



31 August 2016

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Dear Scott

RESPONSE TO VICTORIAN RENEWABLE ENERGY AUCTION CONSULTATION PAPER AND CONSULTATION SESSIONS

This submission is on behalf of the Victorian Electricity Network Service Providers (AusNet Services Transmission and Distribution, CitiPower, Powerecor, United Energy and Jemena).

Victoria's electricity networks are consistently the most efficient performers in the National Electricity Market, and are focussed on providing the best possible service for the lowest possible price.

Electricity networks have a key role in facilitating renewable energy sources, and we are broadly supportive of the intent of the Victorian Government's policy to transition Victoria's energy generation mix. A key challenge, however, is ensuring this transformation is delivered at the lowest cost for electricity customers. This submission, therefore, primarily focuses on 'scheme administration and cost recovery'.

Cost recovery

The Department has proposed that the costs of the Victorian Renewable Energy Auction Scheme (VREAS) will be recovered through electricity tariffs, rather than funded directly by the government. However, it is important to recognise that the recovery of revenue to subsidise public policy through electricity tariffs is likely to distort customer decisions in relation to electricity use and investment for reasons including the following.

Firstly, funding the auction scheme by imposing a levy on electricity bills is not the same as funding through consolidated revenue – recovery of revenue through electricity tariffs places the burden for cost recovery on a different group to general taxpayers. For example, a 2015 Brotherhood of St Laurence report found that the average share of income spent on energy falls as household income rises, so a levy on electricity will be more regressive than taxation, placing a greater share of the burden on lower income households.¹

¹ Azpitarte F., Johnson V., and Sullivan D., (2015), *Fuel poverty, household income and energy spending – An empirical analysis for Australia using HILDA data*, Brotherhood of St Laurence.

Secondly, the recovery of wholesale electricity costs (to fund renewable generation) in network tariffs creates inefficient price signals, and is not consistent with the principles of cost-reflective pricing. These price distortions may lead to inefficient investment to avoid use of electricity networks (and the VREAS levy). In the extreme, price distortions may result in inefficient disconnection from the network even when this is not in the long-term interests of consumers. It is important to note that the costs of partial or full bypass of electricity networks as a result of the VREAS will increase costs to customers who continue to rely on electricity networks.

Victoria's electricity networks believe that it would be more equitable if the VREAS was funded directly from the Victorian State Budget rather than through electricity tariffs.

If the VREAS is to be funded via electricity tariffs, the Government should take appropriate steps to make the contribution to VREAS transparent in customer bills to limit the effect of inefficient price signals and to minimise the scheme's costs. In particular, minimising the proportion of the scheme that is additional to the Commonwealth Renewable Energy Target will reduce the cost to electricity consumers. As currently proposed, there is a risk the costs of the scheme could increase significantly post-2020.

Scheme administration

In the consultation sessions, stakeholders were advised that the preference of the Government is that the scheme administration would be undertaken by a government agency, and that cost recovery would be undertaken by electricity distribution networks.

Victoria's Electricity Network businesses agree that a government agency should be the scheme administrator. It would be costly, inefficient and impractical for networks to play this role.

As stated above, the network businesses' preference is for the scheme to be funded directly from the State Budget. However, if cost recovery is to be via electricity network charges, it is sensible that this would be implemented at the transmission level. Cost recovery through transmission charges would have the lowest administrative costs (avoiding unnecessary duplication of effort by the five distributors), and would ensure costs are recovered evenly across all electricity users (including customers directly connected to the transmission network).

The Australian Energy Market Operator (AEMO) sets Transmission Use of System charges in Victoria. Given these already include variable cents-per-kilowatt-hour charges, it would be most administratively simple for AEMO to include the costs of the VREAS when setting annual transmission tariffs.

Further issues

A number of issues that will need further consideration in determining the final arrangements for scheme administration and cost recovery include:

- Frequency of tariff adjustments – electricity network pricing proposals are currently prepared and assessed by the AER on an annual basis. Resetting tariffs with a higher frequency (e.g. every six months) would be associated with substantial administrative costs for network businesses, the AER and retailers, and would erode price certainty for customers.
- Exemptions – if exemptions are to be provided to vulnerable customers or emissions intensive trade exposed customers, this will need to be administered by either government or electricity retailers. Electricity Distribution and Transmission companies do not have visibility of vulnerable customers or emissions intensive trade exposed companies. Tariff

non-discrimination provisions in the National Electricity Rules are also likely to preclude networks from implementing tariff exemptions on this basis.

- Bill volatility – it is anticipated that it may be difficult to accurately match revenues recovered with annual costs under the auction scheme, and that this could lead to volatility in electricity bills.
 - Potential sources of forecasting error include:
 - annual auction scheme costs – the scheme administrator will need to forecast renewable energy generation under the scheme and the wholesale market price at the time the energy generation occurs;
 - for revenue recovery – depending on the type of tariff used to recover auction scheme costs, the party responsible for cost recovery will need to forecast either electricity usage, electricity demand or electricity customer numbers in order to set the tariff at a rate that will recover the required revenue.
 - The volatility of energy auction costs may increase as the percentage of renewable energy increases (i.e. market price volatility may increase as the percentage of renewables increases). This has recently been seen in South Australia.
 - The Government should consider possible mechanisms to minimise volatility to customer bills associated with the auction scheme. For example, costs could be recovered retrospectively (e.g. 2020 tariffs would recover scheme costs from 2019), to minimise error in forecasting auction scheme costs. Further, adopting a fixed contract option (as opposed to a contract-for-difference model), would minimise network charge volatility.
 - It should also be clearly set out what will be done when the revenues recovered under the scheme do not match the costs under the scheme (i.e. the arrangements for under or over cost recovery).
- Distribution network connection and augmentation costs – the VREAS may lead to a significant increase in renewable energy generation connected to Victoria’s distribution network. This may have material adverse impacts on power quality, particularly for rural networks. The costs of transforming networks to manage this regulatory change may also require additional expenditure beyond that approved by the AER for the 2016–2020 regulatory period.
- Legislative instruments -
 - It is noted that the proposal to have Victoria’s electricity networks recover costs for the VREAS differs to other previous levies (e.g. Premium Feed-In Tariffs), where the networks also administer payments. It will be important to ensure that the legislative obligation addresses the potential tax implications of collecting this revenue. The cost recovery legislative obligation should be designed to create a tax neutral outcome. Networks encourage further consultation on this point once the preferred cost recovery approach is settled.
 - If networks are involved in cost recovery, the Victorian Government should seek advice from the Australian Energy Regulator as to how recovery of reasonable administration costs can be facilitated.
- Transparency – customers should know the contribution of their electricity bill to the recovery of energy auction costs. The proposed cost recovery mechanism currently provides no transparency for customers, as these charges are not set out in their electricity bill. Victorian Electricity Networks support greater disclosure of these charges on retail bills.

The Victorian Electricity Network Service Providers would be happy to answer questions in relation to this submission, and to assist in how best to implement the design of the cost recovery scheme to minimise negative impacts to customers. This particularly applies to the design of the cost recovery legislative obligation.

Sincerely,

A handwritten signature in blue ink, appearing to read 'K Yates', with a long horizontal stroke extending to the right.

Katie Yates
Principal Economist
AusNet Services
on behalf of the Victorian electricity network businesses