



24 August 2012

Mr Warwick Anderson
General Manager - Network Regulation Branch
Australian Energy Regulator
c/o NSWACTelectricity@aer.gov.au

Dear Mr Anderson

Re: SSROC SLI Program Submission on the AER's Preliminary Position on 2014-19 NSW Framework & Approach – Public Lighting

Thank you for the opportunity to comment on the Australian Energy Regulator's (AER) preliminary position on the 2014-19 NSW Framework & Approach for DNSP pricing.

As with previous submissions to the AER, the Southern Sydney Regional Organisation of Councils (SSROC) makes this submission on behalf of 34 Councils participating in the SSROC Street Lighting Improvement Program and constituting approximately 94% of all the street lights in Ausgrid's distribution area. In making this submission, SSROC has held discussions with Ausgrid and undertaken consultations with the councils participating in the SSROC SLI Program.

SSROC welcomes the AER's on-going consultation with public lighting customers in the pricing review process and also welcomes Ausgrid's discussions with councils about the future approach to public lighting pricing.

This submission addresses the three public lighting questions that the AER has posed in its preliminary position paper on the NSW Framework & Approach: the proposed classification of public lighting services, the preliminary position on the approach to be applied and the treatment of new luminaire types or new technologies in the provision of public lighting services.

The AER seeks comments from interested parties on the proposed classification of public lighting services as direct control services and further, as alternative control services.

SSROC strongly supports the AER's preliminary position to classify public lighting as an alternative control service, and to reject a 'negotiated' or unregulated approach. As per SSROC's submission earlier this year and submissions in connection with the 2009-2014 determination, it is essential that public lighting in NSW continues to be regulated as an alternative control service by the AER in the 2014-2019 regulatory period.

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The key basis for this position is that public lighting in NSW is currently an effective monopoly of the NSW DNSPs and the prospects for meaningful contestability and any subsequent competition are extremely limited, as are the prospects for productive pricing negotiations between public lighting customers and the DNSPs. Points of note are that:

- ~95% of public lighting assets in the Ausgrid inventory are deemed to be Ausgrid funded and are Ausgrid owned and maintained.
- ~80% of public lighting on Ausgrid's network is directly mounted on Ausgrid's wooden distribution poles.
- There is no contestability framework for existing street lighting in NSW at the moment: no right for councils to choose other suppliers or authorise anyone else to climb DNSP poles and remove/modify/add lights. The contestability provisions of the Electricity Supply Act 1995, the Electricity Supply (General) Amendment (Customer Contracts) Regulation 1996, and the NSW Code of Practice Contestable Works apply only to installation of new lighting assets (about 0.5%/annum in Ausgrid's case), but not to the maintenance or replacement of the vast majority of existing ones.
- Even in the case of new lighting (eg in new sub-divisions or special areas such as parks) where the initial construction is contestable, councils have no realistic option other than to turn over the assets to the utility on completion as, without critical mass, organising on-going maintenance for small groups of lights that may be added from time to time is particularly costly.
- There are no current contracts for the provision of public lighting in NSW and no legally binding service requirements. In short, NSW councils are required to pay more than \$80 million each year to the three NSW DNSPs in public lighting capital and maintenance charges without a clear governance framework, without meaningful control over key aspects of the service which they are responsible for providing and without clear recourse when things go wrong.
- The only guidance covering the service, the NSW Public Lighting Code is non-binding, notably deficient and a review of this Code initiated by the NSW Government in 2009 appears completely stalled.
- To achieve meaningful contestability and any resulting competition, extensive development of a NSW Public Lighting Contestability Framework would be required. However, a December 2009 Discussion Paper published by NSW Trade & Investment as part of a review of the NSW Public Lighting Code does not suggest that fundamental changes to the public lighting governance framework in NSW are under consideration.¹
- The very limited public lighting contestability and resulting lack of competition in NSW was confirmed by the AER in the lead up to the previous NSW pricing review (*Control Mechanism for Alternative Control Services for the ACT and NSW 2009 Distribution Determinations – Final Decision, AER, February 2008*). There have been no subsequent changes to NSW legislation, regulation or codes that alter this situation.
- Ausgrid, in its May 2012 submission to the AER also acknowledged, "...the absence of effective competition in the provision of public lighting."²
- Current NSW contestability relates to assets owned by and in the control of the customer. Precedent suggests that meaningful contestability and any resulting competition would require a transfer of the public lighting assets to local government or a body controlled by local governments (eg a county council type of arrangement). Even if there were in principle

