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Mr Buckley

Re: SSROC Submission on the AER's Draft Decision - Redetermination of Public Lighting Prices 2010 to 2014

Thank you for the opportunity to comment on the Australian Energy Regulator's (AER) latest Draft Decision - Redetermination of Public Lighting Prices 2009-2010 to 2013-2014.

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 streetlights in EnergyAustralia's distribution area.

Councils have noted this Draft Decision and are deeply concerned about some notable deficiencies it contains as well as the potential impacts if adopted as is. SSROC expects that correction of the deficiencies would result in a modest decline in current prices (as was determined in AER's original determination), rather than the large increase contained in the Draft Decision. These deficiencies are discussed in Section A.

More broadly, Councils note a broader concern regarding the approach to regulation. We acknowledge that the AER is constrained by the NEL and its rules, but believe these issues need to be formally registered. They are discussed in Section B.

Section A. DEFICIENCIES IN THE DRAFT DECISION

The AER Draft Decision contains notable deficiencies that would impose unreasonable costs on Councils and their constituent households and businesses. The draft decision would raise the price of street lighting capital and maintenance from 1 July 2010 by more than 54%. An increase in this order of magnitude would have a catastrophic impact on Councils' ability to deliver services to communities, particularly when the New South Wales

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Government has limited Councils to a rate cap of 2.6%. This would be a highly inappropriate outcome for eight key reasons:

1. **ANY CLAIM OF 'DEFERRED DEPRECIATION' WAS NOT PUBLICLY DOCUMENTED, WAS SPECULATIVE, AND SHOULD NOT BE USED AS A PRETEXT TO INCREASE THE REGULATORY ASSET BASE (RAB)**.
   The AER has proposed a 27% increase in the assumed street lighting regulatory asset base (RAB) from the April 2009 Final Decision to a revised $140.9m. This revision is based on a non-transparent understanding that the AER believes existed between IPART and EnergyAustralia in 2005 about deferred depreciation.

   In contrast, IPART's 2005 decision and a subsequent confirmation sought by EnergyAustralia of IPART in December 2009 make no explicit reference to substantial deferred depreciation. Indeed, EnergyAustralia's original June 2008 Regulatory Proposal confirms in Section 7.6.2 that "…*it is unclear what parameters were underlying IPART's pricing decision. IPART's approval did not include any decision on the asset valuation over time; depreciation rates; or level of operating expenditure to be recovered through the approved public lighting prices."* IPART's 2005 decision did however clearly state that full cost recovery would be achieved by the end of the regulatory period.

   The limited statements that IPART did make in 2005 about EnergyAustralia's depreciation suggested that EnergyAustralia had in fact been "front loading" depreciation. IPART accepted the conclusion of Wilson Cook's 2005 report which found that EnergyAustralia's historic capex had been *"below sustainable levels"*[1] for some time with a *"lack of replacement expenditure in the period 1999 to 2004 in comparison with the depreciation charge taken"*[2]. Wilson Cook also concluded that asset life assumptions by EnergyAustralia were inappropriately short for some assets and went on to acknowledge that capex in the next regulatory period would rise due to the need to replace large number of *"unreliable"*[3] TF2*20 fluorescent luminaires with this one program alone making up more than half of all planned capex (see item 2 below on misinvestment).

   To base a major revision to the street lighting RAB on such a non-transparent understanding about the treatment of depreciation is wholly unacceptable;

2. **ENERGYAUSTRALIA'S RECENT SPENDING TO FIX HISTORICAL MISINVESTMENTS SHOULD NOT BE ADDED TO THE REGULATORY ASSET BASE (RAB) AND CHARGED TO COUNCILS.**
   The draft $140.9m assumed asset value includes recent EnergyAustralia expenditures to remedy a large-scale legacy of misinvestment (for discussion of Council position on misinvestment see Item 1 in Attachment 1). The need to remedy the misinvestment was acknowledged during the previous regulatory decision, where EnergyAustralia accepted that at least $30m of obsolete assets needed to be replaced on an accelerated basis. It would be inappropriate for the AER to add this remedial expenditure to the Regulatory Asset Base in this decision.

   The overarching Revenue and Pricing Principles for AER decisions in Section 7A of the National Electricity Law in subsection 3 that, *"A regulated network service provider should be provided with effective incentives in order to promote economic efficiency with respect to direct control network services the operator provides."* Ratifying large-scale

[1] Wilson Cook Review of EnergyAustralia Public Lighting Expenditure August 2005, p1
[2] Ibid, p15
[3] Ibid, p8

misinvestment would manifestly fail to provide an incentive to invest in an economically efficient manner and hence fail to meet a key objective of the NEL.

