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Briefing note

September 2014

Australia's Renewable Energy Target under review

The uncertainty around Australia's climate change policies continues with the release of the latest report on the country's renewable energy target scheme.

The report has generated considerable debate. It advocates substantial amendments to the scheme which, if adopted in full, are likely to heavily curtail the future development of the renewables sector in Australia.

However, the Australian Government has not finalised its response to the report and there is no guarantee that its recommendations will be accepted.

Purpose of the Renewable Energy Target

Australia's Renewable Energy Target (RET) was designed to increase electricity generation from renewable sources and reduce greenhouse gas emissions from the electricity sector.

Established by the Renewable Energy (Electricity) Act 2000 (Cth) (REE Act), the RET was introduced in 2001 to achieve an additional two per cent of renewable energy in Australia's electricity mix by 2010 on top of existing generation.

From 2010, the scheme was expanded into its current form to mandate that at least 20% of Australia's electricity would come from renewable sources by 2020, which equates to a target of an additional 45,000 gigawatt hours (GWh) of generation. The target was based on the assumption that Australia's electricity usage would grow to 300,000 GWh by 2020.

Since January 2011, the RET scheme has operated in two parts—the Small-scale Renewable Energy Scheme (SRES), which applies to rooftop solar, PV and micro wind and hydro systems, and the Large-scale Renewable Energy Scheme (LRET), which applies to major renewable energy providers such as wind and solar farms and hydro facilities. This briefing focuses on the impact of the RET review on the LRET.

The RET works by allowing accredited renewable energy power stations to create certificates for every megawatt hour of renewable electricity they produce. Large-scale Generation Certificates (LGCs) are sold to entities (mainly electricity retailers) who are required to surrender a specific number of LGCs each year to the Commonwealth Clean Energy Regulator (CER) to meet RET annual targets.

For large scale renewables operating under the LRET, this so-called Green

Key issues

- An independent panel has recommended substantial changes to Australia's renewable energy target scheme
- If the changes are accepted, future development of the renewables sector in Australia is likely to be much harder as the need for new projects and anticipated rates of return decline
- The Australian Government's response to the report is not expected for several weeks and any proposed changes are likely to face a difficult path through the Commonwealth Parliament
- The ongoing uncertainty will continue to affect existing investment in the sector.

Certificate Scheme creates a financial incentive for the establishment or expansion of renewable energy power stations by legislating demand for LGCs.

The REE Act prescribes regular reviews of the RET scheme's operation to ensure it is operating efficiently and effectively. On 17 February 2014, the Commonwealth Ministers for Environment and Industry announced arrangements for the review of the REE Act by an independent panel.

The panel consisted of Dick Warburton AO LVO, a prominent Australian businessman and company director, Dr Brian Fisher AO PSM, a former director of the Australian Bureau of Agriculture and Resource Economics, Shirley In't Veld, company director and former CEO of the Western Australian electricity utility and Matt Zema, head of the Australian Energy Market Operator.

The panel was appointed by the ministers to review the operation, costs and benefits of the RET scheme in the wake of rising electricity prices. The panel received more than 23,000 submissions and conducted around 100 meetings with interested stakeholders before releasing its report on 28 August 2014 (the Warburton Report).

A copy of the report is available here: https://retreview.dpmc.gov.au/ret-review-report-0.

Findings of the panel

The panel observed that the RET scheme had met each of the formal objectives set out in the REE Act, namely:

- successfully promoting additional generation from renewable sources.[1] Renewable energy generation almost doubled between 2001 and 2013 to 33,000GWh. The Warburton Report notes that an additional investment in new renewable generation capacity of A$15 billion in net present value terms by 2020 is predicted if the RET remains unchanged[2]
- reducing CO_2 emissions from electricity generation
- promoting the use of ecologically sustainable energy sources.

