



ATTACHMENT A: CITY OF MELBOURNE MANAGEMENT SUBMISSION

VICTORIAN RENEWABLE ENERGY AUCTION SCHEME: CONSULTATION PAPER

SCHEME STRUCTURE

Questions for stakeholders

How can the Department ensure that a pipeline of projects will be ready to meet the Government's targets for 2020 and 2025 while maintaining appropriate flexibility for Government to adjust the scheme where required?

The Victorian Government will need to implement the auction scheme in a flexible manner that is responsive to market conditions to ensure a competitive and robust market and optimal value for money for the Victorian community.

It will need to consider the number of projects with current development approvals and the timeframes needed to develop future projects. The Department can support the development of a pipeline of projects by providing a clear, consistent and early indication of its intent to conduct the auction in stages. This will provide the market signal needed for project developers and financiers to prepare project proposals. We suggest the Department communicate its intent to conduct the auction, with an indication of load requirements and auction criteria at least 12 months prior to the auction date. Additionally, the Department could publish forward forecasts of the intended auction program for the next 2-5 years and updated annually in response to changing market conditions. For example the ACT Government exercised flexibility in delivering its program of auctions by bringing forward auction dates and targets adjusted to market conditions. For this reason the use of consistent capacity tranches should not be too rigid. The implementation of the scheme will also need to accommodate changing technology.

How much notice should be provided to industry of upcoming auctions?

An indicative forecast over a 2-5 year timeframe is suggested. This should allow for sufficient notice of the intended program of auctions, and sufficient incentives for project developers and financiers to prepare an ongoing pipeline of projects commensurate with the Government's targets.

Should capacity be auctioned in consistent capacity tranches (e.g. 200MW etc)?

Consistent auction tranches may limit the Department's ability to respond to market conditions at the time of each auction, including the availability of projects. Therefore the capacity of each tranche should be flexible in the volume of contracted capacity, dependent on market conditions.

The implementation of the scheme is likely to reduce the cost of renewables over time, particularly solar energy, as the development of technologies, industry capabilities and capacity improves. For that reason, the Department should consider smaller tranches in the first two years to enable the industry to build capacity and capability to increase in scale.

Additionally, the Department could facilitate the development of an adequate pipeline of projects by extending and amending existing planning approvals where they are due to lapse and expediting planning approvals of new projects where appropriate.

In some cases, existing projects which already have planning approval may benefit from amendments to adopt newer technology that has emerged since planning approval was granted. Such amendments may enable existing projects to increase capacity and in some cases, may also reduce any anticipated impacts on communities. In such cases, the Department should expedite amendments to the planning approvals of existing projects.



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At what frequency should auctions be held?

The frequency of auctions should not be too rigid, but rather should be responsive to market conditions including the pipeline of projects and other issues described above.

What proportion of scheme generation should be dedicated to solar projects?

City of Melbourne is supportive of the Victorian Government's proposed approach which allocates a proportion of the auction to solar projects. The benefits of this approach would be to build capacity within the renewable energy industry across a range of businesses, technologies and scales which will best support the growth of a strong and resilient renewable energy industry which is needed to deliver the Victorian Government's targets.

The proportion allocated to solar projects should be responsive to market conditions, including the pipeline of solar projects, rather than a rigid allocation. The long term potential for large scale solar in Victoria and anticipated cost reduction from additional early investment should be considered in the allocation of the tranche so the industry as a whole can deliver the needed capacity as soon as possible.

Should the proportion of solar be different pre and post 2020 to allow a solar pipeline to develop and technology costs to come down?

Yes, for the reasons stated in the response above.

Are there any other matters the State should consider when setting the scheme's technology split?

Other issues that the State should consider when setting the technology split include:

- Diversity of Victoria's energy mix: A diverse energy portfolio with a higher proportion of renewables improves security of supply, but importantly, may also deliver benefits to the wholesale electricity market. For example, electricity generated by solar and wind projects can drive down spot electricity prices if the capacity and diversity of renewables is sufficient to supply the market during high demand events.
- The State may also wish to include an option to auction storage capacity linked to a renewable energy facility. For example, pumped hydro coupled with a renewable generator is a proven and cost effective technology that could deliver significant benefits in terms of peak pricing events and security of supply. Such solutions could take advantage of existing mine sites (e.g. Anglesea) and be a vehicle for transitioning communities dependent on the energy economy by utilising existing skills in the energy sector.

