

8 August 2014

**Mr Warwick Anderson**  
**General Manager, Network Regulation**  
**Australian Energy Regulator**  
**GPO Box 3131**  
**CANBERRA ACT 2601**

**SUBMISSION: Endeavour Energy 2015-19 Price Proposal**

This submission has been prepared by Trans Tasman Energy Group (TTEG)<sup>1</sup> on behalf of Camden council (**Camden**) in response to public lighting aspects of Endeavour Energy's (**Endeavour**) price proposal.

Despite not having sufficient time to fully assess all aspects Endeavour's public lighting proposal, we trust our Submission and the issues we have raised will assist the AER in assessing Endeavour Energy's price proposal.

We advise the AER that if we have not commented on an aspect, it should not be interpreted that we agree with this aspect.

We submit the following issues and our comments to the AER for its consideration, and where appropriate, action.

## Process and Classification

Whilst we have only considered Endeavour's public lighting proposal there are multiple (often complex) documents plus exceeding complex workbooks that require review.

To effectively assess the proposal therefore requires significant resource and time, both which are not readily available to stakeholders. Further complications include that:

- all of Endeavour's proposal was not available on the website, and had to be sought via the AER with some documents (eg the cost model) only recently becoming available,
- Endeavour had removed key inputs and costs in its models and Regulatory Information Notice (RIN) response claiming confidentiality, and
- We are not aware that the inventory or revenue per Tariff Class has been provided by Endeavour which prevents an assessment by Tariff Class

Public lighting is less than a \$20 million p.a. revenue for Endeavour and with costs for providing the service known to Endeavour there should be no need for complex modelling to establish costs. There are only three basic cost components being capital, operating expense and overhead. Indeed the modelling could produce a materially different cost outcome to the costs

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<sup>1</sup> TTEG ([www.tteg.com.au](http://www.tteg.com.au)) provides specialist energy sector advice including commercial, environmental and regulatory aspects pertaining to Public Lighting. TTEG currently act as public lighting consultants to over one hundred Council municipalities and road authorities throughout Australia.

actually incurred by Endeavour. We were not able to ascertain if Endeavour actually reconciled its modelling with its actual costs or whether it's simply claiming the modelled cost is its actual cost?

Recognising the issues we have raised in this submission we request the AER consider requiring Endeavour to submit a simplified proposal that can easily be understood and verified by stakeholders and importantly reflects their "cost incurred". Cost incurred is an important regulatory consideration as if the AER had classified public lighting services as a Negotiated Distribution service then prices should reflect the cost incurred in providing the service. We do not believe there should be a material difference in prices simply because of the AER's Alternative Control classification.

Indeed, recognising the issues outlined in this submission, we request the AER to reconsider the classification of public lighting services as a Negotiated classification. This would not only provide additional information to customers (as confidentiality can be undertaken with Endeavour) but that the process to establish prices is not time constrained. Further customers can establish services directly with Endeavour.

## Profit

From the following table<sup>2</sup> in Endeavour's RIN response, in 2012/13 Endeavour made a \$7 million after tax profit (\$10 million before tax) on \$27.7 million of revenue (including \$7.5 million of customer contributed assets).

Statutory Account code or reference to account code	Description	Audited statutory accounts	Adjustments	Distribution business	Standard control services	Alternative control services
						Public lighting
		\$'000 nominal	\$'000 nominal	\$'000 nominal	\$'000 nominal	\$'000 nominal
	Distribution revenue			1,018,416	1,018,416	
	TUOS revenue			207,898	207,898	
	Cross boundary revenue					
	Profit from sale of fixed assets			667	616	51
	Customer contributions			74,721	67,219	7,502
	Interest income			155	155	
	Climate Change Fund Recovery			72,915	72,915	
	Solar Bonus Scheme Recovery			25,589	25,589	
	Other revenue			30,591	10,381	20,210
	<b>Total revenue</b>			<b>1,430,952</b>	<b>1,403,189</b>	<b>27,763</b>
	TUOS costs			205,212	205,212	
	Cross boundary charges			0		
	Climate Change Fund			74,250	74,250	
	Solar Bonus Scheme Payments			25,577	25,577	0
	Maintenance			189,251	189,251	0
	Operating Expenses			32,828	32,828	0
	Depreciation			179,818	173,955	5,863
	Finance Charges			198,657	198,657	0
	Loss from sale of fixed assets			0		
	Impairment Losses (nature of the impairment loss)			0		
	Other			61,299	49,507	11,792
	<b>Profit before Tax (PBT)</b>			<b>464,060</b>	<b>453,951</b>	<b>10,109</b>
	<b>Income Tax Expenses/(Benefit)</b>			<b>139,240</b>	<b>136,206</b>	<b>3,033</b>
	<b>Profit after tax</b>			<b>324,820</b>	<b>317,744</b>	<b>7,076</b>

<sup>2</sup> Endeavour 210213 RIN response Appendix 1a – public version, sheet number 1 "Income"

If we disregard the contributed assets the \$20.2 million revenue less \$5.9 million depreciation and \$11.8 million 'other' provides a \$2.5 million or 14% net profit before tax on a total cost of \$17.7 million. This appears excessive, and requires AER consideration.

