RIVERINA EASTERN REGIONAL ORGANISATION OF COUNCILS

PO Box 646
Wagga Wagga NSW 2650
ph: (02) 6931 9050
fax: (02) 6931 9040
email: mail@reroc.com.au
website: www.reroc.com.au

8 August 2008

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

Dear Mr Buckley,

RE: REROC submission on Country Energy's Public Lighting Proposal for 2009-14

The Riverina Eastern Regional Organisation of Councils (REROC) welcomes the opportunity to make this submission on the 2009-14 public lighting proposal of Country Energy (CE).

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. In preparing this submission to the AER, REROC has consulted with its membership.

REROC has an ongoing and productive relationship with Country Energy on public lighting matters. We have consulted regularly with Country Energy over the last 18 months in relation to public lighting service provision with a view to agreeing on service level improvements in a number of areas and to the introduction of energy efficient public lighting across our region. Our members look forward to working with the Australian Energy Regulator (AER) on this matter of importance to the public welfare, as well.

Country Energy has proposed increases in public lighting prices for 2009 to 2014 but does not appear to have outlined in its submission to the AER or its supplemental information to

REROC of 6 August 2008[1] what the magnitude of the proposed increases are for councils. Nor has Country Energy provided critical supporting information that had been requested including key cost components or a copy of its pricing model (specific outstanding items are detailed below). However, Country Energy has explicitly proposed to substantially reduce service levels on the primary public lighting tariff used in the Riverina (known as 'Tariff Type 2').

Unfortunately, the missing information severely limits appropriate consideration of Country Energy's proposal and the comments that REROC is able to make at this stage.

In summary, REROC's position is that Country Energy's proposals are inadequately supported by data and analyses, and if approved by the AER, could result in material subsidies from Councils to Country Energy, inefficiencies, and reduction in public welfare.

Accordingly, REROC urges the AER not to approve any increase in public lighting prices, or any reductions in services unless and until detailed, robust analyses demonstrate that such changes would benefit the public interest and reflect the cost of efficiently provided services. We note that this request is consistent with IPART's 26 July 2007 "Statement of Reasons for Decision – Country Energy Public Lighting Price Increase", where IPART noted that, *"...before any further price proposal will be considered by the Tribunal, it will be necessary for Country Energy to provide the Tribunal with a detailed analysis of its economic costs associated with the provision of its public lighting services".*

Among areas where additional information and analysis are urgently needed include the following:

1. **Transparent, robust validation of Country Energy's cost assumptions and price modelling**
   REROC welcomes AER's intent to assess prices against the efficient costs of providing public lighting services. However, CE's pricing proposal contains various assumptions and assertions about costs without any apparent test of the reasonableness of these costs.

   It is not possible to assess CE's proposed pricing without access to CE's detailed cost assumptions and pricing model, including:

   a. labour assumptions (hours provided but assumed labour costs not provided)
   b. cost components (assumed capex costs for key lighting components and assumed equipment costs for ELT not provided)
   c. cost allocations including overheads (not provided)
   d. calculation methods (outline provided but no working copy of model or worked examples for key lighting types provided)
   e. street lighting asset inventory on which the model is based (not provided)
   f. asset replacement and maintenance policies and programs (partial information provided)
   g. asset age assumptions (provided but warrant review as per item 6 below)

   REROC appreciates the receipt of CE's additional cost and pricing information on 6

[1] Letter to REROC from Country Energy's CEO in response to REROC correspondence of 31 July 2008, SLUOS Diagrams outlining the building block methodology for cost calculations and SLUOS Pricing Methodology CEPG2154 outlining many key assumptions used in pricing but NOT including labour, equipment and component pricing information.

August. A detailed review of this information will necessarily take longer than the time available prior to the 8 August AER submission deadline, and accordingly, REROC would appreciate the opportunity to provide a supplementary submission.

