Hydro Tasmania
The power of natural thinking

14 September 2012

Submissions
Climate Change Authority
GPO Box 1944
Melbourne VIC 3001

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Dear Sir / Madam

Re: Renewable Energy Target Review Issues Paper

Thank you for the opportunity to respond to the Renewable Energy Target (RET) Review Issues Paper 'the paper'. As the largest generator of renewable energy in Australia we recognise the important role the RET plays in underpinning the continued development of additional renewable energy in Australia.

Hydro Tasmania supports effective policy and regulatory measures that will reduce Australia's future emissions below business as usual conditions as well as policies that enable and develop Australia's clean energy resources. Complemented by a sound planning approvals framework the RET will be the key policy mechanism by which Australia develops additional renewable energy.

Hydro Tasmania has been a significant participant in the RET scheme since its inception. We have continued to maintain, upgrade and modernise our existing hydro power resources, as well as develop wind farms in Tasmania and on mainland Australia in response to the incentive provided by the RET. Against a hydro power CAPEX program that is in excess of $700million over the next 10 years, the RET provides the incentive to ensure that modernisation and efficiency options that might not otherwise occur, can be undertaken. The RET thereby ensures the ongoing and enhanced contribution of Tasmania's hydropower resources. We currently operate the Bluff Point and Studland Bay wind farms (collectively known as Woolnorth - 140MW) in north-west Tasmania. In addition, we have recently commenced construction of the $400 million, 168 megawatt Musselroe wind farm in north east Tasmania. Hydro Tasmania expects more than 200 people will be directly working on the project during the 18-month construction phase, with approximately 130 of these based on site or in local accommodation during construction. We also have an active project pipeline for potential future renewable energy developments. The RET is a key determinant in progressing these hydro and wind power developments.

The introduction of a two-yearly RET review cycle is causing considerable uncertainty for renewable energy investment. While Hydro Tasmania recognises that policies must be evaluated and adjusted over time, the unsettled recent history of the RET has meant that market participants have a heightened perception of regulatory risk in the RET market. As a result, Hydro Tasmania does not support any change to the RET policy at this review. We strongly advocate this on the basis of the need for policy stability and investor confidence. As noted, the RET has

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undergone significant policy change in the last 3 years. Renewable energy developers including Hydro Tasmania have made investments and secured development sites on the basis of the policy continuing as it is. It is simply too soon to contemplate any significant changes to the RET framework particularly changes based on forward projections such as demand, which can change significantly year-to-year. Subsequent reviews must maintain investor confidence and should have a narrow terms of reference focussed only on positive changes or fine tuning of the RET – this could for example be whether to increase the target or extend the measure beyond its current 2030 end-date only.

The RET is proven and has been highly successful in developing Australia's renewable resources. It will continue to be the primary support mechanism for the Australian renewable energy industry. However, the recent history of the RET has been turbulent due to a combination of well documented State and Federal policy changes, as well as the influence of rapidly falling technology costs for household solar. The splitting of the target at the end of 2010 was an important policy intervention that has restored some stability to the large-scale portion of the target (LRET). This split must be maintained if the LRET market stability is to continue. The differential treatment of small and large scale installations under the RET (due to deeming, the interaction with feed-in tariffs and the impact of multipliers) means that large and small-scale technologies need to compete in separate markets. Hydro Tasmania strongly advises against any recombining of the LRET and SRES targets.

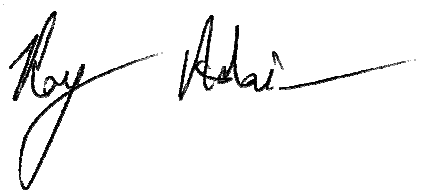
The RET is a least cost renewable energy deployment policy and *"is designed to encourage additional generation from both existing renewable energy power stations, as well as the establishment of new renewable power stations" (RET Review Issues Paper).* While we recognise that there is value in developing a range of renewable resources and expertise in Australia, further support will best be provided through the accompanying and complementary frameworks of the Australian Renewable Energy Agency (ARENA) and the Clean Energy Finance Corporation (CEFC). Both ARENA and the CEFC are likely to invest in a diverse range of technologies and projects including yet to be proven options. Given the overlapping nature of these policies it would confuse policy objectives if the RET became anything other than a least cost deployment mechanism. We therefore support the current policy framework but await further information on the operation of ARENA and the CEFC (including their interaction with the RET target). It is essential that technology eligibility under the RET is not changed. Historically this has been a source of significant uncertainty and has been extensively examined from the original design of MRET, through amendment bills, the Tambling Review, Senate inquiries and most recently COAG.