If we allow \$6.8<sup>3</sup> million overhead in the \$17.7 million, then Endeavour's basic cost becomes \$10.9 million. So Endeavour's contribution to overhead and profit becomes \$9.3<sup>4</sup> million or 85% which is well above the 25% expected industry norm.

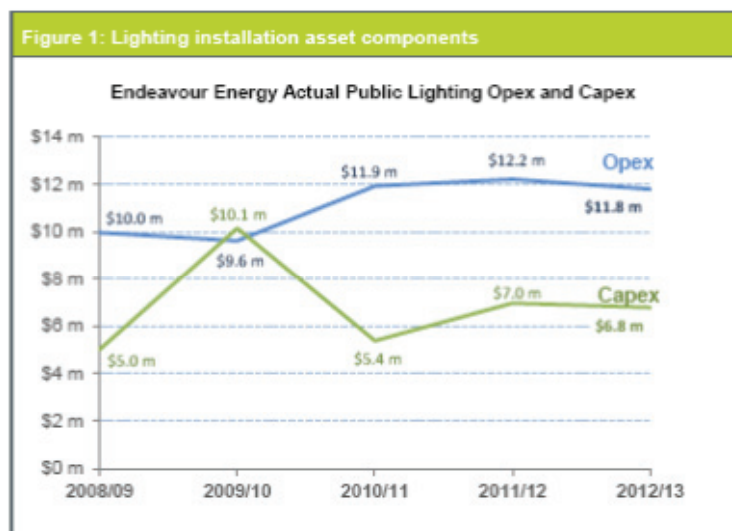
We note the \$11.8 million 'other' costs matches the \$11.8 million Opex in the Endeavour Energy Proposal<sup>5</sup>.

## Data Validity

Endeavour Energy included the following figure in its Public Lighting Proposal<sup>6</sup> noting that the Opex includes overheads.

From the figure we note that Endeavour's 2012/13 Opex and Capex total is \$18.6 million.

The claimed \$6.8 million Capex component is of concern as fails to reconcile with the \$5.55 million of public lighting Capex in 2011/12 that Endeavour Energy identified in its Cost Allocation Method (CAM)<sup>7</sup>.



Of interest we note that the \$5.55 million for 2011/12 is close to the \$5.86 million contained in Endeavour's 2012/13 RIN.

We submit that the AER should require Endeavour to confirm its 2011/12 actual Capex cost.

<sup>3</sup> As derived for 2015/16 later in our Overhead considerations

<sup>4</sup> \$6.9 million overhead and \$2.5 million profit

<sup>5</sup> Endeavour Energy Proposal, Attachment 8.02, Fig 1, page 8

<sup>6</sup> Endeavour Energy Proposal, Attachment 8.02, Fig 1, page 8

<sup>7</sup> Endeavour Energy Cost Allocation Method, page 21, table 8

Table 8: Example allocation of capex 2011-12

Capex / Project	Sub-activity	Cost 2011-12 (\$m)	Cost type	Standard control services	Alternative control services	Unregulated services
Distribution Works Program	18 - Construction - Distribution Works	44.35	Direct allocation	100%	0%	0%
Street Lighting Capital	12 - Construction - Street Lighting	5.55	Direct allocation	0%	100%	0%

Endeavour attributes the rise in Opex from 2010/11 to a loss of business synergies following the sale of Integral Energy which has resulted in higher overheads. We have considered overheads separately in our submission, demonstrating they are excessive and potentially not compliant with Endeavour's Cost Allocation Method (**CAM**).

In addition to the Opex discrepancies we have also noted similar discrepancies regarding Overheads as discussed in our submission.

## Tax Component

Endeavour Energy includes tax costs of between \$6 to \$35 p.a. as a component of the proposed Tariff Class 4 charges (i.e. where Endeavour own the assets that have been gifted to them).<sup>8</sup> The tax costs claimed by Endeavour Energy relate to income tax payable on the lighting assets gifted primarily from developers to Endeavour Energy on which Endeavour then charge SLUOS to public lighting customers. NOTE:

We submit to the AER that it must reject Endeavour Energy's inclusion in its calculations of the SLUoS tariff any tax costs incurred by Endeavour Energy in acquiring assets used to provide Public Lighting Services.

