

Issues in the Bills

Clean Energy Legislation Amendment Bill 2012

Overview

2.1 The Bill has five main sets of amendments:

- to bring gaseous fuels into the carbon price mechanism;
- to ensure the robustness of the processes supporting the Carbon Farming Initiative;
- to enhance the security of the Australian National Registry of Emissions Units;
- to allow the Australian Renewable Energy Agency and the Clean Energy Regulator to share information with the Clean Energy Finance Corporation (CEFC); and
- to enhance the operation of the *National Greenhouse and Energy Reporting Act 2007*.

2.2 The provisions in relation to gaseous fuels operate alongside those in the Clean Energy (Excise Tariff Legislation Amendment) Bill 2012 and the Clean Energy (Customs Tariff Amendment) Bill 2012. The excise and tariff Bills will be discussed with the gaseous fuels provisions.

Gaseous fuels

Background

- 2.3 These provisions arise from a recommendation of the Joint Select Committee on Australia's Clean Energy Future Legislation (JSCACEFL) in October 2011. The Clean Energy legislation last year provided that gaseous fuels would be subject to an equivalent carbon price through the fuel tax system. That committee heard evidence from LPG Australia about the application of the mechanism to liquefied petroleum gas (LPG), which appeared to assume the primary use for LPG is as fuel for transport, despite the wide range of non-transport uses for LPG.
- 2.4 LPG Australia is the peak body for LPG suppliers in Australia. LPG Australia stated at the Joint Committee's hearings:
- Our industry sector is a little perplexed as to why we are not in the emissions trading scheme, and we welcome the opportunity today to raise those concerns again. The industry is represented by a number of petroleum and marketers in LPG. Our industry has two distinct market segments – the auto gas market segment, where we service about 700,000 vehicles and we also handle the stationary energy market. They are two distinct markets. Those two markets are also serviced by electricity and natural gas.¹
- 2.5 LPG Australia indicated that the treatment of LPG under the scheme could lead to distortions in treatment, which would leave the LPG sector disadvantaged. Given LPG's status as a cleaner fuel, this appeared to be inconsistent.
- 2.6 The gaseous fuels sector faces a number of problems with the current legislation. Firstly, there are cash flow issues because firms have to pay an excise on a regular basis, whereas their competitors in other stationary energies do not have to pay their liability until the following February. Secondly, because it is an excise, firms in that sector do not have the opportunity when we go to a trading market in 2015 to purchase international credits and hedge their liability.² Further, LPG Australia stated before the Joint Committee that there are significant compliance costs:

1 JSCACEFL, Mr Warring Neilson, LPG Australia, *Committee Hansard*, Sydney, 28 September 2011, p. 7.

2 JSCACEFL *Advisory Report on the Clean Energy Bills and the Steel Transformation Bill 2011*, October 2011, p. 97.

There is a flow-on cost that occurs in that exercise because, while we are excluded from the litigation and controlling our carbon costs, the complexity of us remaining in an excise scheme is that we are up for a massive reconciliation program with the Australian Taxation Office to handle our transport excise and then on top of that we have got a carbon excise that we have to try to deal with. We deliver thousands and thousands of cylinders and we would have to reconcile each invoice back. It just does not make sense. How we operate in New Zealand is that when we purchase the product and we put it in our storage we pay the carbon tax on that, so we already know what our obligation is in terms of carbon. Under this current regime we would be doing that and all we would simply do is we would adjust that balance with the transport excise and deduct it from the carbon cost. They are the two main things. What will happen is that by remaining in this current mechanism our costs for our consumer will actually increase. So not only do we impair the original consumer but I think we also impair the takeup of a fuel that can provide an enormous contribution to abatement.³

2.7 LPG Australia suggested that the matter could be dealt with in a straightforward way through the new legislation:

I think it is a matter of clarifying the definitions. If you look at the way that natural gas is going to be handled, the same approach could be taken with LPG. It is just a matter of clarifying the definitions so that you clearly identify the marketer and who has the obligation. The producer will have the obligation. I do not think there are a lot of changes that need to occur. I think the system is reasonably – well, I should not say simplistic. Nothing is simplistic in the way the regulations have come about. But I do not believe there is a great deal of complication there.⁴

2.8 The Joint Committee recommended:

That the Government examine the proposals made by LPG Australia concerning the treatment of LPG under the mechanism and, where appropriate, refine the provisions to ensure that a carbon price is most efficiently applied to all uses of LPG.⁵

3 JSCACEFL, Mr Warring Neilson, LPG Australia, *Committee Hansard*, Sydney, 28 September 2011, p. 7.

4 JSCACEFL, Mr Warring Neilson, LPG Australia, *Committee Hansard*, Sydney, 28 September 2011, p. 9.

5 JSCACEFL *Advisory Report on the Clean Energy Bills and the Steel Transformation Bill 2011*,

- 2.9 These points were confirmed in the Regulatory Impact Statement for this proposal.⁶

Commencement of coverage and transitional arrangements

- 2.10 Non-transport liquefied petroleum gas and liquefied natural gas (LNG) will have a carbon price applied under the carbon pricing mechanism from 1 July 2013 in place of the current arrangements. The current arrangements will apply from 1 July 2012 to 1 July 2013 and involve the application of an effective carbon price to non-transport LPG and LNG through the fuel tax system.
- 2.11 Mandatory coverage of non-transport LPG and LNG under the carbon pricing mechanism will begin on 1 July 2013. This allows time for transitional and compliance arrangements to be carefully considered, developed and implemented. This aligns the treatment of non-transport LPG and LNG with the coverage of liquid fuels by the carbon pricing mechanism. It is also consistent with the Government's original commitment on 11 October 2011 to examine coverage of gaseous fuels.
- 2.12 Under the carbon pricing mechanism, the point at which excise or customs duty becomes payable (entry into home consumption, generally by the importer, manufacturer or marketer of non-transport LPG or LNG) will be the initial point of liability for emissions resulting from the use of these fuels.
- 2.13 Regulations made for the *Clean Energy Act 2011* will be able to specify situations in which a person can quote an 'obligation transfer number' (OTN). This will allow a large end user of LPG, LNG or compressed natural gas (CNG) to manage their own liability for emissions from these fuels in specified circumstances. It will also enable businesses that use these fuels as feedstock to avoid paying a carbon price in respect of fuel that does not result in emissions. To bring about coverage of non-transport LPG and LNG under the carbon pricing mechanism, these fuels will not have excise and customs duties applied.⁷

October 2011, p. 99.

