

REVIEW OF THE SOLAR FEED-IN TARIFF PREMIUM

Issues Paper

June 2013



REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (**the Commission**) invites written submissions from interested parties in relation to the conclusions raised in this Issues Paper. Written comments should be provided by 26 July 2013. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to exhibit any submission based on their length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to:

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The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit www.escosa.sa.gov.au.

INTRODUCTION

The Essential Services Commission of South Australia (**the Commission**) is responsible for regulating the Feed-in Tariff Premium (**FIT Premium**) that licensed electricity retailers must pay customers with eligible solar photovoltaic (**PV**) systems. In regulating the FIT Premium, the Commission must be guided by its primary objective as set out in section 6 of the Essential Services Commission Act 2002 (**ESC Act**), which is ***the protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services.***

The current FIT premium as set by the Commission is 9.8c/kWh, which reflects the Commission's best assessment of the value to retailers of the energy produced by PV systems. Electricity retailers must pay at least that amount to eligible solar PV customers until 31 December 2013, which is when the current FIT Premium determination expires. The FIT Premium is additional to the FIT paid by SA Power Networks of 44c/kWh (for systems connected prior to 1 October 2011) or 16c/kWh (for systems connected between 1 October 2011 and 1 October 2013).

Purpose of this paper

Under the Electricity Act 1996 (**Electricity Act**), the Commission was required to make an initial determination of the FIT Premium. Having made an initial determination in January 2012, the Commission has the discretion to determine whether or not a subsequent determination should be made. The Commission is now considering that question and is releasing this Issues Paper to facilitate public consultation on the benefits of ongoing regulation of the FIT Premium from 1 January 2014. Comments are sought on whether electricity retailers should be allowed to set their own FIT Premium amounts to reflect the value of fed-in electricity or some other approach permitted under legislation should be adopted. These issues are being considered by the Commission following submissions made by energy retailers during the process of setting the current FIT Premium. The substance of the retailers' argument was that the FIT premium should be deregulated given that the Government has deregulated retail energy prices in South Australia. Energy retail price deregulation in

South Australia came into effect from 1 February 2013.

The Commission invites comments from interested parties on the future regulation of the FIT Premium. While this Issues Paper focuses on a limited number of key issues, stakeholders are encouraged to comment on issues that this paper has not specifically raised providing they assist in informing the Commission in meeting its objectives, which are discussed below.

Submissions to this Issues Paper should be provided to the Commission by **26 July 2013**. Details on how to make submissions are provided on the previous page.

LEGAL REQUIREMENTS

In July 2011, the Parliament of South Australia enacted legislation to change elements of the electricity feed-in tariff scheme set out in the Electricity Act. Under the amended scheme, the Commission was granted powers to determine the FIT Premium payable by energy retailers.

The initial FIT premium determination made by the Commission in January 2012, was governed by transitional provisions of the Electricity (Miscellaneous) Amendment Act 2011. The new scheme required the Commission to make an initial determination of the FIT Premium, although it offers discretion to the Commission to make any subsequent FIT Premium determinations. In particular, Section 35A(1) of the Electricity Act states that:

- (1) *The Commission **may make a determination** under the Essential Services Commission Act 2002 regulating prices, conditions relating to prices and price-fixing factors for—*
 - (ba) *the feeding-in of electricity into a distribution network under Division 3AB (emphasis added)*

As the Commission has varied the initial FIT Premium determination such that it will now expire on 31 December 2013, the Commission is considering whether or not a further determination is necessary and, if so, what form of regulation of the FIT Premium is required.

If the Commission elects to make a new determination to apply from 1 January 2014, the Electricity Act requires that the Commission must have regard to the fair and reasonable value to a retailer of the electricity fed into the network by qualifying customers.

The Commission's objectives

In addition to pursuing its primary objective, the Commission must, in accordance with section 25 of the ESC Act, also have regard to the need to:

- ▲ promote competitive and fair market conduct; and
- ▲ prevent misuse of monopoly or market power; and
- ▲ facilitate entry into relevant markets; and
- ▲ promote economic efficiency; and
- ▲ ensure consumers benefit from competition and efficiency; and
- ▲ facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and
- ▲ promote consistency in regulation with other jurisdictions.

These objectives and factors will be taken into account by the Commission in determining the approach that will be taken to regulating the FiT Premium (if any) from 1 January 2014.

ISSUES

The Commission invites submissions from interested parties on the various issues discussed below, and on any other matters considered relevant to this review.

The key question that the Commission requests comment on is:

Is it in the long-term interests of consumers for the Commission to continue to regulate the FiT Premium beyond 1 January 2014?

In order to answer that question, the Commission believes that there are various issues that are relevant, which stakeholders may wish to comment on. Those issues include:

- ▲ Defining the relevant market; and
- ▲ Determining whether or not regulation is required in that market, given the level of competition and the costs and benefits of regulatory intervention.

What is the relevant market?

The decision to apply regulation, such as price controls, generally relies on an assessment as to whether or not market failure exists. The typical form of market failure that economic regulators seek to address is the potential for misuse of market power, where monopoly businesses or businesses not subject to sufficient competitive pressures have the ability to charge excessive prices or provide sub-optimal service levels. Regulation of prices and/or service standards is generally applied in those circumstances.

Before the Commission can form a view on the extent of any market power, it must determine what the relevant market is. This is an important question as it may be the case that a business has the potential to misuse market power in one market, but not another, due to differences in the extent to which customers can exercise choice in each market (eg. choice of supplier or choice of other substitutable goods).

