BAKER & MCKENZIE

Baker & McKenzie
Level 27 AMP Centre
50 Bridge Street
Sydney, NSW 2000 Australia
ABN 32 266 778 912

Postal Address:
P.O. Box R126
Royal Exchange NSW 1223,
Australia

Tel: +61 2 9225 0200
Fax: +61 2 9225 1595
DX: 218 SYDNEY
www.bakermckenzie.com

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By email: cefc@treasury.gov.au

CEFC Secretariat
Clean Energy Finance Corporation
c/- Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Submission to Clean Energy Finance Corporation Expert Review

Thank you for the opportunity to make this submission in relation to the establishment of the Clean Energy Finance Corporation (***CEFC***).

As you would be aware from our recent meetings with members of the Expert Review Panel and CEFC Secretariat, Baker & McKenzie is very interested in the role, establishment and ongoing operation of the CEFC. We believe that it can play a significant part in the development of the renewable and clean energy industry.

In our submission we have focused on considering the following issues identified in the Request for Submissions that we believe will significantly impact the effectiveness of the CEFC:

- how the CEFC can facilitate investment;
- whether there are principles beyond financial viability that could be used to prioritise investments, such as emissions impact or demonstration effect;
- opportunities for the CEFC to partner with other organisations to deliver its objectives;
- how the CEFC can catalyse the flow of funds from financial institutions;
- how the CEFC might fit in with other government initiatives on clean energy; and
- issues to consider with respect to the CEFC's governance arrangements.

Some further information about our firm and our experiences in the area is also included.

We would be pleased to discuss any aspects of this submission or related matters in further detail if required.

Question 1: How do you expect the CEFC to facilitate investment?

Renewable and clean energy technologies and projects face a number of different barriers throughout their commercialisation and deployment. Even after technology risks have been mitigated, high levels of market and development risk, as well as high transaction costs, can limit long-term private investment despite the introduction of government policies intended to address market risks. CEFC's objective to address this market failure while leveraging private investment represents an important addition to such policies.

Engagement with industry – particularly project and technology developers and the investment community – will be critical to the success of CEFC's mission. We would expect the CEFC to develop formal an informal mechanisms to work with industry bodies and participants to identify projects for development, design appropriate funding structures and deliver effective investments. This is discussed further below.

The CEFC will need a carefully designed investment mandate, which should enable it to invest in a range of technologies, projects and geographies and through a variety of funding mechanisms, with the most appropriate one chosen for each individual investment.

The CEFC's objectives, as reflected in its investment mandate, should be broad enough to encompass the above whilst being articulated in terms which permit transparency of operation and measurement of performance. We would therefore recommend that a principles based approach be taken when developing the investment mandate and that more specific guidelines and investment criteria be developed over time, whether by reference to particular investment categories or even on a case-by case basis.

We think it will be important for the CEFC to be able to invest for the long term (while preserving options for early exit) and an ability to make very substantial investments where an appropriate investment case can be demonstrated.

A range of financing mechanisms may incentivise private investment in clean and renewable energy projects and technologies, and no single mechanism will be appropriate to support all projects. The CEFC will approach each investment commercially (in a broad sense) and will be guided by the needs of the project, the sponsors and other investors who are putting capital at risk. Accountability and ongoing investment management considerations will also be key.

We would expect the CEFC to provide most of its investments through loan based arrangements (including subordinated or concessional loans to help facilitate the provision of private debt finance) and through the provision of guarantees and other credit support products.

While the Commonwealth typically does not prefer equity investments, we believe that the CEFC should have the flexibility to do this as part of its investment facilitation objective. This could include participating in the establishment of investment funds alongside other private and institutional investors. Equity or hybrid investments would also of course allow the Commonwealth to participate in the upside of successful projects.

Question 2: Are there principles beyond financial viability that could be used to prioritise investments?

Yes. We see that the CEFC has a broader goal to reduce carbon emissions and support development of a clean energy industry. An assessment of financial viability is critical when approaching an investment decision but other factors should also be taken into account, including:

- degree of emissions abatement and abatement cost (potentially with a threshold requirement);
- amount of private capital to be co-invested (including in related projects – eg grid developments, local infrastructure);
- the type of technology to be utilised (and the effect of the investment on further deployment of the technology);
- the the generation capacity of a project (or technology);
- the location of a project (including the effect on the local community and region);
- enhancement of energy security by a project or technology;
- reputation of the business and capability of personnel;
- expected job creation and/or skills development.

