

31 August 2016

Department of Environment, Land, Water and Planning  
PO Box 500  
Melbourne VIC 8002

By email: [Renewable.Energy@delwp.vic.gov.au](mailto:Renewable.Energy@delwp.vic.gov.au)

Dear Sir/Madam,

### **Palisade Investment Partners Limited submission to the Victorian Renewable Energy Auction Scheme Consultation Paper**

Palisade Investment Partners Limited (**Palisade**) is a leading independent infrastructure manager providing dedicated and professional investment management services to large, sophisticated investors, including Australian superannuation funds and institutions, charitable foundations, sovereign wealth funds and offshore pension funds.

Palisade currently has c. A\$2.2 billion in funds under management and commitments with:

- A\$1.2 billion managed through direct investment mandates, and
- a further A\$1.0 billion managed through pooled funds.

Palisade's existing portfolio consists of 21 assets located in Australia, 7 of which have a presence in Victoria, with a combined enterprise value of approximately A\$3.0 billion (on a proportionate basis). Palisade's renewable energy investments include the Hallett Wind Farm, Waterloo Wind Farm Stage 1, Waterloo Wind Farm Stage 2 and an investment in a waste to energy plant.

Investing in renewables is a key focus for Palisade. In conjunction with the Clean Energy Finance Corporation (**CEFC**), Palisade recently announced an A\$1 billion strategy aimed at accelerating the development of Australian renewable energy projects. This strategy involves a \$100 million commitment from CEFC with Palisade's managed funds and its Direct Investment clients also contributing up to \$400 million of additional equity. Victoria is of particular interest to Palisade given our existing investments in Victoria together with the fact that two of our largest clients (VicSuper and HESTA) are based in Victoria.

Palisade welcomes the opportunity to make this submission in response to the request for feedback by the Victorian Government (the **Government**) in relation to the Victorian Renewable Energy Auction Scheme (the **Scheme**). Palisade supports the development of the Scheme as an effective means of encouraging job creation, supporting investment in the renewable energy industry and providing leadership in the decarbonisation of the Victorian electricity sector. Palisade believes that a Scheme which is well designed with clear objectives and parameters will cement Victoria's leadership in the renewable energy industry while ensuring certainty for all stakeholders in the industry.

Yours sincerely,



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## Consultation Paper Responses

### 1. Scheme structure

#### **How can the Department ensure that a pipeline of projects will be ready to meet the Government's targets for 2020 and 2025 while maintaining appropriate flexibility for Government to adjust the Scheme where required?**

Providing further information and certainty regarding the structure of the Government's proposed Scheme and timetable of proposed auctions in the short to medium term will enable project proponents (both developers and long-term investors) to continue investing in and progressing renewable development projects in Victoria. To ensure the Scheme is as efficient as possible it is important that the Government provides this information and certainty as soon as practicable in order to sustain interest in Victorian renewables created by the announcement of the Scheme. This clarity is also important to allow stakeholders to understand the Scheme's potential impact on the renewable industry and the broader electricity market given its scale. While the Government may wish to retain a certain amount of flexibility in terms of Scheme design, it is critical that the core components of the Scheme which are discussed in this submission (including its core structure and interaction with the Federal RET) are finalised and clearly communicated to the market prior to the first auction and that they are not subsequently varied in any significant manner.

#### **How much notice should be provided to industry of upcoming auctions?**

Prospective project proponents are likely to require a minimum of 3 months' notice prior to submission due dates to enable the preparation of accurate and meaningful submissions. This period is required to enable proponents to develop accurate pricing of bids under the Scheme (including conducting tendering for pricing of supply of key components to the project). It is noted however, that maintaining a fixed schedule of upcoming auctions (for example every 6 months) may enable the notice period to be reduced.

#### **Should capacity be auctioned in consistent capacity tranches (e.g. 200MW etc)? At what frequency should auctions be held?**

The proposed scheduling of consistent and semi-regular auctions, for example every 6 months, would enable project proponents to target auction rounds that are most suited to the development timeframe of that particular project. This would also assist in ensuring that projects being put forward are 'contract ready' as opposed to proponents rushing the development for fear of missing out or uncertainty regarding the next auction opportunity. In this regard the auctions would need to be held frequently enough for project proponents to be willing to consider not submitting in the upcoming round in the knowledge that there is another auction round occurring shortly thereafter. While not every round need be for exactly the same capacity, it is important that the capacity being offered in each round does not vary significantly and that the capacities (along with the dates) for the all auctions in the short-medium term is published and known to prospective project proponents.

