

**VICTORIAN
GOVERNMENT
RESPONSE TO THE
ESSENTIAL SERVICES
COMMISSION'S
ENERGY VALUE
OF DISTRIBUTED
GENERATION
FINAL REPORT**

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Victorian Government Response to the Essential Services Commission's Energy Value of Distributed Generation Final Report

Based on an election commitment, the Victorian Government requested the Essential Services Commission (ESC) to undertake an inquiry into the true value of distributed generation. The inquiry was commissioned because the Government believes Victorians should be fairly compensated for the energy, environmental, social and network benefits their solar panels provide.

Upon the advice of the ESC, the Government separated the inquiry into two stages. The first stage of the inquiry assesses the energy, environmental and social value of distributed generation. The second stage considers the network benefits derived from distributed generation.

This response addresses the ESC's recommendations relating to its inquiry into the energy, environmental and social value of distributed generation. The second stage will be completed by February 2017.

The Victorian Government welcomes the ESC *Energy Value of Distributed Generation Final Report*.

The wholesale value of electricity that is exported by distributed generation can differ greatly based on the time of day and location of the distributed generation system in the network. However, the ESC is currently only able to set one minimum rate that applies across the entire year regardless of these time and location differences. The ESC has found that this approach is resulting in a lack of appropriate incentives for distributed generators to export during peak periods when the wholesale value is higher.

The ESC has therefore recommended introducing multiple minimum feed-in tariffs (FiTs) that vary based on the time and location of export. It recommends that these tariffs align with the time blocks operating for flexible retail prices (i.e. peak, shoulder and off-peak) and that a further 'critical peak' tariff be introduced. It recommends that the critical peak FiT be paid when the wholesale price of electricity is equal to or greater than \$300 per megawatt hour.

The Victorian Government supports time-varying FiTs and agrees that they will more accurately reflect the true value of the electricity being exported into the grid. Also, the three-part model being proposed by the ESC will simplify implementation as it reflects the current model used in flexible retail modelling.

The introduction of a location based tariff is not supported by the Victorian Government. The addition of this element would add undue complexity to the scheme, especially as the recommended zones will not line up with the current ones managed by the five electricity distribution businesses.

In relation to the environmental and social value that distributed generation provides, FiT arrangements currently provide no compensation to distributed generation customers for these values. This is resulting in distributed generation customers being under-compensated for external benefits that their systems create. To address this, the ESC has recommended that a separate "deemed output tariff" be introduced that would compensate for these values based on the deemed output of the distributed generation system.

The Victorian Government supports compensating distributed generation customers for the environmental and social value they provide. However, due to the complexity of introducing a special tariff for this, the Victorian Government believes it is preferable that these values be reflected in the current FiT rather than through the introduction of a new tariff, and will legislate for the ESC to do so. The Victorian Government will also issue guidance to the ESC through an Order in Council on an interim methodology for setting environmental and social values in the FiT to ensure they are reflected in payments from 2017.

The Victorian Government believes that the legislative changes to be implemented in response to the ESC's Energy Value Inquiry will result in a fairer approach to compensating distributed generation households for the contribution of their systems to the grid.

The network value component of the ESC's Inquiry will be completed during 2017 with any changes to the FiT arising from this Inquiry to take effect from 2018. A separate Government response will be published following receipt of the ESC's Final Report on Network Value of Distributed Generation which is expected to be released in February

The Victorian Government response to each finding is provided as follows:

Essential Services Commission's Findings

1: Eligibility for payments

The current eligibility criteria for the minimum FiT, which describe eligible technologies and maximum generation capacities, remain sufficient for present market circumstances.

Support

2: Multi-rate feed-in tariffs

The current single tariff can be replaced by a framework that allows for a time and location varying FiT that more closely reflects the underlying wholesale price of electricity.

Support in part (see response to Finding 4)

3: Time-varying feed-in tariffs

It would be preferable for a multi-rate FiT to align with the time blocks operating for flexible retail prices (namely: peak, shoulder and off-peak). The time varying FiT could be supplemented with a 'critical peak' tariff that would be paid when the wholesale price of electricity is equal to or exceeds \$300 per MWh. Time varying FiTs and a 'critical peak' tariff could be calculated by the Commission on an annual basis.