¹ <http://www.trade.nsw.gov.au/energy/electricity/legislative-framework/code-review>

² Ausgrid submission to the AER on public lighting May 2012 p1

agreement amongst councils, the DNSPs and State Government that this should happen, there are some significant barriers to overcome first including:

- The high exit price implied by AER pricing redetermination of April 2010 which set the value of total street lighting assets at \$140.9m as at 1 July 2009³;
 - Establishing clear and comprehensive rules by which 3rd parties could repair, modify, replace or add lighting assets to Ausgrid's existing wooden distribution poles (e.g. access to DNSP poles & wires, notice, approvals procedures, WHS issues, information provision, damage clauses, labour relations issues etc). There is currently no provision for this in the NSW Electricity Act, associated Regulations or Code of Contestable Works;
 - Establishing pricing certainty for residual monopoly services (e.g. connection charges, connection approvals, metering/billing, inventory management);
 - Resolution of potential wiring issues as non-DNSPs (eg councils or ASPs) may not be allowed to own electricity assets such as much of the public lighting that is not wired to meet the Australian Standard AS3000;
 - Lack of council skills or experience in managing electrical assets of this nature;
 - Loss of minimum economies of scale in councils owning relatively few assets individually (eg it costs 40-50% more per luminaire to purchase 10 lights vs purchasing 1000-10,000 lights) and a consequent need to re-aggregate the assets with a likely requirement for ACCC approval to do so; and
 - Identifying and encouraging prospective competitive service suppliers and developing the commercial framework (eg comparable to the UK PFI framework which has taken many years to develop).
- As an alternative to seeking contestability for the current assets Councils could, in theory, progressively move away from the existing arrangements with the DNSPs by replicating the current network of public lighting. This would involve installation of their own dedicated lighting poles and associated wiring in parallel with Ausgrid's network of wooden distribution poles. In Ausgrid's region alone, the cost of this is likely to be at least \$5-\$7 billion (eg \$2000-\$3000 per pole). This would be both completely financially infeasible and an appalling waste of limited public funds through unnecessary duplication of infrastructure.
 - Another alternative path to contestability may be via tiered pricing where customers have the option of providing, operating and maintaining their own street lights⁴ that are directly connected to the utility network and on the public lighting inventory for energy billing purposes only. Such a pricing option did historically exist in Ausgrid's region and was referred to as 'Rate 3'. Ausgrid has long-since classified this as an obsolete tariff. Notably, without a robust contestability framework (see points above), there is no current way for councils to own and maintain lights directly mounted on Ausgrid's extensive network of wooden distribution poles. As a result, 'Rate 3' assets never constituted more than ~2% of historic assets in Ausgrid's region even when such an option was available. And, 'Rate 3' assets were generally lights in special areas (eg parks, reserves, plazas, tunnels) and not general roadway lighting which forms the vast bulk of public lighting. Re-creating such a tariff would not be sufficient to introduce meaningful contestability without parallel development of a contestability framework and addressing such issues as the high residual value of the existing assets.

The alternatives to continued pricing oversight by the AER that are under consideration are the 'negotiated' and 'unregulated' classifications. Under each of these arrangements, councils would be

³ AER Final Decision on EnergyAustralia public lighting April 2010, p9

⁴ AER Preliminary Position Paper p41

primarily responsible for negotiating pricing and service levels with the DNSP, either individually or as groups.

The 34 councils in the SSROC SLI Program already effectively and successfully negotiate with Ausgrid on a wide variety of technology, maintenance, information provision and other service issues and have done so for many years. However, this is in the context of pricing oversight being provided by the AER. Councils are always mindful of the significant market power of the monopoly provider with respect to pricing and would be very concerned about any reduction in their rights to have proper pricing oversight continue.

SSROC has carefully considered the 'negotiated' and 'unregulated' alternatives and has significant concerns about the approaches as follows:

- Pricing regulators, including the AER, have been established worldwide to limit the pricing power of natural monopolies. As discussed above, NSW public lighting is an almost total monopoly of the DNSPs. Without a contestable alternative, the councils would have little or no negotiating leverage under a 'negotiated' or 'unregulated' classification. The councils' protections against the monopoly powers of the utilities are weak already and would be made dramatically weaker if public lighting were classified as a 'negotiated' or 'unregulated' service.
- It would be inappropriate to rely on any potential for competitive tension to emerge under a negotiated approach without significant changes being made first to the public lighting governance framework that facilitate contestability and ultimately, meaningful competition. Supporting this view, *"Ausgrid accepts that the classification of public lighting as a negotiated or unregulated service would depend upon the existence of effective competition in the provision of the elements of this service."*⁵
- Under an alternative control mechanism, the AER has powers to compel the utilities to provide them with detailed information about their actual equipment and contractor tender prices as well as a complete copy of their pricing model. In the last pricing review, this information was used by the AER in a detailed study of Ausgrid's public lighting assumptions and this resulted in significant downward revisions to Ausgrid's claimed costs. In contrast, it is unclear how councils could compel anything like this degree of information disclosure under a negotiated or unregulated approach. Indeed, Ausgrid has repeatedly stated that they are not able to provide councils with the type of information it provides to the AER because of confidentiality undertakings in its tenders. SSROC therefore supports the AER's preliminary position that NSW public lighting customers would have insufficient information to negotiate on an informed basis with the NSW DNSPs⁶.
- No detailed negotiating framework exists that would for example, compel a higher degree of cost transparency than the utilities currently offer councils.
- Ausgrid has not indicated that it would support a negotiated approach to public lighting pricing.
- If a negotiated or unregulated approach were judged to be unsuccessful, as seems highly likely in the absence of competitive tension, it would be challenging for all parties, including the AER, to unwind this part way through the pricing review process and revert to public lighting being an alternative control service.
- SSROC recognises some important weaknesses in the current approach to electricity pricing regulation and has supported the AER's proposal to the AEMC with respect to granting the AER enhanced powers. Recognising weaknesses in the current approach does not however

⁵ Ausgrid submission to the AER on public lighting discussion paper May 2012 p2

⁶ AER Preliminary Position Paper p42

mean that giving up the right to detailed consideration of public lighting pricing by the regulator represents a superior alternative for councils.

- The recent merger of the three NSW DNSPs both increases the market power of the new DNSP because of the scale of the monopoly and further reduces the already weak negotiating position of councils. And, from a utility perspective, differing negotiated outcomes in different regions around NSW are likely to be particularly challenging to manage and in conflict with the stated NSW Government goal of aligning the new utility's purchasing and policy across the State.

In summary, SSROC sees it as essential that public lighting in NSW continues to be regulated as an alternative control service by the AER in the 2014-2019 regulatory period and strongly supports the AER's preliminary position on this issue. In the face of a monopoly service provider and in the absence of competitive alternatives, there are clear risks for councils in moving to a negotiated or unregulated classification for public lighting. No evidence has been presented to SSROC that these pricing mechanisms are more appropriate than continued pricing regulation by the AER under the alternative control mechanism. Council rights are already weak in important respects (eg no clear basis of service, lack of transparency on pricing model and assumptions) and to weaken them further by reducing pricing oversight by the regulator would be highly inappropriate.

The AER seeks submissions on its preliminary position on the control mechanism to be applied to public lighting services.

Apart from the large price shock, one of the most significant impacts of the 2010 pricing redetermination has been the increased pricing complexity and a lack of transparency for councils. In this respect, SSROC agrees with previous utility submissions about the challenges this is creating and supports efforts by all parties to simplify pricing and increase transparency where this can be done without material price shocks or misleading price signals arising.

SSROC has received repeated feedback from councils that the number of bills, unclear billing terminology and the lack of a clear relationship between lump sum capital charges and the costs attributable to individual assets have all created significant confusion. At present, councils cannot readily answer questions such as: How much does this light cost per year? How much does it cost to light this road per year? How much would council save by moving to a new type of lighting? As such public lighting bills do not meet reasonableness test of NSW Public Lighting Code: *"13.1 Bills provided by a Service Provider must identify separately in summary form the charge for each type of Public Lighting Service provided and must contain at least the following information: a) details of the number and type of lights; and b) any other information reasonably necessary for the Customer to verify the accuracy of an amount charged on the bill."*

Councils welcome Ausgrid's recent efforts to openly discuss alternative pricing/billing approaches and SSROC would be pleased to undertake any further discussions with Ausgrid and the AER over the coming months to further develop proposals.

Ausgrid Proposal

One proposal made by Ausgrid to the SSROC SLI Program in August 2012 is to have 2009-14 capital charges be converted into a fixed lump sum payment on bills in the next regulatory period. Ausgrid would then separately provide a council-specific price schedule to each council that would allow them to readily see the capital charge for all assets types individually as well as check the validity of the total lump sum payments. These price schedules would detail capital charges for both pre-2009 assets and 2009-2014 assets.

