

27 March 2009

Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
c/o aer inquiry@aer.gov.au

Dear Mr Buckley,

**REROC Submission on the Draft Distribution Determination 2009-10 to 2013-14
Alternative Control (Public Lighting) Services**

The Riverina Eastern Regional Organisation of Councils (REROC) welcomes the opportunity to make this submission on the Draft Distribution Determination for Public Lighting.

REROC is a voluntary association of thirteen General Purpose councils located in the eastern Riverina of NSW. The members of REROC are the councils of Bland, Coolamon, Cootamundra, Corowa, Greater Hume, Gundagai, Junee, Lockhart, Temora, Tumbarumba, Tumut, Urana and Wagga Wagga. REROC covers an area of some 43,000 sq kms and a population base of approximately 140,000.

Public lighting is an extremely important issue to the REROC members. Currently approximately 10% of Country Energy's public lighting inventory is located in our region costing just over \$1.5 million each year to our member councils. This is a significant expenditure for our member councils, particularly because in NSW local government is rate-pegged and consequently every price increase eats into the ability of councils to deliver other essential facilities and services.

As the AER is aware, REROC has for some time had concerns about the cost and delivery of public lighting services into our region. Our members congratulate AER on its determined approach to obtain better, more detailed information from all the NSW DNSPs in relation to their pricing proposals for public lighting and for the willingness of

the AER to benchmark those proposals against similar operations in other states of Australia.

REROC's Key issues

As a summary our key issues in relation to the CE proposal are as follows:

- a) The accuracy of the CE inventories and the potential impact that inaccuracies will have on the RAB;
- b) The loss of CE's Tariff 2 Class and the consequent ability of councils to fund the replacement of assets through what amounts to an instalment process;
- c) The omission of a mechanism to deal with the funds currently held by CE that were collected through the operation of its Tariff 2 which should be directed towards asset replacement;
- d) The tariffs proposed for energy efficient lighting; our members are concerned that these remain too high when compared with product provided by other DNSPs both within NSW and in other states. Our members remain committed to the adoption of energy efficient technologies but its implementation will depend on a pricing framework that makes these technologies financially viable.

In preparing this submission REROC has reflected the AER's approach and addressed the issues of assets constructed before 1 July 2009 and assets constructed post 30 June 2009. We have also included some general comments in relation to the operation of public lighting, which we trust the AER will consider prior to issuing its final determination.

Assets Constructed before 1 July 2009

Allocation of Closing RAB

1. Our members are concerned about the method utilised by CE to allocate its 2009 closing RAB to individual customers. The proposal indicates that CE has obtained inventory records based on asset type from its public lighting database and valued the inventory using the current replacement cost.
2. Our members do not believe that CE has undertaken sufficient groundtruthing activities to validate its asset database which would enable accurate attribution of asset type valuations to customer inventory records. A number of our members have undertaken groundtruthing activities based on the database inventories supplied to them by CE and while some of those inventories have been reasonably accurate others have been substantially inaccurate. For example in Junee Shire the groundtruthing of data resulted 200 more lights being on the inventory than on the ground including one light that was actually listed as being located in Culcairn, which is part of Greater Hume Shire (some 200 kilometres away), while Temora Shire found 85 entries incorrect on its inventory many of which related to fluorescent lights.

3. Our members recognise that the creation of CE from a number of smaller, disparate DNSPs has generated difficulties for CE in compiling its public lighting asset inventory. We are concerned however that data inaccuracies, in terms of flawed public lighting inventories, will flow through the system under CE's proposal creating long-term financial disadvantage to councils because the application of the asset type valuations to customer inventory records will be used to produce a total bill for each customer.
4. Our members are prepared to accept, as the AER has done that CE does not have accurate information on their public lighting assets and consequently the remaining lives for individual assets are unknown; we are not prepared to accept that CE does not have the capacity to groundtruth its assets and provide an accurate count of the number, type and location of each asset in each LGA. We believe that CE has had sufficient time since its establishment to get its house in order in this regard and that it should be required to do so before it allocates 2009 closing RABs to individual customers.
5. Therefore we request that as a condition of the AER agreeing to the adoption of this approach to CE's RAB that CE be required to provide accurate (that is groundtruthed) GIS-based records on the inventory held for each LGA to each LGA for their acceptance within the next 12 months.