Endeavour Energy has not indicated the extent to which any tax obligations falls upon the developers or what (if any) contributions are paid by Endeavour Energy to the developers on transferring the assets to Endeavour Energy.

We however understand Endeavour Energy may require developers to pay stamp duty and other taxes attributable to the transfer of ownership of assets to Endeavour Energy.

We do not believe Endeavour Energy's tax costs can fairly be included in the SLUoS tariff on the basis that:

- (a) if Endeavour Energy do not own the asset it cannot charge the SLUoS tariff;
- (b) Endeavour Energy may already be claiming tax costs from developers;
- (c) the SLUoS tariff is paid by the public lighting customers to maintain assets owned by Endeavour Energy for the provision of SLUoS and consequently Endeavour Energy must (first) own the asset before Endeavour Energy can charge a SLUoS tariff for a service provided by that asset;

<sup>8</sup> Endeavour Energy proposal Attachment 8.2, model – "TC4" sheet column L

- (d) Endeavour Energy gain an asset from the gifting of the light as the value of the asset appears on their balance sheet;
- (e) the tax cost is a cost to Endeavour Energy of acquiring the asset, rather than a cost incurred in providing SLUOS Services to councils

In summary, Endeavour Energy must seek the payment of any tax obligations from the parties gifting the lighting assets to Endeavour Energy. It must not be included in the SLUOS charge where we note Endeavour Energy treats it as capital and applies WACC and indexation.

## Regulatory Asset Bases (RAB and TAB)

Endeavour appears to have applied a Roll forward model and Post Tax Revenue model approach in establishing its capital charges for pre 2009 assets. Whilst this is one approach, it is not a required approach for Alternative Controlled assets, and indeed, as we explain below it is not an appropriate approach to establishing cost reflective charges.

The Endeavour Energy supplied councils submitted to the AER that public lighting should be classified as a Negotiated Distribution service (**NDS**). Under the National Electricity Rules (**NER**). The price for a Negotiated Distribution service must reflect the cost of providing that service. Having classified public lighting services as an Alternative Controlled service, we would expect that the AER would carefully consider Endeavour's pricing proposal, ensuring that the resultant tariffs were similar to that which would be derived from a NDS classification and that customers were not disadvantaged by the AER's classification.

In the following table <sup>9</sup>, our understanding is Endeavour's Opening Regulatory Asset Base (**RAB**) for assets installed prior to 2009 is around \$28.6 million and that its taxation asset base (**TAB**) is around \$1.1 million representing a material disconnect between the distributor's actual cost (which is based on the TAB) and the asset cost it is proposing to its customers.

Whilst we understand Endeavour is a corporatized NSW government entity, our understanding of the TAB is Endeavour has almost fully depreciated these assets and will have fully depreciated during the coming period.

Our view is if the assets have been fully depreciated then there can be no cost incurred by Endeavour Energy. If we have understood Endeavour's workings, despite having no cost, Endeavour is claiming costs for these assets of around \$8.3 million over the regulatory period at ~ \$1.6 million p.a.<sup>10</sup> based on the \$28.6 million.

We submit to the AER that Endeavour Energy's proposed capital components for tariff class 1 are not cost reflective, and if approved, would provide a windfall profit to Endeavour.

<sup>9</sup> Endeavour Energy proposal Attachment 8.2, model – "RAB" sheet

<sup>10</sup> Endeavour Energy proposal Attachment 8.2, model – "TC 1 & 2" sheet row 634

