

12 February 2016

Essential Services Commission of Victoria
Level 37, 2 Lonsdale St
Melbourne VIC 3000

Lodged (by online/email): energy.submissions@esc.vic.gov.au

Inquiry into the True Value of Distributed Generation

The Australian Energy Council (AEC) welcomes the opportunity to make a submission to the Essential Services Commission's Inquiry into the True Value of Distributed Generation – Our Proposed Approach (the Approach Paper)

The AEC is the industry body representing 22 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEC is supportive of the Commission's overall approach, namely to separate the calculation of the energy value from the network value, given the entirely different bases for calculating these. We comment further on these components below. We also support the Commission's identification of environmental benefits being rewarded through the up-front subsidy provided under the Commonwealth's Small Scale Renewable Energy Scheme, which represents an adequate recognition of the potential for renewable distributed generation to contribute to greenhouse gas emissions reduction. Further we agree with the Approach Paper's conclusion that "the commission has been unable to identify other public benefits that can be attributable by distributed generation that are easily quantifiable". The condition that such benefits be "easily quantifiable" is a reasonable one – any potential adjustment to feed-in tariffs will need to be easy to understand and implement and if the reward does not consistently reflect the underlying benefit, then the tariff will improve neither the efficiency nor the fairness of the electricity system.

Energy Costs

As the Commission notes, the energy value is already captured in existing feed-in-tariffs which reward customers who export distributed generation for avoided wholesale costs. In the context of the Commission's proposal to evaluate the merits of developing a methodology for calculating the economic benefit on a time-of-use and locational benefit, we would note that the current approach reflects the simplicity valued by most customers who do not pay for their consumption on a time – of–use or location basis. It's not clear that it would send signals for the efficient siting and use of distributed generation to reward export and import in different ways. It would also conflict with the competitive market for retail customers if any such methodology were imposed on retailers as a mandatory payment.

The Victorian Government's terms of reference are somewhat paradoxical: they rule out the Commission examining the deregulation of the feed-in-tariff whilst expecting an assessment of the current policy and regulatory framework and whether it can be improved to guarantee effective compensation for distributed generation customers.. Whilst the terms of reference ask the Commission not to consider this issue, we believe that the Government ought to receive independent advice on this matter because it provides a solution to their overarching concern that distributed generation customers be effectively compensated.

If the Commission compares states that have regulated feed-in-tariffs with those that do not then they see that customers are properly compensated for the energy value that their system generates. As IPART stated in a 2014 solar feed-in-tariff determination:

*"In our view, a competitive market is the best way to provide the fair value for PV exports, and the market should determine the fair value of PV exports through competition. We consider that mandating minimum feed-in-tariffs will lead to fewer offers that consumers can choose from and less incentive for retailers to innovate.... Mandating minimum feed-in tariffs will also not guarantee that PV customers will be better off ... because feed-in tariffs are only one component of a retailer's market offer."*¹

We agree with this observation and believe that it applies to the broader market for distributed generation. Customers with distributed generation comprise a significant and growing proportion of the market and retailers that offer an uncompetitive feed-in-tariff risk losing customers. The incentive for retailers to offer a competitive feed-in-tariff will only continue to rise along with the anticipated increase in distributed generation.

It is also paradoxical that Victoria has deregulated its retail prices but is of the view that a regulated feed-in-tariff will deliver better outcomes for consumers. The deregulation of retail prices represented an acknowledgement that competitive markets were better placed to more efficiently set prices than regulators. Deregulation of the feed-in-tariff is likely to introduce more competition and greater incentives to promote greater offer diversity. This will ultimately benefit consumers who will be able to exercise their choice to find their preferred feed-in-tariff.

Network Costs

We recommend that the Commission engage with the AEMC on this topic, since they are considering a similar issue through their Local Generation Network Credit rule change process. This will provide an opportunity to share feedback from stakeholders and also to consider the interaction between national and jurisdictional rules. Regardless of the merits of a network credit for exported distributed generation, it is important to avoid double-counting by having duplicate schemes. This should be a general principle throughout this inquiry: duplicating existing incentives, provided by other programs will not lead to more efficient electricity system outcomes.

Our response to the AEMC's issues paper noted that there is a lack of evidence that generic small-scale embedded generation systematically assists in reducing network costs. The impact on network costs of small scale PV varies with a range of factors including location, feeder

¹ Independent Pricing and Regulatory Tribunal, *Final report- Solar feed-in-tariffs- The subsidy free value of electricity from small scale solar PV units from 1 July 2014*, 16 June 2014, p. 9.

characteristics and local penetration. Analysis by EY for the Clean Energy Council² shows that for sample feeder types, the impact on network costs can change from a benefit at low penetration rates to a cost at high penetration rates. It also shows that the impact can be highly variable between feeders. This will inevitably make the attribution of a single ‘true value’ incorrect unless it is calculated for each individual installation.

Further, AEMO have forecast³ that as early as 2023, PV penetration in South Australia could be sufficient for the output of distributed PV to exceed demand on occasion. This would result in the marginal embedded PV output needing to use the low, medium and high voltage network and the interconnector in order to be ultimately consumed in Victoria. In such a scenario, the argument that exported embedded generation is only using a small part of the network on its journey to a consumer fails to hold.

Interaction with import tariff structures

As with energy costs, it could be inefficient and inequitable to have a situation where a consumer with distributed generation is facing a supposedly “cost-reflective” network credit for export but is able to continue to pay a flat network tariff on their consumption, which may undervalue the costs they impose on the network. It is important that the Commission consider its approach to any network component of a feed in tariff in the context of the Victorian Government’s opt-in model for cost-reflective network tariffs on energy consumed as well as the AER’s decision that the Victorian networks should face a revenue cap rather than a price cap. That is, any costs incurred providing a network component of a feed-in tariff will be reallocated to other consumers. This wealth transfer is not welfare enhancing unless there is robust evidence that the distributed generation is systematically reducing networks’ underlying costs.

If the inquiry recommends additional payments to distributed generation investors, these should only apply to new investments

If the Commission considers that additional incentives are required to achieve the socially optimal level of distributed generation investment, then these incentives should only be directed to future distributed generation investments.

Providing increased compensation to existing distributed generation investments will not do anything to close any identified investment gap: only additional investment can do that. If the payments made to existing distributed generation investors are increased this will be a windfall gain to these investors at the expense of other consumers. This is a suboptimal use of the resources of other consumers.

We note that it is implicit in the Commission’s ‘behavioural response’ principle (set out on page 6 of the Paper) that any additional compensation should only be payable to future investments.

² <http://fpdi.cleanenergycouncil.org.au/reports/value-of-small-scale-generation.html>

³ <http://www.aemo.com.au/Electricity/Planning/National-Transmission-Network-Development-Plan>

Any questions about our submission should be addressed to Panos Priftakis, by email to panos.priftakis@energycouncil.com.au or by telephone on (03) 9205 3116.

Yours sincerely

A handwritten signature in blue ink that reads "Kieran Donoghue". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Kieran Donoghue
General Manager, Policy & Research