#### **What proportion of Scheme generation should be dedicated to solar projects? Should the proportion of solar be different pre and post 2020 to allow a solar pipeline to develop and technology costs to come down?**

Dedicating a separate proportion of capacity for large-scale solar projects prior to 2020 is likely to assist in the development of solar generation in Victoria which may otherwise lag behind other States given the relative levels of solar irradiance. Dedicating a 20% proportion for large-scale solar-only auctions as proposed by the Government is considered to be an acceptable proportion for the period to 2020.

#### **What is the best way to treat LGCs under the Scheme to enable successful proponents to secure project finance, ensure Scheme costs are minimised and ensure adequate market interest from industry to participate in the auctions is attracted?**

In order to maximise proponents' ability to secure competitive terms for project finance debt and equity (and therefore ensure the most efficient levelised cost of energy), the Scheme should be designed to take all LGC's (for both pre and post 2020 auctions) and therefore effectively offer successful Scheme proponents a bundled price for both LGCs and energy. In order to minimise uncertainty regarding future revenue for successful projects under the Scheme, the Government should strongly consider taking change in law risk in respect of LGCs created under the RET (which may include incorporating a broad definition of environmental

products). Creating this level of revenue certainty for proponents will have a substantial positive impact on the financing efficiency of prospective projects which in turn benefits both the Government and consumers through a lower levelised cost of energy.

Based on initial indications in the consultation paper together with verbal feedback during industry consultation sessions, the current uncertainty regarding how the Government will treat LGCs under the Scheme has the potential to create substantial market risk, both for potential proponents under the Scheme as well as on a national basis given the scale of the Scheme in the context of the RET. It is therefore critical that the Government clearly articulates how it intends to treat LGCs it acquires under the Scheme and that this approach does not change throughout the life of the Scheme.

## 2. Payment structure

### **Do stakeholders agree with the proposed CfD payment structure approach?**

The proposed CfD payment structure is considered acceptable and in line with current market practice for Power Purchase Agreements (PPAs). It is however critical that the CfD accurately reflects the 'price exposure' borne by the project proponent (as detailed below).

### **If a CfD payment structure is used, on what basis should a NEM reference price be set? (e.g. monthly average, half hourly NEM price)?**

It is critical that the reference price under the CfD matches the energy price actually received by a project proponent. Any variation between the price received by a project proponent and the CfD reference price creates a 'gap' risk which would result in the CfD failing to deliver an effective fixed revenue stream to the project as intended. Any 'gap' risk created through the potential 'monthly average' pricing structure would be difficult for both equity and banks to price, leading to greater uncertainty and therefore less efficiently priced projects. While there may be technical arguments in support of the 'monthly average' pricing approach, the reality is that the impact on the overall levelised cost of energy for projects which were required to incorporate this 'gap' risk would likely negate any potential benefit.

Accordingly, in our view it is critical that the CfD reference price reflects the actual price received by a particular project proponent during each trading interval.

### **What would be the impact of adding a floor price to cap the total payment applicable in any one period?**

The inclusion of a floor price of zero when prices are negative has the potential to increase the required contract price under the Scheme. While a floor price is considered sensible to prevent generators being incentivised to dispatch during periods of significant oversupply, a corresponding option not to generate would also need to be included in the contract to prevent the project being required to generate during negative price periods.

Given renewable energy projects are intermittent generators and their ability to generate at a certain point in time (for example when pool prices are high) is governed not by choice, but rather by the prevailing climatic conditions, if a floor price were to be included in the Scheme then consideration may need to be given to ensuring a minimum level of revenue is still received in the event that negative pool prices prevailed for an extended period of time. While this concept may not currently be common in offtake agreements, the scale of the proposed Scheme and the likely concentrated build out from a geographic perspective increases the risk of negative pricing for renewable generators over time.