Implicit in the submissions of energy retailers is the view that deregulation of the FiT premium is appropriate because it is part of the same market in which retailers sell electricity to retail customers, which is no longer subject to price regulation. Furthermore, the Commission notes that prices in the electricity generation market are also largely deregulated.

The Commission will be reviewing this issue carefully, and it encourages stakeholders making submissions to consider the following question:

In the absence of a regulated FiT Premium, are there likely to be any differences in the extent to which consumers could exercise choice between energy retailers providing retailer feed-in tariffs, as distinct from energy retailers selling electricity to end-users more generally?

While all retailers must currently provide at least the regulated minimum FiT Premium, if the FiT Premium were to be deregulated, there is nothing to prevent a retailer from not offering a FiT Premium amount at all. If deregulation were to result in fewer retailers offering a FiT Premium than were offering to sell electricity, it could be argued that the market for retailer feed-in tariffs to solar customers is different to the broader electricity retail market. If, on the other hand, the degree of customer choice between retailers is likely to be the same as that applying to electricity retailing, then the provision of a retailer feed-in tariff may be considered part of the electricity retail market.

It is noted that, prior to the commencement of the regulated FiT Premium in July 2012, only a minority of electricity retailers voluntarily offered a FiT Premium to solar customers.

Issues of competition and market power

The decision to deregulate a certain market is generally implemented when that market exhibits a high level of competition or has developed certain conditions for competition to thrive in that market. The decision to deregulate the FiT Premium can be made only after carefully analysing competition in the relevant market. The Commission will look for any evidence of market power and, if market power exists, the potential for that power to be misused. Information on retailer market shares for solar customers, rates of switching by solar customers and the extent to which retailers are actively marketing to solar customers are useful for assessing the level of competition and the extent of any market power. The Commission will be requesting information from energy retailers on these matters, on the basis that there is currently little data available to answer these questions based on information already reported to the Commission and the Australian Energy Regulator (who also collects and reports data on energy retailing in South Australia).

Is there sufficient competition in the relevant market (however defined) to ensure that consumer interests can be promoted without the need for direct price regulation?

The costs and benefits of regulation

Ultimately, the Commission will impose regulation when there is a clear case that the benefits of regulation (in terms of consumer protection) outweigh the associated costs (including compliance costs to retailers). Understanding the market failure that is to be addressed is fundamental to this question, but it is also important that any regulation is proportionate to the problem that may exist.

If the Commission chose not to directly set the FiT Premium, it may still rely on other forms of regulatory intervention outside of its price determination powers if appropriate, such as providing guidance or principles that retailers must follow in determining their FiT Premiums. Such an approach may be considered by the Commission if full deregulation was not seen as appropriate, or as a means of transitioning to full deregulation.

It is also noted that the Australian Energy Regulator currently provides an energy price comparison service (“Energy Made Easy”) that includes information on FiT Premiums offered by retailers. The Commission supports the publishing of transparent and understandable information on all retail market offers, including FiT Premiums.

In terms of direct regulation of the FiT Premium, should the Commission choose to follow that path, there are limited options available to it. While the Independent Pricing and Regulatory Tribunal (IPART) sets a voluntary benchmark range for the retailer FiT, that approach would not be available to the Commission on the basis that any determination must set a “prescribed amount” as the minimum FiT Premium (as defined in Division 3AB of the Electricity Act) and does not allow for a range of amounts, nor for retailer payments less than that amount. The Commission must set a single value for the FiT Premium, which may introduce greater costs than the option of setting a range. For example, if the value to retailers of fed-in electricity were significantly lower than the amount reflected in the regulated FiT Premium, retailers would be required to pay FiT amounts that exceed the avoidable cost to them (in terms of avoided wholesale energy purchases), and the difference may be funded through higher electricity prices paid by all customers.

However, it is possible for the Commission to set a relatively low FiT Premium - if it believed that retailers would voluntarily offer higher amounts, as the Electricity Act only requires the Commission to “have regard” to the fair and reasonable value to a retailer of electricity fed into the network by a solar customer. As an example, the Commission may consider a range of values that it considers to be fair and reasonable and elect to set an amount at the low end of that range, if there are other factors weighing in favour of that outcome.

If this approach were to be adopted, it would be based on the view that competition, rather than regulation, is best able to promote the long-term interests of consumers.

Do the benefits of setting a regulated FiT Premium outweigh the associated costs?

Are there other regulatory approaches that should be considered by the Commission rather than directly determining the regulated FiT Premium?

An indicative timetable for the review is set out below.

TIMETABLE FOR THIS REVIEW

Stage	Timing
Issues Paper released	27 June 2013
Submissions to Issues Paper due	26 July 2013
Draft Report released	Mid-September 2013
Public consultation on Draft Report (6 weeks)	Late October 2013
Final Report released (including a Final Determination, if relevant)	End November 2013 / early December 2013
New determination (if made) takes effect	1 January 2014

FURTHER INFORMATION

Any queries relating to this consultation should be directed to:

▲ Con Carellas, Manager Market Analysis

If you would like to keep up to date with the Commission’s electricity industry activities and the release of papers for consultation, subscribe at <http://www.escosa.sa.gov.au/subscribe.aspx>.

NEXT STEPS

Following its consideration of submissions to this Issues Paper, the Commission will prepare a Draft Report (and Draft Price Determination if appropriate), to be released in September 2013. If the Commission considers that a new determination should apply from 1 January 2014, the derivation of the proposed FiT Premium will be explained in the Draft Report. In that circumstance, the Commission would apply the same methodology for calculating the FiT Premium as used in the June 2013 Determination of the FiT Premium to apply from 1 July 2013.

Following public consultation on the Draft Report, the Commission will release its Final Report (and Final Price Determination if made) in November/December 2013.



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