Hydro Tasmania believes that the introduction of a carbon price in conjunction with the national Renewable Energy Target (RET) and significant investment in research and development will provide an appropriate platform for the transition to cleaner energy sources. Australia has excellent renewable energy resources and is well placed to be a significant recipient of investment and employment opportunities stemming from renewable energy deployment. Critical to this is a stable, fair and effective regulatory and policy environment. Please find some specific answers to the questions raised in the Issues Paper at Attachment 1.

Hydro Tasmania is a member of the Clean Energy Council (CEC) and endorses the contents of their submission. We do not support the view put forward in the National Generator's Forum (NGF) and energy supply association of Australia (esaa) submissions that the LRET target should be lowered.

Hydro Tasmania welcomes the opportunity to provide the Climate Change Authority (CCA) with further information about the contents of this submission or any other issues. Should you have any queries or require further information, please contact Mr Colin Wain (colin.wain@hydro.com.au or telephone: 03 6230 5661)

Yours faithfully



Roy Adair
CEO Hydro Tasmania

Attachment 1 – Hydro Tasmania Submission on Issues Paper

Are the existing 41,000 GWh LRET 2020 target and the interim annual targets appropriate? What are the implications of changing the target in terms of economic efficiency, environmental effectiveness and equity?

Should the target be a fixed gigawatt hour target, for the reasons outlined by the Tambling Review, with the percentage being an outcome?

Should the target be revised to reflect changes in energy forecasts? If so, how can this best be achieved – as a change in the fixed gigawatt hour target, or the creation of a moving target that automatically adjusts to annual energy forecasts? How should changes in pre-existing renewable generation be taken into account? What are the implications in terms of economic efficiency, environmental effectiveness and equity?

The legislative change to split the RET into the LRET and SRES attributed a target of 41,000GWh in 2020 to the LRET. Hydro Tasmania believes this is an appropriate and achievable target for Australia. We note that the *Renewable Energy (Electricity) Bill 2010,* Explanatory Memorandum stated that the Commonwealth Government is committed to ensuring that 'the equivalent of **at least 20 per cent** of Australia's electricity supply comes from renewable resources by 2020'. Further, as the Issues Paper and the Tambling Review note, a fixed GWh target will provide investment certainty that a floating target cannot:

> *"any future target should continue to be expressed in terms of a fixed GWh level. By their nature, projections of electricity demand contain a degree of uncertainty……. The Review Panel considers that a fixed target is more compatible with market certainty, with MRET's industry development objective, which defines a level of renewable energy generation rather than a percentage of a fluctuating electricity market over which the industry has no control."*

Hydro Tasmania notes the recent significant debate around the appropriateness of the 2020 LRET target and whether this will represent 20% in 2020. Hydro Tasmania strongly advocates for no change to the 41,000 GWh LRET target for 2020. There are several significant reasons for this:

1. Changing the target at this stage sends a very poor signal about the regulatory certainty of the LRET target. Renewable energy developers have made substantial investments on the basis of the current interim and 2020 targets. Any change to these will increase the perception of regulatory risk in the measure and could delay and seriously undermine further investment in the measure.
2. Calls to change the target are being made off the back of changing demand forecasts. Forecasts are typically volatile and should be treated as such. It would be highly detrimental to adjust future targets at this stage when there is little certainty about the actual level of demand that will eventuate.
3. The excess supply of Large-scale Generation Certificates in the market created as a result of overlapping Federal and State policies, compounds the importance of setting future targets appropriately. The LGC market is particularly susceptible to changes in forward targets. Any downward revision will delay the point at which demand exceeds supply and new generation is required. This will most likely result in an immediate delay in additional renewable investment. Only upward reviews of the LRET target should ever be contemplated.

4. While Hydro Tasmania acknowledges that a lower LRET target will require less LGCs, the impact of this change on residential electricity bills would be very small in relative terms. This is because the LRET already represents a very small portion of the average household bill – in the order of 2% to 3% (Clean Energy Council research 2012). Even a substantial downwards revision of the LRET target would therefore not be likely to reduce bills by more than 1%. The corresponding cost of this change would be a decimation of the renewable energy industry in Australia and a loss of any investor confidence in the LRET target.

As the paper correctly notes:

> *"For the reasons mentioned in the Tambling Review, the relationship of the LRET GWh target to the 20 by 2020 policy commitment will remain imprecise. Not only is 2020 electricity demand unknown, but so are the contributions from the (uncapped) SRES, and the future of output of pre-1997 capacity. The latter can vary as most of the pre-1997 capacity is hydro and is affected by levels of rainfall. All of these uncertainties affect the percentage of electricity supply that will be contributed by renewable energy sources in 2020."*

Hydro Tasmania strongly advises against revising the LRET interim or 2020 targets at this stage, particularly given the uncertainty of demand forecasts.