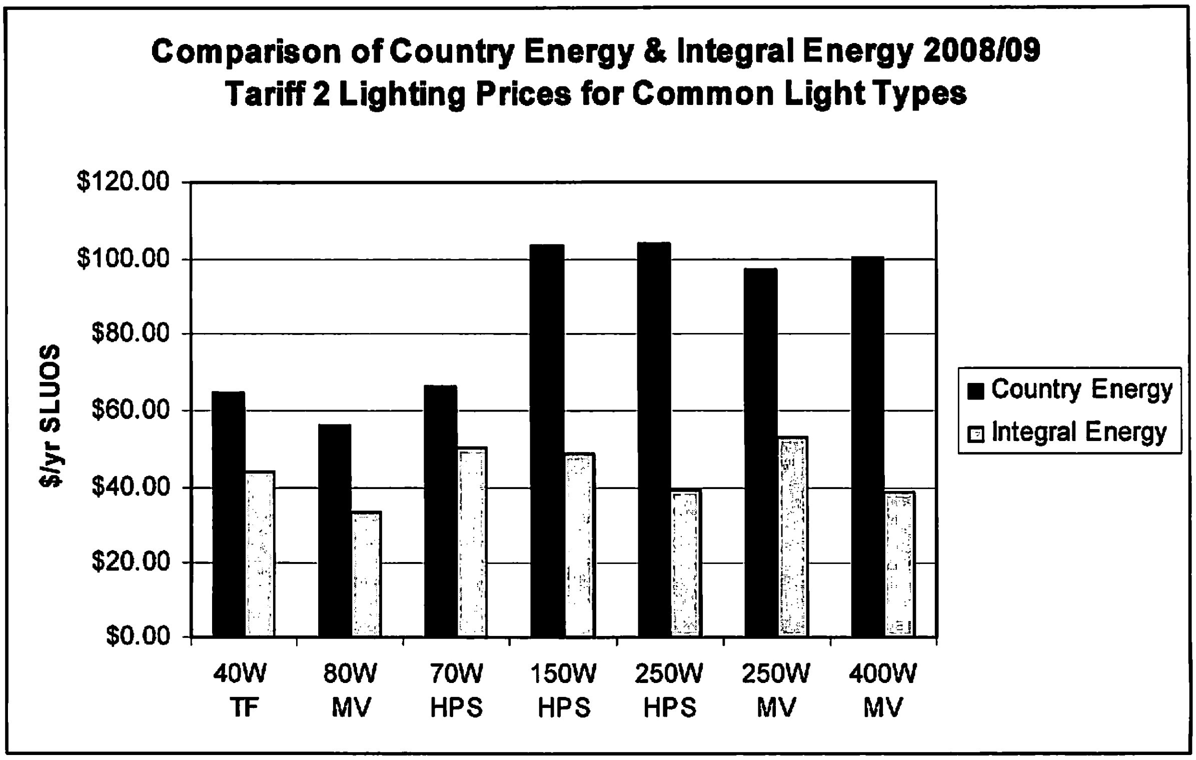
REROC also notes that full detailed validation is an extensive exercise beyond the resources of one council or small group of councils, and that there is longstanding information asymmetry between CE and councils.

Accordingly, assessment of CE's detailed cost assumptions and pricing model would benefit greatly from an open and transparent validation process led by the AER. The Essential Services Commission (ESC) Victoria review of public lighting prices provides one example. In that review, the ESC developed a detailed independent model that incorporated all relevant cost elements for the leading lighting types.[2] Key assumptions and the model itself were published and subject to public review and comment. This approach provides a thorough, transparent basis upon which to assess proposed lighting prices, and clear benchmarking data for all concerned parties.

2. **Benchmarking of CE's cost assumptions and pricing relative to other RNSPs in NSW and elsewhere in the National Electricity Market**

Benchmarking of costs and pricing against other RNSPs in NSW and the NEM is an important step in demonstrating the suitability of proposed prices. In addition, performing a benchmarking study should be useful in determining whether best practices are being used, and identifying opportunities for cost and performance improvement.

Benchmarking would be a natural extension of cost and pricing validation discussed in item 1 above. The primary additional effort would involve accounting for differences in detailed service level definitions, ie, under different tariff types, and for geographic and related factors. Again, the process used by the Essential Services Commission – Victoria presents one example of a relatively open and transparent benchmarking exercise.