REROC understands that the limited nature of CE's data in relation to public lighting and therefore accepts the AER's recommendation that a half-life assumption be adopted to calculate depreciation before 1 July 2009. However, as stated in our previous submission to the AER the adoption of this assumption has implications that include the following:

- a. **Overestimate maintenance costs and capital-related costs** - Older assets tend to have higher failure rates and maintenance costs. Accordingly, if CE relies on recent outage rate data that represents relatively old assets (ie, older than 50% of typical life), CE will overestimate the maintenance costs of an efficiently managed system. Similarly, the fraction of assets requiring capital replacement (as opposed to maintenance), would be higher. While those higher costs may reflect recent CE experience, they would not represent an efficiently managed system, but rather one with aged assets and a history of under-investment of capital.
- b. **Underestimate of accumulated capital-related payments for assets under Tariff 2 and other tariffs** - Under CE's current Tariff 2, which applies to most councils in southern NSW, CE has collected funds for capital replacements. If the average age of lighting assets is higher than CE's proposed 50% of typical life assumption, CE will underestimate the councils' sinking fund contributions to date.

Annual Capital Charge

6. REROc notes that it is CE's proposal to calculate its return on capital based on the 2009 closing RAB which has been allocated to each customer, as stated above we believe that the calculation of the closing RAB is flawed because of the level of inaccuracies contained in the CE data.
7. Most lighting in the Riverina region is currently priced under a CE tariff known as Tariff 2. Under this tariff, initial capital costs are paid for by councils or developers and the on-going charges for the asset include components for maintenance and the **cost of asset replacement**. To that end, CE's ongoing charges include payments from Councils into what is essentially a sinking fund to cover the costs of future replacements (but do not include capital recovery contributions, because the Councils provide the initial capital).

Country Energy's current Tariff Type 2 Definition from 2007-08 Country Energy's Street Lighting Management Plan (Section 6 page 18) is as follows:

Tariff Type 2: *The street lighting customer or a third party has installed the luminaires and supports at their cost, however **Country Energy maintains and replaces the lamps, luminaires and supports**. Country Energy recovers the cost of replacement of the installation in the annual tariff as well as maintenance charges. All assets installed under this Tariff Type are regarded by Country Energy as gifted assets and are owned operated and maintained by Country Energy. Transfer of ownership to the customer (Tariff Type 3) will be negotiated however there will be no payout of capital required.¹*

8. We note that the Table 5.1 of the Draft Determination does not include a tariff offering similar provisions (eg the AER's proposed Tariff Class 2 is a maintenance-only tariff) and therefore our current CE Tariff 2 assets will become "stranded". Either councils will have to pick up the cost of capital replacement and transition to the new Tariff Class 2 (as defined in the Draft Determination) or they will be forced to transition to new Tariff Class 1. The failure of an inclusion of a tariff to replicate the old CE Tariff 2 will result in a substantial reduction in service levels to councils in our region.
9. Our members would support the inclusion of an additional tariff "Customer funded, DNSP maintained" with charges based on maintenance cost and a capital charge (using annuity) which does not include a contribution for WACC. The annuity component to be "ring-fenced" in a sinking fund to be used for future asset replacements.

¹ <http://www.countryenergy.com.au/wps/wcm/connect/c8f6fb0049900baf8084d5c9baaf5941/CEPG1023.pdf?MOD=AJPERES>

10. On 6 August 2008 CE wrote to REROC and proposed that for pre-1 July 2009 assets, CE would use the accumulated sinking fund to pay for the cost of replacements until that fund was depleted copy of letter is **enclosed**. After the fund is depleted, councils would face either the full cost of replacement at end of life as a one off charge or would need to agree to transition to a Tariff 1 basis.
11. We note that the issue of the "sinking fund" has not been addressed in CE's current proposal to the AER nor has it been addressed by the Draft Determination. Our members are concerned that if this issue is not appropriately addressed in the Final Determination then CE may view the sinking fund as "windfall profits". We therefore request that the AER obtain an indication from CE of the amount of funds it has collected from councils to meet the replacement costs of the assets and how it intends to apply these funds to the replacement of the pre-1 July 2009 assets.
12. It is our belief that the funds held by CE should be substantial and, based on the Draft Determination substantially revising downwards many of CE's assumptions, may have been over-collected.
13. We also request that the AER make it a condition of the Determination that CE keep accurate records of when pre -1 July 2009 street lights are replaced and provide these to councils on a regular basis to enable councils to commence making capital provisions in their own budgets for the replacement of the lights. In addition we request that mechanisms be put into place to ensure that the distribution of the funds is undertaken equitably. As stated above, CE has suggested that it will be "responsible" (using funds from the sinking fund) for the first replacement of the light and then the capital outlay will subsequently fall to councils.
14. Our members' other concern relates to the real cost of replacing a street light at the end of its useful life. For councils on the new Tariff 2 there does not appear to be provisions in place for the council to engage the DNSP to replace lights. Future replacement of Tariff 2 lights is a monopoly service, particularly in rural areas. Capital costs for replacement lighting should therefore be an explicit part of the Final Determination.
15. Our members believe that it is imperative that an additional tariff is included in the Determination which covers "installation only" by a DNSP, where the capital cost is met by the council and the DNSP provides the labour. The replacement light would be re-gifted to the DNSP and included on the DNSP's inventory for maintenance purposes. This tariff would then allow council to weigh the comparative advantages of continuing to fund the capital component of new lights or of moving to the AER's Tariff 3.