6 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, p. 10.

7 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, p. 35.

Coverage of non-transport CNG

- 2.14 To correctly apply the carbon charge on non-transport CNG under the Government's Clean Energy Plan, the exemption from fuel excise or excise equivalent customs duty for non-transport use of CNG needs to be restored from 1 July 2012. Non-transport CNG will instead be subject to the carbon price directly under the carbon pricing mechanism.
- 2.15 Coverage of non-transport CNG from 1 July 2012 will occur because:
- CNG is produced from natural gas that is already subject to an upstream price under the carbon pricing mechanism. This allows coverage to be implemented relatively simply by removing the requirement for producers of non-transport CNG to pay carbon price equivalent excise duty; and
 - some small non-transport CNG producers are not currently required to participate in the excise system, and would be required to install metering equipment to enable their participation in the excise system.
- 2.16 The requirement for CNG producers to pay excise or customs duty on non-transport CNG will be removed through legislative changes to excise arrangements for CNG producers and the adjustment of administrative arrangements by the Tax Office. The default point of liability for emissions from non-transport CNG will then rest with the natural gas supplier that supplies the gas from which the CNG is produced.
- 2.17 CNG producers will have the option of quoting an OTN to their supplier which will enable them to assume mechanism liabilities for the natural gas they use to create CNG. The natural gas supplier would not be able to refuse this transfer of liability.⁸

Off-road use in agriculture, forestry and fisheries activities

- 2.18 An equivalent carbon price is not applied to off-road fuel use by the agriculture, forestry and fishing sectors. This policy will be continued by allowing non-transport LPG, LNG and CNG users in these industries to claim fuel tax credits which are equivalent to the amount of carbon price

8 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, p. 36.

even when the fuel is subject to the carbon pricing mechanism and no fuel tax has been paid.⁹

Ongoing coverage of gaseous fuels under the fuel tax system

- 2.19 Non-transport CNG will be covered by the carbon pricing mechanism from 1 July 2012. From 1 July 2013 non-transport LPG and LNG will move from the effective carbon price under the fuel tax system to being covered by the carbon pricing mechanism.
- 2.20 Bringing about coverage of non-transport CNG, LPG and LNG under the carbon pricing mechanism requires excluding non-transport CNG, LPG and LNG from excise and customs duties and as a consequence excluding users of non-transport CNG, LPG and LNG from being able to claim fuel tax credits (FTCs) for their use of the fuels.
- 2.21 A new FTC will be available for the agriculture, fishing and forestry industries. The FTC will be equivalent to the amount of the carbon price that is embedded in the cost of gaseous fuels acquired for non-transport use. This is consistent with the general policy that these industries should not be subject to a carbon price on the fuels acquired for non-transport use.¹⁰

Carbon Farming Initiative

- 2.22 The Initiative is a voluntary scheme. Participants are eligible to receive carbon credits for every tonne of carbon pollution saved or stored. These credits can be exported or sold to companies that want to offset their emissions or to sell carbon neutral products.¹¹
- 2.23 The Bill seeks to maintain the integrity of the Carbon Farming Initiative by requiring that projects have secured all required regulatory approvals before they receive any credits. It simplifies the process of finalising methodology determinations by clarifying the material to be used by the Domestic Offsets Integrity Committee in making determinations.

9 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, p. 36.

10 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, pp. 36-37.

11 The Hon. Mr Greg Combet MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 24 March 2011, p. 3147.

- 2.24 The Bill provides more time to approve methodologies for existing projects to facilitate the transition of these projects into the Initiative. Methodologies submitted for assessment by the middle of 2012, and approved by the middle of 2013, can be backdated to the middle of 2010 and that will improve the operation of the Carbon Farming Initiative for project proponents.¹²

Australian National Registry of Emission Units

- 2.25 The Registry underpins the Carbon Farming Initiative. The aim is to allow farmers, landholders and other participants with offsets projects under the initiative to receive, hold and transfer their carbon credits securely.
- 2.26 It is based on a previously existing registry that the Australian Government established in 2008 to meet key obligations that Australia has under the Kyoto protocol. Legislation introduced in March 2011 has put the Kyoto registry, which was previously operating on an administrative basis, on a legislative footing.
- 2.27 Units held in the registry are to be treated as personal property for the limited purposes of laws relating to bankruptcy, external administration, wills, intestacy and deceased estates, and any other prescribed purpose. This reduces any legal uncertainty surrounding the units in these circumstances. A range of information in the registry will be made publicly available, including the name of account holders, and the regulations may require publication of the total number of specified Kyoto units held in accounts.¹³
- 2.28 The Bill amends the Australian National Registry of Emission Units Act (ANREU Act) to enable regulations to identify Registry accounts that are subject to restrictions or limitations in relation to the operation of the account, including restrictions or limitations on the transfer of carbon units, Australian Carbon Credit Units, Kyoto units or prescribed international units to or from the identified account or the issue of carbon units to the account.
- 2.29 The Bill also amends the ANREU Act to increase the period within which the Clean Energy Regulator can defer giving effect to an instruction from

12 The Hon. Mr Greg Combet MP, Minister for Industry and Innovation and Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 23 May 2012, p. 9.