As SSROC understands it, the key advantages of this Ausgrid proposal over the preliminary proposal of the AER to have a separate asset-specific price schedule for 2009-2014 assets are that it would:

- **Avoid Large Unproductive Expenditure on Billing Systems**
Ausgrid states that its alternative approach would avoid costly billing system modifications. Its current billing system would be unable to handle the multiple price schedules required to meet the proposed AER approach. To adapt its billing engine to handle multiple price schedules would require extensive and costly modifications. Councils recognise that large expenditure on billing system modifications will likely be passed on to councils in the end. Councils are keen to avoid this kind of unproductive expenditure by Ausgrid particularly when it will only lead to more billing complexity and no overall improvement in billing transparency.
- **Improve Transparency**
If each council had a price schedule outlining capital charges for all assets in its area covering both 2009-2014 assets and pre-2009 assets, they would be able answer questions they currently cannot such as: How much does this light cost per year? How much does it cost to light this road per year? How much would council save by moving to a new type of lighting? This would represent a dramatic improvement in billing and pricing transparency.
- **Have No Overall Cost Implications**
SSROC understands that this proposal is not about overall costs for councils and has few implications for the AER assessment of claimed expenditure or other aspects of the pricing determination. Ausgrid has stated that this proposal could be implemented in such a way as to have no overall cost implications for councils (apart from reducing unnecessary expenditure on billing system modifications). As SSROC understands it, the proposal could be implemented so as to have the same NPV and total charges on bills as the AER's proposed approach. That is, whether this is implemented by converting 2009-2014 capital costs into an annuity over a defined period corresponding to the remaining life of the assets or by converting 2009-2014 capital costs into a new 2009-2014 RAB, there would be no change to the NPV from Ausgrid's perspective and no need for there to be a change in overall charges for councils from those which the AER deems appropriate.

On the basis of the above points, the SSROC SLI Program believes that this Ausgrid proposal may have merit and should be explored further as an improvement on the proposed approach in the AER's Preliminary Position.

The AER seeks submissions on the treatment of new luminaire types or new technologies in the provision of public lighting services.

INTERIM TARIFFS TO FACILITATE ADOPTION OF EMERGING TECHNOLOGIES

As noted in SSROC's May 2012 submission on public lighting, public lighting is entering a period of rapid change with technologies such as light emitting diodes (LEDs), light emitting plasma, induction, advanced ceramic metal halide and adaptive lighting controls and others emerging quickly and offering potential cost, maintenance and energy efficiency benefits. LED lighting in particular has experienced progressively declining costs and performance improvements.

The current regulatory approach, which implicitly assumes relative stability in technologies, progressive increases in costs in line with CPI and a relatively similar maintenance regime for all public lighting assets is not appropriate for dealing with the next generation of emerging lighting technology.

The present process for pricing new technology is lengthy, complex and requires individual pricing approval for each new lighting type on an *ad hoc* basis. Indeed, given the current rate of technology

change, by the time a pricing approval process is finished, the model being priced is likely to have been superseded. Some LED manufacturers, for example, are releasing two-to-three new product updates each year.

SSROC suggests that, if DNSPs and councils agree, there should be some provision made by the AER for an interim tariff for new technologies to allow trials and initial adoption to take place easily and quickly without the need for a lengthy AER pricing approval process.

Continued pricing oversight by the AER would still be essential but might take place at the time of the annual price review rather than on an *ad hoc* basis. Even if the AER found initial pricing agreement to be in error under this approach, the potential for significant windfall gains or losses for either party in the initial stages of technology adoption appears relatively small in the context of the overall public lighting charges being paid.

SSROC notes that the chances of this approach to interim pricing for new technology working successfully would be considerably greater if the pricing assumptions and model used by the DNSPs were transparent. In this context, SSROC concurs with the AER's preliminary position that the NSW public lighting customers have to date been allowed access to insufficient information to negotiate an overall pricing agreement on an informed basis⁷ and note that this applies to the pricing of individual new technologies as well.

Other Pricing Matters

SSROC welcomes the AER's acknowledgement of other public lighting issues, beyond the current Framework & Approach decision, that are to be considered in the context of each DNSP's regulatory proposal⁸. These include: the high claimed valuation of inherited residual asset base value; council requests for access to full public lighting pricing models and assumptions at an early stage in the distribution determination process; the need to reduce billing complexity and increase pricing transparency; and concerns about inappropriate asset age assumptions and the resulting distortions.

SSROC welcomes further discussion with the AER and Ausgrid/Networks NSW about any of the items in this submission.

Yours sincerely



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⁷ AER Preliminary Position Paper p42

⁸ AER Preliminary Position Paper p40