



Final decision

**Control mechanisms for alternative control
services for the ACT and NSW 2009 distribution
determinations**

February 2008

© Commonwealth of Australia 2008

This work is copyright. Apart from any use permitted by the *Copyright Act 1968*, no part may be reproduced without permission of the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601.

Contents

Shortened forms	iii
1 Introduction	1
2 Rule requirements	2
2.1 Deciding on a control mechanism.....	3
2.2 Annual pricing approvals	4
3 Other relevant regulation	5
3.1 ICRC	5
3.2 IPART	5
4 Reasons for the statement on the control mechanism for alternative control services	8
5 AER preliminary positions	9
5.1 ACT.....	9
5.2 NSW.....	9
6 Issues raised in submissions and the AER response.....	13
6.1 ACT.....	13
6.1.1 Stakeholder comments	13
6.1.2 AER conclusion	13
6.2 NSW.....	13
6.2.1 Potential for competition.....	13
6.2.2 Proposed asset valuation	14
6.2.3 Relationship between service levels and price.....	16
7 Consideration of factors set out in the rules	18
8 AER decision.....	20
8.1 ACT.....	20
8.2 NSW.....	20
Appendix A: Submissions received on the alternative control mechanism.....	21
Appendix B: Statement on the control mechanism for alternative control services	22

Shortened forms

AER	Australian Energy Regulator
capex	capital expenditure
CPI	consumer price index
DNSP	distribution network service provider
EMRF	Energy Markets Reform Forum
Excluded Services Rule	Rule 2004/1—Regulation of Excluded Distribution Services
ICRC	Independent Competition and Regulatory Commission (ACT)
IPART	Independent Pricing and Regulatory Tribunal (NSW)
MCE	Ministerial Council on Energy
MEU	Major Energy Users Inc.
NEL	National Electricity Law
NEM	national electricity market
NER	National Electricity Rules
opex	operating expenditure
Public lighting code	NSW Public Lighting Code
RAB	regulatory asset base
SSROC	Southern Sydney Regional Organisation of Councils
WACC	weighted average cost of capital

1 Introduction

In November 2007, the Australian Energy Regulator (AER) published an issues paper on the control mechanisms for alternative control services for distribution network service providers (DNSPs) in the ACT and NSW for the 2009–14 regulatory control period and called for submissions from interested parties. After reviewing submissions, the AER released a preliminary positions paper in December 2007.

The preliminary positions paper invited submissions from interested parties of which the AER received seven submissions on the control mechanism for alternative control services. This decision sets out the AER’s consideration of comments raised in these submissions. The publication of the accompanying statement of the AER’s likely approach to control mechanisms for alternative control services is done under clause 6.2.5(e) of the transitional Chapter 6 rules.

The AER is responsible for regulating the revenues and/or prices of in the national electricity market (NEM) in accordance with the National Electricity Rules (NER), which were notified in the South Australian Gazette on 20 December 2007. This decision and corresponding statement apply to Country Energy, EnergyAustralia and Integral Energy (collectively referred to in these documents as ‘the NSW DNSPs’) and ActewAGL.

Within the NER, Chapter 6 deals with the classification and economic regulation of distribution services, while Chapter 6A deals with the economic regulation of transmission services. The Ministerial Council on Energy (MCE) has determined that transitional arrangements will apply to the preparation and assessment of the ACT and NSW 2009 distribution determinations. The transitional arrangements for the 2009–14 distribution determinations for DNSPs in the ACT and NSW are set out in appendix 1 to Chapter 11 of the NER. Clause references in appendix 1 are numbered commencing with a six. This decision and the accompanying statement will only apply to the transitional period, 2009–14. At future regulatory determinations ACT and NSW DNSPs will be subject to Chapter 6 of the NER.

The NER distinguishes between the rules in Chapter 6 and Chapter 11 by referring to the Chapter 6 rules as ‘general Chapter 6 rules,’ and Chapter 11 rules as ‘transitional Chapter 6 rules.’ The AER has followed this convention in this document when referring to the two sets of rules.

2 Rule requirements

Part B of the transitional Chapter 6 rules confers power on the AER to determine the forms of control for alternative control services.