13 The Hon. Mr Greg Combet MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 24 March 2011, pp. 3150-51.

no more than 48 hours to no later than the end of the fifth business day after the day on which the instruction was received.¹⁴

Providing information to the Clean Energy Finance Corporation

- 2.30 The CEFC will make decisions concerning investments in clean energy technologies and projects. In making these decisions or concerning the ongoing efficacy of investments, the CEFC may require information about specific issues from the Australian Renewable Energy Agency or the Clean Energy Regulator.
- 2.31 The sharing of relevant and appropriate information between the CEFC and the Australian Renewable Energy Agency and between the CEFC and the Regulator is limited to the circumstances spelt out in the Australian Renewable Energy Agency Act and the Clean Energy Regulator Act respectively and this is not a general ability for the CEFC to obtain or request information.
- 2.32 The bill includes a new section 73A in the Australian Renewable Energy Agency Act, which provides that the Agency may disclose information to CEFC if the disclosure will enable or assist the CEFC to perform or exercise any of its functions or powers.
- 2.33 The bill amends section 49 of the Clean Energy Regulator Act, to add the CEFC to the list of bodies with which the Regulator may disclose 'protected information'. Section 49 specifies the circumstances in which the Regulator may disclose such information and the manner in which this may occur.¹⁵

National Greenhouse and Energy Reporting System

- 2.34 The System is the national framework for the reporting of information on greenhouse gas emissions, energy consumption and energy production.
- 2.35 A person with 'operational control' of a facility is generally responsible for carbon price liability and associated reporting obligations. Where operational control is not clear, a nomination may be made. The Bill

14 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, p. 58.

15 Explanatory Memorandum (Combined), Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012, p. 63.

streamlines the requirements for nomination. Annual nominations will no longer be required and nominations may last for as long as required.

- 2.36 The Bill provides that the regulator only needs to publish a 'net energy consumption'. An additional requirement to publish 'total energy consumption' is removed. The 'net energy consumption' requirement is more appropriate because it does not include the transformation of one energy commodity into another.¹⁶

Clean energy customs and excise Bills

- 2.37 These Bills deal with the treatment of gaseous fuels and are linked to the Clean Energy Legislation Amendment Bill 2012. They are discussed above.

Clean Energy Finance Corporation Bill 2012

Background

- 2.38 The Clean Energy Finance Corporation Bill 2012 (CEFC Bill) gives effect to the Government's commitment to establishing a Clean Energy Finance Corporation as part of its Clean Energy Future Package.
- 2.39 The Government appointed an Expert Review Panel (the Review Panel) on 12 October 2011 that was tasked with advising on the design of the CEFC. The Review Panel members were Ms Jillian Broadbent AO, the Chair, Mr David Paradise and Mr Ian Moore.
- 2.40 In addition to consulting with key stakeholders about the role of the CEFC and its relationship with the Renewable Energy Target (RET), the Review Panel received 151 public submissions, which are available on its website.¹⁷
- 2.41 In its report, the Review Panel provided the Government with broad principles to guide the direction of the CEFC, and proposed a 'flexible mandate for the CEFC to enable the corporation to respond to changing circumstances and opportunities'. The Review Panel concluded:

16 The Hon. Mr Greg Combet MP, Minister for Industry and Innovation and Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 23 May 2012, p. 9.

17 CEFC Expert Review, <<http://www.cefcexpertreview.gov.au/content/Content.aspx?doc=consultation/submissions/default.htm>>.

The Review Panel believes that the CEFC will play an important role in furthering Australia's place in a cleaner energy world and developing the technology, design, construction and operating skills to do so. Australia requires these skills to integrate cleaner energy technologies with our existing energy infrastructure and markets. Australia's geography, renewable resources and adaptive engineering skills are well suited to our playing a significant global role in this sector.¹⁸

- 2.42 The Government released the Review Panel's report on 17 April 2012, and supported the 26 recommendations. The CEFC Bill seeks to implement the framework outlined in these recommendations.

Key features of the CEFC Bill

- 2.43 The CEFC will be a mechanism to help mobilise investment in renewable energy, low-emission and energy efficiency projects and technologies in Australia. The focus will be on technologies that are solely or mainly Australian-based.
- 2.44 The CEFC will receive \$2 billion per year for five years from 2013-2012. However, it is the intention that the CEFC will become self-sustaining. If the Bill is passed, the substantive provisions of the Act will commence six months after Royal Assent. It is intended that CEFC investment operations will commence on 1 July 2013.
- 2.45 In the second reading speech, the Minister for Industry and Innovation and Minister for Climate Change, the Hon Greg Combet AM MP (the Minister), described the CEFC as a key part of the Government's plan to 'build a clean energy future which will strengthen the economy and protect our environment'.¹⁹ In the Explanatory Memorandum, the CEFC was described as a fund dedicated to investing in clean energy, it was stated:

The Corporation will supplement existing initiatives, such as the Renewable Energy Target and the carbon price, to catalyse and leverage the flow of funds for commercialisation and deployment of renewable energy, low-emission and energy efficiency technologies necessary for Australia's transition to a lower carbon economy.

18 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. iv.