[2] http://www.esc.vic.gov.au/public/Energy/Regulation+and+Compliance/Decisions+and+Determinations/Review+of+Public+

Comparison of current Country Energy Tariff 2 pricing for the most common light types with current 2008/09 Integral Energy pricing for the equivalent tariff[3] and, the rural and remote premiums allowed under the last Essential Services Commission – Victoria pricing review, suggests that there are significant unexplained differences in the pricing of key lighting types used by Country Energy as compared to relevant benchmarks (see graphs below).

For the most common lighting types, Country Energy 2008/9 Tariff 2 pricing for key light types is 32-164% higher on average compared to Integral Energy where the same tariff definition applies. Further, the rural and remote premium being charged by Country Energy appears unusually high compared to the differences approved in the Essential Services Commission Victoria 2004 Final Determination (see below). In summary, these were a 13-17% rural premium for the most common light types and a 29-44% remote premium for the most common light types.

Victorian ESC 2004 Final Determination

LIGHT TYPE	**Urban Areas** ($/yr excl GST)	**Rural Areas** ($/yr excl GST)	**Remote Areas** ($/yr excl GST)
MV 80W	**= $25.02**	**= $28.29 (13%)**	**= $32.21 (29%)**
HPS 150W	**= $50.83**	**= $59.33 (17%)**	**= $73.18 (44%)**
HPS 250W	**= $50.94**	**= $59.45 (17%)**	**= $73.30 (44%)**

SOURCE: http://www.esc.vic.gov.au/NR/rdonlyres/600FE5D0-1B02-4AEA-ACD9-6EED28E0F64F/0/040812_PublicLightingFinalDecisionV6.pdf

Beyond the benchmarking of pricing for the current common light types, it is essential that the pricing of new energy efficient lighting is set at an appropriate level that does not discourage the timely adoption of energy efficient alternatives. The pricing proposed by CE for new energy efficient CFL lighting appears high compared to current lighting types and with respect to the known underlying capital costs of this equipment.

REROC has, for over 18 months been advocating for the introduction of energy efficient public lighting in our region and we have been negotiating with Country Energy for the inclusion of an energy efficient alternative on their standard list of luminaires, which would enable councils to choose to be energy efficient. While not currently used by Country Energy, an appropriate price for new energy efficient lighting is a material issue for REROC members over the regulatory period as up to half of all residential road lighting is expected to be replaced as County Energy removes aged, obsolete and poorly performing tubular fluorescents from the network, as well as undertaking normal replacements amongst the balance of the lighting population.

Lighting+Excluded+Service+Charges/Review+of+Public+Lighting+Excluded+Service+Charges.htm