6.2.5 Control Mechanisms for direct control services

- (e) The AER must, before 1 March 2008 or the date that is one month after the commencement date (whichever is the later), *publish* a statement indicating its likely approach to the control mechanisms for *alternative control services*. In preparing the statement, the AER may carry out such consultation as the AER thinks appropriate and may take into consideration any consultation carried out before the commencement date.

The transitional Chapter 6 rules classify distribution services into the following categories:

- direct control services
- negotiated services
- unregulated services.

The services in each category will be subject to a different form of regulation. The two types of direct control services are standard control and alternative control. Standard control services must be regulated using a building block calculation, however, alternative control services may, but need not be, regulated using a building block calculation.

The transitional Chapter 6 rules, at clauses 6.2.3B and 6.2.3C, prescribe which services will be classified as alternative control services:

- ACT: the provision of and servicing of meters for customers consuming fewer than 160 megawatt hours per annum (types 5–7 meters), including:
 - meter testing
 - meter reading
 - meter checking
 - the processing of metering data
 - the provision of non-standard meters
- NSW: the construction and maintenance of public lighting infrastructure by DNSPs in NSW.

The transitional Chapter 6 rules do not define the services which should be classified as ‘public lighting infrastructure’. However, the notes to clause 6.2.3B(b) of the transitional Chapter 6 rules do refer to the Independent Pricing and Regulatory Tribunal’s (IPART’s) 2004–09 distribution determination as the basis for establishing which services should be classified as alternative control. Accordingly, in considering

which services are part of public lighting infrastructure it is appropriate to use the same approach as that adopted by IPART.

The services which IPART considered to be excluded services were the construction and maintenance of public lighting assets.¹ In addition, IPART did not consider the following two services, related to public lighting, to be excluded services:

1. The provision of distribution services to deliver energy to the public light was considered to be a prescribed distribution service.
2. The provision of the energy consumed by the public light was considered by IPART to be a non-distribution service and was not affected by the 2004–09 determination.²

The transitional Chapter 6 rules also provide that in the future additional services may be classified as alternative control services. Clause 6.2.3B(b)(2)(ii) provides that the services set out below, which are to be classified as unregulated in 2009–14, may be classified as alternative control if the AER determines that the DNSP is no longer in substantial compliance with the provisions of IPART’s Rule 2004/1—Regulation of Excluded Distribution Services (the Excluded Services Rule):

- customer funded connections
- customer specific services
- type one to four metering services.

2.1 Deciding on a control mechanism

Clause 6.2.5(c2) of the transitional Chapter 6 rules sets out the form of control that the AER may apply:

6.2.5 Control mechanisms for direct control services

- (c2) The control mechanism for alternative control services may consist of:
- (1) a schedule of fixed prices;
 - (2) caps on the prices of individual services;
 - (3) caps on the revenue to be derived from a particular combination of services;
 - (4) tariff basket price control;
 - (5) revenue yield control;
 - (6) a combination of any of the above.

Clause 6.2.5(d) sets out the matters the AER must have regard to in considering the appropriate control mechanisms for alternative control services.

¹ IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09*, Final Report, June 2004, p 175.

² *ibid.*

6.2.5 Control mechanisms for direct control services

- (d) In deciding on a control mechanism for *alternative control services*, the AER must have regard to:
- (1) the potential for development of competition in the relevant market and how the control mechanism might influence that potential; and
 - (2) the possible effects of the control mechanism on administrative costs of the AER, the *Distribution Network Service Provider* and users or potential users; and
 - (3) the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination; and
 - (4) the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and
 - (5) any other relevant factor.

2.2 Annual pricing approvals

Clause 6.18.2 of the transitional Chapter 6 rules requires DNSPs to submit pricing proposals to the AER on an annual basis that include proposed tariffs and tariff classes for alternative control services.

6.18.2 Pricing proposals

- (a) A *Distribution Network Service Provider* must:
- (1) submit to the AER, as soon as practicable, and in any case within 15 *business days*, after *publication* of the distribution determination, a *pricing proposal* (the "*initial pricing proposal*") for the first *regulatory year* of the *regulatory control period*; and
 - (2) submit to the AER, at least 2 months before the commencement of the second and each subsequent *regulatory year* of the *regulatory control period*, a further *pricing proposal* (an "*annual pricing proposal*") for the relevant *regulatory year*.

