TRANS TASMAN ENERGY GROUP

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Submission - SA Power Networks' Regulatory Proposal (public Lighting)

We welcome the AER's invitation for written submissions to SA Power Networks' 2020-25 regulatory proposal.

Our submission provides a high level response which focuses exclusively on unmetered public lighting services.

We apologise for the timing of our response. We had advised the AER that we would be providing a submission but had to delay to consider information confidentialities.

General Comment

On page 45 of the AER's SAPN distribution determination 2020-25 ("**Issues Paper**") the AER was interested in hearing views regarding SAPN's 2020-25 regulatory Proposal ("**Proposa**l")and stakeholder expectations.

In summary, as we have identified below, SAPN's Proposal appears excessively priced with regard to services.

Further, as we have identified below, SAPN's proposal is excessively complex considering the size of the business. SAPN's proposal lacks transparency as formulae have been removed in some work books.

In our response we have referenced the page number or workbook number pertaining to our comments.

Corporate overhead (page 17).

We understand that SAPN may include corporate overhead in its costs, but in reality, this is a cost impost on the relatively small public lighting business which is less than $20 million p.a. Small businesses, typically do not have any corporate overhead and we do not believe that it is appropriate that corporate overheads are applied to SAPN's lighting business. We have not reviewed SAPN's Cost Allocation Method but would hope if the AER agrees with our consideration, that SAPN's corporate overhead could appropriately be recouped against their main network business and not public lighting.

We do not believe that including corporate overhead in a (public lighting) business of this size can reasonably be considered efficient cost of providing that service, something which the AER must consider (page21).

6% increase (page 21)

With the change to new LED lighting decreasing maintenance costs, plus the other issues we have raised in this submission, SAPN's increase of 6% appears materially excessive and requires AER careful review of SAPN's proposal.

Luminaire Recovery Period (page 23)

There are two lives that may be considered, being:

- The "effective life" which should reflect the actual useable life of the asset. Although some suppliers may claim a useable life of 20 years, the life for new LED lights has not been reliably established as most installed in Australian conditions for well less than 20 years, and
- The "economic life" which should reflect the tax life. Last time we reviewed the tax life for lights it was 15 years and SAPN have used the same in their PTRM model.

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SAPN have proposed a 17 year life? This is problematic and must not be accepted as if SAPN have fully depreciated the light over 15 years (which they will have with the ATO) then SAPN must not receive any return of asset beyond the 15 year tax life. The lights can remain and if they last till 20 years, then great, but SAPN must not receive any asset payment beyond the 15 years.

To remove any issue regarding capital, we have identified in our response to 14.5.3 (below) the maintenance of the public lighting network via replacement lights can be seen as expense.

SAPN Survey Results: SAPN uses survey responses to support it proposed position. A survey cannot be relied upon by SAPN for establishing policies and process as it can be skewed. An example, is the recent poll prediction (survey) for the federal election .

Access/ Gateway portal: Page 23, SAPN allowed $300,000 in capex. We have not assessed any requirement for this portal or the cost. We have not assessed if should be treated as capital. But if so, it should be depreciated over the ATO life otherwise SAPN would be over recovering. It should also have a separate line item on any PTRM (if used).

Column Pricing (Page 23):

We expect that the majority of columns will be utilised by a relatively small number of customers. As such, a postage stamp approach is not appropriate as all customers will be paying for these few. Further, some columns are expected to be significantly more expensive than others – so again the customer should pay, not everyone.

The AER should apply the same logic for individual pricing for "post top" (decorative) luminaires (page 25).

SAPN have not specified the financial impact of columns in the sector assets. The AER should require SAPN to provide full information regarding these assets, including which poles/columns SAPN have funded and those funded by Customers. These longer term assets require to be clearly identified and segmented so that appropriate costs can be assessed and decreases made re appropriate tariffs.

Total Revenue

As advised by the AER in its Issues Paper, the AER may determine an arbitration and the determination may impact the modelling used to calculate the alternative control services prices. Due to time constraints we have not reviewed the NERs for the review process, but we would hope that if there is a material change then the AER would seek stakeholder comment again, including those that provided submissions.

14.5.3 Public Lighting Assets

SAPN has treated replacement lights as capital, yet there is a case that can be made to say that SAPN is simply maintaining a public lighting network, and on that basis replacements could fairly be treated as expense (Refer Australian Accounting Standards Board AASB 116). This would avoid customers (re)paying the depreciation amount (which is indexed) and also a (WACC) component for interest. Treating the maintenance of the public lighting network as an expense would provide lower costs to customers as we demonstrate below.