19 The Hon Greg Combet AM MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 23 May 2012, p. 6.

Australia is a late starter in the transformation to clean technology due to its access to low cost fossil fuels. This transformation will require substantial capital which the private sector alone may not be able to provide. Current global financial conditions, the complex nature of Australia's electricity markets, the cost of renewable energy, and the preference of investing institutions for listed assets inhibit the financing of the clean energy sector.²⁰

- 2.46 The CEFC is designed to complement other Government policies and programs, such as the Australian Renewable Energy Agency (ARENA), the Clean Technology Investment Program and the Clean Technology Innovation Program. It is planned that the CEFC will liaise with ARENA to form an 'innovation chain'. ARENA will focus on the early stages of development, for example by providing grants and support for newer renewable energy projects. The CEFC will concentrate its investments on projects and technologies that are at the later stage of development and commercialisation. The aim is to assist commercially viable projects which may be facing some barriers to obtaining solely private funding.²¹
- 2.47 A brief outline of key features of various parts of the CEFC Bill is included below.

CEFC Board and staffing

- 2.48 Part 3 of the CEFC Bill establishes the CEFC Board and sets out the appointment, termination, terms and employment conditions and process for Board meetings. Part 4 establishes the position of Chief Executive Officer (CEO) and sets out procedures for their appointment and resignation, and deals with the recruitment of staff and consultants and committees.
- 2.49 The CEFC will be established as a Commonwealth Authority under the *Commonwealth Authorities and Companies Act 1997*. The CEFC will be managed by an independent board comprised of members who must have the 'appropriate reputation and expertise' in a range of areas including: banking and finance, investments, economics, engineering, energy technologies, government funding programs or bodies, the environmental sector, financial accounting and law. The requirements for appointment are outlined in proposed section 16 of part 3.
- 2.50 The CEFC Bill provides that the Board shall consist of a Chair and at least four, but no more than six, other members. Board members are appointed

20 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 7.

21 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 36.

for a term of up to five years, but they can be reappointed for another term. They are paid allowances determined by Remuneration Tribunal regulations.

- 2.51 The CEFC Board will be appointed by the Government. However, the Minister highlighted the intention for the CEFC to operate independently, stating that the Government will not be able to 'direct the corporation in relation to specific projects for investment'.²²
- 2.52 The CEFC Board's function includes oversight of the CEFC's investment function to invest, directly and indirectly, in clean energy technologies. The Board appoints the CEO, who will be responsible for the day-to-day administration of the CEFC. This is a full-time position.
- 2.53 The CEFC will be staffed with experienced personnel to provide support to the Board and CEO to 'determine the best investments and manage taxpayers' money appropriately'.²³

Financial arrangements

- 2.54 Part 5 establishes a CEFC Special Account and sets out the procedures and payments to and from the Account. For the purposes of section 21 of the *Financial Management and Accountability Act 1997*, a Special Account is a ledger which records a right to draw money from the Consolidated Revenue Fund. The CEFC will be able to draw on money when needed for its functions. The Minister explained the purpose of this arrangement is:
- To allow the corporation to focus on its primary function of investing in the clean energy sector, a special account is being created to manage surplus funds and limit the corporation's need to undertake a cash management function.²⁴
- 2.55 It is envisaged that the CEFC will invest using commercial principles and return a profit. The profits and returns on investments will be available to reinvest. The CEFC may receive gifts of money or assets (with the written approval of the nominated Minister) and will be exempt from income tax, in keeping with the practice for entities in the government sector.

22 The Hon Greg Combet AM MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 23 May 2012, p. 6.

23 The Hon Greg Combet AM MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 23 May 2012, p. 7.

24 The Hon Greg Combet AM MP, Minister for Climate Change and Energy Efficiency, *House of Representatives Hansard*, 23 May 2012, p. 7.

Investment function

- 2.56 Part 6 sets out the CEFC's investment function and performance criteria. Proposed section 58 provides that the CEFC 'is to invest directly, and indirectly, in clean energy technologies'. The CEFC may do any or all of the following:
- (a) investing in businesses or projects for the development or commercialisation of, or in relation to the use of, clean energy technologies;
 - (b) investing in businesses that supply goods or services needed to develop or commercialise, or needed for use in, clean energy technologies;
 - (c) giving guarantees in accordance with section 69.²⁵
- 2.57 The definition of investment in the CEFC Bill has been extended to include giving a guarantee. However, guarantees are to be limited to the amount of the uncommitted balance in the CEFC Special Account.²⁶
- 2.58 Proposed section 60 of the CEFC Bill outlines the nature of clean energy technologies that the CEFC may invest in:
- (1) *Technologies that are any one or more of the following are **clean energy technologies**:*
 - (a) *energy efficiency technologies;*
 - (b) *low-emission technologies;*
 - (c) *renewable energy technologies.*
 - (2) ***Energy efficiency technologies** includes technologies (including enabling technologies) that are related to energy conservation technologies or demand management technologies.*
 - (3) ***Renewable energy technologies** includes:*
 - (a) *hybrid technologies that integrate renewable energy technologies; and*
 - (b) *technologies (including enabling technologies) that are related to renewable energy technologies.*
 - (4) *A technology is a **low-emission technology** if the Board is satisfied, in accordance with guidelines made under subsection (5), that the technology is a low-emission technology.*
 - (5) *The Board must, by writing, make guidelines setting out the matters to which the Board will have regard in satisfying itself that a technology is a low-emission technology.*
 - (6) *The guidelines must not be inconsistent with the Investment Mandate.*