Support

4: Locational feed-in tariffs

Victoria can be divided into two regions reflecting differences in average line losses across the state ((i) Melbourne, Geelong and the east of the state; and (ii) the north and west of the state). Higher line losses would apply in the north and west of the state. Different multi-rate FiTs in each region would reflect these differences in average line losses.

Do not Support:

The Government believes the addition of a location-based tariff would unduly complicate the FiT scheme, especially as the two regions proposed by the Commission do not align with the current ones managed by the five electricity distribution businesses.

5: Fully reflective feed-in tariff

If an electricity retailer is able to offer a FiT that fully reflects the half hourly prices in the wholesale market, and the distributed generator provides express and informed consent when accepting that tariff option, then the retailer's obligation to offer regulated multi-rate FiT rates should be suspended for the duration of that agreement.

Support (delay implementation):

Legislation to implement will be included in legislative changes arising from the network value inquiry to allow electricity retailers sufficient time to organise their billing systems to reflect this recommendation.

6: The environmental and social value of distributed generation

The only environmental and social benefit of distributed generation that can be estimated reliably at this time is the greenhouse gas emissions avoided when distributed generation displaces centrally dispatched electricity. The quantum of greenhouse gas emissions avoided as a result of distributed generation is determined by the marginal generator displaced in the wholesale electricity market. Avoided emissions could be calculated by the Commission on an annual basis for each of the eligible technologies.

Support (see response to Finding 7)

7: A payment mechanism for environmental and social value

7 (a) Calculating a Deemed Output Tariff

A Deemed Output Tariff (DOT) could be paid to a distributed generator to reflect the environmental and social value of distributed generation. A DOT could be calculated based on the deemed output of the distributed generation system, where that output can be reliably estimated. The deemed output of solar and wind systems can be reliably estimated using factors published in the *Renewable Energy Target (Electricity) Regulations 2001 (Cth)*. The deemed output of other distributed generation systems cannot be estimated reliably at this time.

7 (b) Scope of a Deemed Output Tariff

At commencement, the scope of a DOT would be limited to reflecting the value of reduced greenhouse gas emissions. If additional, reliable information becomes available, the deemed output tariff should be adjusted at yearly intervals to reflect other social and environmental benefits.

Support in part:

The Government will direct the ESC to consider the environmental and social value in setting the FiT rather than through a separate Deemed Output Tariff.

8: Minimum tariffs

The regulated tariff structure could continue to impose a minimum obligation on retailers. Retailers could offer higher rates on one or part of the components of the minimum FiT, DOT or both, as set on an annual basis by the Essential Services Commission.

Support (excluding location and deemed output tariffs)

9: Implementation timeframes

A phased implementation of the proposed tariff structure would allow sufficient lead time for the required system changes by industry and the new rates to be communicated to customers. For example:

- Year 1 (starting 1 July 2017) introduce a multi-rate FiT, including different rates for peak, off-peak, shoulder and critical peak periods.
- Year 2 (starting 1 July 2018) introduce the Deemed Output Tariff (DOT) component, establishing a payment reflecting avoided greenhouse gas emissions.
- Year 3 (starting 1 July 2019) introduce location-based pricing in the form of two loss-zones in Victoria.

Support in part

The Government will amend legislation to enable the ESC to set multi-rate FiTs with different rates for peak, off-peak, shoulder and critical peak tariffs from 1 July 2017. Between 1 January and 1 June 2017, the 2016 minimum rate of 5.0 cents per kilowatt hour will continue to apply. As noted above, the Government does not support the introduction of either a deemed output tariff, or locational pricing.

From 1 July 2017, the setting of minimum FiTs will move from a calendar year to a financial year basis, as recommended by the ESC. The Government will consider whether further amendments to the FiT arrangements should be introduced from 1 July 2018, based on the findings of the ESC Final Report on the Network Value of Distributed Generation (Final Report due in February 2017).