

Ref: MR:JC:C903683

27 March 2009

Mr Mike Buckley
General Manager
Network Regulation Northern Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Buckley

Supplementary Draft Decision for Alternative Control (Public Lighting) Services for NSW DNSPs

Country Energy appreciates the opportunity to respond to the Australian Energy Regulator's (AER's) supplementary draft decision for alternative Control (Public Lighting) Services for NSW DNSPs determination. Country Energy submitted a revised regulatory proposal on 16 January 2009 in response to the draft decision, and this submission should be read in conjunction with the revised proposal for alternative control (public lighting) services.

Country Energy would be pleased to discuss the matters raised in this submission with the AER. Should you require further information or clarification please feel free to contact Natalie Lindsay on 02 6589 8419 or Jason Cooke on 02 6338 3685.

Yours sincerely



Bill Frewen
Executive General Manager Customer and Corporate Affairs



Country Energy's Response to the Supplementary Draft Decision for Alternative Control (Public Lighting) Services for NSW DNSPs

27 March 2009

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1 Overview

This submission responds to the Australian Energy Regulator's (AER) Draft Distribution Determination 2009-10 to 2013-14, Alternative Control (public lighting) services, dated 6 March 2009 (henceforth the 'Draft Decision'). The Draft Decision sets out a proposed schedule of fixed prices for:

1. the first year of the next regulatory control period; and
2. for each subsequent year of that period

These schedules are set out in Appendix A to the Draft Decision as it applies to Country Energy.

This submission also responds to the AER's invitation for Country Energy to provide additional supporting information with respect to the following matters:

- Cost of bulk lamp replacement (for existing assets);
- Overheads for plant and materials and evidence of bulk purchasing; and
- Cost of construction of new assets.

In addition, Country Energy takes the opportunity to comment on:

- The practical application of tariff 5 (early replacement of assets at customer's request); and
- Various minor matters.

The Draft Decision sets out reductions in future tariffs for the provision of public lighting services. Country Energy considers that reductions in the prices for tariffs 1, 2 and 4 are realistic and reasonable. In its January 2008 proposal, Country Energy proposed average price reductions of 16 per cent in nominal terms for existing assets. At the same time, it proposed to replace 46,000 lamps a year from 2009-10 through a bulk lamp replacement program, compared with the less than 15,000 spot maintenance defects in 2007-08.

Country Energy does not, however, support reductions in tariffs to levels that are not cost reflective. Nor does it support reductions proposed for tariff 3, where overall costs are rising. Country Energy therefore does not agree with the proposals in the Draft Decision for average price reductions of 33 per cent in nominal terms for existing assets.

Country Energy is constrained by its obligations under the NSW Public Lighting Code to meet minimum service standards with respect to public lighting services. This means it is unable to adjust its service levels to reflect lower prices.

Country Energy's overall observation on the Draft Decision is that it may be based on unrealistic expectations about the extent of achievable cost reductions. This relates in particular to the cost of bulk lamp replacement program, management of inventories and plant on costs for operating charges, and the capital costs for new assets. These points are discussed in detail below.

2 Context for Present Submission

Country Energy strongly supports the principle that improvements in the quality, durability, and cost of public-lighting inputs should be passed on to consumers in the form improved services at lower or similar prices. Country Energy wishes to stress that innovation and new technology are being systematically applied to minimise costs while at the same time maintaining or improving service levels.

Improved services obviously benefit the direct customers for Country Energy's public lighting services – local authorities. They pay less but receive a more energy efficient service. Importantly, lower prices and improved services also benefit the ultimate users of the service – the communities that rely on public lighting for amenity, convenience and public safety.

The principle that cost savings should be passed on in lower prices was reflected in Country Energy's proposal to the AER in January 2009. Against a background where for historical reasons prices for public lighting had in many instances been set below cost reflective levels, the proposal sets out reductions in prices for existing installations averaging 16 per cent.

A key development in Country Energy's proposal to support price reductions is the move to a proactive bulk lamp replacement program. In the past, it was more economical to replace individual lamps as they failed. However, the cost of spot defect maintenance is significantly higher than the cost of replacing lamps as part of a bulk lamp replacement program, where reduced travel times and other economies can be applied.

Improvements in reliability mean that bulk lamp replacement programs can be used to substitute spot defect maintenance (note that spot defect maintenance is still required, but at much lower rates). Accordingly, replacement costs are decreasing, leading to operating and maintenance costs for existing assets that are lower than otherwise.

Another development is the use of photo-electric (PE) cells to control the operation of public lights. The PE cells activate and deactivate public lights automatically at dusk and dawn. This is a lower cost and more efficient than the use of network of control wires to each individual installation operated from the Supervisory Control and Data Acquisition (SCADA) control room. Activation by PE cells is gradually replacing the use of control wires. At present, 68 per cent of installations are operated by PE cells and this is expected to increase by 2014.