25 Clean Energy Finance Corporation Bill 2012, clause 58(2).

26 Clean Energy Finance Corporation Bill 2012, clause 69.

- (7) *The Board must publish guidelines made under subsection (5) on the Corporation's website.*
- 2.59 In determining investments the CEFC must apply a 'commercial filter' to select viable projects. However, it was qualified in the EM that the standard would not be as stringent as the private sector equivalent as it would also be giving weight to the wider positive benefits of the project.²⁷
- 2.60 The CEFC will be required to develop and publish a number of policies on its investment activities, which must cover:
- the investment strategy of the Corporation;
 - benchmarks and standards for assessing the performance of the Corporation's investments and of the Corporation itself;
 - risk management for the Corporation's investments and for the Corporation itself; and
 - a matter specified in the regulations.²⁸
- 2.61 The CEFC must publish on its website its first set of policies by the time it starts performing its investment function on 1 July 2013.
- 2.62 Proposed section 63 sets certain parameters for the CEFC and its subsidiaries' investments, for example by prohibiting direct investment in property or infrastructure. The Explanatory Memorandum stated:
- The Corporation and its subsidiaries may only invest through a broad range of financial assets. Allowing the Board to invest directly in non-financial assets would be inconsistent with the Government's broader fiscal policy and budget management. It is intended the Corporation will facilitate finance for clean energy technologies and projects through its investments, not build or buy projects.²⁹
- 2.63 The CEFC will also be guided by an investment mandate, comprised of directions in the form of legislative instruments, provided by the Government. The investment mandate is a mechanism for the Government to articulate its 'broad expectations for how the Corporation's funds will be invested and managed by the Board'.³⁰ Proposed subsection 64(3) provides the directions may include:
- (3) *Without limiting subsection (1), a direction may set out the policies to be pursued by the Corporation in relation to any or all of the following:*

27 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 39.

28 Clean Energy Finance Corporation Bill 2012, clause 68.

29 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 42.

30 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 43.

- (a) *matters of risk and return;*
- (b) *technologies, projects and businesses that are eligible for investment;*
- (c) *the allocation of investments between the various classes of clean energy technologies;*
- (d) *making investments on concessional terms;*
- (e) *the types of financial instruments in which the Corporation may invest;*
- (f) *the types of derivatives which the Corporation may acquire;*
- (g) *the nature of the guarantees the Corporation may give and the circumstances in which they may be given;*
- (h) *broad operational matters;*
- (i) *other matters the responsible Ministers consider appropriate to deal with in a direction under subsection (1).*

2.64 The responsible Ministers are to consult the Board on the initial investment mandate, and subsequent changes. The CEFC are to receive a draft of new directions and be provided the opportunity to make a submission on the changes. Directions under section 64(1) will be made legislative instruments (non-disallowable) and registered on the Federal Register of Legislative Instruments and tabled in parliament, along with any relevant CEFC submissions.

2.65 The investment mandate will also include the application of the Australian Industry Participation Plans, to help ensure that the Australian industry is afforded full, fair and reasonable opportunity to participate in projects.³¹

Miscellaneous provisions

2.66 Part 7 covers miscellaneous matters including CEFC subsidiaries, the publication of investment reports and annual reports, disclosure of information, delegations and review of the Act.

2.67 Proposed section 71 provides that CEFC subsidiaries must not be incorporated or formed outside Australia.

2.68 To help ensure transparency of CEFC operations, the organisation is required to produce and publish annual reports and quarterly investment reports.³² Proposed section 73 makes provision for protecting commercial-

31 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 44.

32 Clean Energy Finance Corporation Bill 2012, clauses 72-74.

in-confidence information. However, the onus is on the affected person to demonstrate that the release of the information would be detrimental to their commercial interests.

- 2.69 Proposed sections 76 to 80 provide for the delegation of certain powers and functions by the relevant Minister, the CEFC, the Board, CEO and officers.
- 2.70 A review of the operation of the CEFC Act will occur after 1 July 2016, which is to include assessing the CEFC's effectiveness.³³

Discussion on the CEFC

CEFC operating environment

- 2.71 The CEFC will have a commercial approach to its operations. The Review Panel stated that the CEFC will finance Australia's clean energy sector using financial products and structures to address the barriers currently inhibiting investment.'³⁴ The Review Panel considered that an appropriate objective to be to:

...apply capital through a commercial filter to facilitate increased flows of finance into the clean energy sector thus preparing and positioning the Australian economy and industry for a cleaner energy future.³⁵

- 2.72 The Review Panel noted that the CEFC will be challenged in achieving this objective because 'there is a tension between funding the clean energy sector, applying a commercial filter, and maintaining the financial self-sufficiency of the corporation.'³⁶ In particular, the Review Panel commented that the CEFC 'will invest responsibly and manage risk so it is financially self-sufficient and achieves a target rate of return.'³⁷

33 Clean Energy Finance Corporation Bill 2012, clause 81.

34 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. ix.

35 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. ix.

36 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. ix.

37 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. ix.

- 2.73 The EM stated that ‘it is expected that the Corporation will apply a commercial filter when making its investment decisions, focussing on projects and technologies at the later stages of development.’³⁸
- 2.74 During the hearing, the committee examined the Treasury about the CEFC’s operating environment, its investment mandated, target rate of return, and how the CEFC may differ from a private sector equivalent. The committee sought further information on the rationale for the CEFC concentrating its investments projects and technologies that are at the later stages of development and commercialisation. Treasury stated:
- When the expert review panel examined where the gaps are in the market, it was also cognisant of the fact that it was going to be primarily an investment vehicle. It saw the initial R&D stages as investments that are more likely to require grants because, at that stage, a project is unlikely to make a financial return into the future. By focusing on later stage developments and the commercialisation of the project, the commercial filter that they spoke about is about projects that have a real prospect of making a return. The early-stage R&D is more appropriate for grants programs such as ARENA.³⁹
- 2.75 The EM noted that ‘by allowing the payment of profits from the Corporation to ARENA to support projects and technologies along the innovation chain, the Act recognises that the Corporation has a public policy purpose of furthering the development of the renewable energy sector.’⁴⁰
- 2.76 A further area of examination focused on the CEFC’s investment mandate. Clause 64 of the Bill sets out how the responsible Minister may, by legislative instrument, give the Board directions about the performance of the Corporation’s investment function. The EM stated that ‘it is appropriate that the Government, as manager of the economy and owner of the Corporation, have a mechanism for articulating its broad expectations for how the Corporation’s funds will be invested and managed by the Board.’⁴¹ The EM noted that ‘a direction from the responsible Ministers may also include: matters of risk and return; eligibility criteria for investments; allocation of investments between different types of clean energy technologies; the types of financial

38 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 10.