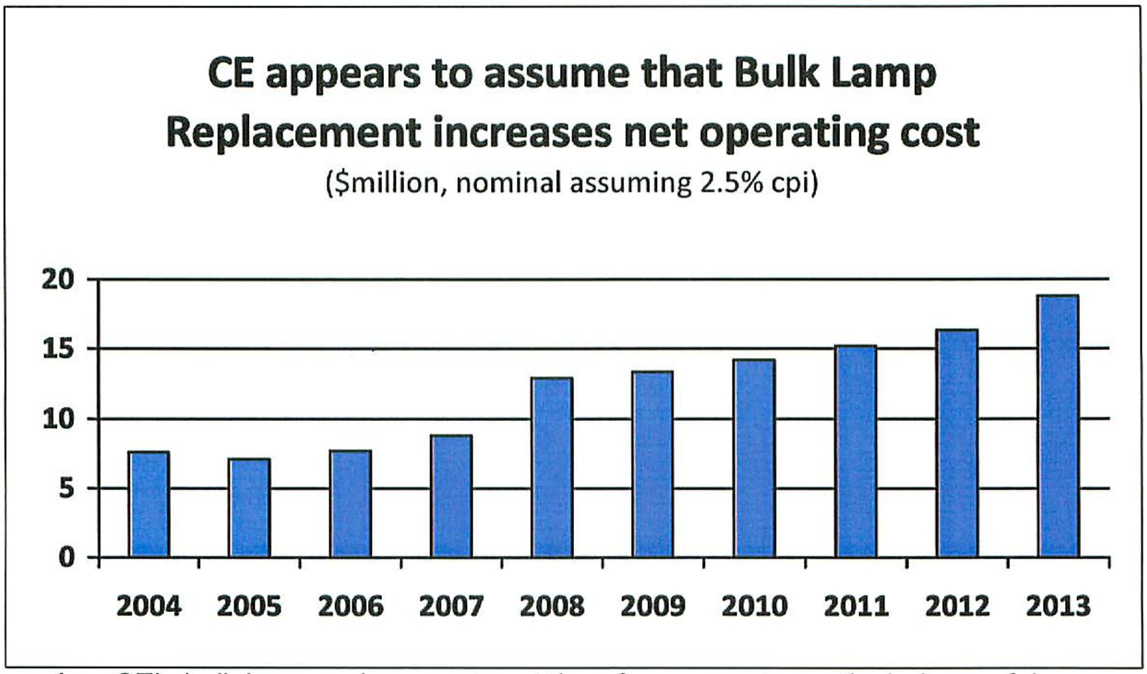
[3] Contrary to Country Energy's letter to REROC of 6 August 2008, Integral Energy uses the same tariff definition for Tariff 2 excluding initial funding but INCLUDING both maintenance and replacement of the equipment (see Schedule 2 tariff definition in Integral Energy 2008-09 Public Lighting Price List)

REROC would appreciate the opportunity to make a supplementary submission on indicative benchmarking. Inclusion of that information in this submission is not possible, as details of the revised definition of the Tariff type 2 (which is the most common tariff amongst REROC councils) only became available from CE on 6 August, which did not allow adequate time for consideration by the 8 August AER submission deadline. Further, key information remains outstanding as outlined in Section 1 above.

3. Analysis of the net costs of a bulk lamp replacement regime for lamp maintenance, rather than spot replacement only.

Country Energy has introduced Bulk Lamp Replacement, as one step to meeting the requirements of the NSW Public Lighting Code. Lamps used in public lighting fail at a non-linear rate, with much higher failure rates in the latter parts of their expected life. Bulk lamp replacement is therefore widely accepted and adopted as a cost saving approach for RNSPs because of the marked decrease in subsequent spot repairs (eg reducing spot repairs each year from perhaps 30-40% of the lamp population to about 3-10%, depending on the lamp type and age of luminaire[4]).

CE indicates that the introduction of bulk lamp replacement has produced a "step change" in operating expenditure. However, while bulk lamp replacement should markedly decrease the number of spot replacements required, it appears that CE has projected no or minimal savings, as shown in the figure below. This is a counterintuitive result, particularly for a regional and rural utility with a higher cost of servicing spot



repairs. CE's bulk lamp replacement cost therefore warrants particularly careful consideration, analysis, and benchmarking.

On initial review of CEP2154 provided by Country Energy to REROC on 6 August, a material issue appears to be Country Energy's assumption that a bulk lamp replacement takes 0.53 hrs per lamp. This does not seem consistent with good work practices or benchmarks elsewhere.

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[4] Note that these figures are consistent with CE's own assumptions in CEPG1254 provided to SSROC on 6 Aug 2008 – see page 9 Lamp Replacement Frequency.

REROC would appreciate the opportunity to make a supplementary submission on this matter, once it has time to assess the relevant detailed cost information supplied by CE on 6 August and further information that remains outstanding.

4. Analysis of CE's Tariff 2 plan to discontinue replacing assets

Most lighting in the Riverina region is under Tariff 2. Under Tariff 2, initial capital costs are paid for by Councils or developers and not by CE, but with maintenance and asset replacement costs to be paid by CE. To that end, CE's ongoing charges include payments from Councils for 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.)