The CEFC objectives and investment mandate should acknowledge these relevant principles, which could be reflected in more specific investment criteria to be used when assessing particular investment opportunities or classes of investment.

These criteria may be developed over time based on experience and market needs. They should be developed in consultation with stakeholders and published.

The CEFC should also ensure that these assessment criteria are designed so as to be used not just at the investment decision stage, but as the basis for continued reporting and monitoring of the CEFC's investment over the life of a project.

Question 3: What are the opportunities for the CEFC to partner with other organisations to deliver its objectives?

There are many opportunities for the CEFC to partner with other organisations, and the CEFC should actively look for and facilitate such opportunities. Such opportunities may include partnerships with other government bodies such as the Australian Renewable Energy Agency (***ARENA***) (discussed further below at Question 8) but also, critically, with private sector stakeholders in the power sector. The continued involvement of the private sector will be crucial to the CEFC delivering its objective of reducing carbon emissions and encouraging investment in cleaner energy.

Opportunities to partner with private stakeholders may include:

- (**co-investment**) the CEFC could establish mechanisms and structures to co-invest alongside other providers of capital. This could include the sponsorship of investment funds, which could potentially be managed by private sector parties. It would also include development of processes to align investments and investment approaches to enable the CEFC to "piggy-back" off the technical, financial and legal due diligence that is being done by co-investors in relation to a project. This will be an important step in minimising transaction costs and ensuring that the investment decision process is not unduly delayed in rounds of due diligence.
- (**distributors/conduits**) CEFC could utilise the distribution networks of large, credible organisations as a route to market. For example, the CEFC could sponsor the take-up of renewable energy products or energy efficiency products by consumers or business users by making funding available via energy retailers or other utility providers. The retailer could tender to CEFC for funding and use this to finance the provision of the technology to their customers, with the cost then to be recovered by them over time through the usual billing process. This would be an administratively simple way for the CEFC to invest in significant projects, provide a well disbursed benefit and also limit CEFC’s credit exposure.
- (**engagement**) ensuring that the CEFC has an active and visible presence in the Australian energy market, including attending and contributing to relevant industry associations, and industry and investment forums. The CEFC may consider running more structured investment forums and provide opportunities for project developers to pitch their projects to the CEFC and interested co-investors. The CEFC should ensure that it develops and maintains high level relationships with financial institutions and investors, and also that it acesses the expertise of these parties, for example by inviting their executives to participate in CEFC investment committees and other investment processes. The CEFC should also regularly engage with other Commonwealth agencies, State governments and local councils in relevant areas (eg identified renewable energy precincts) to share information and align interests where possible.

Question 4: How could the CEFC catalyse the flow of funds from financial institutions?

Catalysing the flow of funds from financial institutions forms the basis of the CEFC's mandate. We have identified above certain investment structures and products which could facilitate this, including the use of funds or other co-investment vehicles, through the provision of subordinated debt and through the provision of credit support instruments.

The CEFC may also seek to play a leadeship or even transformative role to overcome clear instances of market failure (which are unrelated to technological or development risk). For example, the lack of liquidity in the market Renewable Energy Certificates (***RECs***) is constraining the development of large scale wind power projects at present. The CEFC could play a role in working with regulators, Government agencies, financial institutions and other market participants to cause such a market to develop, and then play an active role in that market to promote liquidity and price stability.

As mentioned above, a core part of the CEFC's work should be to engage formally and informally with financial institutions to identify barriers to their participation in the clean energy sector, understand their investment processes, and to access their expertise.

Question 8: How do you see the CEFC fitting with other government initiatives on clean energy?

As identified by the Government, the CEFC must operate as an independent stand-alone body. However, it must operate so as to complement the existing federal and state bodies and initiatives regarding renewable energy uptake, such as:

- ARENA;
- the Clean Technology Innovation Program;
- the Remote Indigenous Energy Program;
- the Low Carbon Communities program;
- the enhanced Renewable Energy Target;
- the carbon pricing mechanism;
- the Carbon Farming Initiative; and
- State schemes (i.e., solar feed-in tariffs).

ARENA

The CEFC should have a very close working relationship with ARENA in particular. ARENA will operate largely as an early-stage grant provider to clean technology developers focussing on research and development and demonstration projects, whilst the CEFC is designed to offer products to take projects through to the next stage of commercial deployment.