39 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 3.

40 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 36.

41 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 43.

instruments the Corporation may invest in; and broad operational matters.’⁴²

- 2.77 The investment mandate is made after the passage of the legislation. Treasury stated:

Under the legislation the investment mandate is made by the government with the board, so the investment mandate cannot be physically done prior to the passage of the legislation and the board being appointed. The government has publicly stated that the expectation will be around the government bond rate, which is what was included in the expert review panel's report.⁴³

- 2.78 Treasury advised that the Corporation's rate of return will be around the government bond rate. The expectations will not be as great as a private sector equivalent. The Review Panel stated:

The filter will not be as stringent as the private sector equivalent, as the CEFC has a public policy purpose and values any positive externalities being generated. Consequently, it has different risk/return requirements. For a given return, the CEFC may take on higher risk and, for a given level of risk, due to positive externalities, may accept a lower financial return.⁴⁴

- 2.79 The Review Panel noted that in achieving the target rate of return, 'the portfolio will need to earn a rate sufficient to incorporate a margin for losses and operating expenses.'⁴⁵ The Department of Finance and Deregulation (Finance) advised that 'we have a fairly conservative estimate that around 7½ per cent of its total capital each year will not be recovered.'⁴⁶ Finance noted that the budget includes a 'provision for \$150 million of investments that will not be recovered.'⁴⁷

- 2.80 Some members suggested that this could mean that the Corporation could lose \$600 million over four years but Finance did not agree with this conclusion. Finance commented that it 'would not agree because the investment mandate will set an investment return target for the body', and

42 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 44.

43 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 3.

44 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. xi.

45 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 19.

46 Mr David Nicol, Department of Finance and Deregulation, *Committee Hansard*, Canberra, 28 May 2012, p. 7.

47 Mr David Nicol, Department of Finance and Deregulation, *Committee Hansard*, Canberra, 28 May 2012, p. 7.

you 'would not separate the investments from the returns, because it is a business.'⁴⁸ Finance stated:

...that the impact on the budget will be driven by the target rate of return, and that will be made up of, essentially, two factors: one is the assumption of a default rate and the other is an assumption of a return rate. With regard to how you get your target rate of return, there are an infinite range of possibilities – from a higher default rate and a higher return rate to a lower default rate and a lower return rate, from how the corporation goes about its business to what risk profile it takes on its portfolio.⁴⁹

2.81 Treasury was asked on what evidence was the 7.5 per cent default rate based. Treasury stated:

The assumed rate for the purposes of the forward estimates for the investments of the Clean Energy Finance Corporation (CEFC) is 7.5 per cent of the additional invested funds each year. The rate of 7.5 per cent is an average across the portfolio of CEFC investments and is based broadly on expected performance of the corporation, noting the risks of the industry in which the CEFC will invest, particularly the potential for higher risk in renewable energy sector....

The 7.5 per cent rate represents an initial assumption and will be reviewed as necessary following experience with the operation of the CEFC.⁵⁰

2.82 A final point of examination focused on Clause 61 of the Bill relating to Australian-based investments. The EM notes that 'in making the Corporation's investments, the Board must also be satisfied that the investment is solely or mainly Australian-based.'⁵¹ The Board will determine guidelines setting out the requirements of Australian-based investments which can only be done after the passage of the legislation and the creation of the Board. Some members raised questions about whether the potential Australian-based investments might be overseas owned. Treasury advised that 'we are talking about where the assets would be located and not the ownership.'⁵² This focus on Australian-

48 Mr David Nicol, Department of Finance and Deregulation, *Committee Hansard*, Canberra, 28 May 2012, p. 8.

49 Mr David Nicol, Department of Finance and Deregulation, *Committee Hansard*, Canberra, 28 May 2012, p. 12.

50 Department of the Treasury, *Answers to Questions on Notice*, 28 May 2012.

51 Explanatory Memorandum, Clean Energy Finance Corporation Bill 2012, p. 42.

52 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 3.

based investments stems from the Clean Energy Finance Corporation Expert Review. The Review Panel stated:

The Panel regards it as paramount that CEFC investments must be principally located in Australia. This requirement would not exclude foreign participation in projects operating in Australia.⁵³

Financial barriers to investment in clean energy

- 2.83 One of the key topics discussed in the hearing was the barriers that exist to companies being able to raise finance to make substantial, long term investments in clean energy. Currently in Australia, there are a number of institutional and economic impediments to the sort of investments that Australia needs to make to establish a robust clean energy industry. Such investments will provide jobs and wealth for Australians and reduce the impact of climate change, which has potentially catastrophic costs.
- 2.84 The committee accepts that government intervention in an economy should not be taken lightly, but it is widely recognised that market failure can occur and that governments have a role in correcting these failures. The discussion in this section picks up on these market failures and explains the fundamental reason for the CEFC. In short, there is market failure in the finance sector and the CEFC will address this in a way that minimises market distortions and disruption.

