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QIC Limited ACN 130 539 123

10 February 2022

Ms Anna Collyer
Chair
Energy Security Board

Lodged via email: info@esb.org.au

Dear Ms Collyer,

QIC Response to the ESB Capacity Mechanism Project Initiation Paper

QIC Global Infrastructure (“**QIC GI**”) welcomes the opportunity to make a submission to the Energy Security Board’s (“**ESB**”) consultation in relation to the Capacity Mechanism Project Initiation Paper currently being considered by the ESB (“the **Consultation**”).

QIC GI is a business division of QIC Limited (“**QIC**”), a leading investment manager with over A\$100billion in funds under management as at 31 December 2021. Established in 2006, QIC GI is one of Australia’s largest infrastructure investors, and has successfully invested over ~\$27billion of our clients’ equity infrastructure allocation into a global portfolio of 21 infrastructure investments across Australia, Europe, UK, Asia, Middle East and US. QIC GI’s major clients are some of the largest sovereign wealth and superannuation funds globally, including both domestic and offshore investors. As at December 2021, 12 of Australia’s largest superannuation funds have committed ~\$6.7billion to QIC GI for investment in infrastructure (with a significant allocation to the energy sector). This provides QIC GI with a unique insight as to how this large pool of capital views investments, in particular new energy generation relative to other investment opportunities. QIC GI’s institutional clients comprise a significant source of investment capital, access to which will be critical to funding the ongoing transition of the Australian energy sector, and hence it is important that policy settings are balanced such that these investors continue to choose to invest in the Australian energy sector.

QIC GI’s track record of investing in Australian energy sector

QIC GI has a strong track record of providing long-term capital and supporting growth in Australia’s energy infrastructure, having made the following investments in the sector:

- **Tilt Renewables** (“**Tilt**”) (2021) – 80% equity interest. The Tilt Australian business was acquired by QIC GI’s portfolio company PARF in 2021, combined Tilt is Australia’s #1 renewable energy platform (by capacity) with 860 MW across 8 operating assets + 849 MW under construction plus >3,000MW of development assets.
- **Pacific Energy** (2019) – 100% equity interest. Australia’s #1 remote and off grid power platform, owns and operates ~48 power stations with >550MW under contract.



- **Powering Australian Renewables Fund (“PARF”)** (2016)¹ – 80% equity interest. A leading strategic partnership between QIC GI managed clients and AGL Energy to establish a dedicated renewable energy vehicle which owned and developed 800MW of solar and wind assets in the NEM.
- **Lochard Energy** (2015) – 50% equity interest. Lochard’s Iona Gas Storage Facility is the largest independent gas storage infrastructure in Australia dedicated to serving Eastern Australia and in winter provides up to 45% of the peak gas demand to Victoria; and
- **Epic Energy South Australia** (2013) – 100% equity interest. The owner and operator of the 1,185km Moomba to Adelaide Pipeline System (“MAPS”) and the 70km South East Pipeline System (“SEPS”), as well as a growing portfolio of renewable energy projects including rooftop and small-scale solar, microgrids, and wind farms.

QIC GI creates value via active management of its investments and has continued to make significant investments in the NEM via its portfolio companies post acquisition. Key investment highlights in the NEM include QIC’s ongoing investments to support growth in Lochard Energy, Tilt Renewables and Epic Energy.

Lochard Energy

Since QIC GI’s acquisition in 2015, Lochard Energy has invested and committed significant capital of more than \$200 million to expand the withdrawal, storage and injection capacity of the Iona Gas Plant. Since QIC GI’s acquisition of Lochard Energy, the capacity of the facility has been increased by ~40% to 545Tj/d today and the reliability of the facility has been significantly enhanced. These investments have been critical to ensure that Lochard’s gas storage customers have quick and reliable access to gas during peak demand periods to allow for energy security in the eastern markets.

It is likely that additional expansions will be required to support growing customer needs for flexible gas supply which will require hundreds of millions of dollars of additional investment by Lochard Energy. QIC GI plans to continue to support Lochard Energy’s ongoing growth and expansions to meet customer demand and to continue to play a critical role in ensuring energy security within the NEM.