The panel noted that since the expanded RET scheme began in 2010, the policy and economic landscape in Australia has changed significantly. Demand for electricity has been significantly lower than forecast over the past five years and projections of electricity demand to 2020 have been repeatedly revised down, meaning that the RET is likely to achieve a greater than 20% share of electricity from renewable sources by 2020.[3]

The panel concluded that with the renewables industry now established in Australia and investment in additional generation capacity not required to meet electricity demand, the main rationale for the RET now hinges on its capacity to contribute towards the Australian Government's CO_2 emissions reduction target in a cost effective manner.[4]

The panel's modelling predicted that continuing the RET scheme under its current settings would result in a further A$22 billion cross-subsidy in net present value terms from electricity consumers to the renewable sector over the remainder of the scheme.

The panel concluded that the RET promotes activity in the renewables sector ahead of alternative, lower cost options for reducing emissions that exist elsewhere in the economy and so "the costs imposed by the RET are not justifiable".[5]

Given this finding, the panel recommended that the RET should not be continued in its current form and proposed significant reform to both the LRET and SRES schemes.

Suggestions for reform

The panel took the view that an immediate end to the RET would create significant adverse financial implications for existing investors. Instead, the panel recommended that the LRET continue, but in a significantly modified form that better balanced the interests of existing investors with those of the nation as a whole.[6]

The panel suggested that the LRET be amended in one of two ways, without advocating one option over the other.

- The first option was to close the LRET to new entrants and set an annual renewable energy target, with LRET's last year of operation being 2030. Under this option, the CER would set the annual target based on estimated output from accredited power stations included in the LRET.
- The second option suggested was to allocate an annual LRET target as a share of electricity demand growth. Under this option, the CER would set the LRET target each year, increasing annually by an amount up to 50% of the increase in national electricity demand to 2020 with a final year of operation of 2030. Under this option, new renewable energy power stations would only be supported if electricity demand increased. If demand remained

flat or fell year on year, the target would be held at the previous year's level. The panel estimated that this approach would achieve a 20% share for renewables in the electricity generation sector by 2020, based on current electricity demand forecasts.

Interaction with other renewable energy programmes

Established renewable energy technologies in Australia (specifically wind farms) already receive support through debt financing or re-financing contributions from the Australian Renewable Energy Agency (ARENA) and the Clean Energy Finance Corporation (CEFC).

The panel noted that as these agencies aim to increase the range of technologies that could become competitive with established renewable energy technologies, they serve a different purpose to the RET.

The panel recommended that projects, or components of projects, that receive support under the RET should not also be eligible for additional funding from either ARENA or CEFC.[7]

Mixed reaction to the Warburton Report

The Warburton Report had a mixed reception. Most peak industry groups have expressed support for the second option for reform of the LRET.

The report has been criticised by the renewable energy industry, which predicts that either recommendation for reform of the LRET would ensure that no new renewable electricity generation would be built until such time as it can undercut existing generation.

Industry specialists claim that this move would reduce certainty for those investing in the renewable energy industry and increase sovereign risk concerns.

What next?

The Warburton Report contains no firm path forward for the future of the RET. The Australian Government is considering the panel's recommendations but has not indicated how it will respond.

Any changes to the RET will require changes to the REE Act, which will in turn require the Government to negotiate with either the opposition Labor Party or the independent and cross bench members of the Senate who hold the balance of power to ensure amendments are passed by the Parliament.

At the time of writing, neither the Labor Party nor the crossbench in the Senate has indicated that they would be prepared to negotiate changes to the RET scheme.

Impact

Until the Australian Government has finalised its response to the Warburton Report and released its proposed amendments to the REE Act, debate and uncertainty will continue to dominate the renewables landscape in Australia.

Project owners and financiers with exposure to renewable energy projects should be reviewing the terms of financing arrangements and considering their options should the RET scheme be changed substantially.

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[1] There are 416 power stations accredited in the LRET.

[2] Warburton Report, page i

[3] Wholesale electricity prices in Australia's National Electricity Market have been falling as demand for electricity has declined while supply has increased. However, this has not been mirrored in retail electricity prices, which have increased substantially mainly due to increasing network costs.

[4] Warburton Report, page 44. Australia has committed to reducing its greenhouse gas emissions by between 5 and 15 or 25 per cent below 2000 levels by 2020. The five per cent target is unconditional. However, the 15 per cent and 25 per cent targets are conditional on the extent of international action.

[5] Warburton Report, page i.

[6] Warburton Report, page 63.

[7] Warburton Report, section 8.2.1

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