### **Do stakeholders agree that payments should be made under the Scheme based on energy delivered as defined above? Are there other ways that stakeholders consider are possible to provide locational signals to projects to ensure they are appropriately sighted on the network?**

The proposed definition of energy delivered results in the revenue received by project proponents being impacted by changes to Marginal Loss Factors (MLF) or Distribution Loss Factors (DLF). While this is considered acceptable and encourages a more geographically diverse build out of renewables, it is noted that this may result in higher prices being bid than if MLF and/or DLF risk was not borne by project proponents. It should also be noted that such risks may be exacerbated over time given the proposed scale of the Scheme.

Consideration will also need to be given by the Government as to how to ensure that transmission infrastructure is appropriately upgraded to enable the build out of high quality renewable projects. Failure to ensure sufficient transmission capacity may result in projects with high capacity factors failing to be built (or built at a higher cost) due to grid constraints.

**Do stakeholders agree that a fixed payment approach would be less likely to address the barriers faced by project proponents in relation to attaining project finance, resulting in lower value for money bids?**

A fixed payment approach is considered less likely to deliver the revenue certainty required to enable efficient and lowest cost project finance and long-term equity investment. In order for a fixed payment approach to deliver the required level of certainty it would need to be of a significant quantum to effectively underwrite debt service (and potentially a minimum level of equity return). A fixed payment of such a quantum would likely distort energy prices and may lead to an increased risk that payment amounts are changed at a later date depending on the contractual structure adopted. Accordingly, Palisade is of the view that a long term CfD is the most effective way to provide the level of certainty required to attain project finance and equity investment at the most competitive cost of capital.

### 3. Contracting elements

**Are the above contract elements broadly appropriate?**

The high level contract elements disclosed are broadly appropriate, subject to the clarifications provided below and further details being provided as part of the Scheme design process. It is important that clarity is provided on items such as termination rights, the identity and credit rating of the proposed offtaking counterparty. Uncertainty regarding termination and the credit quality of the offtaking counterparty may result in higher contract prices being required by debt and equity investors.

It is important that the Government provides clarification regarding the proposed contracting requirements for auction winners; at the recent consultation workshops it was proposed that successful bidders may still be required to contract with a retailer for a PPA and that the Scheme would provide a 'top up' to a certain fixed price which was bid as part of the auction process. This structure results in a lack of incentive for project proponents to negotiate competitively priced PPAs with an energy retailer when their downside is capped. Accordingly, in our view the Scheme would be best served by Government either removing the requirement to contract with a retailer or by setting clear parameters around the requirements to contract and the terms of such a contract.

**Within the contract range of 10 to 20 years, is there an ideal duration, particularly with the aim of minimising project financing costs?**

A contract period of between 15 and 20 years is considered optimal in order to maximise the financial efficiency of prospective projects and to minimise the levelised cost of energy of each project. A longer contract period provides greater revenue certainty for both debt and equity investors, and allows other sources of capital to be considered (for example long-tenor debt or bonds); collectively enabling a lower cost of capital and contract prices for the Government and ultimately for consumers under the Scheme.

Longer contract periods are particularly important given the proposal to commence the tenure of the contract from the date of signing rather than the date of commissioning.

**What would be an appropriate project delay threshold for contract termination clauses?**

The inclusion of termination rights for delay increases risk and may therefore impact return requirements for long-term investors. This would likely translate into higher contract pricing being required. To the extent such termination rights are to remain, it is our view that they should apply only to delays in reaching financial close or commencing construction (rather than, for example, commissioning delays). There should also be reasonable buffer periods and flexibility should be incorporated into the termination trigger rights for any events which occur beyond a project's control.

**Would quarterly payments have a significant impact on financing costs compared to monthly payments?**

Providing quarterly rather than monthly payments is likely to result in higher financing costs as project proponents will be required to carry a higher level of working capital in the project entities in order to meet working capital and debt service obligations. Quarterly payments would also result in a greater deviation between the weekly receipt of income from market revenue and the subsequent receipt or payment under the CfD. Ideally this timing difference should be minimised. While a timing difference is still present in monthly payments it is more accommodating for project proponents seeking to align their income and expenses than quarterly payments.

**What are the implications of a two-way CfD?**

A two-way CfD is considered acceptable provided that there is no differential between the reference price under the CfD and the price received by project proponents (see earlier discussion regarding 'gap' risk). As both project financiers and long-term equity investors will likely value future cash flows assuming the strike price under the CfD, it is likely that there would be limited benefit to the Government in the form of a lower contracted price resulting from a one-way CfD as opposed to a two-way CfD. In contrast a two-way CfD would offer the Government the ability to recoup Scheme costs where the prevailing market price exceeded the contracted price.