		Opening RAB	Opening TAB
		\$	\$
<b>Asset Class Name</b>			
1 x 20 W Fluorescent		2,732	1,874
2 x 20 W Fluorescent		3,349	2,656
4 x 20 W Fluorescent		-	-
2 x 14 W Fluorescent		-	29,999
2 x 24 W Fluorescent		-	-
1 x 40 W Fluorescent		10,444	8,685
2 x 40 W Fluorescent		-	-
1 x 42 W Fluorescent		-	-
50W Mercury		4,507	3,379
80W Mercury		2,781,053	17,849
125W Mercury		70	171
250W Mercury		197,036	1,791
2 x 250W Mercury		-	-
400 W Mercury		91,938	388
700 W Mercury		-	-
50W Sodium		-	-
70W Sodium		-	-
90W Sodium		-	-
100W Sodium		15,715	6,964
120W Sodium		6,799	5,496
150W Sodium		1,019,918	46,339
250W Sodium		1,261,303	-
2 x 250W Sodium		-	-
310W Sodium		-	-
400 W Sodium		111,617	-
2 x 400 W Sodium		432	1,022
4 x 600W Sodium		-	-
60 W Incandescent		-	-
100 W Incandescent		-	-
500 W Incandescent		1	-
1000 W Incandescent		-	-
1500 W Incandescent		-	-
100 W Metal Halide		1,896	275
150 W Metal Halide		2,126	36,914
250 W Metal Halide		17,799	678
2 x 250 W Metal Halide		2,748	6,517
400 W Metal Halide		-	5,448
2 x 400 W Metal Halide		1,152	2,743
1000 W Metal Halide		-	36
600 W Sodium		3,417	1,873
Pole mounting bracket minor (<=3m)		1,550,165	317,117
Pole mounting bracket major (>3m)		2,160,956	159,284
Outreach Minor (<=2m)		325,963	86,746
Outreach Major (>2m)		387,111	-
Minor Column (<=9)		3,938,620	-
Major Column (>=9)		14,740,264	349,487
<b>Total</b>		<b>28,639,132</b>	<b>1,093,730</b>

## LED Luminaires

Endeavour has proposed 25W LED tariffs for 2015/16 at \$61 p.a for Tariff Class (TC) 4 and \$126 p.a for TC3.

Whilst not approved via the 2009-14 process, in 2013 the AER approved a 25W LED light tariff for Endeavour Energy (without stakeholder scrutiny) on the basis that the tariffs were established in a manner consistent with current determination.

Whilst we understand the AER's reasons and its pricing methodology, we advise the AER that the 25W LED light (and all other LED lights) must be considered an "emerging public lighting technology" for the 2015-19 period.

Our view that the LED lights are an emerging technology is supported by the fact that the current Australian Standard for public lighting AS 1158.6 are not suitable for LED lights and that many distributors do not have LEDs "approved".

Whilst Endeavour has "approved" the 25W LED we are not aware that it has installed any significant number of LEDs and as such is not in a position to effectively establish a tariff.

Like Victoria, SA and Tasmania, we believe these emerging technologies should be treated as Negotiated Services – an approach which will enable services and charges to be negotiated for these very different light types.

Treating LEDs like any other light is fundamentally flawed. Indeed Endeavor in its proposal has used a 12 year life for LEDs yet a 20 year useful life for all other light types. This variation has not been explained by Endeavour.<sup>11</sup>

In addition, the characteristics of the LED light are materially different to that of other lights. In particular, the maintenance requirements of LED lights are significantly less. In this regard, we advise the AER that the proposed tariffs are inappropriate as it has been based on the same maintenance regimes (and cost model) as applied to existing light types.

Further, as public lighting end users are able to negotiate extended warranty periods with LED manufacturers, we expect DNSPs can too. As such, if cost models as applied to existing technologies are applied to LED (emerging) technologies then the DNSP will be provided with a profit windfall.

We submit to the AER that it rejects Endeavour's proposed LED tariffs and reclassifies emerging technologies as a negotiated distribution service.

We also submit that if the distributor intends to introduce any new tariffs during a regulatory period that the distributor's proposal is provided for stakeholder scrutiny.

## Overheads

In the table below we have estimated Endeavours overhead component at \$6.85 million based on Endeavour's proposal.

Overhead Calculation <sup>12</sup>			
	lights	other	Total
rate	\$33.62	\$8.40	
inventory	156,372	190,691	
	<b>\$5,256,453</b>	<b>\$1,602,528</b>	<b>\$6,858,982</b>

<sup>11</sup> Endeavour Energy proposal Attachment 8.2, model – "Annuity" tab, row 32 column E and F

<sup>12</sup> Endeavour Energy proposal Attachment 8.2, model. Rates ex "Annuity" sheet column L and Inventory ex "RAB" sheet, column L– "TC4" sheet column N summated for the relevant components.

As Endeavour's proposed 2015-16 revenue is \$21.7 million<sup>13</sup>, its basic cost (net of overhead) becomes \$14.9 million. The \$6.8 million overhead represents around 45% on the basic cost.

Frustratingly, Endeavour's overhead allocations have been blanked out in its RIN.<sup>14</sup> We do not see that this can be confidential information and request the AER to require Endeavour to publish. Without the allocations known stakeholders cannot assess compliance with Endeavour's CAM.

Interestingly, Endeavour's 2012/13 operating overheads were \$4.0 million<sup>15</sup>

This overhead allocation requires careful consideration by the AER to ensure CAM compliance.

