Department of Treasury

Mr Paul Baxter
Senior Commissioner
The Independent Competition and
Regulatory Commission
GPO Box 296
CANBERRA ACT 2601

Dear Mr Baxter Paul

Treasury offers the following comments in relation to the Independent Competition and Regulatory Commission's *Issues Paper - Electricity Feed-in Renewable Energy Premium: Determination of Premium* released in November 2009.

The design of the gross Feed-in Tariff (FiT) requires that all consumers of electricity pay for the higher costs associated with generating renewable energy through higher energy bills. As the scheme is not capped, high take up rates could lead to substantial increases in energy prices for all electricity consumers.

There are significant equity issues with respect to the FiT. The initial capital investment precludes many consumers from participating, whereas the costs are shared by all consumers irrespective of their capacity to pay.

From an equity and allocative efficiency perspective, the FiT should be set at a rate that:

- ensures those who elect to invest in renewable energy are not over compensated; and
- encourages the installation of the most efficient energy systems in the most efficient locations.

The risks associated with the production of renewable energy, such as inefficient systems, inadequate sighting of solar panels or poor weather, should not be transferred to consumers. The FiT is the mechanism by which risk transfer is avoided. The energy producer, who elects to make a commercial decision, should bear the risk in doing so. The energy consumer is not in a position to manage these risks and therefore should not be required to bear them.

The capital costs for the calculation of the FiT should be the actual upfront investment less any subsidies or rebates available.

Given the existing scheme guarantees a purchase price for 20 years from the time of connection, this is an appropriate payback period for calculating the FiT. An appropriate discount rate would be the after tax risk free rate. (This assumes that income from the FiT is not subject to taxation.) This rate is considered appropriate because:

- the risk free rate means that the producer retains the risk - a higher rate would shift the cost of risk on to consumers; and
- the 'after tax' rate prevents distorting investment choices as a result of different tax treatments.

The calculation for the FiT should be based on the solar systems that provide the highest energy output per dollar of capital invested. This will ensure that the FiT encourages the most efficient systems to be installed.

The FiT should not include an additional premium to encourage take up. This is not necessary if the tariff covers the initial capital investment and provides an appropriate internal rate of return.

It is also important that the FiT provides a high degree of certainty and transparency for both consumers and producers. The FiT should also be simple to administer.

Thank you for the opportunity to provide comments on the issues paper. If you would like to discuss these matters further please contact Kim Salisbury (02 6207 0337).

Yours sincerely

Megan Smithies
Under Treasurer
8 January 2010