Tenor of Australian debt markets

- 2.85 The length of time until a debt matures is sometimes referred to as its tenor. In Australia, the tenor of Australian debt is approximately five years. In its submission to the Expert Review, Royal Bank of Scotland stated that bank finance has a typical loan tenor of seven to nine years, and ANZ stated that the wholesale Australian debt markets have a tenor of one to five years.⁵⁴
- 2.86 This compares with the much longer periods involved in these investments, which ANZ pointed out can be up to 25 years. Therefore, longer term projects face greater risk, either due to the possible need to refinance or through the need to amortise debt more quickly.

53 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 13.

54 Submissions to CEFC Expert Review: Royal Bank of Scotland, p. 5; ANZ, p. 2.

Availability

- 2.87 The general lack of funds available for clean energy investment was a common theme in the Expert Review.⁵⁵ In its submission to the review, Acciona Energy referred to this as ‘timidity in the capital market’.⁵⁶ Treasury gave an overview of this problem at the hearing, noting that Australia’s lack of experience in the sector creates difficulties at a financial level, as well as operational:

Importantly, there is really a limited track record of dealing with these projects within the financial sector, which means that financial corporations add a risk premium because of the uncertainties. That is important for renewable energy projects because of the high upfront capital costs imposing a high risk premium on them. The benefits from the investment come from very long investment periods, so the returns are highly discounted. Under traditional financing mechanisms, that tends to mean that they do not get over the hurdle rates of return.⁵⁷

- 2.88 A further factor is that assessing energy projects needs to be done on a case by case basis, which makes due diligence expensive. The Expert Review discussed this as follows:

A number of submissions cited the costs associated with conducting due diligence on renewable energy projects and the lack of standardisation of projects. Assessment of the quality of the resource and potential production variability are central to the due diligence process. However, the cost of undertaking these assessments can be a deterrent. In addition, unique factors in clean energy projects do not lend themselves to a standardised assessment and approval process. Without these economies of scale, the financial sector underinvests in its capacity to service the industry.⁵⁸

- 2.89 Treasury advised the committee that the Global Financial Crisis has compounded this effect because banks in other countries, which have

55 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 25.

56 Submission to CEFC Expert Review: ACCIONA Energy Oceania, p. 1.

57 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 4.

58 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 26.

more experience in the due diligence of these projects, are concentrating on domestic business.⁵⁹

- 2.90 Westpac gave some practical examples of how clean energy projects in Australia can miss out on financial support in its submission to the Expert Review. For instance, most solar projects in Australia have a capacity of 5MW and require \$10-15 million in funding. This financial scale puts them at the level of commercial banking, but the technology risks and the complexity of the project require a (higher) institutional banking level of due diligence.⁶⁰ In the current climate, and given lenders' level of expertise, this sort of project will find it difficult to obtain funding.

Positive spillovers

- 2.91 An important goal for the CEFC will be to secure positive externalities for Australian industry and the Australian community. These externalities are expected to be in making clean energy cheaper and innovations in processes. Treasury summarised this as follows:

The CEFC in making its investments will look to the externalities from each project. Those externalities relate primarily to moving along the innovation chain and down the cost curve. Those benefits are not captured directly by the proponents of a project but subsequent proponents of other projects and ultimately in cheap and marginal costs of production of renewable energy.⁶¹

- 2.92 For example, there may be a project that is potentially valuable to Australia in terms of the innovation it may generate amongst the clean energy industry or its ability to push down prices. If that project cannot clear current funding hurdles, given the lack of expertise and increased risk in Australia currently with these projects, then it would be to Australia's advantage to ensure that the project is funded and goes ahead through other means. The CEFC will allow such a project to proceed, by taking into account Australia's best interests, rather than the more traditional, narrow approach through a private bank.

- 2.93 As the Review Panel noted, the goal is for the clean energy industry to mature:

Beyond the spillover effects to subsequent projects and the potential for knowledge sharing, as the CEFC's investments are

59 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 3.

60 Submission to CEFC Expert Review: Westpac, p. 5.

61 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 5.

made and projects progress, the sector will mature. This progress to maturity is critical if Australia is to develop the skills and expertise to capture the employment and industry opportunities available and ultimately to provide us with a range of real options for energy production in the future.⁶²

- 2.94 As the industry matures, private sector lenders will have a greater level of expertise and the technology will also become more established. The risks in lending will reduce, thereby reducing the need for the CEFC. One matter that the Government may wish to consider is whether an exit strategy for the CEFC, or Government involvement in it, is required. This would be a suitable matter to consider in the review of the operation of the CEFC, envisaged in clause 81 of the Bill.

Minimising market distortions

- 2.95 The committee notes two features of the CEFC and its operations that will minimise market distortions. The first is that, as recommended by the Expert Review and confirmed by Treasury in evidence, the CEFC should only offer finance on the least generous terms that will enable a project to proceed. Treasury described the effect of this in evidence as, 'that means we are not providing supernormal profits to those corporations, simply because they get cheap finance.'⁶³
- 2.96 The second is that the CEFC will apply a commercial filter to its investments, which will often result in it co-investing with a commercial partner during the early stages. The Expert Review discussed this and it was confirmed by the Department of Climate Change and Energy Efficiency at the hearing.⁶⁴
- 2.97 The CEFC is being established to address market failure and generate positive spillovers. It would not be appropriate for such an organisation to then create substantial negative externalities or market distortions in another way. The commerciality and 'least generous' requirements for investments will minimise the chance this occurs.

62 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 32.

63 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, Canberra, 28 May 2012, p. 13.