3 Other relevant regulation

3.1 ICRC

The Independent Competition and Regulatory Commission (ICRC) excluded metering services from the revenue cap that applied to distribution services at the last reset in the ACT. The ICRC determined that metering services in the ACT would be subject to a separate total revenue cap which is escalated annually by the consumer price index (CPI).

3.2 IPART

Rule 2004/1—Regulation of Excluded Distribution Services

IPART decided that all excluded distribution services would be regulated through the Excluded Services Rule. In particular, this Rule outlines the regulatory framework including pricing principles, information disclosure requirements and price monitoring arrangements, and additional requirements that would apply to public lighting.

These principles require that:

- prices are to signal the economic costs of service provision by being subsidy-free (this requires them to be between incremental and stand alone costs)
- the underlying service classifications, cost data, cost allocations and other elements that contribute to the prices charged by the DNSP should be periodically reviewed and updated where relevant to reflect industry developments and changes in user requirements and preferences, methods of service provision and associated costs
- DNSPs must also consider the impact of the price change on customers.

Two months prior to any price changes, DNSPs must submit a public lighting report to IPART outlining the proposed price changes, the costs of providing the services, the service standards supporting those costs, and an assessment of the impact of the changes on customers.

IPART assessed the proposed changes against the pricing principles and whether the DNSP has considered the impacts on customers. If IPART was not satisfied it would require the DNSP to submit an alternative proposal. Any price change information and new prices would be made available to customers one month before the new prices became effective.

NSW Public Lighting Code

In addition to the Excluded Services Rule, the Department of Energy, Utilities and Sustainability (DEUS) introduced a voluntary code of practice for a range of public lighting services in NSW, the NSW Public Lighting Code (the Public Lighting Code),

in January 2006.³ The purpose of the Public Lighting Code is to help clarify the relationship between public lighting service providers and customers, and sets out some benchmarks to assist local councils. In particular, it sets out:

- minimum maintenance standards and associated service level guarantees
- minimum requirements for inventories, management plans, performance reporting and billing
- a requirement that service providers consult with customers in deciding which core lighting types they are going to offer
- a mechanism allowing for connection of lighting types outside the core choices offered by service providers.

The types of minimum standards and service level guarantees set out in the Public Lighting Code include:

- operating a 24 hour call centre
- minimum repair times and contact with customers and the road authority as appropriate
- compensation where the service provider fails to repair faults within certain time periods
- using luminaries that comply with Australian standards and that the service provider take into consideration the requests of customers
- regular maintenance of public lighting assets.

The AER notes that the Public Lighting Code is voluntary, it is not enforceable, and it does allow for variation where ‘local circumstances necessitate alternative arrangements’. Clause 17 states:

17 Variation

17.1 This Code establishes a framework for the management of Public Lighting Assets that the Service Provider owns and maintains or has agreed to maintain. However, it is acknowledged that local circumstances may sometimes necessitate alternative arrangements.

17.2 Either a Service Provider or a Customer may seek written agreement from the other to expressly vary the application of this Code to particular circumstances that affect both parties. If such agreement is sought, both the Service Provider and the Customer must negotiate in good faith. Any variation to the operation of this Code, including any alterations to the minimum standards, must be specified in the Service Level Agreement or (if there is no Service Level Agreement) otherwise documented in writing.

17.3 If a Service Provider and a Customer have agreed (in accordance with 17.2) to alter the application of this Code in specified circumstances by reducing the

³ The Department of Water and Energy has now assumed responsibility for the Code.

minimum standard of service under the Code, the Service Provider is only obliged to comply with the agreed reduced standard of service in those circumstances specified.⁴

As set out above, the service provider or customer may seek agreement from the other party to vary the operation of the Public Lighting Code. Where such agreement is reached, the service provider will only be required to comply with the agreed reduced standard of service. In addition, Chapter 11 of the Public Lighting Code sets out general minimum service standards. However, at 11.3(b), the Public Lighting Code allows for longer response times where repairs are required in ‘remote locations’.

Importantly, the AER notes, the Public Lighting Code is voluntary and distributors and customers have scope to vary parts of the Public Lighting Code and still be in compliance with the Public Lighting Code.

The AER understands that the Department of Water of Energy is currently reviewing the Public Lighting Code, with a view to determining its effectiveness and whether any amendments are necessary.