Is the target trajectory driving sufficient investment in renewable energy capacity to meet the 2020 target? How much capacity is needed to meet the target? How much is currently committed? Has the LRET driven investment in skills that will assist Australia in the future?

Given the uncertainty that has existed in the target to date, insufficient renewable capacity has been installed since 2010 to meet the expanded RET target. However, this is an outcome of policy uncertainty and the surplus of LGCs, not an indication of the industry's inability to meet the target. According to CEC data, there are sufficient renewable energy projects announced or in development across Australia to meet the 2020 target from a variety of renewable sources. Large-scale renewable developers are well placed to invest in the projects and skills to meet Australia's 2020 target (and will be further supported through the CEFC and ARENA). What is needed at this stage is policy certainty and stability from which renewable energy companies can make the necessary long-term investments. The MRET experience (2001-2010) illustrates that the renewable energy industry is more than capable of delivering on policy objectives provided there is policy certainty.

Through our international consulting business Entura, we export renewable energy skills and expertise nationally and internationally. This growing capacity pool of 280 FTEs has been built in part as a result of Hydro Tasmania's investments under the RET as well as that developed through consulting work for other renewable energy developers in Australia. In addition, recent projects such as our Lake Margaret redevelopment, Catagunya Dam upgrade, Poatina modernisation and our current Musselroe project in North-East Tasmania have seen the development of local skills and increased employment opportunities.

In the context of other climate and renewable policies, is there a case for the target to continue to rise after 2020?

The significant role that the energy sector plays in Australia's emissions profile indicates that the sector will be required to largely decarbonise by 2050 if Australia is to meet its long-term goal of an 80% emissions reduction based on 2000 levels. This will require a substantial and growing contribution from zero emissions generation over time. Ensuring that the RET continues to drive additional renewable energy could be one way to ensure this, and as such a rising target post-2020 would be appropriate. The RET's interaction with the carbon price at this point will be critical as will the relative costs of conventional and renewable technologies. As the Issues Paper correctly notes, *"all other things being equal, the higher the carbon price, the lower the certificate prices will be under the RET."* As a result, alongside a mature and long-term carbon price, an increasing and extended RET can provide the appropriate investment signal for a growing renewable energy contribution. While Hydro Tasmania sees this as an appropriate and important long-term role for the RET, due to the current need for policy stability, we are not advocating for an increase or extension to the target at this review.

What are the costs and benefits of increasing, or not increasing, the LRET target for Clean Energy Finance Corporation-funded activities? What are the implications in terms of economic efficiency, environmental effectiveness and equity?

The benefits of increasing the LRET target for CEFC funded projects would be a greater deployment of renewable energy. Requiring more LGCs to be bought by retailers and wholesale customers to account for an increased target would have overall cost implications however, these should be considered against the benefits of further renewable energy deployment. CEFC projects that generate LGCs are likely to enter the market in an unpredictable manner. The critical issue for LGC market stability is for LRET participants to be able to judge the timing and volume of projects entering the market. Increased uncertainty would change the risk profile for LRET renewable developers and potentially delay the deployment of projects. It is therefore crucial that CEFC projects are transparently announced to the market at the earliest possible date to reduce uncertainty for LRET developers.

Is the calculation of individual liability using the RPP the most appropriate methodology?

Is it appropriate to set the RPP by 31 March of the compliance year?

Are there other issues relating to the liability or surrender framework the Authority should consider?

Is the shortfall charge set at an appropriate level to ensure the 2020 target is met?

The shortfall charge is not CPI indexed and as a result the value it represents will decrease over time. Currently, the LGC price is trading considerably below the penalty price and therefore is not affecting investment. Towards the end of this decade, the penalty price will begin to be factored-in to investment decisions and as such at some stage in the future it may be worth reviewing its relative cost at this point. Several factors will affect the appropriate level for the penalty price

including progress towards the LRET target, technology costs and the existence and level of carbon pricing. Hydro Tasmania has previously advocated indexing the shortfall charge to CPI.

What are the costs and benefits of the current exemption arrangements?

The self-generator exemption pre-dates the EITE partial exemptions – are both required? If so, why?

What, if any, changes to the current exemption arrangements should be made? What would be the impact of those changes on directly affected businesses and the broader community?