Tilt

QIC GI has committed a total of \$2.2bn of equity capital into Tilt (across PARF and Tilt) and manages 80% of the equity interest in the combined Tilt business. Tilt’s current portfolio comprises ~1.7GW in assets in operations / under construction, and a development pipeline of ~3GW in capacity across the NEM:

Asset	Size	Location
Operations / Commissioning		
Broken Hill Solar Farm	53MW	NSW
Nyngan Solar Farm	102MW	NSW
Silverton Wind Farm	199MW	NSW
Blayney Wind Farm	10MW	NSW
Crookwell Wind Farm	5MW	NSW
Snowtown 1 Wind Farm	101MW	SA
Salt Creek Wind Farm	54MW	VIC
Dundonnell Wind Farm	336MW	VIC
Construction		
Rye Park Wind Farm	396MW	NSW
Coopers Gap Wind Farm	453MW	QLD

¹ PARF was subsequently combined with QIC’s Tilt acquisition and now collectively operates as Tilt Renewables



QIC GI plans to continue to invest in Tilt's growing platform and including providing Tilt with the equity funding required to execute on its >3GW development pipeline across various renewable technologies in the NEM.

Epic Energy

Since QIC GI's acquisition in 2013, Epic has invested and committed significant capital to support Australia's energy security needs and to ensure, in particular, that its South Australian customers have the capacity and flexibility to utilise and supply gas to more than ~450,000 end-user retail, commercial and industrial customers. Foremost amongst these investments include:

- QIC GI's funding of the interconnection of the MAPS and SEA Gas pipelines via a new lateral pipeline allowing for injection of gas from the SEA Gas pipeline into MAPS and bi-directional gas flow on the MAPS, providing an additional source of gas and greater flexibility to customers supplying the Adelaide region;
- Significant ongoing investment in pipeline protection systems including cathodic protection and intelligent pigging programs, full crack detection runs, dig ups to maintain safe and reliable operation, delivering ~240TJ/day of southern-haul capacity with significant latent capacity to respond and support Australia's evolving energy needs; and
- Capital investment to a diverse portfolio of renewable infrastructure, including the Timboon West and Yawond Wind Farms, the IKEA Adelaide Solar and Battery Microgrid, and most recently, the Mannum Solar Farm.

Furthermore, Epic has access to a large renewables development pipeline which QIC plans support.

QIC Response to the Capacity Mechanism Project Initiation Paper

QIC GI recognises that the ESB's proposed capacity mechanism will significantly influence the trajectory of the NEM transformation over the coming decades. QIC GI supports the key messages expressed by Tilt, CEC, CEIG and the Australian Institute in their respective submissions to the Consultation process.

We would specifically highlight that as per these submissions, the need for a capacity mechanism has not been demonstrated. AEMO's analysis has not found any clear reliability problem under existing frameworks. Expected investment in new thermal projects, coupled with the much larger capacity pipeline of renewable generation and storage, means no obvious reliability shortfall is projected to occur in the NEM over the next decade². We remain of the view that more work is required to establish that this is an issue before commencing fundamental market structural change.

In addition to those submissions, QIC would like to specifically make the following comments as a leading equity investor in the Australian energy sector.

1. To meet the substantial investment needs of the NEM, significant private capital is available, but policy stability and certainty are key to reduce investment risk, reduce cost of capital and reduce consumer bills. QIC GI is concerned that a capacity mechanism will generate significant uncertainty. This significant uncertainty will both disincentivise the investment in new capacity required to meet the energy requirements of the NEM as well as increase consumer electricity prices due to the higher cost of capital required due to a higher risk investment environment:

² AEMO, 2021 Electricity Statement of Opportunities.