⁴ Clause 17 of the NSW Public Lighting Code.

4 Reasons for the statement on the control mechanism for alternative control services

Clause 6.2.5(c2) of the transitional Chapter 6 rules gives the AER discretion regarding the forms of control that are to apply to alternative control services for the ACT and NSW 2009–14 regulatory control period.

The AER is required to publish a statement indicating its likely approach to the form of control for alternative control services.

Under clauses 6.2.4 and 6.2.5 of the transitional Chapter 6 rules, the AER is to make a distribution determination for each DNSP that is to impose controls over the prices or revenue, or both, of direct control services. The control mechanism is the means by which the AER will impose controls over the prices and/or revenues of direct control services.

The AER's statement on control mechanisms for alternative control services sets out the control mechanisms that the AER is likely to apply to the ACT and NSW DNSPs and explains how they will be applied.

5 AER preliminary positions

5.1 ACT

In its preliminary position paper, the AER stated it considered that retaining the existing approach to regulating ActewAGL's alternative control services for the next regulatory control period was appropriate and consistent with the transitional Chapter 6 rules.

Under this approach, ActewAGL would propose a revenue allowance based on a limited building block analysis, with maximum allowable revenues to be escalated each year by CPI. Consistent with the approach taken in the current regulatory control period, the revenue allowance would be established based on the rolled-forward value of the relevant metering assets, and an analysis of the change in costs associated with providing the services. The AER proposed that it would allow a return on capital for alternative control services equal to that allowed for standard control services.

The AER also noted additional obligations may be placed on ActewAGL during the next regulatory control period by the MCE. These obligations are associated with the roll-out of interval meters. The AER stated efficient costs incurred through meeting these obligations should be recovered through ActewAGL's charges. Under clause 6.2.6(c) of the transitional Chapter 6 rules the costs of providing alternative control services (like these) may be recovered via the pass through mechanism.

5.2 NSW

Proposed form of control and implementation for public lighting in NSW

The AER proposed to apply the following form of control to public lighting services over the next regulatory control period:

- a schedule of fixed prices in the first year of the regulatory control period
- a price path (such as CPI-X) for the remaining years of the regulatory control period.

The AER proposed using a limited building block analysis to establish the schedule of fixed prices and a price path. The proposed approach would simplify the building block approach in the following ways:

- DNSPs will not be required to provide a separate proposal on the weighted average cost of capital (WACC) for public lighting services. DNSPs may propose the same WACC as applied to standard control services.
- DNSPs may propose reasonable simplifying assumptions within the building block model. In particular, the AER will accept the present depreciation assumptions applied by DNSPs.
- DNSPs may base their opening asset valuation for existing public lighting assets on the existing asset valuation, with any efficient adjustments for capex and depreciation in the current regulatory control period.

The AER proposed to conduct a high level evaluation of the existing DNSP asset valuations for public lighting. The AER proposed applying the historical asset base with any adjustments resulting from the current regulatory control period.

Regulatory proposal for public lighting in NSW

The AER stated that the following information should be provided to support the proposed control mechanism:

- an overview of the public lighting services provided by the DNSP
- cost information
- asset valuation information
- pricing information
- service level information.

Form of control

The AER considered that some aspects of the control mechanism that IPART adopted for alternative control services are consistent with the transitional Chapter 6 rules but the following two elements do not appear to be consistent:

- Clause 2.2(a)(1) of the Excluded Services Rule includes a list of pricing principles with which DNSPs are required to comply. These pricing principles, set out in the Excluded Services Rule, are different to the pricing principles set out in clause 6.18.5 of the transitional Chapter 6 rules.
- Clause 2.3(a)(2) of the Excluded Services Rule allows DNSPs to amend prices on an ad hoc basis during the regulatory control period. The AER did not consider this to be consistent with the list of control mechanism set out at clause 6.2.5(c2) of the transitional Chapter 6 rules which requires the control mechanisms to apply across the entire regulatory control period.

Therefore, to be consistent with the list of control mechanisms at clause 6.2.5(c2) of the transitional Chapter 6 rules, the AER proposed that the control mechanism would be a schedule of fixed prices for the first year followed by a price path such as CPI-X for the remaining years of the regulatory control period. The AER notes that the practical application of the Excluded Services Rule may deliver an outcome that is similar to the AER's proposed form of regulation.