**What do stakeholders think about the generation requirements being considered? Where maximum and minimum generation volumes are contained in Scheme contracts how should these be set?**

Minimum electricity generation requirements would increase projects' exposure to availability and output risk and may lead to less efficient pricing outcomes. Minimum generation requirements should be set with reference to an externally validated forecast output on a project-specific basis and allow sufficient buffer for factors outside the project's control which may affect output over the project's life. Consideration should also be given to the time period over which minimum generation should be measured to ensure short-term variations are taken into account.

In addition to the above, an important factor in assessing the potential impact on prospective projects of minimum/maximum generation volumes will be the contractual effect of a project's failure to meet the minimum generation requirements. For example, a "make-whole" regime which sought to place the Government (as offtaker) in the same economic position as if the minimum generation had been delivered would obviously be preferable to a termination right under the offtake contract for failure to meet minimum generation requirements.

**Are there any other contract elements that should be considered?**

In determining the detailed contract terms, the Conditions Precedent to the contracts should be clear and objective; ideally the only condition precedent would be the project reaching financial close.

**Are any of the elements likely to lead to perverse outcomes?**

Commencing the contract tenure from signing (rather than first generation or practical completion) is likely to favour PV solar and smaller scale wind farms which have shorter construction periods compared to larger wind farms. This may distort the allocation of contracts away from the most efficient source of renewable energy generation towards those with shorter construction timeframes. It may also encourage developers to compress the timeframe from contract signing to financial close and/or the actual construction timeframe which may have longer-term consequences on asset life or total generation.

#### 4. Auction evaluation principles

**What do stakeholders think of the proposed evaluation criteria set out above?  
Do stakeholders have views on how evaluation criteria might be weighted?**

The proposed evaluation criteria are considered acceptable given the aims and objectives of the Scheme. Weighting should be given primarily to value for money, followed by economic development and contribution towards Victoria's targets.

It is important that the Government provides clear guidance on how qualitative and more subjective criteria (for example economic development and community engagement) will be judged and/or provide clear minimum requirements to be met such that project proponents can appropriately address these factors. Clear guidance on the final weighting determined and judging criteria will also improve the credibility of the Scheme and willingness of project proponents to continue applying for auction rounds.

**Are there other evaluation criteria/principles that the Government should consider to ensure the Scheme meets its objectives?**

The Scheme represents an attractive opportunity to promote Australian investment in clean energy. The increased revenue certainty provided by the Scheme will act as a catalyst for Australian superannuation funds and institutional investors, who seek long-term stable returns, to increase investment in renewable energy assets in Victoria. Appropriate consideration should be given to viewing projects that have support from long-term, Australian equity investors more favourably given these projects are not only more likely to achieve Financial Close and be developed in a timely fashion (due to local market knowledge and experience), but also represent an opportunity to support the local investment industry and everyday Australians through superannuation fund returns.

**Would there be benefit in asking proponents to submit expressions of interest to participate in the auctions to ensure only more advanced projects proceed to the full evaluation round and that costs are minimised for project proponents where possible?**

Submissions of expressions of interest could be beneficial if it resulted in decisions for each round of the auction being made in a timelier fashion. The Government should avoid adopting multiple layers of process that would result in longer auction processes.

## 5. Other Considerations

While specific feedback on this point was not sought as part of the consultation process, Palisade would like to note that the proposed size of the Scheme is likely to have a material impact on the National Electricity Market and potentially the Federal Government's Renewable Energy Target which will not be confined to Victoria. In some ways the scale of the impact will depend on the implementation of some aspects of the Scheme which have been discussed in this submission. As such, the scale and timing of implementation of the Scheme should be carefully considered to ensure that the introduction of such a large quantity of intermittent generation in a concentrated geographic area does not have unintended consequences in terms of grid stability, impact on existing generation (and the communities who support that generation) and the broader electricity market in terms of pricing and volatility.

Palisade appreciates the opportunity to participate in this consultation process and would welcome the opportunity to discuss our submission with the Government in further detail if required.