- The ESB’s proposed capacity mechanism introduces a significant change to the NEM with significant implications for investment risks, costs of capital, and long-term consumer bills.
- Mechanisms that either directly or indirectly support the extension of coal fired generators will deter investment away from renewable energy and new firming technologies and slow the energy transition. QIC GI’s clients have mandates to invest across a range of sectors and geographies, hence, to attract the capital required to fund new infrastructure for the energy transition task at hand, Australian energy investments must be sufficiently attractive when assessed against other sectors (e.g. transport and social infrastructure) as well as when assessed against international opportunities.
- A key factor in an infrastructure investor’s decision to invest is cashflow stability/certainty. Clearly the introduction of a capacity mechanism will create significant uncertainty given this is a significant fundamental market shift. This uncertainty will drive higher return requirements from investors to compensate for the additional risk which ultimately will result in higher cost of capital and higher electricity prices for end consumers.
- As a longstanding investor in the energy sector, QIC GI has seen the adverse impact of regulatory uncertainty on the pricing and availability of capital in recent years, for example as evidenced by the significant decrease in renewable investment following from the unprecedented variability in marginal loss factors and grid connection challenges in recent years.
- Given there is no evidence to support the need for a capacity mechanism and given the significant uncertainty that would arise if a capacity mechanism were to be introduced, QIC GI is of the view that a capacity mechanism would increase in the cost of capital and therefore increase end consumer bills.
- In addition:
 - *QIC GI supports Tilt’s submission which raises concern with the ESB’s proposed approach of undertaking work on the problem definition in parallel to the design of the capacity mechanism.* QIC is concerned that this approach poses the very real risk that the capacity mechanism designed and ultimately proposed for implementation in December 2022 will not be suited to the problem (once defined), elongating the regulatory development process whilst investment remains deterred by the uncertainty created.
 - *QIC GI supports Tilt’s submission that there is a need to focus on minimizing regulatory complexity and uncertainty.* Investors are already grappling with significant changes in the NEM amidst an increasingly complex regulatory environment. To avoid hampering investments unnecessarily, QIC GI supports Tilt’s advocacy for exploring incremental changes to the existing reliability settings and measures before resorting to more drastic, fundamental changes to existing frameworks.
 - *QIC GI supports Tilt’s submission that a capacity mechanism that does not address key Ministers’ Principles such as driving “commitments to new investment” and “provide greater certainty around closure dates of existing generation” and risk losing stakeholder buy-in.* QIC acknowledges the complexity of balancing competing priorities within the Ministers’ Principles and is concerned that if the proposed fundamental changes to the NEM could result in outcomes contradictory to the original intent of the Energy Ministers, the absence of key stakeholder buy-in will result in prolonging the reform process.

2. Policy must be supportive of the transition to decarbonisation:

- New policy should support the entry of new firming technologies as aging coal plants retire, without inadvertently decelerating or reversing the rate of energy transition. There is significant momentum in decarbonisation across Australian corporates and governments. All states in the NEM have committed to Net Zero Emissions (NZE) by 2050, and most states are establishing their own Renewable Energy Zones (REZs) to facilitate an orderly acceleration of energy transition. Over half of



the ASX's market capitalisation (~\$1 trillion)³ now have net zero commitments, with a growing number of corporates committing to new or increased carbon reduction targets. Policies which extend the asset lives of coal fired generation will disincentivise investment in renewable energy and alternative storage technologies, compromising the ability of Australian corporates and governments to achieve decarbonisation objectives.

- In addition:
 - *QIC GI supports Tilt's submission that the ESB's proposed capacity mechanism will in essence force retailers to pay revenue to dispatchable generators (the majority of which are fossil-fuelled) rather than stimulate investment in new renewable dispatchable capacity. Instead, existing safety nets and the introduction of the demand response mechanism and new essential system services will enable the market to continue providing pricing and incentives for capacity that will be suited to a changing environment. As a leading investment manager with over A\$100 billion in funds under management, QIC has a deep understanding of its clients' investment mandates and evolving ESG requirements. Based on these insights, QIC GI is concerned that an investment environment which effectively compensates fossil fuelled generation will struggle to attract investment.*

As a major investor in the Australian infrastructure and energy sector, QIC GI is supportive of regulatory reforms that support Australia's energy transition whilst ensuring reliability of supply to facilitate the increasing penetration of variable renewable energy and delivering cost efficient outcomes to end consumers. We do however note that policy stability and certainty is key to accessing private investment capital, and that preferably policy developments are incremental. Any policy developments that represent significant structural changes, such as the capacity mechanism, would need to be supported by strong evidenced-based analysis as such structural changes are likely to cause significant uncertainty and therefore a significant increase in the cost of investment capital.

QIC GI appreciates the ongoing efforts of the ESB to engage with numerous stakeholders and take a collaborative approach to working with industry. We are supportive of establishing the advisory panel and working groups to facilitate industry engagement on the matter and are pleased to have the opportunity to provide our feedback on the development of ESB's capacity mechanism. We welcome the opportunity to discuss this submission with you.

Yours sincerely

A handwritten signature in black ink that reads "Ross Israel".

Ross Israel
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E: r.israel@qic.com

A handwritten signature in black ink that reads "Angela Karl".

Angela Karl
Partner, QIC Global Infrastructure
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³ ASCI – Promises, Pathways and Performance (Aug 21)