

Ref : TRIM10/12810

21 February 2010

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001*Via email to aer inquiry@aer.gov.au*

Dear Mr Pattas,

**Submission regarding AER Victorian electricity distribution network
Pricing Determination (2011-15)**

VicUrban welcomes the opportunity to comment on the Distribution Network Service Providers' (DNSPs) regulatory proposals for the Australian Energy Regulator (AER) Draft Determination on electricity distribution revenue regulation in Victoria for the period 2011 to 2015.

As the Victorian Government's sustainable urban development agency, VicUrban is committed to delivering high quality, sustainable communities that enhance Victoria's liveability while stimulating local economies and creating jobs.

The buildings and infrastructure being constructed today will continue to have an impact on the environment for the next 50 – 100 years. Urban redevelopment therefore creates a major opportunity to reduce the carbon pollution from our cities in a cost effective way. Retrofitting of infrastructure at a later date is highly likely to be cost prohibitive.

VicUrban has therefore been exploring the implementation of sustainable energy infrastructure as part of a number of our developments.

VicUrban has taken significant steps to reduce carbon pollution from energy use in individual buildings. Of particular significance has been the range of renewable energy and low carbon energy technologies such as tri-generation encouraged by the *Green Star* rating system developed by the Green Building Council. However there are significant commercial constraints to achieving further significant reductions in carbon pollution on a building by building basis.

VicUrban has therefore been exploring a number of opportunities to develop precinct-wide sustainable energy infrastructure solutions in the following major projects:

- Melbourne Docklands is Victoria's largest urban renewal project, partnering with private developers to accommodate approximately 17,000 residents and 40,000 workers.
- VicUrban's outer urban development at Officer in Melbourne's south east growth corridor will be home to 15,000 new residents and 6,000 jobs, and the town will service a broader regional catchment of 45,000 people.
- VicUrban has recently established a Federal-State partnership to build a new suburb in Melbourne's west to develop the 128ha former Department of Defence site in Maribyrnong. The project is expected to create up to 3000 ongoing employment opportunities and create 6,000 homes.
- VicUrban has also partnered with the City of Greater Dandenong to deliver a \$290million investment by the Victorian Government in new infrastructure and place-making to revitalise central Dandenong and leverage over \$1billion in private sector investment over the next 20 years. The project will create 5,000 new jobs and 4,000 new homes close to the transit corridor and in the city centre.

In the absence of proven business models for precinct wide sustainable energy infrastructure, VicUrban has undertaken extensive research and modelling, with a particular focus on the Dandenong project, to demonstrate a delivery model for sustainable energy infrastructure as part of urban renewal projects.

The first stage of this investigation involved a market process to procure the selection of a private sector party to finance, design, construct, own and operate a central tri-generation facility in central Dandenong. Respondents to this market process included both energy generation and distribution businesses. Despite a positive commercial feasibility the market was unable to provide a solution due to a number of regulatory and market failures.

It is VicUrban's experience that order for these types of projects to be implemented successfully and within a commercial framework, an appropriate regulatory process needs to be established to provide confidence, such that the market can pursue these opportunities with certainty. Existing institutional barriers to local embedded generation pose a real risk that the opportunities to help climate proof our cities through urban renewal will be lost.

It is clear from our market testing that existing and proposed regulatory structures are likely to frustrate rather than facilitate this economically and environmentally beneficial outcome. In particular VicUrban would like to explain and share the evidence of the impact of the following distribution related constraints on our developments:

1. System costs

VicUrban recognises the DNSPs fundamental role to maintain safety and reliability of the network, and that the mechanisms for investing in system upgrades and recouping costs are bound by the regulatory framework.

It is acknowledged that the DNSPs are obliged through Guideline 15 to facilitate connection of embedded generation to their network. However VicUrban have been advised by DNSP's that the implementation of embedded generation can require significant system upgrades to ensure the safety and reliability of the network, particularly in constrained areas of the network.

The mechanisms by which DNSP's are able to plan for and fund system upgrades to accommodate distributed generation do not provide certainty for developers. In particular the lack of a systematic and forward looking approach to such system upgrades may result in an unfair sharing of the costs amongst the full range of beneficiaries of the distributed clean energy generation.

2. Transmission system usage charges

Guideline 15 also outlines the provision for the pass through of avoided distribution system costs and the negotiation of avoided transmission system usage charges. There appears to be, however, little incentive for the DNSPs to facilitate connection of embedded generation when this leads to a loss of their revenue.

Where local embedded generation is installed, resulting in no reliance on the transmission network, uncertainty around the extent to which transmission system charges will apply is a significant additional risk to developers. The transaction cost of negotiating any reduction in charges on a case by case basis is also prohibitive, with significant information asymmetries strongly favouring the DNSPs.

3. Distribution system usage changes

VicUrban acknowledges that there are benefits to distributed energy providers of being connected to the network. These are both the potential opportunity to sell excess power generation capacity to the market, and the use of the network as a form of "back up" for any failure in the distributed generation system.

However it is not clear that it is fair or reasonable for developers to pay the full level of distribution charges irrespective of the level of demand on the system. In a similar way to transmission charges, developers face significant information asymmetries in negotiating any reduction in charges, strongly favouring the DNSPs, resulting in substantial uncertainty and cost

In light of our direct experience of these issues, VicUrban would be very happy to share the extensive technical and commercial modelling that we have undertaken across our projects, and highlight the commercial impacts of these regulatory issues. VicUrban also has some suggestions in relation to how these issues could be overcome.

We would therefore appreciate an opportunity to meet with you and your staff to discuss and present our practical experience of having sought to develop and (unsuccessfully) procure distributed energy infrastructure within urban renewal projects.

We would be particularly interested to meet with you ahead of the release of the draft determination as we hope that the draft determination will provide a rational framework to enable distributed energy to make a cost effective contribution to reducing the carbon pollution from urban development.

In the meantime, should you require any clarification or further detail, please contact Sarah Iwaniw on (03) 8317 3582.

Yours faithfully



David Young
General Manager
Project Planning and Innovation