Limited building block

The AER proposed to assess the efficient costs of providing public lighting services under the form of control through a limited form of building block analysis. The AER considered that a limited building block analysis finds the right balance between providing stakeholders with assurance of underlying costs and the administrative burden on the DNSPs and the AER.

Price path

The AER considered that a price path will minimise the ongoing costs and difficulties of applying the regulatory control mechanisms for public lighting for all parties involved. It considered that the proposed approach will:

- provide predictable pricing outcomes for customers
- limit price volatility
- provide transparent information to interested parties
- simplify the pricing approvals process, avoiding repetitious and lengthy processes.

Regulatory asset base

The AER considered that the historical regulatory asset base (RAB) values are a reasonable basis on which to determine the opening asset valuations in the next regulatory control period. The AER did not intend to duplicate this process due to the material regulatory cost impost of revaluing an established asset base and a significant number of low value assets. The AER also recognised the limited ability of DNSPs to provide a complete regulatory proposal for public lighting in the context of the larger regulatory reset preparation being undertaken by DNSPs at the present time.

Cost criteria

The AER's preliminary position was it would assess public lighting costs on the basis of efficiency. The AER considered this approach to be consistent with the light-handed regulatory regime envisaged by the transitional Chapter 6 rules for alternative control services. The AER also proposed to use the Public Lighting Code as a general service level benchmark for assessing efficient costs.

Price path escalators

The AER considered that all price path escalators should be proposed and valued in the regulatory proposal. These escalators should be based on the cost information provided by the simplified building block analysis, and DNSPs should demonstrate the relationship between the final escalators and this analysis. DNSPs should also submit indicative prices in its regulatory proposal for the next regulatory control period based on the proposed escalator values.

Service levels

The AER's preliminary position was that it will allow DNSPs to collect revenues through prices which are reflective of the costs of providing efficient public lighting services of a particular standard. The AER considered it appropriate to apply the voluntary Public Lighting Code as this standard of service level performance.

To ensure that prices are reflective of service levels and associated costs, DNSPs must demonstrate how their prices reflect the agreed levels of service for public lighting in their regulatory proposals. Where the service level outlined in the Public Lighting Code is not acceptable or appropriate, customers may negotiate with the DNSP for a variation in prices reflective of the agreed service levels.

Information transparency and price caps

The AER considered that the proposed price path and annual pricing review processes to set tariff prices and their individual tariff components will provide more certainty for customers regarding prices and price changes.

Pricing

In its preliminary position paper the AER stated that pricing will not be assessed against the criteria outlined in the Excluded Services Rule but rather NSW DNSPs will be required to follow the pricing principles outlined in the transitional Chapter 6 rules.

The regulatory proposal process

The AER considered that the information requirements set out in the transitional Chapter 6 rules require DNSPs to supply all necessary information to the AER at the time of submission. The AER also noted that clause 6.8.2(c)(4) of the transitional Chapter 6 rules requires DNSPs to outline indicative prices within the regulatory proposal. Integral Energy submitted a phased approach to implementing the regulatory mechanism by proposing that the regulatory proposal should:

- outline the proposed form(s) of control to apply over the next regulatory control period
- demonstrate its functionality
- contain supporting information to demonstrate the way the control mechanism will apply (Integral Energy calls this the ‘proof of concept’).

The AER considered that DNSPs will need to provide more than just ‘proof of concept’ information regarding the form and operation of control for public lighting services.

The DNSPs should propose a price path for the five years of the regulatory control period along with indicative prices.

6 Issues raised in submissions and the AER response

The AER received seven submissions regarding the control mechanism for alternative control services. Most of the submissions that the AER received were broadly supportive of the AER's approach regarding the control mechanism for alternative control services.

6.1 ACT

6.1.1 Stakeholder comments

ActewAGL stated that maintaining the current control mechanism for metering services during the next regulatory control period is appropriate. ActewAGL also added that the ICRC has stated that it does not intend for ActewAGL to be disadvantaged by the decision to mandate the roll-out of interval meters. Accordingly, ActewAGL submitted the AER should state that it will be able to pass through the costs associated with the roll-out of interval meters irrespective of whether it meets the AER's materiality threshold.