Efficient Maintenance Charges

16. REROC strongly supports the AER's stance in relation to achieving efficient maintenance charges. We have, in previous submissions, expressed our concerns that CE is not operating at the most efficient level particularly when compared to similar operations in rural Victoria.
17. Our members support the AER's adoption of the ESCV's 5 percent materials premium for rural areas and believe that this level premium is sufficient, particularly considering that much of CE's public lighting assets are located in urban communities (Wagga Wagga, Albury, Dubbo, Bathurst, Port Macquarie, Coffs Harbour, Tamworth, Queanbeyan, Griffith, Orange to name some of the larger cities) with good transport networks and local CE depot.
18. Our members believe that the proposal from CE that lamp replacement takes 16.8 minutes is excessive and we are very concerned that Integral Energy is able to perform the same task in 6.85 minutes. Therefore, our members strongly support the AER's request that CE model its annual maintenance charges using the assumption of lamp replacement under a bulk lamp replacement taking 8.22 minutes.
19. We note that the suggested time is based on bulk lamp replacement and wish to raise our concerns that the AER must put into place mechanisms that ensure that this is the default option for maintenance programs. REROC is concerned that DNSPs may resort to spot replacements because they provide an avenue for higher cost recovery.

Price Path

20. Our members are concerned about possible double counting in the application of labour escalators and inflation to the price path.
21. Our members are not in a position to comment on the proposition that 60% of the maintenance costs of public lighting is attributable to labour as we are not privy to how CE has determined its charges to date. However we are prepared to accept the AER's recommendation that the price path for tariffs be calculated by applying 60% of the NSW EGW real labour growth rates to maintenance costs. We are not convinced however that the inflation rate should apply to 100% of the maintenance costs if there has already been a price uplift for 60% of the costs through the application of the labour escalation factor.
22. We also wish to ensure that the DNSP's cannot apply the inflation factor to the maintenance costs post the application of the labour escalation factor which we believe would result in a form of double-counting.

23. REROC supports the AER's request for an amendment to the CE proposal in order to remove the double counting of inflation on the capital component of its tariffs.

Assets Constructed after 30 June 2009

Annuity Model

24. The REROC member councils accept the AER's proposals for the annuity model and its recommendations in relation to the application of the WACC for DNSPs.

Efficient Material and Installation Costs

25. The REROC members support the AER's request that CE remodel its charges that apply to the effective labour rate, particularly as it relates to the design costs which we agree appear to be excessive.
26. We believe that it is appropriate to benchmark CE's performance in this area not only against the other DNSPs in NSW but also against similar service providers in rural areas in other states. To this end we support the AER's decision to cap the overhead premium that CE applies to its operations in rural areas to 5% over and above the materials rate.
27. Our members support the AER's proposition that the purchasing of materials be done in bulk in order to reduce unit costs, we would request that bulk purchases are undertaken after consultation with customer councils as to the types of technologies they want installed in their communities and not before. We are concerned that past practices may have resulted in communities being "stuck" with bulk purchasing decisions that do not reflect customer wants or needs.
28. Our members note that it does not appear that the Draft Determination has addressed the issue of a discount to customers where asset replacement occurs as part of a bulk replacement program because the full maintenance effort is not required. We note that Country Energy's pricing assumptions are based on a 100% spot luminaire replacement approach. However, in the Riverina, a large-scale replacement of obsolete lighting is planned by CE over the next regulatory period. The efficiencies of bulk replacement should be recognised in the pricing for this.

Early Replacement of Assets at Customer's Request

29. Our members believe that there will be occasions when assets that were not funded by the DNSP will require early replacement. For example within our region the member councils remain very keen to improve street light performance through the use of energy efficient alternatives. This is likely to include the early replacement of some energy inefficient lights with new lighting technologies.

30. We note that there is no tariff that permits a council to purchase the new light, then have CE install it and include it on its inventory for maintenance. As stated above our members believe that the determination of an efficient "installation only" tariff to cover this eventuality is required to ensure that a full service is available.

