



11 May 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 Discussion Paper: Matters relevant to the framework approach NSW DNSP's 2012-19 Public Lighting Services

Thank you for the opportunity to comment on the Australian Energy Regulator's (AER) NSW Public Lighting Services Discussion Paper. SSROC welcomes the AER's early consideration of this issue in the pricing review process and also welcomes Ausgrid's early and open discussions with Councils about pricing-related issues.

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.

HIGH RESIDUAL ASSET VALUATION REMAINS KEY ISSUE FOR COUNCILS

While the AER Discussion Paper focuses on possible approaches to cost allocation, Councils note that there is a more fundamental issue in pricing: the overall cost of public lighting itself and how the underlying capital base has been determined.

Councils note that the revaluation of the existing Ausgrid street lighting assets was the key driver of the 49% average increase in capital and maintenance charges from 1 July 2010. The Ausgrid street lighting asset valuation is viewed by Councils as grossly excessive and having little relationship to actual efficient costs or the history of the assets themselves.

That neither IPART (under its 'light-handed' approach in previous decisions) nor the AER (following the Australian Competition Tribunal decision) was free to properly consider the fair value of historic Ausgrid street lighting assets has fundamentally undermined the confidence of Councils in the pricing review process.

By way of example, the AER's independent experts in the 2010 pricing redetermination concluded in their opex review that Ausgrid'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 Ausgrid's labour productivity to an efficient level. Importantly, the same inappropriate labour assumptions have been used by Ausgrid historically as the basis of its claimed capex and the corresponding basis of its claimed asset base.

Lvl 2, Suite 2E, Hurstville House
34 MacMahon Street
Hurstville

PO Box 536
Hurstville NSW 1481

Ph: 9330 6455
Fx: 9330 6456
Email: ssroc@ssroc.nsw.gov.au
Web: www.ssroc.nsw.gov.au

Councils cannot reconcile the position that substantial revisions to assumptions on the opex side of the pricing decision were appropriate in the last pricing review but not able to be considered with respect to the claimed asset base. This is particularly so in view of the demonstrable case of past misinvestment by Ausgrid in many street lighting assets that were obsolete when installed.

While Councils strongly welcome Ausgrid's recent work to substantially improve its maintenance performance and update its lighting technology offerings, the high valuation placed on the existing street lighting asset base is directly at odds with Ausgrid having one of the most antiquated and poorly performing portfolios of street lighting assets. This high asset valuation results in an unreasonable financial burden for ratepayers and a significant barrier to the timely deployment of more energy efficient and reliable lighting.

GREATER TRANSPARENCY ESSENTIAL FROM OUTSET OF AER PRICING PROCESS

A major concern of Councils in the 2009-2014 pricing determination was Ausgrid's withholding of key street lighting pricing assumptions and the overall pricing model throughout the pricing review, appeal and redetermination.

Council concerns about the lack of transparency were documented in a number of SSROC submissions to the AER in the last pricing reset. For example, the only partial model provided by Ausgrid 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 was a spreadsheet covering OPEX costs only and had been stripped of assumptions, asset quantities and key cost details leaving it of little value to Councils in understanding and questioning Ausgrid's pricing proposal.

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

Councils are seeking the release of the full street lighting pricing model and underlying assumptions from the outset of the forthcoming pricing review including:

- assumed capital costs for all key capital components;
- assumed installation times for poles, brackets and luminaires (including transit assumptions and allocation of labour to the different components);
- assumed bulk replacement costs and productivity;
- assumed spot repair times;
- assumed spot replacement rates per annum by component;
- total labour costs per hour for a two person crew (with bucket truck and overheads) on the two different roadway classifications including assumed traffic control costs for Category V lighting repairs and replacements; and
- any other overheads, component costs or modelling assumptions reasonably required to understand and independently validate the Ausgrid street lighting pricing model.

AER Question 1

What has been the experience for customers under the current regulatory approach to public lighting? For example, do the current arrangements result in pricing that is too complex or lacking in transparency?

Aside from the large price shock resulting from a substantial asset revaluation (discussed above), the most significant impact of the 2010 pricing redetermination has been with respect to pricing complexity and a lack of transparency for Councils.

Since the pricing redetermination, Councils have received three monthly street lighting bills with network charges spread across all three of them. The feedback the SSROC SLI Program has received is that Councils find both the current bills and forecasting increases complex and opaque. Specific Council feedback about items creating confusion included the following:

- Unclear why three bills are needed for one service and what the difference is between them
- Unclear terminology and labelling on bills
- Mixing of capital and maintenance charges together without clear distinction is confusing
- Splitting of capital charges across two bills is confusing
- Lack of clear relationship between bills and street lighting assets (in particular, the lack of transparency resulting from the bundling of pre-2009 asset charges)
- 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 this new type of 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.”*
- Guidance on price increases in Ausgrid public tariffs does not appear to be consistent with AER advice at redetermination or experience of Councils.

Broad and apparently arbitrary Ausgrid asset age assumptions have led to bizarre outcomes in practice when Councils seek to negotiate exit charges from existing assets. Specifically, Ausgrid’s assumption about the average age of each asset class in each LGA does not appear to have any relationship to real asset age.

In the extreme, similarly aged adjacent assets on either side of Council boundary can have capex charges differing by seven fold. The lack of a relationship to the real assets has been highlighted to Councils when they have wanted to exit from existing park lighting arrangements and in negotiations on replacement of particular asset classes.

Should public lighting in NSW continue to be regulated by the AER as an alternative control service or is there merit in classifying the service as a negotiated service or an unclassified (unregulated) service?