> *The financial implications of Depreciation and Inflation can be seen in SAPN'sTable 14.15 where in 2020/21 these items total $3.5 million and well in excess of SAPN's forecast Capex of $1.5 million. In an expense scenario, SAPN would be able to claim the $1.5 million plus a margin.*

There is also a requirement to consider component aspects other than luminaires:

Whilst the initial Lamp and PE Cell may be considered as capital, any replacements must be considered expense.

We understand that initial brackets may be being paid for by customers ie not SAPN and the AER should ensure SAPN demonstrate there is not a 'double count".

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14.5.4 Public Lighting Services

SAPN has proposed a Transferred Infrastructure (**TFI**) package which the customer funds the asset. SAPN then assume full maintenance responsibility. This is acceptable, but SAPN then claim they have responsibility for future replacement of the installation at the end of its useful life.

The AER cannot accept this as it may be seen a type of "regulatory capture". Instead, Customers should have the option of how they fund any future lights. A current example is customers wanting to fund their light replacements or conversions to LED.

SAPN funding replacements may be an option, but it should be the customer's choice.

AER must reject any SAPN claim for automatic replacement of lights.

14.5.4.2 Pole / Column Maintenance

Columns may have a life in excess of 40+ years. This would be consistent with SAPN's proposed 2% replacement from 2020/21.

We question why SAPN has proposed that 6% of the 9,000 columns inspected annually requires replacement and not 2%? Are we to understand that SAPN are intending to provide a "catch-up" service? Does this mean SAPN have under serviced in past years? Have SAPN charged in prior years? We cannot answer these questions as we do not have access to SAPN's prior costings and how tariffs were established as an NDS.

We again repeat that these costs should be identified by SAPN so stakeholders can make informed decisions. It may be appropriate that these charges are not be postage stamped.

14.5.6 Pricing Methodology

SAPN have introduced aspects of the Post Tax Revenue Model (**PRTM**) in its Proposal. This specialised model requires expertise which is well in excess of most stakeholders to assess. It is however a model very familiar to SAPN. On this basis we suggest the AER question its (in)appropriateness. Also, to our understanding a post-tax approach has not been required historically for streetlight within the NEM.

Indeed, it could be argued that the PTRM was designed for long term stable assets like network poles and wires and that it is not the most appropriate model for assets with relatively short life cycles with high operational and maintenance component costs like public lighting.

Recognising the size and nature of the business we submit that the PTRM should not be utilised and a simplified pricing methodology employed. In our view, to enable assessment of SAPN's proposal, a simplified and more appropriate approach should be required by the AER in all future price reviews.

14.5.6.1 Luminaire Capital

Our experience across many jurisdictions is that the vast majority of customers are typically ill-informed and do not effectively understand how charges are established under a regulatory system, including the NERs.

In this section SAPN propose an annuity charge (to at least the TFI lights) for the future replacement cost. That is, it is effectively a payment in advance for a future service. The AER must prevent distributors, including SAPN for charging (eg via an annuity) for services they have not provided.

It is our view the AER must insist that SAPN's fees reflect the efficient cost of providing a service (NEO). As discussed earlier, SAPN should not have an automatic right to replace the asset. This right should appropriately lay with the Customer.

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Even if the AER decided to allow an annuity prepayment, on our brief reading of SAPN's proposal we did not see how SAPN proposed to manage and account for any annuity prepayments. Were payments to be set up as a separate line item to offset asset costs? Appropriate accounting must be in place to ensure customers are aware that the annuity funds are theirs and not SAPNs.

Further, do the prepayments get allocated against those customers that made the prepayment? Or simply in to a pool? Until there is a clear methodology for managing annuity funds they must not be considered acceptable.

14.5.6.3 Infrastructure Capital

In our submission we have identified multiple issues regarding Infrastructure capital, including 14.5.3 also the potential double count of brackets and column prepayments, the Luminaire Recovery life issue.

SAPN have claimed a standard life of 28 years and have a remaining life of 18 years although 19.4 years used in the PTRM workbook (14.7)? We advise the AER of the following concerns regarding SAPN's proposal, including:

a) 28 years for all assets. To provide visibility on asset costs and charges SAPN need to separate assets that have different criteria e.g. luminaire, columns and brackets all have different lives.

b) Our understanding is the process of replacing assets is a continual one and that properly managed assets should be around 50% depreciated. But SAPN have claimed 18 years remaining and not 14? Does this mean SAPN have not been replacing assets when due? Has this resulted in higher maintenance costs as the assets are older? We did not notice in SAPN's Proposal if SAPN has provided asset accounting from 1999 which is needed to assess SAPN's proposal?