6.1.2 AER conclusion

ActewAGL's submission was the only submission the AER received which commented on the form of control for alternative control services in the ACT. ActewAGL supported the proposed approach and the AER has decided it will proceed with the approach outlined in the preliminary positions paper.

The AER maintains its position on the pass through of costs associated with the mandated roll out of interval metering in the ACT. That is, the recovery of additional costs associated with alternative control services may be accommodated under clause 6.2.6(c) of the transitional Chapter 6 rules. However, determining the arrangements for pass throughs for alternative control services is an issue to be addressed at the distribution determination.

6.2 NSW

The submissions on the form of control applicable to NSW DNSPs raised the following issues:

- the proposed asset valuation
- the potential for competition
- the relationship between service levels and price.

6.2.1 Potential for competition

Stakeholder comments

Southern Sydney Regional Organisation of Councils (SSROC) submitted that the prospects for contestability and especially the development of meaningful competition

are more limited than the AER suggested in its preliminary position paper. SSROC stated that only design, construction and maintenance of new public lighting infrastructure is contestable. SSROC added there is no contestable market for the maintenance, modification or removal of the approximately 200 000 lights owned by EnergyAustralia.

AER consideration

In adopting a control mechanism for alternative control services, one of the factors the AER is required by clause 6.2.5(d) of the transitional Chapter 6 rules to have regard to is the potential development of competition in the relevant market and how the control mechanism might influence that potential.

The AER agrees with the SSROC that under the current arrangements there is limited competition and that there is limited potential for its development. The scope for additional competition in this area in the future is largely a policy matter for the NSW government.

AER conclusion

The AER recognises that, without policy intervention, there is limited potential for the development of competition for the provision of public lighting services in NSW.

However, in deciding on an appropriate control mechanism, the AER is to have regard to all the factors set out at clause 6.2.5(d) of the transitional Chapter 6 rules. Accordingly, the form of control that the AER applies for the 2009–14 determination must have regard to previous regulatory arrangements, additional administrative costs placed on the AER and DNSPs and how the control mechanism might influence potential competition.

In view of the limited prospect of competition, the AER considers that a price path based on revenues (to be established through a limited building block analysis) is an appropriate form of control. The form of control will allow for a reasonably robust assessment of the efficient costs of providing the service as well as providing users with information on price levels over the regulatory control period.

The AER also considers it appropriate to set prices that are cost reflective for the 2009–14 regulatory control period.

6.2.2 Proposed asset valuation

Stakeholder comments

EnergyAustralia stated that the existing Excluded Services Rule applying to public lighting did not formally establish an asset value, nor were revenues linked to a specific return on capital. EnergyAustralia considered it will be very difficult to establish a roll-forward approach to asset valuation.

For the current regulatory control period (2004–09) EnergyAustralia and IPART agreed on the price that was applicable for public lighting but EnergyAustralia stated that the means of arriving at that price were not consistent or agreed. EnergyAustralia stated that it:

... is able therefore to provide the AER with an understanding of the asset value on which services were provided as at 1 July 2004 and the changes between that asset value and the asset value that should apply at 1 July 2009.

Country Energy submitted the best approach is to verify the efficiency of a schedule of fixed prices that is rolled forward each year of the regulatory control period in accordance with an approved price path. Country Energy sought clarification of the AER's position regarding the approach adopted for the control mechanism and how the AER would derive an asset base.

Integral Energy supported the proposed approach, stating it should generate an appropriate balance of certainty and efficiency. Integral also welcomes the simplified process. The Energy Markets Reform Forum (EMRF) also supports the AER's proposal to use a limited building block analysis given the short timeframe available.

However, SSROC questioned the current street lighting pricing regime and was not satisfied that it will result in a robust review of the asset bases claimed by DNSPs.

AER consideration

In light of Country Energy's submission, the AER considers it is appropriate to clarify its preliminary position. The AER will not require the DNSPs to provide a low level stocktake, that is a bottom-up analysis of their asset base. The AER's intent was that the DNSPs would roll forward the regulatory value derived from the price levels that were agreed with IPART at the last reset.

The AER considered that the historical RAB values would simplify the building block analysis and avoid the need to develop a bottom-up valuation where there are a large number of low value assets.