The current exemptions have been designed to partially shield large electricity users from increased RET costs that have resulted from the 2009 expansion of the target. These are combined with compensation for carbon costs under the Government's Jobs and Competitiveness Program within the Clean Energy Future legislation. The consequence of partially exempting industry from RET costs is that this cost is transferred to all other consumers including households. As a result, the appropriate level of exemption is a policy trade-off for Government.

Hydro Tasmania supports the CEC submission's position that exemptions are "a question of equitable sharing of costs" and that "the critical aspect for the deployment of renewable energy is that the target and therefore liability remain unchanged in total."

Is a list approach to 'eligible renewable sources' appropriate?

The RET is aimed at deploying least cost additional renewable energy. The list of 'eligible renewable sources' should and does reflect this. Where renewable energy applications fit more appropriately under the SRES or Commonwealth energy efficiency frameworks they should be incentivised under these approaches and not through the LRET. The RET has proven successful in deploying additional renewable energy from a range of sources and avoiding any erosion of the existing renewable energy base. To maintain these incentives it is essential that technology eligibility under the RET is not changed. Historically technology eligibility has been a source of significant uncertainty and has been extensively examined from the original design of MRET, through amendment bills, the Tambling Review, Senate inquiries and most recently COAG.

Are there additional renewable sources which should be eligible under the REE Act?

Should waste coal mine gas be included in the RET? Should new capacity of waste coal mine gas be included in the RET?

The inclusions of waste coal mine gas in the LRET was done for policy reasons and not because it represents additional renewable energy. It does not therefore appear to be appropriate for new waste coal mine gas capacity to be eligible under LRET.

What would be the costs and benefits of any recommended changes to eligible renewable sources?

As this submission states above, the current technology eligibility under the RET is appropriate and has been extensively examined. RET market participants such as Hydro Tasmania have made substantial investments on the basis of the current list of eligible technologies. As noted by the discussion paper the RET *"is designed to encourage additional generation from both existing renewable energy power stations, as well as the establishment of new renewable power stations"* (RET Issues Paper). Importantly, the inclusion of the baseline methodology for pre-1997 power stations has ensured appropriate ongoing investment in the maintenance, upgrade and modernisation of Australia's renewable energy base. Any recommendation to change eligibility would cause sovereign risk issues and put hundreds of millions of dollars of investment and GWhs of generation at risk.

Are the LRET accreditation and registration procedures appropriate and working efficiently?

Hydro Tasmania has extensive experience of the accreditation and registration procedures. We believe the accreditation and registration procedures appropriately fulfil the objectives of the RET.

What do you consider to be the costs and benefits of having a separate scheme for small-scale technologies?

Should there continue to be a separate scheme for small-scale technologies?

Hydro Tasmania strongly believes that there should continue to be separate schemes for large and small scale technologies. This is because the approaches used to incentivise their deployment are fundamentally and critically different, as are the time horizons of project proponents. While large-scale projects must negotiate Power Purchase Agreements (PPAs) and compete with the wholesale electricity price, small-scale installations are normally the recipients of feed-in tariffs which are equal to or above the retail electricity price in some states. Further, large scale developers have long term horizons (15 – 20 years) whereas the deeming of certificates upfront means that small-scale developers have no investment in the ongoing viability of the RET. The existence of such profoundly different incentive structures and time horizons means that small and large scale deployments must continue to be treated under separate market structures. Any re-introduction of small-scale technologies into the LRET will almost certainly immediately stall investment in large-scale projects due to the recent experiences of certificate supply volatility and the increased market risk this would bring.

Is the uncapped nature of the SRES appropriate?

What do you see as being the costs and benefits of an uncapped scheme in terms of economic efficiency, environmental effectiveness and equity?

Is the SRES driving investment in small scale renewable technologies? Is it driving investment in skills?

The difficulty in appropriately designing and administering the small-scale scheme is its close interaction with other investment issues such as the solar multiplier, falling technology costs, feed-in tariffs and other state-based incentives. 2012 represented a very high cost year for the SRES where the combination of incentives offered to small-scale deployments was overly generous in many states. It would not be an efficient or rational outcome for this to be repeated in the future. The recent decrease in state based feed-in tariffs and the end of the solar multiplier on 1 July 2013 are likely to keep SRES costs at a more economic and appropriate level. However, if the SRES is to continue to operate as an uncapped scheme then the Government and Clean Energy Regulator must closely monitor incentives to ensure that these remain appropriate and that the volume of STCs required for compliance is reasonable.

What is the appropriate process for considering and admitting new technology to the SRES?

Should any additional small-scale technologies be eligible to generate STCs?