The objectives of these two organisations are naturally aligned and certain businesses or projects may be able to be taken right through the chain. The CEFC and ARENA should jointly consider the extent to which such alignment should be formalised. At the least, legislation establishing the CEFC should permit (or even oblige) ARENA and the CEFC to share information and reporting (with, potentially, a publicly accessible national database of funded projects) . CEFC and ARENA could also consider whether there is scope to have shared board members, joint investment or technical advisory panels and/or due diligence teams, particularly during the initial establishment phase of the CEFC. ARENA may also be able to provide a “pipeline” of well understood investment opportunities to the CEFC.

Given that the Clean Technology Innovation Program, Remote Indigenous Energy Program and Low Carbon Communities initiatives are all grant based programs, similar arrangements to those suggested above in respect of ARENA's relationship with the CEFC and ARENA should be considered, especially in terms of shared information, reporting and "dovetailing" to finance commercial deployment of new or risky technology.

Enhanced Renewable Energy Target, carbon pricing mechanism, CFI and solar feed-in-tariffs.

Central to the design of the CEFC is to bridge the market gap until such time as renewable energy technology can compete with traditional energy forms in terms of levelised cost of energy and attracting private sector investment. With this policy setting in mind, it should be acknowledged that there are other significant Federal and State policy measures to assist renewable energy providers attract additional revenue from supplying electricity into the grid from renewable sources, most significantly, from selling RECs under the *Renewable Energy (Electricity) Act* 2000. This is complemented by the carbon pricing mechanism and other state-based schemes (such as the solar feed-in tariff), which assist renewables compete with traditional forms of energy. Given that the price of RECs and carbon are a function of the market, it will be important that the CEFC products are flexible enough to factor in REC and carbon pricing such that the CEFC funding is appropriately targeted such that developers are not (over or under) compensated.

Comments on the CEFC's governance arrangements

The CEFC will have a very significant budget and high degree of visibility in the market. It will need to establish credibility with large financial institutions and the finance sector, with other independent bodies and regulators, with large corporations active in the market, with project developers and the other entities who will seek to access funds from the CEFC and with the public generally. It will need to develop robust systems and methodologies to assess, make, monitor, realise and potentially restructure its investments and have highly skilled personnel in its various areas of operation.

Whilst independence and autonomy are critical, the CEFC will also need to be in tune with Government policy at both the Commpnwealth and State levels and work very effectively with Treasury and other relevant agencies.

The CEFC could be strucured to operate either under the *Commonwealth Authorities and Companies Act* 1997 (***CAC Act***) (and the *Corporations Act 2001*) or the *Financial Management and Accountability Act* 1997, however our preliminary view is that structuring the CEFC (or its operating subsidiaries) as a Corporations Act company regulated under the CAC Act may be the preferred model. This would support the development and authority of a high calibre board, potentially allow greater flexibility in staffing arrangements and place the CEFC on a similar commercial footing to many of the entities it will engage with in the market. The broader investment and policy objectives of the CEFC may provide an element of complication for a Corporations Act company however these could be addressed by the formulation of appropriate objectives and a sound investment mandate.

We believe that these governance arrangements and matters of structure will require more detailed work as the role of the CEFC is defined in the context of the expert review. Engagement with relevant agencies should continue and expert advice should be obtained. The review team should also monitor legal developments in the area, including the judgement of the High Court in the current *Williams v Commonwealth of Australia* case which is expected to be released shortly.

Information on Baker & McKenzie

To give this submission some context, we thought it would be worthwhile to provide some basic background information on our firm. Baker & McKenzie is a leading international law firm with 70 offices in 41 countries. With over 3800 lawyers globally, including around 300 in Australia, and FY11 global revenues of more than US$2.3 billion, we are one of the largest firms in the world and have a market leading clean energy practice.

We have advised many Governments and Government businesses around the world as well as key global institutions such as the World Bank. In Australia, we have acted for numerous State and Commonwealth Agencies and bodies on significant transactions and advisory matters, while also representing major global corporations who have participated in many of the large Australian privatisations over the years.

Recent matters including advising the State of NSW on its Energy Reform Program and we are currently representing the Commonwealth Department of Resources, Energy and Tourism on the Contract for Closure program, part of the Government's Clean Energy Future reforms. We are also proud of the role we have played in engaging and working with Government on the development of its climate change and clean energy programs over many years.

Please do not hesitate to contact me if you require further information about this submission or our firm, or if you believe we can assist in any way with the development and implementation of the CEFC.

Yours faithfully,
Baker & McKenzie

Christopher Hughes
Partner
+61 2 8922 5184
christopher.hughes@bakermckenzie.com