Price Path

31. The REROC members support the AER's proposal that the forecast CPI be used as the appropriate escalator for the price path to apply to charges for assets constructed after 30 June 2009 (as set out in table 3.11 of the Draft Determination).
32. Our members trust that any further proposals lodged by the DNSPs in relation to the price path will result in another round of consultations with affected councils prior to a pricing determination taking place.

Other Issues

Revised Tariff Classes and Tariff Class Designations

33. REROC supports the new tariff classes as proposed by the AER with the following exceptions:

- a. Our members request the inclusion of a tariff that permits councils to contribute to the replacement costs of assets over time. A "Customer funded, DNSP maintained" tariff whereby charges are levied to cover both the maintenance cost as well as an annualised capital charge (excluding WACC) to cover the cost of replacing the asset at the end of its useful life.

The capital charge component would be "ring-fenced" in a sinking fund (which could earn interest) which would then be applied to asset replacement as required. The annualised capital charge would reflect the 20 year life span of the asset. This approach provides a better cash flow outcome for councils.

- b. There is no provision for a customer to purchase replacement lights that are then gifted to the DNSP and maintained by the DNSP. Our members request that an "installation only" tariff be included which would be the amount charged by a DNSP to install a new light at the request of the customer which is paid for by the customer.

The Need for Transitional Arrangements

34. As noted above the transitional arrangements have not addressed the issue of the "sinking fund" that CE has acquired through the use of its current Tariff 2. The

current Tariff 2 includes a fee to cover the capital replacement of the asset in addition to the maintenance costs.

35. Our members believe (based on the figures provided through this Determination process) that up to 50% of the street lighting charges collected by CE and its predecessor organisations, from Tariff 2 councils (who are predominately located in southern NSW) should have been held, in trust, in the sinking fund for the purpose of asset replacement
36. Unfortunately our discussions with CE about this issue have yielded neither the actual percentage attributable to capital replacement nor the amount that is held in the sinking fund. As stated above our members are concerned that if this issue is not addressed in the transitional arrangements of this Determination CE will view those funds as "windfall profits".

Other Comments

37. As the AER is aware REROC does have some further issues with the provision of street lighting services by CE. Our members appreciate that in some instances the AER does not have the power to address these issues, however as the Regulator that determines pricing we do believe that there is some room for the AER to use price-based incentives to encourage CE to appropriately address its deficiencies in service delivery. The issues that our members are concerned about are as follows:

- a. *Lack of consultation in relation to the replacement of assets and the technologies to be adopted* - CE' s consultation with councils regarding replacement of assets in individual LGAs is very poor. There have been several instances where bulk luminaire replacement has apparently occurred without the affected council receiving any advice nor being consulted about its lighting needs.

The Public Lighting Code requires DNSPs to consult with councils about what technologies they wish to utilise when asset replacement occurs, however CE appears in the past to have ignored the requirement. The fact that councils have funded the asset replacement (though CE's current Tariff 2) makes the situation more frustrating for councils.

If CE goes ahead with the proposal that it will meet the cost (from the sinking fund) of the first light replacement then it becomes vitally important to councils that the choice made is the right choice, because the cost of each subsequent replacement will be met directly by the council.

- b. *Lack of an Energy Efficient Lighting Option* - while CE has finally placed an energy efficient option on its price list, an outcome that REROC has spent the last 2 years lobbying for, our members are concerned that the pricing for

T5 and CFL lighting appears high compared to other choices and compared to the recent AER Final Determination in Victoria on the appropriate charges for energy efficient lighting

- c. *Performance Reporting* - Our member councils believe that CE must improve its performance reporting to councils. At a meeting with CE last August we were advised that the Public Lighting Code constituted their Service Level Agreement (SLA) with councils. This stance was repeated in a letter to the AER in October. If the Lighting Code constitutes the SLA then CE should be required to report accurately against the benchmarks within that document. Ideally our member councils would prefer a position whereby members could enter into individual SLAs with CE and that performance would be judged against that. We note that in our discussions with CE it was stated that while they would require councils to pay extra for services beyond those contained in the Code, if CE failed to meet the Code there were no financial or other penalties that applied.

Conclusion

Our members appreciate the energy and commitment which the AER has brought to the task of determining pricing for public lighting for the next regulatory period. We have also appreciated the time taken by the AER to meet with us and listen to our concerns in relation to the service provision offered by CE to our member councils.

Our members would be happy to meet with the AER to discuss any points raised in our submission or indeed any other issues that may be of common interest in relation to this matter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Paul Braybrooks', with a long horizontal flourish extending to the right.

Cr Paul Braybrooks
Chairman