light of the current financial conditions and current and projected exchange rates.

In the current uncertain financial climate it would be wise to consider the use of a CPI escalator on the shortfall charge to ensure that the real value is maintained. It is critical that the government announces the penalty prices as a matter of urgency. This will provide industry with the confidence to start the final planning for the first projects needed by the increased measure.

Figure 3: Projection of monthly REC prices



Source TFS Brokers 2009

The history of spot REC prices to date shows that the supply / demand balance in the market will determine the actual prices for trades in RECs. There has been an active market for RECs and this is expected to grow with the increased size of the revised target.

Recommendation: The shortfall charge be set at a level to ensure compliance and should escalate with CPI.

The legislation proposes a scheme review in 2015, but does not propose any terms of reference for the review. This adds a degree of uncertainty to the industry. The previous review of the MRET lead to a stalling of investment as there was a perception that that one potential outcome was a scrapping of the scheme. The VRET legislation allows for amendments to the target, but only in an upwards fashion which provides better levels of certainty to developers. While the draft legislation calls for the review to be tabled in parliament, it does not place a requirement on the Minister to respond to the Review. This uncertainty over the potential government response to the review places further uncertainty on the industry.

Recommendation: The legislation should include limiting terms of reference for the scheme review, including a requirement for the Minister to respond within a set period.

The attachment to this submission provides some further comments on other design details raised in the original issues paper.

If you are seeking clarification on any of the issues raised in this paper, please do not hesitate to contact the undersigned or the Council's General Manager – Policy, Mr Rob Jackson on (03) 9929 4105 or email rjackson@cleanenergycouncil.org.au.

Yours sincerely,



Matthew Warren
Chief Executive