<u>Re PTRM:</u> Streetlight tariffs are typically established on a pre-tax basis which is a sensible approach for a business this size and we question why SAPN has introduced the PTRM? We propose a simplified pre-tax approach to costs should be required as the PRTM is well known to SAPN but not to other stakeholders. This prevents transparency. A far simpler model can be used, with costs summarised on 1 sheet, much like the 2000 SAIIR Report did in Table 3.5

Table 3.5 ***Total revenue requirement for 2000-01, ($'000)***

COST CATEGORY	AMOUNT PROPOSED BY AGL SA/EU	SAIIR'S CONCLUSION
Total retail revenue recovery	**20,436**	**18,420**
less AGL SA cost recovery of	3,718	3,380
Equals total revenue recovered by EU	16,718	15,040
less DUOS+TUOS recovery of	2,670	2,670
Equals total revenue recovery for SLUOS	14,048	12,370
less Return on assets	3,049	3,049
less Depreciation	3,964	3,964
less Operation & maintenance	5,470	4,402
Which is comprised of:		
Maintenance & repair	*4,209*	*3,850*
Asset replacement	*610*	*155*
Asset inspection	*378*	*125*
Fault identification	*80*	*80*
Technical standards & related costs	*32*	*32*
Administration costs	*160*	*160*
Equals elevation charge	1,566	955

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Margin

On page 18 of the Issues Paper we understand SAPN has proposed a 6% margin applies to the cost build up. If we understand WACC correctly, it already includes a return on equity component, a "margin" if you like.

SAPN's cost build up includes WACC applied to capital (assets) cost. Any further margin should not be applied to this component as it would be a double dip.

SAPN's proposal includes a depreciation amount for assets. This represents repayment of the capital (assets) cost by the customer. The depreciation is also indexed. SAPN already receive a return on capital via the WACC so any extra margin on depreciation would represent a double dip.

In summary, the AER must not allow SAPN any further margin applied to assets component costs.

The cost build up includes corporate and other overheads being expenses which are paid by customers. Surely SAPN cannot be seeking to make a profit on these expenditures? If the AER agrees to the 6% margin on these costs then the more SAPN spend ,the greater their $ return and this provides the wrong incentive.

Alternatively, we propose the AER can simply approve a return to SAPN via WACC applied to the assets.

14.5.6.5 Administration and Systems

SAPN have proposed an $8 per Stobie pole charge or around $1.5 million p.a. or ~ $7.5 million over the regulatory period. This is despite our assessment that there is no additional material cost to SAPN. If the AER has any doubt regarding any cost impost due to lights then it has a duty to fully inform itself.

SAPN support their claim by stating that ESCOSA reviewed the claim in 2000 and 2009. We are not aware that any ESCOSA 2009 review has been made public? If SAPN are to rely on this argument then the 2009 review should be made public.

Irrespective, any ESCOSA assessment was not pursuant to the NERs including the Alternative Controlled Distribution Services ("**ACDS**") regulatory criteria. Critically, any assessments by ESCOSA were made under different regulations and for a different regulatory purpose being a "fair and reasonable" test.

Whilst referring to the 2000 SAIIR report SAPN has failed to advise the AER of the following from the report including:

> *Both 'pole attachments' and 'elevation' are prices allowed for 'value-adding' to existing "infrastructure <u>(there is little aspect of real 'cost' about them),</u> but as a return on the stobie pole is already recovered through the DUOS charge, <u>they could be regarded as creating super profits</u>. While this may be justifiable for 'pole attachment' by a commercial profit-orientated business (ETSA Utilities is sharing in the commercial exploitation by the Telco of ETSA Utilities' assets), such an argument does not apply to the use of pole for a 'public good'.* (Page 35, TTEG underline)

Further, that the SAIIR Report did not establish any monetary amount."

> *"….the SAIIR sees the determination of a "fair and reasonable" elevation charge as being beyond the scope of this enquiry"(page 37), and*
>
> *"…it is recognised that no definitive assessment of this charge has been possible for this enquiry".* (page 49)
>
> *"The elevation charge should recover any disruption costs to maintenance of the distribution network plus provide an incentive to encourage greater utilisation of the poles. Further work (theoretical and practical) is needed to determine this charge for future determinations, and SAIIR will support such work by ETSA Utilities and other entities*." (Page 42)

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SAPN also argue that the pole charge is analogous to an easement charge. SAPN have however failed to advise that SAPN has free access to council land to install Stobie poles. As discussed in the SAIIR report, the free access for poles for lighting can reasonably be seen as comprising the "regulatory bargain" under which SAPN purchased the business from ETSA.

SAPN refer to an Incenta Report. We have not seen a copy of the Incenta Report we are unaware of what their brief was? Further we are not aware how they concluded that there was any justification in terms of the NEO when SAPN are fully compensated for the pole and the luminaire which are both paid for by the customer. In addition, the public lighting customers pay SAPN a DUOS charge for "pole use". We are also curious how Incenta have established that it takes longer to perform standard functions due to the lights? Our understanding is there is no material cost impost attributable to having lights on the poles, and certainly not the $1.5 million or so suggested by SAPN. Our view was supported by the SAIIR Report on page 35 regarding pole attachment "…*there is little aspect of real 'cost' about them".*

We submit to the AER it must reject SAPN's claim for $8/pole or around $7.5 million over the regulatory period.