It is essential that public lighting in NSW continues to be regulated as an alternative control service. The vast majority of public lighting assets are owned by the NSW DNSPs and there is no contestability framework for street lighting in NSW at the moment: no right for Councils to choose suppliers or authorise anyone else to climb DNSP poles and remove/modify/add lights. As such, the DNSPs have an almost total monopoly supply position and hence require vigilant regulatory oversight. And, it would be inappropriate to rely on any potential for competition to emerge without significant changes to the current governance framework.

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.

This assessment of street lighting contestability 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.

To achieve meaningful contestability, 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

Given that Ausgrid is deemed to have funded and owns almost all street lighting assets (the vast majority of which sit on their wooden distribution poles), there is little comparable precedent to draw on, as current NSW contestability relates to assets owned by the customer.

Even setting aside full contestability and assuming that Ausgrid was prepared to simply transfer responsibility to Councils or other parties for existing assets would present some significant barriers 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;
- 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, OH&S issues, information provision, damage clauses, union issues etc). There is clearly no provision for this under the NSW Electricity Act, associated Regulations or Code of Contestable Works at present;
- Establishing pricing certainty for residual monopoly services (e.g. connection charges, connection approvals, metering/billing, inventory management);
- Resolution of potential wiring issues with non-DNSPs (eg Councils or ASPs) may not be allowed to own electricity assets that are 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).

Has the current approach resulted in greater (or less) competition in the construction or provision of public lighting services?

The current regulatory approach has not changed competition or the prospects for competition in NSW public lighting which are extremely limited. As discussed above and unlike the provisions in other jurisdictions noted in the Discussion Paper, there are no NSW provisions allowing a customer to request a third party to alter, relocate, or replace public lighting assets. And, in any event, Ausgrid customers would have to first pay Ausgrid's high claimed residual asset charges to exit current arrangements. These charges present a significant financial barrier to greater competition even if there were steps taken to create a contestable framework for public lighting in NSW.

AER Question 2

The AER seeks comments regarding the use of Option 1. In particular: A. What are the main advantages and disadvantages of this approach?

SSROC agrees with Endeavour Energy that the introduction of third type of capital charge has the potential to further increase complexity. And, SSROC agrees with Ausgrid that there may be opportunities to greatly simplify pricing, avoiding the increasing complexity implied in Option 1 with the introduction of a third type of capital charge. Furthermore, there would appear to be opportunities to do this without significant price shocks or misleadingly price signals because:

- Capital costs (and maintenance charges) for many closely related assets are very similar; and

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

- Many lighting types used in the past are no longer used in new installations and, by the time the next regulatory period commences, it is unlikely that any of the asset types approved for use at the start of the last regulatory period will be accepted Standard Luminaires for new installations in the next regulatory period. It should therefore be possible to draw a line under the capital charges old asset types, with no need re-determine capital charges for anything other than the new asset types.

SSROC would also suggest that asset age assumptions can be considerably improved as the age of all Ausgrid assets from about 2000 is known accurately. In addition, the age range of particular lighting types used prior to that is well understood and the age of most 'special installations' (eg parks, reserves and decorative lighting types) appears readily ascertained from Ausgrid's inventory and Council records.

AER Question 3

The AER seeks comments on Endeavour Energy's submission. In particular:

A. What are key advantages and disadvantages of the approach proposed by Endeavour Energy?

B. Would the averaging of capital costs used to calculate the annuity for assets constructed in the 10 year period 2009 to 2019 disadvantage third party providers of these assets?

SSROC agrees with Endeavour Energy that the introduction of third type of capital charge has the potential to further increase complexity. However, Councils are not in a position to determine the price distortions that 10 year averaging of capital costs might create but would welcome modelling to assess the potential impact of such an approach.

AER Question 4

The AER seeks comments on Ausgrid's submission. In particular:

A. Would a simplified pricing structure such as this come at the expense of cost reflective prices?

Councils have no objections in principle to a simplified pricing approach, provided that cost-reflectivity and price shocks for individual Councils are modelled first. However, Councils are not in a position to assess the potential windfall gains and losses of Ausgrid's proposed approach for the 2014-19 regulatory period nor the degree of potential non-cost reflectivity created by bundling.

Councils strongly welcome Ausgrid's recent efforts to model various pricing scenarios before pricing submissions are made to the AER and SSROC would be pleased to undertake any further discussions and work with Ausgrid over the coming months to further develop proposals.

B. Would this approach permit the entry of third party providers of public lighting services?

Councils do not believe that moves to simplify pricing would have any material impact for contestability or result in any increase in competition.

INTERIM TARIFFS TO FACILITATE ADOPTION OF EMERGING TECHNOLOGIES

As an additional comment, SSROC notes that public lighting is entering a period of rapid change with technologies such as LEDs, light emitting plasma, adaptive lighting controls and others emerging quickly and fundamentally changing the mix between capital, energy and maintenance costs. In recent years, LEDs for example, have seen declining capital costs of some 30% per annum and simultaneous increases in efficiency at a similar rate. It is common for major LED luminaire manufacturers to replace models every six months in the current market.

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 does not appear well suited to dealing with the next generation of emerging lighting technology. The process for pricing new technology is lengthy and complex. Indeed, by the time a pricing approval process is finished, the product being priced is likely to have been superseded.

SSROC suggests that, if DNSPs and Councils agree on it, 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 without the need for a lengthy AER pricing approval process. The AER might reasonably set a volume limit on such interim tariffs (eg 500 luminaires) after which a formal pricing approval would be required.

SSROC notes that, if the pricing model used by the DNSPs were transparent, it is much more likely that DNSPs and Councils could readily agree on interim tariffs for new technologies under such an approach.

SSROC welcomes further discussion with the AER and Ausgrid about any of these items.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Helen Sloan', written in a cursive style.

Helen Sloan
Acting General Manager
Southern Sydney Regional Organisation of Councils