3. **ENERGYAUSTRALIA'S INFLATED, INEFFICIENT LABOUR ASSUMPTIONS OVERSTATE THE RAB & VALUE OF INVESTMENTS ADDED TO THE RAB.** The $140.9m assumed asset base is in large measure based on EnergyAustralia labour assumptions that have been found to be markedly in error by the AER and its independent experts in the context of their detailed opex review. The AER's review concluded that EnergyAustralia's assumed labour rates were up to 77% too high, assumed travel times were 31% too high and overall, that a number of significant adjustments to pricing assumptions were required to bring EnergyAustralia's labour productivity to an efficient level. Importantly, the same inappropriate labour assumptions have been used by EnergyAustralia historically as the basis of its claimed capex and the corresponding basis of its claimed asset base.

4. **ORIGINAL FUNDING OF LIGHTING ASSETS BY COUNCILS AND COUNTY COUNCILS SUGGESTS BASIS OF TARIFFS FOR MOST ASSETS IS INCORRECT**. The original funding for most street lighting points on EnergyAustralia's well established lighting network was provided by Councils or the County Councils they formed and this is substantiated in the NSW legislative record and other public documents (see Item 2 in Attachment 1).

   In 1990, the Sydney Electricity Act (Act No.117,1990) dissolved the Sydney County Council that was by then an amalgamation of many Council and County Council assets. The Act established Sydney Electricity, the direct predecessor to EnergyAustralia. Notably, Schedule 5 Part 2 of the Sydney Electricity Act[4], transferred all assets of the previous County Council to Sydney Electricity and the Act contained no provisions for compensation of Councils for the assets of their former County Councils including the street lighting assets.

   EnergyAustralia's Rate 1 tariff (now Tariff 1 as per AER definitions) implicitly assumes that EnergyAustralia has provided all historical capital for street lighting where as in reality the tariffs should be based on Councils and their County Councils having provided the original capital for most lighting on EnergyAustralia's current network (e.g. a perpetual sinking fund model).

5. **INCORRECTLY ASSUMING THAT OBSOLETE ASSETS HAVE A LONG REMAINING LIFE WILL LOCK IN POORLY-PERFORMING, ENVIRONMENTALLY DEFICIENT & COSTLY LIGHTS.**
   Setting residual charges for assets that Councils wish to replace based on the high assumed asset base proposed and using average remaining life assumptions instead of the best available information about the age of particular installations would create a significant barrier to the timely adoption of energy efficient lighting by making exit charges for the existing assets inappropriately high.

   Notably, a large percentage of assets that have actually been replaced early in recent years are underground supplied decorative lighting in parks and town centers where EnergyAustralia's asset inventory as supplied to Councils does appear to contain accurate installation dates and in many cases, other available documentation exists in Council records to substantiate the installation date. It would be particularly inappropriate to assign arbitrary assumed ages to these relatively high cost assets.

[4] http://www.legislation.nsw.gov.au/sessionalview/sessional/act/1990-117.pdf

6. **A 10.81% GUARANTEED RETURN ON ASSETS IS FAR HIGHER THAN JUSTIFIED FOR A RISK-FREE, MONOPOLY BUSINESS THAT PROVIDES AN ESSENTIAL SERVICE TO LOCAL GOVERNMENT ON BEHALF OF HOUSEHOLDS AND LOCAL BUSINESSES.**

   As has been stated earlier, street lighting is an essential monopoly service and payments for street lighting services in this context are a risk free transfer of funds between one branch of government overseen by the State and another State government-owned entity. Given the absence of risk and the monopoly nature of the service, the cost of capital for street lighting should be considerably closer to the risk free rate of return. The use of a commercially-derived guaranteed return per annum on assets of 10.81% in this context amounts to a decision to tax residents at a higher rate, albeit indirectly via large consequent increases in Council rates.

7. **ENERGYAUSTRALIA CONTINUES TO WITHHOLD CRITICAL INFORMATION, OBSTRUCTING A MEANINGFUL REVIEW.**

   Energy Australia has continued to withhold much of the underlying street lighting pricing model from Council review throughout the pricing review, appeal and redetermination. The only partial model provided by EnergyAustralia for Councils was issued on 4 March 2010, some 596 days after first being formally requested by SSROC on 16 July 2008. This partial model is a spreadsheet covering only OPEX costs and has been stripped of asset quantities and key cost details leaving it of limited value for Councils at this very late stage in the pricing process.

