

27 March 2009

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

Dear Mr Buckley

Submission on AER draft public lighting determination of 13 March 2009

Integral Energy is pleased to provide its response to the Australian Energy Regulator's *NSW draft distribution determination 2009-10 to 2013-14, Alternative control (public lighting) services*, released Friday 13 March 2009.

In the draft public lighting decision the AER endorsed many aspects of Integral Energy's submission, but requested further clarification in some areas. Specifically, Integral Energy was asked to clarify the following:

- Labour rates and overheads – Integral Energy can confirm that the labour rate of \$127.51 used for our public lighting submission is an all inclusive rate, reflecting all elements of the cost of the public lighting service other than direct materials and plant costs. The labour rate includes direct labour, labour on costs, local overheads and corporate support costs. The overheads and corporate support costs allocated to public lighting include materials handling and inventory costs as well as plant overhead costs. These costs are collected centrally and allocated based on activity drivers in accordance with Integral Energy's AER approved Cost Allocation Model (CAM).
- Bulk quantities – Integral Energy can confirm that, given the volumes involved, we purchase the key materials used for public lighting in efficient batches according to usage, lead time and holding value. This is neither a bulk buying (maximum order quantity) nor a just in time arrangement, but is designed to reduce overall cost across the business. Integral Energy would still incur materials handling costs as lead times and efficient order quantities mean that equipment may remain in store for some period of time demanding people and resources to manage the stock holdings. This also means that store space is required together with specialist handling equipment to assist in the stock movement process. As such, we believe that the material handling overhead embedded in the overall labour rate noted above is an appropriate reflection of our inventory and materials handling costs.

Going further for you is what we do

INTEGRAL ENERGY ABN 59 253 130 878
51 Huntingwood Drive Huntingwood NSW 2148

www.integral.com.au

par12/061553924



The power is in your hands

- Capital expenditure escalators – Integral Energy welcomes the AER's statement that it "*is generally accepting of methods for deriving escalators which reflect the movement in input costs*" and believes that such an approach best reflects the efficient costs of delivering the service. Integral Energy applied the same capital cost escalator to public lighting as was used in our Revised Regulatory Proposal for standard control services, which we believe is a reasonable approach at the aggregate level. Integral Energy does not dispute the AER's assertion that labour costs of public lighting construction account for 50% of the total and therefore, for simplicity, would accept the principle of escalating public lighting capital expenditure by 50% of the NSW EGW real labour escalation rate in addition to inflation.

Integral Energy also notes that the AER's draft decision differs from Integral Energy's position in a number of key assumptions. We wish to take this opportunity to reiterate our position as follows:

- Weighted average cost of capital (WACC) – As noted in Integral Energy's Revised Regulatory Proposal to the AER on 14 January 2009, Integral Energy believes that the averaging period proposed by the AER will result in an unrepresentative WACC over the 5 year regulatory control period, due to the global financial crisis. Integral Energy has proposed a more representative averaging period and believes that our proposed approach should apply to both standard control services and alternate control services such as public lighting.
- Labour content of operating costs – Integral Energy has used a labour content of 65%, consistent with the labour content of our Regulatory Proposal operating costs, to escalate the operating costs associated with public lighting. However in the draft decision the AER have used a figure of 60% and noted that "*The AER...considers it reasonable to apply a labour escalator to maintenance charges based on labour costs representing 60 per cent of maintenance costs*". The AER have not offered any basis for this assertion, nor offered a reason why Integral Energy's position is unreasonable. Integral Energy believes that the use of a 65% labour content for escalation of our public lighting operating expenditure is reasonable and consistent with our Regulatory Proposal and therefore should be maintained.

Further, in the draft public lighting decision the AER appear to be considering setting a public lighting price path in nominal terms, that is, with inflation rates fixed at the time of the decision based on the forecast CPI. Integral Energy believes that this approach is inconsistent with the use of real escalators in the decision for direct control services and could lead to confusion among stakeholders, with some parts of the AER's 2009 decision being published with real price paths and others in nominal terms. Integral Energy believes that the public lighting price path should be expressed in real terms with the CPI adjustment being added each year, consistent with the approach for NUOS charges.

Integral Energy also draws the AER's attention to the fact that the Integral Energy 2008-09 closing RAB value of \$37.5 million was derived using a notional inflation rate of 3.0% for 2008-09, subject to final calculation once 2008 December quarter data became available. This approach was taken to be consistent with IPART's roll forward methodology and Integral Energy's revised direct control services Regulatory Proposal. Integral Energy has now calculated the 2008-09 inflation rate at 4.35% using the 2008 December quarter data and notes that the closing RAB value should therefore be updated to \$38.0 million.

Finally, in reviewing the draft public lighting decision, Integral Energy has identified a number of other issues for comment. These have been noted in the attached table for consideration by the AER.

Integral Energy strongly supports the consultative approach that the AER has taken to date and looks forward to working with the AER and other key stakeholders to finalise the public lighting decision.

For further information on Integral Energy's public lighting submission, please contact our Manager Regulatory & Pricing, Mike Martinson, on telephone 02 9853 4375.

Yours faithfully



Daniel Lucas

**General Manager
Regulatory and Corporate Affairs**

Attachment: Integral Energy - Comments on AER draft public lighting determination of 13 March 2009.