What is the best way to treat LGCs under the scheme to enable successful proponents to secure project finance, ensure scheme costs are minimised and ensure adequate market interest from industry to participate in the auctions is attracted?

The stated objectives regarding LGC treatment are very sound – minimising costs and getting projects built need to be prioritised. The State's proposed approach of requiring proponents to retain ownership of LGCs will reduce administrative burden for the State, but if not structured correctly, could place too much risk with project proponents.

City of Melbourne has found through the Melbourne Renewable Energy Project (MREP) tender that different market participants may have varied appetite for taking LGC price risk, particularly over the long term in a fairly volatile market. The CfD structure could allow proponents to choose to bid a 'bundled' LGC + power strike price, or bid a price where LGCs and power prices are explicit. If the State required a bundled strike price, proponents will be required to take a long term view on LGC spot prices, potentially impacting on project bankability. This could also impact on the pool of



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projects bidding into the auction process by excluding proponents with no appetite to carry LGC price risk.

What are stakeholders' thoughts about complementarity/additionality if the Federal RET were extended/expanded?

In the period prior to 2020, the scheme should complement the Federal RET. This will reduce unnecessary complexity from the operation of a multiple state-based schemes, and consequent RET market distortion.

Post 2020, the Victorian scheme needs to be additional to the Federal RET to drive the additional investment needed to meet Victoria's targets. This will provide long term certainty to investors in the renewable energy industry in the state. Furthermore, the economic, social and environmental advantages of early action to reduce greenhouse gas emissions warrant the higher national targets that would result from additionality. Leadership from Victoria will create enabling conditions for higher national targets and jobs growth located in Victoria.



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PAYMENT STRUCTURE

Questions for stakeholders

Do stakeholders agree with the proposed Contract for Difference (CfD) payment structure approach?

City of Melbourne is supportive of the proposed CfD payment structure. The proposed approach is market tested, understood by the industry and may deliver long term benefits to the Victorian community if established as a two-way CfD as proposed.

If a CfD payment structure is used, on what basis should a NEM reference price be set? (e.g. monthly average, half hourly NEM price)?

No response.

What would be the impact of adding a floor price to cap the total payment applicable in any one period?

A floor price should be set at a level that ensures project viability and bankability while minimising risk exposure to the State and to end users of electricity. To that end, a floor price set above zero may also be appropriate. Project developers and retailers will have a more informed view on an appropriate floor price and the City of Melbourne does not have a specific comment on this point.

Do stakeholders consider that any alternative payment structures could be employed for the scheme, such as a fixed payment approach? If so, what are the relative advantages and disadvantages of these options?

In our view, any alternative payment structure that transfers the risk of generation (volume risk) from the generator to the State should offer significant financial (or other) benefits for it to be considered. Fixed payments awarded on installed capacity would transfer plant performance risk to the State. This would increase the need for additional due diligence to assess technical and commercial risks adding complexity and cost to the process. For that reason, we support the CfD structure based on dispatched electricity and LGCs generated because this places the risk with the parties most able and appropriate to manage that risk.



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CONTRACTING ELEMENTS

Questions for stakeholders

Are the above contract elements broadly appropriate?

City of Melbourne broadly agrees with the proposed contract elements, with the following comments:

City of Melbourne does not have a view on the frequency of payments. On this issue, the State should seek comment from industry.

It is unclear how contracting arrangements would be implemented in practice if the contracting counterparty were to be a distribution or transmission business or electricity retailer. It may be necessary for the State to provide undertakings to the project developer that payments would continue to be made in the event that the contracting counterparty defaulted. City of Melbourne has explored implementing 'direct payment deeds' to address these circumstances and is able to provide further comment on request.

See comments below in relation to minimum generation requirements.

Within the contract range of 10 to 20 years, is there an ideal duration, particularly with the aim of minimising project financing costs?