   SSROC has previously advised the AER of its difficulty in responding adequately to submissions because of the unwillingness of EnergyAustralia to grant access to data. SSROC has provided to AER and EnergyAustralia formal endorsement by each Council for SSROC to be viewed as their agent and to be provided with their data. Notwithstanding those endorsements access to data was constrained.

   SSROC reiterates that street lighting is an essential but monopoly service and as such, as there should be absolute transparency on the costing models that a decision on efficient costs is to be based on. This is particularly pertinent in the context of the large number of EnergyAustralia pricing assumptions that were ultimately found to be in error by the AER during the review.

   SSROC urges the AER to establish in its Final Decision that, as part of normal ongoing activity, and for future pricing reviews, a complete cost model along with all key financial and technical assumptions is publicly released <u>at the outset</u> and then validated and revised in an open process. This approach would be consistent with recent Victorian ESC pricing reviews and consistent with the level of disclosure in the AER's February 2009 Energy Efficient Public Lighting Charges – Victoria Final Decision and the current on-going AER 2011-2015 Victorian pricing review.

8. **A PRICE HIKE OF MORE THAN 54% IS UNPRECEDENTED, AND WOULD BE APPALLING GIVEN THE MAJOR DEFICIENCIES IN THE ANALYSIS UPON WHICH IT WOULD BE BASED.**

   Increases in Council rates in NSW for 2010/11 are capped at 2.6%[5] (nominal) or about 0.1% in real terms given the Reserve Bank's underlying inflation forecast of 2.5% for 2010/11. In the context of Council rate capping, an increase in street lighting capital and maintenance charges by more than 54% is an extraordinary price shock for Councils. With no flexibility to cut street lighting costs, it will inevitably result in significant cuts to other vital public services provided by Councils. If there are to be price increases of any

[5] http://www.dlg.nsw.gov.au/dlg/dlghome/documents/Circulars/10-02.pdf

size, to avoid unnecessary dislocation in council services, it should be smoothed over the regulatory period.

Section B. A BROADER CONCERN REGARDING THE REGULATORY APPROACH

SSROC acknowledges that the AER is constrained by its Rules and the NEL. However, SSROC is of the view that the broader structure of regulation established in the NEL is inappropriate for street lighting and in any case needs to be applied differently to street lighting given its past 'light handed' regulatory treatment. In contrast to other distribution services, street lighting has a unique assets, history, quality of the service and, most importantly, impact on communities, that is not given sufficient consideration. Furthermore, the regulation under the NEL treats street lighting as a commercial activity, whereas in fact street lighting is a public good, it is a monopoly service, Councils have no substantive input into pricing decisions and are forced to meet all payments.

This is a fundamental issue. There is a split between ownership of assets, legal responsibilities and payments for services. SSROC contends that for effective management these must be aligned. Currently, Councils are responsible for safety of the community and for the payment of charges, DNSPs are the owners of assets, with no responsibilities. Unless there is a single line of accountability from liability to service provision to asset ownership there will continue to be major problems. Unfortunately this Draft Decision (because of the restriction of the Rules) does not address the matter.

SSROC is of the view that the April 2009 Final Decision by the AER was essentially correct and that the introduction of additional information is inappropriate particularly on topics which the Australian Competition Tribunal did not find to be in error. Accordingly this Determination should profoundly reflect that original Final Decision.

SSROC welcomes further discussion with the AER about any of these items as well as matters raised in previously submitted documents.

Yours sincerely,

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SSROC

ATTACHMENT 1 – Further comments in response to the AER's Draft Decision

1. Material Misinvestment By EnergyAustralia

Councils' position is that most EnergyAustralia tubular fluorescent installations (e.g. TF2*20, TF1*40 and other obsolete fluorescent variants) are the result of long-term and large-scale misinvestment by EnergyAustralia in the post-1985 period. A similar case can be made with respect to the continued installation of high wattage mercury vapour (e.g. MV250, MV400 and MV700) on main roads long after the use of this inefficient technology had ceased elsewhere

In summary, EnergyAustralia has had responsibility to ensure that the lighting technology practices were efficient and current for decades. Historically, councils have had little say on technology selection, and have been dependent on EnergyAustralia for performing public lighting services efficiently. However, as discussed in the following points, EnergyAustralia failed to meet its obligations in this regard in the case of several types of lighting constituting more than half its total inventory at the beginning of the last regulatory period:

- In EnergyAustralia's Supplementary Response to the AER on public lighting[6] the company stated that its approach to technology selection had *"…been to evaluate and install luminaires that would avoid a maintenance regime that would increase cost of service to public lighting customers and decrease the effectiveness of public lighting to the community".* This statement is consistent with lighting contracts that existed in past decades which specified that EnergyAustralia would *"…keep the lamps and all appliances…efficient and reasonably in accordance with the latest improvements"*[7] and statements that EnergyAustralia *"…has been exercising a close control over all aspects of costs with a view to minimising price increases."*[8].
- The TF 2*20W and similar luminaires was developed in about 1958-1959 and its optical characteristics and performance changed little over subsequent decades.
- As per a report on Australian public lighting conducted for the Australian Greenhouse Office, *"Until about 1985, 2*20W and 40W fluorescent lamps were the common choices [on residential roads in Australia]."*[9]
- However, by the mid 1980's, 2*20W and 40W fluorescent luminaires were acknowledged to have high overall costs due to high outage rates.
- Recognising this, most Australian utilities discontinued new installations in the mid 1980s and, in the case of Victoria, the SECV began a pro-active bulk removal program for TF2*20 luminaires in the mid 1980s which is understood to have been largely complete by about 1990.
- Evidence of the high outage rates and consequent high cost maintenance regime required for the TF2*20 is to be found in EnergyAustralia's bulk lamp replacement cycle on residential roads which, until about 2005, needed to be 18 months to cope with the requirements of the large population of TF2*20 luminaires on the EnergyAustralia network[10].
- EnergyAustralia only discontinued installing TF2*20 lighting after July 2004 when Councils, having independently been made aware of the consequences, jointly wrote

[6] Response to Submissions on EnergyAustralia's Public Lighting Proposal, 30 October 2008, p11
[7] PBA "EnergyAustralia Streetlighting Cost to Serve" 16 October 2003, p. 28.
[8] Sydney Electricity letter to councils, 27 June 1991.
[9] Public Lighting in Australia – Energy Efficiency Challenges and Opportunities Final Report 2005, Dept of the Environment and Heritage, Australian Greenhouse Office, p19
[10] As per EnergyAustralia briefings to SSROC in 2004/05 on a review of the BLR cycle

to EnergyAustralia insisting installations be stopped (along with installations of obsolete high wattage mercury vapour luminaires on main roads –see below)

- TF2*20W lighting does not currently and has not for many, many years complied with key aspects of AS1158.3.1, the lighting standard for residential roads in Australia.
- With respect to lighting effectiveness, the TF2*20W delivered lighting to the absolute minimum lighting level in AS1158 to about 15m either side of the pole. It was thus impossible to comply with the minimum required lighting levels in AS1158 over more than 30m or less than half of what was needed at an absolute minimum. Indeed, the average spacing of EnergyAustralia's lights on residential roads is perhaps 66m based on a historic practice going back at least eight decades of installing a light on every second distribution pole in the former Sydney County Council distribution area (and elsewhere in Australia).
- On those occasions in which some council input was involved in lighting selection, Councils generally requested and relied on EnergyAustralia advice that in hindsight was often incomplete and incorrect. For example, Councils regularly receive requests from the public for additional lighting to be installed. In those cases, the normal practice was for the Council to refer the request to EnergyAustralia, seeking advice as to whether and what type of new luminaire would be appropriate. EnergyAustralia regularly recommended use of additional TF2x20s up to July 2004.[11] Furthermore, it should be noted that EnergyAustralia also continued to encourage the use of TF2x20s through prices which were lower than those for the better performing mercury luminaires widely used by other Australian utilities from the mid 1980s, and indicating that such cost differences were cost-reflective.[12] Historical pricing, based on poor cost analyses, continually and inappropriately encouraged councils to accept TF2x20s.
- A similar case of misinvestment exists for the continued deployment of high wattage mercury vapour lighting (e.g. MV250, MV400 and MV700) by EnergyAustralia on main roads long after new installations of this lighting type had ceased elsewhere. As per the last consolidated EnergyAustralia inventory supplied to Councils in 2007, more than 41,000 main road lights were high wattage mercury vapour luminaires. This obsolete technology thus constituted aapproximately 60% of EnergyAustralia's main road lighting network. Excluding EnergyAustralia's asset mix from the data, this is fully double the national average of other Australian utilities where the residual population of mercury vapour on main roads was some 29% of total main road lighting in 2004 and has been progressively declining since. As is clear from the national figures, EnergyAustralia also failed to maintain technical currency with regards to main road lighting technology.
- At least the last decade of high wattage mercury vapour installations on main roads by EnergyAustralia constitute a clear case of misinvestment. Notably, high wattage mercury vapour lighting on main roads has energy consumption 33% higher than the high pressure sodium technology that replaced it with consequent higher energy and network distribution costs for Councils as a result of this misinvestment.
- By comparison, Integral Energy has not claimed to have ANY residual populations of obsolete tubular fluorescent lighting nor of high wattage mercury vapour lighting. As

[11] e.g., general design guidance provided in a letter from EnergyAustralia to Sutherland Shire Council, 16 April 1997; and numerous specific examples, e.g., EnergyAustralia, letter to Burwood Council, 8 September 2003.