Attachment 1 - Integral Energy – Comments on AER draft public lighting determination of 13 March 2009

Issue	Page	Comment
<p>The wording on pages 2 and 22 implies that the bill modelling provided by Integral Energy is intended to represent the total bill for 2009/10. This is not the case. The bill impact provided to the AER and included in Appendix D of the draft decision is based on the inventory at December 2008 and shows the impact of the new rates for assets constructed prior to 30 June 2009, if no assets were added or removed (i.e. on a ceteris paribus basis).</p>	<p>2, 22</p>	<p>The comments on p2 would apply to Integral Energy if changed to "A better comparison of the bill impact of the AER's proposed tariffs for existing assets can be obtained by comparing representative annual costs using 2008/09 rates and proposed 2009/10 rates for a common inventory (as at December 2008)." and "...the total bills for Integral Energy's customers would increase on average between those years by 4%, assuming a common asset inventory." The comment on p22 should also be amended as follows: "...Integral Energy provided an estimate of total bill impact for each customer using the proposed 2009-10 prices and a common asset inventory"</p>
<p>The approach to inflation rates have been treated inconsistently throughout the document.</p>	<p>30,31,33, 49</p>	<p>Integral Energy's revised submission on public lighting used an inflation rate of 2.55% for each year of the regulatory control period, as is correctly reported in Table 3.11 of the AER's draft decision. However, prior to issue of the draft decision the AER requested Integral Energy to model inflation rates of 3.0% for 2009/10 and 2.5% in following years. Integral Energy made these changes and the final prices published by the AER were on this basis. Due to this fact the draft decision statements on p33 stating "...the price path...will be calculated by applying...the draft decision forecast inflation rates used in table 3.11 of this draft decision" and p49 stating "...the price path...will be calculated using...the draft decision forecast inflation rates set out in table 3.11" are inconsistent with the inflation figures actually used for the prices contained in the draft decision.</p>

Attachment 1 - Integral Energy – Comments on AER draft public lighting determination of 13 March 2009

Issue	Page	Comment
<p>Comments on Table 4.3</p>	<p>37</p>	<p>In Table 4.3 the purpose of the table would be clearer if the heading was "DNSP's proposed annuitised capital equipment costs" as the existing heading "DNSP's proposed annuitised capital costs" may be misinterpreted as including labour.</p> <p>Also the costs for Bracket – minor roads and Bracket – major roads are transposed in the table.</p>
<p>Early replacement of assets at the customer's request</p> <p>The AER's draft distribution determination for public lighting services states that:</p> <p><i>"The AER agrees with Integral that the rates for tariff class 6 (now tariff class 5) would be either tariff class 3 or 4 (depending upon the capital funding arrangements) plus an upfront payment or an annual payment for the residual assets charge determined at the time of agreement to a customer's request to early replacement."</i></p> <p>Emphasis added.</p>	<p>46</p>	<p>Integral Energy has concerns with the proposal to allow an annual payment for the residual asset charge. Allowing an annual payment will require the creation of a series of prices for individual replacement projects which will all need to be tracked over time until such time as the residual value has eroded to zero. Such an approach would be extremely difficult to execute in Integral Energy's current systems. Having an upfront payment will mean that the billing system only needs to accommodate the tariff class 3 or 4 rates.</p> <p>Integral Energy believes that the payment for the residual value of assets replaced early at a customer's request should be an upfront payment only.</p>
<p>In the AER's NSW draft distribution determination for public lighting services the AER states that:</p> <p><i>"Integral Energy also noted that the AER's tariff class 5 referred to assets owned by the customer but maintained by the DNSP, that is, gifted to the DNSP."</i></p> <p>This was not correct.</p>	<p>50</p>	<p>In Integral Energy's Public Lighting pricing proposal submitted to the AER on 16 January 2009, Integral Energy stated that the work associated with the AER's proposed Tariff Class 5 was contestable and therefore unregulated. This was on the basis that the customer owned the assets but the maintenance could be undertaken by the DNSP or any other suitably qualified contractor. The customer does not gift the assets to the DNSP.</p> <p>Integral Energy reiterates that it is our belief that in this case the</p>

Attachment 1 - Integral Energy – Comments on AER draft public lighting determination of 13 March 2009

Issue	Page	Comment
<p>Integral Energy supports the AER's conclusion that the new public lighting tariffs will apply if a customer accepts a quotation for construction of new assets after 30 June 2009.</p>	<p>52</p>	<p>public lighting maintenance activity is contestable and therefore charges for this work are unregulated. Integral Energy invites the AER to comment if they hold a different view.</p>
<p>Integral Energy is generally supportive of the proposed process for introducing new public lighting assets during the regulatory control period as detailed in the AER's draft decision.</p> <p>If Integral Energy wishes to introduce a new type of public lighting asset during the regulatory control period it needs to submit an application to the AER demonstrating that the proposed charges are efficient. The proposed charges would be developed using the same methodology as that used to calculate the charges for assets installed after 1 July 2009.</p>	<p>52,53</p>	<p>The AER's final decision should also make it clear that the new public lighting tariffs will apply in situations where an individual existing luminaire is replaced after 30 June 2009. Individual replacement of existing luminaires could occur for a number of different reasons including vandalism, motor vehicle accidents or obsolete fittings with no available spares.</p> <p>Where Integral Energy and a public lighting customer agree on a bulk luminaire replacement programme the arrangements detailed in the AER's draft decision should apply.</p> <p>Integral Energy's only real concern with this process is the proposed six month timeframe for the AER to make a decision on Integral Energy's application. Integral Energy believes that a six month timeframe for a decision on the price for a new type of public lighting assets is too long and would impact on Integral's ability to respond to customer requests for the installation of new energy efficient type luminaires in a timely manner.</p> <p>Integral Energy believes that the time taken to make a decision on any application should be three months. This timeframe could be extended if required with the agreement of the DNSP and the AER.</p>