While it is not apparent from CE's proposal as supplied to the AER, in recent discussions with Riverina Councils, CE management has indicated that CE plans to substantially redefine Tariff 2 to reduce service levels, and in particular to discontinue asset replacement. As now confirmed in CE's Letter to REROC of 6 August, CE proposes the following:

- For new gifted assets funded by councils installed after 1 July 2009, no contribution to capital replacement will be included in Tariff 2 and hence Country Energy will not offer an end of life replacement service. At end of life, Councils would face either the full cost of replacement as a one off charge or would need to agree to transition to a Tariff 1 basis.
- For existing Tariff 2 assets, CE would use the accumulated Tariff 2 sinking fund to pay for the cost of Tariff 2 replacements until that fund is depleted. After this 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.

On review of the proposed redefinition of Tariff 2, it is clear that the change is material, and could have inefficient and costly implications. Among the issues that merit careful consideration and analysis are:

a. Details of the size of the existing accumulated sinking fund for assets in the Riverina, how that fund size was estimated, and the adequacy of key supporting data;

b. Details of how CE would track usage against particular existing assets;

c. Details of how CE would allocate the fund to Councils within the Riverina and elsewhere;

d. An assessment of the likely costs to Councils for end of life replacement of a luminaire under redefined Tariff 2;

e. An assessment of the public welfare benefits that motivate the fundamental change in Tariff 2 definition;

f. Clarification of whether this proposal covers luminaires only, or whether it also includes other lighting assets (eg brackets and dedicated supports).

REROC notes that Country Energy's assertion in its letter of 6 August to REROC that this change is being made to align with the tariff definitions of other RNSPs does not appear correct. Indeed, Integral Energy uses the same current tariff definition for its Schedule 2 as Country Energy's Tariff 2 (eg excluding initial funding but INCLUDING both maintenance and replacement of the equipment -see Schedule 2 tariff definition in Integral Energy 2008-09 Public Lighting Price List). Further, Country Energy's Tariff 2 appears broadly consistent with the core pricing assumptions under the ESC – Victoria 2004 pricing decision.

Councils would welcome the opportunity to make a supplemental submission on this matter once they have had sufficient time to review the additional material provided on 6 August 2008 and further information that remains outstanding.

5. Analysis of the potential for a competitive market for asset repair services

Under CE's proposed redefinition of Tariff 2, councils will have to source asset replacement services from suppliers who are free from price regulation. However, CE presents no analysis that an effective competitive market exists or would eventuate.

Furthermore, it is unclear that the disaggregation of repair services could be effectively implemented. CE's proposed redefinition of Tariff 2 would disaggregate repair services into maintenance and asset replacement activities. This would appear to introduce a significant risk of inefficiency, additional cost, and poorer public service. For example, an outage repair may require either a relatively simple maintenance activity such as replacing the lamp, or the replacement of the entire luminaire. Typically, a service crew could perform either function effectively, and could carry both a replacement lamp and luminaire in the service vehicle. However, under a disaggregated system, it is unclear which crew should be dispatched. This would increase the number of required service calls on average, and increase contracting complexity. In practice, it is impossible to discern from a service call what items require replacement or repair and, whether they are consumables or capital items. Frequently it is a combination consumables (eg lamp, photocell, lens, seal, fuse, wiring connections and, in the case of new luminaires, the replaceable electronic ballast) and capital items (eg bracket, connection wiring and luminaire). Where it is a combination, would separate crews be required to undertake the different activities? How would conflicts of interest between the party assessing whether capital replacement was required versus the installer of that capital item?

Prior to adopting such a substantive change to Tariff 2, CE should perform a detailed assessment of the market supply of competitive O&M services for public lighting in rural and regional areas, including the following:

a. assessment of the extent to which the market is effectively competitive, and to which it is an inherent monopoly;
b. assessment of whether relatively small service purchasers such as Councils, would face a less competitive market than a large, nearly state-wide buyer such as CE;
c. pro forma service contracts representing the arrangements with competitive service suppliers for each of the proposed tariff types. This is needed to better inform the ability to economically and efficiently disaggregate "maintenance" and "replacement" responsibilities. It is also necessary for informing the ability to disaggregate 'capital provision' services, e.g., as relate to lamp or luminaire failures shortly after installation of a new capital item.

