
Mandatory Renewable Energy Target Review Submission

1. Introduction

Westpac Institutional Bank (“Westpac”) is a broad-based participant in the electricity market. We are an active adviser to, and financier of, Australian electricity and gas businesses. In addition, we trade in electricity and renewable energy certificates (RECs) as part of a strategy to deliver valuable risk management services to our customers.

We welcome the opportunity to comment on the MRET Review and have generally restricted our comments to those issues under the terms of reference that may affect REC market operation and liquidity.

2. Comments Under the Terms of Reference

Items:-

b. “the extent to which the policy objectives of this Act have been achieved and the need for any alternative approach”

d. “the level of penalties provided under this Act” and

j. (ii) “relevant economic and social impacts that have resulted from the implementation of the provisions of this Act”

It has been suggested that it is possible for liable entities to treat their REC obligations as a regulated charge and simply pass through the full cost of the penalty to end-users on regulated retail tariffs. Thus there may be little or no incentive for such entities to minimise the cost of REC purchases. We therefore question the effectiveness of the current penalty system. Direct results of this behaviour may be:

- a) the negation of a primary benefit of a trading certificate system of reducing greenhouse gas emissions at the least cost on society through an efficient market-based system.
- b) retail customers bear higher costs than necessary and become prejudiced against beneficial environmental measures.

Item g.

“the possible introduction of a portfolio approach, a cap on the contribution of any one source...”

The liquidity of the REC market would be greatly decreased if a portfolio approach or cap on contributions from one technology were adopted. Price discrimination between the different renewable technologies would simply increase market complexity and prices. This would not deliver a least cost solution to the community. It should be born in mind that the REC market is relatively small, being worth approximately \$12 million and \$40 million in its first and second years respectively and ultimately reaching a market size of roughly \$400 million per annum at the end of its first decade. By comparison the wholesale electricity market has an annual volume of roughly \$6,000 million and still experiences issues with liquidity. We would therefore argue strongly that the size of the REC market is too small to be able to support a subdivision of the basic contract unit into more than one instrument.

“ ...and measures to recognise the relative greenhouse intensities of various technologies”

Westpac would not be averse to introducing measures that assigned a larger number of RECs to technologies that offered a greater greenhouse abatement benefit. The only requirement is that the underlying trading instrument remains uniform for all renewable technologies for market liquidity reasons.

Item i. (i)**“level of participation in and transparency of the Mandatory Renewable Energy Target measure”**

Market transparency would be greatly increased if generators were required to register their RECs within one year of the generation occurring. This would prevent REC prices being artificially inflated if large generators withhold disclosure of RECs that they have produced by not registering such RECs immediately. {The panel may wish to investigate if there are any FSA implications or continuous disclosure issues.

Item i. (ii)**“scheduled end-date of 2020”**

The closed ended nature of the REC regime creates considerable uncertainty over the future value of RECs created during the final few years of the scheme by projects whose output becomes uncontracted during that period. Potential overbuild earlier in the life of the regime, or other circumstances could foreclose the market for certificates created by those projects. This may result in low values being attributed in investment cases for uncontracted REC streams during the final years of the scheme.

Item i. (iv)**“need for future reviews”**

Regulatory uncertainty substantially hinders market development and investment. With a more certain MRET framework, investors and market participants will be more willing to commit to projects and transactions into the future. The existence of the current review has restricted many participants from trading beyond the first three to four years of the scheme and put new investment on hold. Generation projects have high capital costs that are only paid back in the medium to long term and regulatory certainty is required for new investment to proceed.

New renewable projects are dependent for their economic viability on the revenue they receive for their RECs. Their cash costs exceed by some considerable margin the revenues that they can receive from electricity and sale of any by-products. If the REC instrument or an equivalent alternative cashflow is not available without interruption over the next 18 years, then there is material risk that renewable projects will not be able to pay their obligations in a full and timely manner and may default on payment to their creditors. Investors, both equity and debt, will be wary about committing to new investment if there is any doubt about the continued, uninterrupted existence of revenues based upon RECs or some replacement.

Item j. (iii)**“inclusion of renewable energy sources and technologies not specified in the Act or Regulations”**

The renewable energy industry is continuously developing and it is not possible to predict what new technologies will be introduced over the next twenty years. In that respect it may be appropriate to give the Regulator discretionary powers to determine whether a particular technology is eligible. This would also allow for any omissions that occur through oversight in the legislation, for example, solar hot water heating is eligible however geothermal heating and cooling is not.

3. General

We encourage the Review Panel to consider whether it intends for the scheme to operate solely for compliance purposes or whether it wishes the trading certificate market to be active and supported so that the environmental targets are delivered to society at least cost. If the latter we encourage further detailed consultation with traders and participants familiar with market design.