The AER must also reject SAPN's $0.60 per light or around $600,000 over the regulatory period to validate asset data. In accordance with the Metrology process SAPN is required to maintain accurate inventories for billing purposes. If SAPN has not done so then we submit that SAPN should

Model 14.6 Pricing Model

Consultation Procedures: Whilst we have not considered whether the AER is conducting a "Distribution Consultation Procedure" pursuant to Part G clause 6.16, the issue we are raising with the AER is that many cells in the workbook contain a numerical result of a calculation but do not contain the relevant formulae. As such we cannot assess the appropriateness of the calculation. We have requested a complete version from SAPN but we have not received to date.

Without the calculation known we are not able to appropriately assess SAPN's model and methodology.

The AER should require SAPN to provide full operational models.

GSL: In the "GSL" tab it appears SAPN have claimed around $240,000 over the period for GSL. This must be disallowed by the AER as the GSL is a cost to SAPN for not providing a service. If the GSL is paid by the customer, then where is the penalty to SAPN – there is none?

Cable Faults: SAPN have claimed around $8.5 million over the period yet have failed to clearly establish how this can failed to be applied to customers in terms of the National Electricity Objective. There are several major issues for consideration.

Firstly, the connection point i.e. where the network stops and the light begins. This needs clear definition otherwise SAPN may potentially be "double dipping" as the cable cost to the lights may be included by SAPN as a DUOS cost input.

Secondly, the way SAPN installed the cables may have contributed to the problem and cost? Did SAPN install their wiring in conduits or simply bury them? The latter being particularly problematic when it comes to fault rectification. Customers should not have to pay if it was SAPN's installation practices that have caused the cost. Without clarity on the physical installation aspect, SAPN's true cost (pursuant to the NEO) cannot be determined in SAPN's proposal.

Thirdly, the SAIIR did not include these charges. Refer SAIIR Table 3.5 in 14.5.6.3 earlier.

Model 14.7 PTRM

This workbook has remaining lives of 19.4 years on 28 years for operational life and 11 years on 15 years for tax.

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Asset Class Name	Opening Asset Value	Assets Under Construction	Remaining Life	Standard Life	Opening Tax Value	Tax Remaining Life	Tax Standard Life	Base Regulatory Year	Length of Regulatory Control Period (Year)
Public Lighting Post 1999 Capex	42.27		19.39572913	28.00	36.69441836	10.83895288	15.00	2020-21	5

As discussed earlier, for efficient management assets should be at half the life.

We cannot simply accept SAPN's claimed Open Asset Value at 2010. It c cannot be validated as SAPN have failed to provide its depreciation since 1999. This is particularly critical to assess because of the issue regarding asset lives we have already identified.

Model 14.8 RFM

On the "RAB Roll Forward" tab, SAPN have used a 28 years for lighting for assets and 7 years for IT despite the tax treatment of 15 and 7 years respectively.

We have not have time to be able to determine the financial impact of this on Customers, as the PTRM complexity hampers cost transparency and easy assessment.

For transparency, and also for appropriateness (eg correct asset value and lives etc), the assets claimed by SAPN must be unbundled to enable effective analysis to determine costs eg split in to luminaires, brackets., columns, decorative columns etc.

Validity?: SAPN has failed to establish the validity of its opening asset base. The last public values and projections we have seen for assets was in the 2000 SAIIR Report. SAPN appear however to have commenced its model from 2010 providing a gap in data between 2000 to 2010 as the SAIIR report included estimated expenditure for 2000 to 2005.

1999 Assets: Whilst not part of the 2020-25 period, we note on the "RAB Roll Forward" tab that SAPN appear to have been depreciating the 1999 assets until 2016. This is as a concern as the SAIIR Report established tariffs based on a useful life for these assets that would have seen them fully depreciated by no later than 2010. If SAPN were charging a depreciation cost for these assets to 2016 then it is most likely SAPN has overcovered on depreciation on these assets. We submit to the AER that this requires investigation as if SAPN included 2.93 million in their tariffs on fully depreciated assets then Customers will have been overcharged around $18 million.

If this is so, then the AER can recognise this overcharge as a "credit" and reduce the asset base.

CPI and Inventory

We note that SAPN has proposed CPI to be applied on tariff costs year on year. SAPN have however failed to recognise that the streetlight inventory increases year on year. On a per light basis this should require that tariff increases are less than CPI on a per light basis. Any tariff increase should be CPI less % inventory increase.

Questions

We would welcome any questions regarding our submission.

Yours sincerely

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