6. Analysis of the age and remaining lives of public lighting assets, and of the implications of CE's '50% of lifetime' assumption

Noting that it "does not have age related information for every public lighting asset in service," CE asserts that 'the only reasonable assumption open to Country Energy appears to be that assets are, on average, halfway through their useful life."

Given the critical role of asset age in determining appropriate pricing, CE's proposed blanket assumption is inadequate, and could significantly disadvantage councils. Further consideration of both asset age and the implications for costs and cost analyses is urgently needed.

Notably, a higher than assumed average asset age and lower average remaining life has several material implications for pricing, including 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 under-investment of capital.

b. **Underestimate of accumulated capital-related payments for assets under Tariff 2 and other tariffs.** As discussed under item 4 above, the most common tariff type in the Riverina is Tariff 2. Under Tariff 2, 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.

c. **Overestimate of value of assets for councils wishing to acquire them.** CE allows councils the opportunity to take ownership of public lighting assets, with a payment to CE for the undepreciated portion. However, if assets are older than CE's proposed assumption of 50% of lifetime, the cost of council acquisition would be overly high and not cost reflective.

REROC appreciates that perfect information is not available to CE. However, the matter is significant enough to warrant careful consideration. This consideration should be given both to developing better age and life estimates, and to better understanding the cost and pricing implications of the assumptions adopted.

With respect to the first area, for example, historical total public lighting capex may be available even if age data is not available for individual assets. This broader information may help assess whether there has been, for example, a pattern of under-investment in public lighting.

Notably, under Section 8.1 of the NSW Public Lighting Code, recording of the installation date of new equipment is required and was agreed to by Country Energy in December 2005.

7. Assessment of financial penalties for service deficiencies

REROC welcomes that AER adopts the service levels defined in the NSW Public Lighting Code. However, as noted by the AER, at present, with a voluntary NSW Public Lighting Code, there are no meaningful commercial or regulatory consequences of any failures to achieve service levels. Prior to approving any increase in pricing or reductions in service levels, further consideration is urgently needed of appropriate financial penalty mechanisms.

Our members are concerned that despite repeated assurances from Country Energy that they would negotiate Service Level Agreements with councils in relation to public lighting, this has not occurred and consequently our members are unable to validly hold Country Energy to account in relation to its performance.

Conclusion

In conclusion we would like to emphasis the following points in relation to our submission:

a) Country Energy's proposals are inadequately supported by data and analyse, however on the information provided our members believe that the proposals are likely to result in material subsidies from councils to Country Energy;

b) In 2007, IPART determined that no further price proposals would be considered until Country Energy provided a detailed analysis of its economic costs associated with the provision of its public lighting services, this has not been provided;

c) It is not possible to properly assess Country Energy's proposed pricing without access to CE's detailed cost assumptions and pricing model;

d) Country Energy's proposals should be benchmarked against other RNSPs in NSW and the NEM;

e) Country Energy's bulk lamp replacement costs do not appear to be generating any real savings as against their current spot replacement program;

f) Country Energy's proposed changes Tariff 2 will result in significant price increases to councils, without any apparent corresponding lift in service provision;

g) CE should perform a detailed assessment of the market supply of competitive O&M services for public lighting in rural and regional areas to determine if an effective market exists before requiring councils to source asset replacement services;

h) Country Energy should give further consideration to both asset age and the implications for costs and costs analyses in relation to public lighting assets.

i) Country Energy has not been able to enter into Service Level Agreements with councils; therefore councils are not in a position to adequately assess performance levels. In addition, under current practices there are no meaningful commercial or regulatory consequences of any failures to achieve service levels therefore councils are unable to hold Country Energy to account when service levels are not achieved.

Thank you again for the opportunity to make this submission. Our members would welcome the opportunity to discuss any of the issues raised in our submission with you, and look forward to working with the AER to progress these important matters in the future.

Yours sincerely,

Paul Braybrooks

Cr Paul Braybrooks
Chairman