Diagnostic methods for testing the structural integrity of dedicated poles supporting public lighting assets, especially wooden poles, are also improving. This also introduces an efficiency bonus in the form of lower diagnostic costs, and reduced asset failure rates (with attendant safety gains).

3 Country Energy's Service Territory

It appears to Country Energy that the Draft Decision may be based on the expectation that the cost of providing public lighting services in Country Energy's territory is broadly comparable with the cost for networks that are much smaller in length. Country Energy stresses that its network territory is not comparable with other NSW DNSPs or Victorian DNSPs.

Country Energy operates the largest network by length in Australia with around 200,000 kilometres of power lines. Country Energy's network operating area now extends across 95 per cent of NSW's land mass, and into parts of Queensland, Victoria and the Australian Capital Territory. Country Energy now operates with around 4,200 employees serving a customer base that includes around 770,000 network customers.

Country Energy's workforce operates from 142 Customer and Field Service Centres, nine Regional Offices and several metropolitan locations. This decentralised structure reinforces Country Energy's accountability and commitment to local customers.

The extensive nature of the network increases costs at every stage relative to a more concentrated network. For example, a one way trip to Tibooburra in the far North West of NSW is at least a five hour one way trip from the nearest field service centre at Broken Hill. While Tibooburra is unusually remote, the map below (see Exhibit 1) provides an indication of the distances between field service centres especially in the far western, north western and northern regions. There are many other remote locations where travel times from the nearest field service centre are significant.

Exhibit 1: map of Country Energy's service territory and field service centres.



Country Energy's public lighting pricing model uses inputs from its information management system that in its view accurately captures the cost of operating in its service territory. It considers this data is superior to comparisons with costs in dissimilar networks.

4 Cost of Bulk Lamp Replacement

The AER considered Country Energy should apply Integral Energy's time to replace each lamp under a bulk lamp replacement program (that is, 6.85 minutes per lamp) with a 20 per cent increase in this time per lamp to take into account the rural nature of Country Energy's network (that is, 8.22 minutes per lamp).¹

Country Energy does not agree that an allowance of 8.22 minutes per lamp is realistic or reasonable. Country Energy maintains that 16.8 minutes is the correct allowance.

Country Energy's proposed budgeted allowance is based on actual outcomes for bulk lamp replacement for the 2007-08 financial year. The budgeted allowance, however, represents a substantial improvement relative to the actual value for 2007-08. This is on the basis that efficiency improvements will occur as the bulk lamp replacement program scales up and crews gain greater experience. There is, however a minimum labour input required and this is substantially greater than the proposed 8.22 minutes.

Country Energy's Electricity Safety Rules (CEPG8030) requires that a minimum of a two person crew is required to undertake any work on the public lighting network. Country Energy's cost estimate therefore refers to two persons. Its budgeted allowance is therefore 16.8 person minutes or two times 8.4 minutes.

Country Energy is unable to comment on the use of two person crews by other DNSPs. However, it notes it is possible the costs provided in Table 3.7 of the Decision for other DNSPs might not be directly comparable.

For each lamp, the two person crew must undertake the following tasks:

- review and record Hazard Identification Risk Assessment and Control (HIRAC) details for each specific site (for example, elevation, slope, traffic, vegetation and other hazards)
- setup the elevated work platform (EWP)
- establish traffic control
- replace lamp & photo-electric cell
- clean lantern
- test lantern operation
- record maintenance tasks
- pack up EWP
- remove traffic control

¹ See page 27 of the AER's Supplementary Interim Decision, March 2009

5 Allowance for Overheads for Plant and Materials and Evidence of Bulk Purchasing

The AER stated in its Draft Decision that it has not been provided with sufficient information from Country Energy to support a materials overhead of 56 per cent or a plant overhead of 48 per cent.² It therefore requested that Country Energy remodel its charges applying a plant overhead rate of 25 per cent and a materials overhead rate of 25 per cent. With respect to the overhead rate for materials, the Draft Decision required that the DNSPs demonstrate that the majority of purchases are made in bulk quantities.³

Country Energy does not agree that overhead rates for plant and materials of 25 per cent, as proposed by the Draft Decision, are realistic or reasonable, given the nature of Country Energy's service territory. Country Energy maintains that its material overhead of 56 per cent and plant overhead of 48 per cent are both realistic and reasonable.

Country Energy notes that it submitted its cost allocation method to the AER and the method was found to be appropriate. It appears to Country Energy that Table 4.5 in the Draft Decision⁴ reflects the application of various cost allocation methods by NSW DNSPs and hence direct comparisons may be difficult.

With respect to materials, Country Energy maintains an extensive inventory of public lighting materials. The extensive nature of Country Energy's network, together with service standard obligations requiring prompt repair or replacement of failed assets, means that 'just in time' deliveries of materials from suppliers is not feasible.