[12] e.g., Sydney Electricity, letter to Marrickville Council, 12 May 1995 in response to a query regarding the most cost efficient and lowest cost lighting solution for residential streets.

such, it did not seek a price for TF2*20, TF40, M250, MV400 or MV700 lights in the AER pricing review[13].

EnergyAustralia's 2004/05 revised pricing submission accepted the difficulties with these assets when it proposed an accelerated replacement of large numbers of obsolete tubular fluorescent lights in a $30 million capital replacement program over 7-8 years[14]. This program has only been partly completed and has been dropped from consideration by EnergyAustralia in submissions to the AER post June 2008 including the current submission.

As originally proposed by EnergyAustralia, this program involved accelerated replacement of some 105,000[15] obsolete and poorly performing tubular fluorescent luminaires (more than 40% of the total inventory at that point) at a rate of approximately 15,000 luminaires per year or up to three times faster than the normal rate of asset replacement.

The clear pattern of misinvestment by EnergyAustralia described above and substantiated by the very different inventory mix held by EnergyAustralia as compared to other utilities should be given fuller consideration in the context of the proposed RAB revision.

2. **Further consideration of ORIGINAL funding for lighting is required**

The original funding for most street lighting points on EnergyAustralia's well established lighting network was provided by Councils or the County Councils they formed and this is substantiated in the NSW legislative record and other public documentation.

To summarise previous SSROC submissions, what matters in terms of capex contributions for an asset that is to be perpetually replaced like street lighting is who **FIRST** paid for the asset at the time that the initial asset was installed. In short, the capital contributions for a perpetual sinking fund to replace contributed assets are a fraction of those required if another party funded the initial installation.

A fundamental assumption behind EnergyAustralia's 'Rate 1' tariff and the assumption implicit in AER Tariff 1 is that the original capital for lighting at that point was provided by EnergyAustralia. In contrast to this assumption, the vast majority of lighting points on EnergyAustralia's well established network were in fact **FIRST** lit by Council Electricity Departments or by County Councils in the decades prior to the creation of corporatised electricity companies.

The first street lighting in Sydney was installed by the Municipal Council of Sydney beginning in 1904[16]. By 1929 all of the streets of the City and 34 suburbs were being lit by the Municipal Council[17].

On 1 January 1936 the Sydney County Council assumed control of the Electricity Department formerly conducted by the Municipal Council of Sydney.[18] The Local Government Act, 1919 had provided for the establishment of County Councils in NSW by groups of municipalities and shires to perform nominated functions delegated by the Councils concerned[19].

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[13] AER Final Decision p 636-638

[14] EnergyAustralia's Revised Public Lighting Proposal to IPART, June 2005, 11 and EnergyAustralia's Supplementary Submission to IPART on its Public Lighting Pricing Proposals, February 2005, p 4.

[15] Based on summary inventory supplied by EnergyAustralia to Councils in 2004

[16] http://www.ewh.ieee.org/r10/nsw/subpages/history/history_electricity_syd_county_council.pdf

[17] ibid

[18] http://investigator.records.nsw.gov.au/Entity.aspx?Path=%5CAgency%5C499

[19] http://investigator.records.nsw.gov.au/Entity.aspx?Path=\Agency\3488

Successive amalgamations of Council electricity assets and County Councils followed over subsequent decades culminating in 1980 with the amalgamation of Sydney County Council with Brisbane Water, St George and Mackellar County Councils.[20]

The Sydney Electricity Act, 1990 (Act No.117,1990), dissolved the Sydney County Council and established Sydney Electricity, the direct predecessor to EnergyAustralia. Notably, Schedule 5 Part 2 of the Sydney Electricity Act[21], transferred all assets of the previous County Council to Sydney Electricity and the Act contained no provisions for compensation of Councils for the assets of the former County Councils including the street lighting assets.

In summary, it is clear from the NSW legislative record that the **FIRST** capital for street lighting was provided by Councils or the Country Councils they owned and managed until 1990 and that they were not compensated for these assets at corporatisation. Councils re-iterate that there is therefore a material question about basis of EnergyAustralia's Rate 1 tariff which assumes that EnergyAustralia has provided all historical capital and thus the appropriateness of key assumptions underlying the claimed RAB.

[20] ibid
[21] http://www.legislation.nsw.gov.au/sessionalview/sessional/act/1990-117.pdf