This position was based on the AER's understanding that IPART scrutinised and set down the regulatory values at the last regulatory control period.

Through submissions and subsequent consultation with IPART, the AER has become aware that an asset valuation was not formally established for public lighting assets. However, IPART advised that at the last reset, public lighting was moved from a prescribed service to an excluded service. As part of this shift a value was deducted from the RAB corresponding to prescribed services. IPART has advised that an asset valuation for public lighting asset could be derived by taking the closing RAB at the end of the 1999–2004 regulatory control period and subtracting the opening RAB from the 2004–09 period. The difference will provide the asset valuation for public lighting assets.

This advice supports EnergyAustralia's submission that it can provide the AER with an understanding of the asset value on which services were provided as at 1 July 2004 and the changes between that asset value and the asset value that should apply at 1 July 2009.

The AER notes concerns raised by the SSROC regarding the robustness of the pricing regime. The use of a building block analysis will provide all parties with a better indication of the costs of providing the service with a view to setting efficient prices.

AER conclusion

The AER expects that the DNSPs will provide robust data to justify the asset base and the proposed capex and opex. Until then, the AER would expect the DNSPs' pricing to reflect incremental cost.

Owing to the limited time before regulatory proposals are due and the potential cost, the AER does not propose to require a bottom-up approach to produce an asset register that identifies each asset. Rather the AER will require DNSPs to present an asset valuation that is derived from the previous determination. IPART has advised that this value can be calculated by taking the closing RAB at the end of the 1999–2004 regulatory control period and subtracting the opening RAB from the 2004–09 period.

6.2.3 Relationship between service levels and price

Stakeholder comments

EnergyAustralia submitted that there is a relationship between service levels and prices, and added that this relationship must be treated as a package. EnergyAustralia submitted that any service benchmark must be balanced with a proportional response in efficient prices.

EnergyAustralia considered that IPART previously addressed customer concerns as to price by constraining price increases to customers such that the revenues fell below the efficient costs of providing the service. EnergyAustralia added that due to price constraints, the AER should recognise that it may take the full regulatory control period before the DNSP is able to transition to the level of service required by the Public Lighting Code.

AER consideration

The AER considers that there is a relationship between service levels and the costs of service provision, and therefore efficient prices. As the service level increases so does the cost of providing the service. Therefore, the AER considers that DNSPs must set out in their regulatory proposals the proposed level of service for public lighting. Further, the level of service will need to be specified in a manner consistent with that specified in the Public Lighting Code.

The AER considers it appropriate to allow DNSPs to collect revenue through prices which are reflective of the costs of providing efficient public lighting services at the level set out in the Public Lighting Code.

The AER has limited reliable evidence concerning actual service levels and pricing outcomes. The AER will have the opportunity over the upcoming regulatory control period to assess whether DNSPs are providing service levels consistent with the Public Lighting Code. The AER notes there is scope for DNSPs and customers to negotiate an alternative price and service combination.

AER conclusion

For the 2009–14 regulatory control period, the AER must use a standard to assess level of service. Accordingly, the AER considers it appropriate to assess the DNSPs' services against the Public Lighting Code. In this regard, the AER expects DNSPs will be able to meet the requirements of the Public Lighting Code.

The AER acknowledges that compliance with the Public Lighting Code is voluntary. Enforcement of the Public Lighting Code is an issue for councils and the NSW Government. The AER will, however, require the DNSPs to report their service levels against the Public Lighting Code requirements. The AER will report on service levels which will assist with future regulatory arrangements.

The AER will allow the DNSPs to charge prices that are sufficient to recover the efficient costs of providing a level of service that is set out in the Public Lighting Code. The AER will monitor the levels of service achieved and will consult with the relevant authorities in respect of remedies if DNSPs fail to meet the service levels set out in the Public Lighting Code.

7 Consideration of factors set out in the rules

The transitional Chapter 6 rules set out a number of factors for consideration in setting the form of control to apply to alternative control services. The AER's consideration of these issues (where they have not otherwise been addressed) is set out below.

Potential for the development of competition and how the control mechanism might influence that potential

The AER agrees with SSROC that under current arrangements there is limited competition in the market for the provision of public lighting services. While there is potential for competition for the construction of new public lighting assets, there does not appear to be competition for maintenance services for existing infrastructure.