No response.

What would be an appropriate project delay threshold for contract termination clauses?

No response.

Would quarterly payments have a significant impact on financing costs compared to monthly payments?

No response.

What are the implications of a two-way CfD?

A two-way CfD is considered an appropriate and effective mechanism to share risk and benefits between the renewable energy generator and the State. In the event of pool prices above the contracted price, revenue earned by the State could be re-invested in emerging technologies, subsidies to low income households or other activities that assist with the transition to a low emissions electricity supply.

What do stakeholders think about the generation requirements being considered? Where maximum and minimum generation volumes are contained in scheme contracts how should these be set?

The contract elements above are broadly appropriate, with the exception of the generation requirements. Penalties for minimum generation may be problematic due to intermittency or variability of renewable energy generators, especially wind power. Any penalty clauses that do not adequately allow for low resource years may unfairly penalise the generator which in turn may not be viewed favourably by project financiers.

An alternative to ensure the State has recourse for non-performance or plant failure would be to apply penalties to plant availability – if the generation capacity is unavailable for greater than an agreed proportion per year, penalties could be applied.

Are there any other contract elements that should be considered?



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No response.

Are any of the elements likely to lead to perverse outcomes?

Whilst the City of Melbourne is strongly supportive of the proposed scheme and the targets set by the State, there is some potential to adversely impact the voluntary purchasing market. The MREP, led by the City of Melbourne, seeks to purchase electricity and LGCs from a new renewable energy facility to supply a group of government and corporate customers. The City of Melbourne's objective is to enable the replication of this approach in order to further drive the uptake of new renewable energy projects, underpinned by corporate off-take agreements. Prospective customers include councils, universities, water authorities and large corporations. There may be a role for the State in facilitating the formation of these kinds of purchasing groups.

In a market where the State is implementing an auction scheme for large volumes of renewable energy capacity, the pool of projects available for customers such as the MREP group to purchase from will be reduced. In the short to medium term, the Victorian auction scheme may make it more difficult for large energy using customers to contract for voluntary renewable electricity supply due to strong demand for projects driven by State investment.

However, flexible, well planned and appropriate schedule of auctions will help mitigate this risk by ensuring auction tranches reflect the project developer's ability to competitively supply the market. In the medium to long term, this could benefit voluntary purchases by large customers by driving further market maturity and price efficiencies.

An additional perverse outcome of which the State seems to be aware is security of supply in a market with a high penetration of intermittent renewable energy generators. Our earlier suggestion to consider the application of storage capacity coupled with renewable energy generators could help alleviate some of these risks.



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SCHEME ADMINISTRATION AND COST RECOVERY

Questions for stakeholders

What are the relative advantages and disadvantages of the different scheme administration and cost recovery options listed above?

In our view the scheme needs to be administered by a statutory Victorian Government agency to ensure transparency and cost effectiveness in the transition to renewable energy is delivered on behalf of the community.

If the scheme were administered by private electricity distribution or transmission businesses, there would be a conflict of interest between the need for private businesses to achieve profitable returns on investment, and the government's objective to keep administration costs low for consumers. The risk of inflated administration costs passed through to consumers would risk the level of public support needed to deliver Victorian Government objectives. This is particularly important for low income households vulnerable to electricity price increases, and the associated public cost of the winter energy concession.

Is there another mechanism for recovering scheme costs the Government should consider that would result in better outcomes?

No response.

The Department's proposed position is currently to exempt emission intensive trade exposed companies (as defined under the Federal Government's RET scheme) from paying scheme costs. Do stakeholders agree with this approach? Are there any other parties Government should consider exempting from scheme costs? If so, how should this occur?

The Department should consider that the exemption of costs to emission intensive trade exposed companies represents a transfer of these costs to other Victorian businesses and the Victorian community. In our view, it would be appropriate for any exempt parties to deliver emission reductions through energy efficiency or other means to contribute to the necessary progress toward State targets.



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AUCTION EVALUATION PRINCIPLES

Questions for stakeholders

What do stakeholders think of the proposed evaluation criteria set out above?