## Annual Adjustment

We notice that Endeavour has an Adjustment for Volume Growth in its model<sup>16</sup>, <sup>17</sup>

Unfortunately, as once again the data has been hidden by Endeavour, we cannot assess.

What we can gather from the information provided is that it does not appear that Endeavour has not made any allowance for reducing its tariffs year on year to reflect the additional (new) lights installed in that year. These new lights increase Endeavour's inventory, and would result in decreasing (on a \$/light basis), the fixed components of Endeavour's costs (eg overhead).

We submit to the AER that it should require Endeavour to recognise the year on year impact of additional (new) lights in establishing its tariffs.

## Tariff Classes

Endeavour has identified the following Tariff Classes and the services it intends to provide in the following table<sup>18</sup>

Table 5: Public lighting tariff structure				
Tariff	Install Date	Capital Provision	Maintenance Responsibility	Replacement Responsibility
Rate 1	<=1 July 2009	Endeavour Energy	Endeavour Energy	Endeavour Energy
Rate 2	<= 1 July 2009	Customer	Endeavour Energy	Endeavour Energy
Rate 3	> 30 June 2009	Endeavour Energy	Endeavour Energy	Endeavour Energy
Rate 4	> 30 June 2009	Customer	Endeavour Energy	Endeavour Energy
Rate 6	N/A	Customer	Endeavour Energy manages the Lamp	Endeavour Energy Customer Photo Cell and Fuse. Rest of the maintenance by the Customer

<sup>13</sup> Endeavour Energy proposal – 8.02A1 – Proposed relative major customer bill impacts (Public)

<sup>14</sup> Endeavour 210213 RIN response Appendix 1a – public version, sheet number 15 "Overheads Allocation"

<sup>15</sup> Endeavour 210213 RIN response Appendix 1a – public version, sheet number 11 "Operating Overheads"

<sup>16</sup> Endeavour Energy proposal Attachment 8.2, model – "TC3" tab, cell E 173

<sup>17</sup> Endeavour Energy proposal Attachment 8.2, model – Annuity sheet

<sup>18</sup> Endeavour Energy Proposal, Attachment 8.02, Table 5, page 9



### **Tariff Class 1**

The issues regarding the RAB/TAB and capital costs and the application of WACC have been discussed earlier and require consideration by the AER.

### **WACC**

Endeavour has applied WACC on the opening RAB for each year yet as shown in the model, the RAB decreases during each year.<sup>19</sup> By adopting the approach it has, Endeavour is therefore proposed to receive more revenue than if applied to the average asset base for the year.

### **Tariff Class 3**

Endeavour has established prices based on an annuity approach and then added tax. As discussed earlier, the tax component must be removed

Whilst Endeavour has provided its capital cost to install a light, how this cost has been derived has not been explained and customers have therefore been denied the opportunity to assess. Importantly it is not clear if the capital cost includes overhead? If so, then Endeavour has not demonstrated compliance with Endeavour's CAM?

### **Tariff Class 4**

We have not had sufficient time to appropriately assess Endeavour's proposal, but as established in our submission the tax component must be removed.

### **Tariff Class 6 and Extra Tariff**

Endeavour has not provided rates for this tariff so we cannot comment on their appropriateness and compliance. Note: This is another ideal situation for a Negotiated service classification.

We note from Essential Energy's proposal that it has introduced a Tariff Rate 99.<sup>20</sup>

*"This was previously Rate 6 and is a tariff that does not attract SLUOS charges. It is in the system for lights that are connected unmetered to the low voltage network and as such there remains a need to calculate their consumption and retail and network charges however maintenance is performed by other parties and there is no SLUOS charge. This tariff has been renamed to Tariff rate 99 so that it does not get confused with SLUOS related tariffs."*

We submit that the AER requires Endeavour energy to establish a "Tariff 99" to match the services provided by Essential Energy for their Tariff 99.

We advise the AER that without a "Tariff 99", the market cannot develop effectively as customers would not have a tariff allowing them to own and maintain lights.

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<sup>19</sup> Endeavour Energy proposal Attachment 8.2, model – "RF" tab, row 1563

<sup>20</sup> Essential Energy Proposal, Attachment 8.1, page 14

## Carbon Scheme Reduction

We are not aware that Endeavour Energy has identified a reduction in its costs from the removal of the Carbon scheme from 1 July 2014.

This requires investigation by the AER.

## Asset Replacement

For Tariff Classes 1 to 4, Endeavour has assumed it will automatically replace lights at the end of their useful life.

Whilst replacement may be indicated in the Public Lighting Code, customers should be provided the opportunity to change tariffs at this time, including changing to Tariff Class 6, where customers own and maintain the replacement light.

**END**