Is it appropriate to include displacement technologies in the SRES?

Should additional eligible technologies be limited to generation technologies?

Is deeming an appropriate way of providing certificates to SRES participants?

Are the deeming calculations for different small-scale technology systems reasonable?

Hydro Tasmania does not create STCs and is not a small-scale technology developer. Through our Victorian based retailer Momentum, we must source STCs to meet our SRES liability. Issues of SRES technology eligibility and treatment will not be covered in this submission.

As noted earlier in this submission, the deeming provisions currently applied to SRES technologies had a significant impact on the RET market before the SRES and LRET split. The Review must be aware of the power of deeming and its ability to produce volatile swings in the supply of permits. Given the uncapped nature of SRES, changes to deeming provisions could affect the cost of the measure in a relatively short timeframe.

What are the lessons learned from the use of multipliers in the RET? Is there a role for multipliers in the future?

The recent experience of multipliers in the RET strongly cautions against their future use. Particularly under the LRET, the use of multipliers for large-scale technologies could have a

destructive impact on market confidence and the supply-demand balance of LGCs. Hydro Tasmania advises against any future use of multipliers in the RET.

Is the STC Clearing House an effective and efficient mechanism to support the operation of the SRES?

Should changes be made to the Clearing House arrangements? If so, what would be the costs and benefits of any suggested alternative approaches?

Is $40 an appropriate cap for small-scale certificates given the recent fall in cost of some small-scale technologies, particularly solar PV?

Are the SRES administration arrangements appropriate and working efficiently?

Hydro Tasmania does not create STCs and so will not comment on the effectiveness of the clearing house or of the price cap.

Should the RET design be changed to promote greater diversity, or do you think that, to the extent that there are barriers to the uptake of other types of renewable energy, these are more cost-effectively addressed through other means?

What would be the costs and benefits of driving more diversity through changes to the RET design?

As stated earlier in this submission, the RET has been designed to deploy least-cost additional renewable energy. Where there is value in further promoting the development and deployment of a diverse range of clean energy technologies this will already be provided through the existence of ARENA and the CEFC. To intentionally alter the RET to cater for a wider range of technologies that compromises least cost outcomes would confuse the objectives of the measure and create increased uncertainty as to how it should interact with other policy mechanisms. Such a significant change would harm investor confidence and could reduce the value of investments made to date by market participants.

Approaches such as 'banding' or the use of incentives such as multipliers in the LRET would be complex to administer and recent evidence suggests, would be almost impossible to set in an efficient manner. Changes such as this would not only damage the perception of RET as an investment grade policy but would increase costs to consumers and make the achievement of the target more problematic.

Hydro Tasmania strongly supports the RET's intention to deploy least-cost additional renewable energy. There are compelling reasons why this objective and the current eligibility criteria should not be compromised.

What is the appropriate frequency for reviews of the RET?

What should future reviews focus on?

Hydro Tasmania notes that the current legislative requirement is for the RET to be reviewed every two years. Based on experience of this and previous RET reviews, we believe that a formal review process will always introduce uncertainty in the market and will cause some slowing of investment until this uncertainty is resolved.

The importance of the 2012 review is paramount as it will serve as a guide for market participants as to the nature of future reviews. Hydro Tasmania does not support any change to the RET policy at this review. A 'no change' outcome would send a strong signal to the market that the RET is long-term and stable policy particularly given its turbulent recent history. We advise against continual 'tinkering' with the RET policy purely because there is a review and that, should the Climate Change Authority choose to make recommendations about the policy, that these are done so only where there is a clear and pressing need for reform. Any recommendations of the review should be cognisant of the precedent they will set for future reviews. In Hydro Tasmania's opinion 2012, is too soon to sufficiently understand how the RET will function over the period to 2020 and beyond. The LRET investment environment has begun to settle and should continue to be allowed to do so. While we recognise that some of the issues raised at this review may need to be considered at some point in the future we do not believe the 2012 review is the appropriate time to recommend significant change.

Hydro Tasmania strongly believes that for the RET to function effectively and to achieve its policy objectives, there must be policy stability and investor confidence in the measure. A two yearly review of the entire scheme is too frequent given the long-term importance of the policy and the need for policy stability. If a two-yearly review cycle is to remain then the terms of reference must be narrow and administrative in scope. Any more extensive consideration should only contemplate whether to increase the target or extend the measure beyond its current 2030 end-date. This would ensure investor confidence in the RET. If future reviews focus on key policy and design issues then a two-yearly review will always cause uncertainty in the market and undermine the long-term and stable policy intent of the RET.