The proposed criteria are generally sound and appropriate. However, the State may wish to consider an assessment on the technical and commercial strength of proposals. The level of detail required for technical and commercial due diligence should be dependent on the final contract structure and risk allocation. Regardless, some form of technical and commercial assessment would be appropriate to consider in the evaluation criteria to ensure the State is contracting with proponents that are likely to deliver the desired outcomes.

The criteria “Wholesale market participation” could also be delivered through the auction specification or as a mandatory requirement, rather than as an evaluation criterion. Proponents would either “meet” or “not meet” this criteria, so weighting and evaluating this element is not the best way of achieving the outcome.

City of Melbourne acknowledges the need to support the community in the Latrobe Valley and the efforts of Latrobe Valley City Council in delivering local programs to increase local employment and training opportunities and community health. We note that the brown coal electricity generation industry in the Latrobe Valley contributes approximately 85 per cent of Victoria’s electricity generation, 20 per cent of the Latrobe City Gross Regional Product and 20 per cent of local jobs, either directly or indirectly.

We note the Victorian Government’s commitment to \$40 million for the Latrobe Valley to support the growth of future industries and the community in addition to the funding provided to implement the recommendations of the Hazelwood Mine Fire Inquiry. If suitable conditions are available in the region for renewable energy businesses to undertake projects in this region, this may further support community transition. City of Melbourne suggests the Department investigate the potential to support renewable energy projects and industries in this region as a complement to the auction scheme including the manufacture of componentry, training needs and the location of regional offices.

Do stakeholders have views on how evaluation criteria might be weighted?

Value for money needs to be weighted heavily to ensure contracted projects are cost effective and associated costs to consumers are not unnecessarily inflated.

In addition, the Government could include mandatory, non-weighted criteria to ensure all projects conform to the objectives of the auction scheme. For example, the tender for the Melbourne Renewable Energy Project included minimum hurdle requirements for some evaluation criteria. The tender proposals needed to meet these minimum requirements to be assessed as conforming bids.

In determining criteria, the State needs to consider the risk of non-generation and development risk, and weight the evaluation criteria commensurate with these risk assessments. The timeframe of project delivery also needs to be considered in the assessment of risk. If projects fail to generate or fail to complete development in the early years of the scheme, there is still the potential to make up the shortfall in later years. However, the failure of projects to complete development or achieve generation in the later years of the scheme is a greater material risk to the scheme’s success.



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Are there other evaluation criteria/principles that the Government should consider to ensure the scheme meets its objectives?

This point is addressed in our response to the previous question.

Are the costs associated with developing a proposal to bid into the scheme based on addressing the above criteria effectively likely to be prohibitive?

No response.

What would be appropriate minimum project sizes (both in general and for large-scale solar)?

We suggest a minimum project size of 500kW-2MW. In our view, the scheme architecture should allow the State some flexibility to respond to new technology and enable large distributed energy solutions to bid into the auction process in the future. However, the scheme should not be designed to enable aggregated rooftop scale projects to bid in the auction process. This would result in rooftop generation displacing the development of large scale generation in the energy system. There are other effective and proven initiatives appropriate to encourage rooftop solar including financial incentives such as a feed-in tariff as well as mandatory building regulations.

Would there be benefit in asking proponents to submit expressions of interest to participate in the auctions to ensure only more advanced projects proceed to the full evaluation round and that costs are minimised for project proponents where possible?

There are several benefits to establishing an expression of interest process for the auction scheme. It will reduce costs to project developers in the early stages of a project, particularly when new technology or new business models are required. It will provide an early opportunity for constructive feedback to improve final project proposals, and increase the benefits to the Victorian community of projects. The Government could use this process as an opportunity to target promising projects with additional advice to increase the number of projects in the pipeline in line with strategic objectives. The process will also provide the Government with market intelligence on the pipeline of projects, range of technologies, geographical location and alignment to strategic objectives as well as gaps that need to be addressed. This information is needed to inform the auction scheme design and size of tranches which will enhance the success of the scheme in meeting Government targets. The communication of market trends to project developers can also play a role in increasing competition, identifying gaps and opportunities, and promoting the further growth of the Victorian renewable energy industry.