64 Ms Jenny Wilkinson, Department of Climate Change and Energy Efficiency, *Committee Hansard*, 28 May 2012, p. 20.

Benefits to the community

- 2.98 As discussed earlier, an important goal for the CEFC will be to secure positive externalities for Australian industry and the Australian community. In its review, the Review Panel stated:

While each investment will individually support the sector, it is the cumulative impact of the positive externalities of expanding the sector experience, moving down the cost curve and creating third party benefits, which are essential to positioning Australia for a cleaner energy future. These strengthen the foundation for the ultimate goal to create a vibrant Australian clean energy sector with real options for future energy generation and, in the longer term, the jobs and export opportunities it brings.⁶⁵

- 2.99 The Review Panel envisaged that:

Positive externalities will flow from each CEFC investment. These positive externalities are necessary if the CEFC's objective is to be achieved. They flow initially as spillover benefits to subsequent projects. Over time, they will have a broader cumulative impact across the sector, on carbon emissions and contribute to the task of preparing and positioning the Australian economy for a cleaner energy future.⁶⁶

- 2.100 In its evidence to the committee, Treasury reiterated that in addition to the financial return, positive externalities – the wider benefits to the Australian community – would be taken into account in the CEFC's determination of its investments into clean energy projects.

- 2.101 Treasury indicated that the CEFC will operate to reduce barriers to renewable energy investment, and so bring in renewable energy earlier and reduce the cost of production of renewable energy.⁶⁷ Treasury stated:

In essence it is allowing movement down the cost curve so that renewable energy projects are more efficient and, therefore, their costs are cheaper to implement.⁶⁸

- 2.102 When questioned by the committee on whether these cost efficiencies would directly benefit households, Treasury responded:
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65 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 9.

66 CEFC Expert Review Panel, *Clean Energy Finance Corporation Expert Review: Report to Government*, March 2012, Commonwealth of Australia, p. 32.

67 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, 28 May 2012, p. 5.

68 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, 28 May 2012, p. 9.

I do not know what goes through to households. But my point was that it would result in more efficient or cheaper production of energy. How that cheaper production goes through to the household is another matter, allowing for the competitiveness of the retail sector and whether or not they pass it on. By having more efficient renewable energy generation with lower marginal costs into the future, that should reduce costs.⁶⁹

- 2.103 The Department of Climate Change and Energy Efficiency confirmed that electricity prices were expected to increase by 10 per cent as a result of emissions pricing. In response to similar questioning on what benefits the CEFC might deliver to households, the Department commented:

...if the Clean Energy Finance Corporation reduces the cost of investing in renewable technologies, then you would expect that to result in lower wholesale electricity prices and, potentially, lower large-scale renewable energy certificates. So you would expect both of those to come down if the cost of actually financing these investments was lower.⁷⁰

Conclusion

- 2.104 The committee supports the passage of the package of Bills. The Clean Energy Legislation Amendment Bill 2012 contains a range of amendments, the most important of which is to bring non-transport gaseous fuels into the emissions pricing mechanism. This has been requested by industry and was also a recommendation in 2011 by the Joint Select Committee on Australia's Clean Energy Future Legislation. The amendment will mean that it will be easier for industry to manage its cash flow, firms will have more flexibility in managing their carbon liabilities, and compliance costs will be reduced.
- 2.105 The Bill also makes other amendments to improve the operation of the emissions pricing framework. They include:
- requiring that projects under the Carbon Farming Initiative have secured all required regulatory approvals before they receive any credits;

69 Mr Mike Waslin, Department of the Treasury, *Committee Hansard*, 28 May 2012, p. 13.

70 Ms Jenny Wilkinson, Department of Climate Change and Energy Efficiency, *Committee Hansard*, 28 May 2012, p. 22.

- enabling regulations to be made to identify accounts under the Australian National Registry of Emissions Units that are subject to restrictions or limitations; and
 - streamlining requirements for nominating a person with 'operational control' of a facility under the National Greenhouse and Energy Reporting System.
- 2.106 The provisions of the Clean Energy Legislation Amendment Bill 2012 and the associated excise and customs bills are non-controversial and were only briefly covered during the hearing.
- 2.107 The hearing concentrated on the Clean Energy Finance Corporation Bill 2012. The Bill reflects the design of the Expert Review chaired by Jillian Broadbent AO, which consulted extensively with the finance and clean energy sectors. Its recommendations comprise a way to bring the two sectors closer together.
- 2.108 The committee heard evidence that there is a significant shortage of funding for clean energy projects due to market failures. In particular, there is a lack of expertise in the financial sector about the clean energy sector, making it difficult for banks to accurately assess and price risk, with the consequence that many projects are not going ahead. Overseas banks have this expertise, but they are not engaged in international loans following the Global Financial Crisis. Further, Australian debt markets operate on much shorter maturities than those involved in energy infrastructure projects, which again increases risk.
- 2.109 The CEFC will take a broader view of these investments and will provide finance to projects that demonstrate positive spillovers, such as through industry-wide effects such as reducing costs or enhancing innovation. The whole community will benefit from these projects proceeding.
- 2.110 The CEFC will apply a commercial filter to its decisions. Although the Government will set the broad directions, individual decisions will be made separately from political influence. The CEFC will aim to deliver a positive return on its investments, most likely around the Government bond rate. Therefore, taxpayers' funds will be properly managed and adverse effects on the economy through market distortions will be minimised.
- 2.111 The CEFC will be an effective means of encouraging private sector investment in clean energy. It will not replace the private sector or deter the private sector from making commercially sound investments. What it will do, through co-financing initially, is increase private sector

involvement in a high-technology sector with a growth outlook. The Bills should pass.

Recommendation 1

- 2.112 The House pass the Clean Energy Finance Corporation Bill 2012, the Clean Energy Legislation Amendment Bill 2012, the Clean Energy (Customs Tariff Amendment) Bill 2012, and the Clean Energy (Excise Tariff Legislation Amendment) Bill 2012.**

Julie Owens MP
Chair
30 May 2012