Materials are therefore purchased in bulk and initially delivered to one of three bulk storage facilities. Bulk supplies are continually "topped up", sometimes with relatively small orders, as noted in the AER draft decision. This is, however, consistent with the existence of bulk purchasing arrangements and the presence of significant inventories.

Inventories consisting of poles, brackets, lanterns, lamps and other materials are then distributed to and stored at one of Country Energy's numerous Field Service Centres. Given the significant travel time required for moving stock to field centres, sufficient stocks need to be in place to enable the timely spot defect maintenance, or to fulfil bulk lamp replacement programs. In addition because of the diversity of assets currently in place, stocks need to include a variety of different asset types.

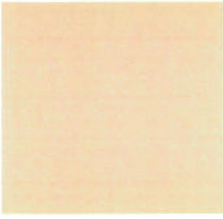
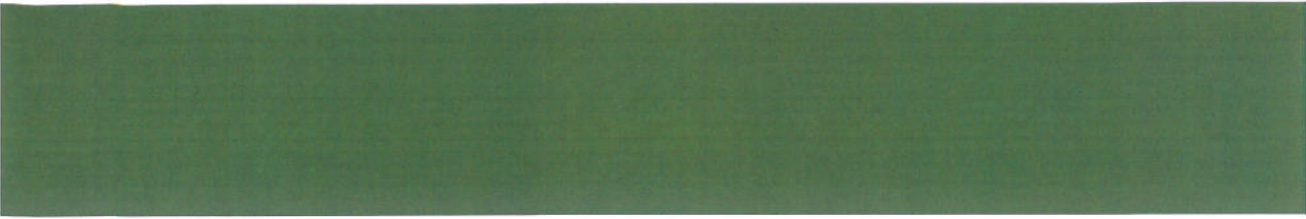
The distribution function is undertaken using dedicated Country Energy transport assets. Poles, in particular, are bulky and require significant transportation and storage space.

Other supplies also take up valuable floor space and require ongoing inventory management. The cost of managing the overall inventory of materials for Country Energy's dispersed service area is substantial. On-cost components include: stores, technical and business support, network (shared costs) and corporate overheads.

² Ibid. page 27 for pre 2009 and also reference in page 42 for post 2009.

³ Ibid page 28.

⁴ Ibid page 41.



With respect to plant, plant required for public lighting services include: elevated work platforms; trucks; cars and utes; traffic control (both painted and electronic road signs); and other equipment. This equipment is shared with network, enabling capital and other charges to be substantially lower than otherwise. These cost savings were incorporated into Country Energy's January 2009 price proposals.

The internal charges applied to plant are the same for public lighting and other network operations, and are considered reasonable. Plant costs include the cost of fuel and maintenance, as well as insurance and other overheads.

The extent of plant inputs required is considerable and hence cost is highly sensitive to travel times. As noted elsewhere, aggregated travel times faced by Country Energy are substantially higher than for other NSW or Victorian DNSPs. Consequently, Country Energy considers that substantially higher plant cost allowances relative to other DNSPs are realistic and reasonable.



6 Cost of Construction of New Assets

Consistent with its position with respect to the bulk lamp replacement program for assets constructed before 30 June 2009, the AER considered that an overhead rate of 25 per cent be applied to plant and materials.

With respect to the bulk lamp replacement cost and overhead costs, Country Energy's earlier comments apply. It does not consider the allowances of a 25 per cent overhead rate are realistic or reasonable. Instead these allowances should not be reduce from 56 per cent for materials and 48 per cent for plant.

7 Early Replacement of Assets at Customers' Request

In the Draft Decision, the AER accepted there are many variables relating to calculation of the residual asset charge and therefore does not require the NSW DNSP's to develop tariffs for tariff class 5.⁵ Country Energy agrees these charges should therefore be calculated at the time of the agreement with the customer.

Country Energy agrees with the method for calculating the residual capital charge set out in the Draft Decision.⁶ This is consistent with the method outlined in Country Energy's January 2009 submission.

Country Energy understands the Draft Decision to mean that residual capital charges for early replacement of the lantern will be recovered immediately and the customer is to fund the capital cost of the replacement asset. Given the phased nature of early replacement, Country Energy does not consider this requirement would be overly onerous. Country Energy notes that Councils will be able to apply to recover some of the cost of early replacement from the Energy Savings Fund.

⁵ Ibid page 47

⁶ Ibid page 47



8 Minor Matters

Country Energy understands that the Weighted Average Cost of Capital (WACC) to be applied to Alternative Service Charges will be the same as that applied to Standard Control. Accordingly, Alternative Service charge rates will be updated to reflect the final Determination with respect to WACC.

Country Energy notes that there will be no separate tariff rates for spot defect maintenance. Rather, tariffs will be based on a bulk lamp replacement program inclusive of appropriate allowances for spot defect maintenance for older style lamps and new lamps. Accordingly, the final published tariff rates will not include spot defect maintenance rates as currently provided for in Appendix A to the Draft Decision.