The form of control selected by the AER will allow for a reasonably robust assessment of the efficient costs of providing the service as well as providing users with information on price levels over the regulatory control period. The scope for additional competition in the provision of public lighting is largely a policy matter for the NSW government to address.

Possible effects of the control mechanism on administrative costs to the AER, the DNSP and users or potential users

The AER considers that the proposed control mechanism appropriately balances the administrative costs to the AER, the DNSPs and users with the need to introduce additional rigour into the analysis of price levels. The AER estimates that the proposed regulatory control mechanism may result in higher regulatory costs during the regulatory determination process. However, these costs should be strongly offset at future resets by the establishment of a price-path mechanism, which will avoid the lengthy price change processes of past resets.

The regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination

The AER must adopt a regulatory control mechanism which is permitted under clause 6.2.5(c2) of the transitional Chapter 6 rules. In determining an appropriate control mechanism the AER is to have regard to the existing regulatory arrangements.

Overall, the AER is of the view that parts of the current form of regulation are not entirely consistent with the transitional Chapter 6 rules. In particular, the Excluded Services Rule includes different pricing principles to the transitional Chapter 6 rules and also permits an ad hoc approach to price changes which is not consistent with the list of control mechanisms set out in clause 6.2.5(c2) of the transitional Chapter 6 rules.

Therefore, the AER has found it necessary to depart from the regulatory arrangements applicable to public lighting immediately before the commencement of the distribution determination in order to satisfy the requirements of the transitional Chapter 6 rules. Nevertheless, the control mechanism selected by the AER is reasonably consistent with that employed by IPART in that it requires the establishment of initial price levels. Consequently, the control mechanism selected by

the AER should minimise the adjustments required by the NSW DNSPs to comply with the transitional Chapter 6 rules.

The desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction)

The AER considers that consistency between regulatory arrangements for similar services across the NEM is desirable. However, there is insufficient time available to assess whether a common approach to public lighting and metering can be developed across the NEM. In addition, the AER also notes that the classification of public lighting and metering is not, presently, consistent and this would first need to be addressed. The classification of alternative control services is fixed in the transitional Chapter 6 rules for ACT and NSW. Given these constraints the AER has proposed a form of control that is most suitable to the circumstances in the ACT and NSW.

In summary, the AER will maintain the current form of control mechanism for alternative control services in the ACT. The AER considers that the current form of control arrangements for public lighting in NSW is a useful starting point but there are some elements that are inconsistent with the transitional rules that will require the AER to modify the current control mechanism. Accordingly, the form of control that the AER will adopt for public lighting services will include a schedule of fixed prices and a five year price path.

8 AER decision

As set out in the attached statement, the AER has decided that the control mechanisms that should apply are as set out below. The AER's decision and statement apply to the following businesses:

- In the ACT:
 - ActewAGL
- In NSW:
 - Country Energy
 - EnergyAustralia
 - Integral Energy

8.1 ACT

The AER will maintain the total revenue control mechanism adopted by the ICRC during the current regulatory control period.

Under this approach, ActewAGL will propose a revenue allowance based on a building block analysis, with maximum allowable revenues to be escalated each year by CPI. The revenue allowance will be established based on the rolled-forward value of the relevant metering assets, and an analysis of costs associated with providing the services.

The AER proposes to allow a return on capital for alternative control services, equal to that allowed for standard control services.

8.2 NSW

The AER will apply a schedule of fixed prices in the first year of the regulatory control period as its primary form of control.

The AER will also determine a price path based on efficient costs for the remaining years of the regulatory control period, to be set down in the AER's regulatory determination.

Appendix A: Submissions received on the alternative control mechanism

The following interested parties provided submissions on issues relevant to the AER's proposed control mechanism for alternative control services:

- ActewAGL
- Country Energy
- EnergyAustralia
- Energy Markets Reform Forum
- Integral Energy
- Major Energy Users Inc.
- Southern Sydney Regional Organisation of Councils

Copies of these submissions are available on the AER's website at www.aer.gov.au.

Appendix B: Statement on the control mechanism for alternative control services

Appendix B is the AER's Statement on the control mechanism for alternative control services to apply to the NSW and ACT 2009 distribution determinations; it is attached as a separate document and is available on the AER's website, www.aer.gov.au.