



8 December 2011

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Re: SSROC Submission on the Consolidated Rule Request - National Electricity Amendment (AEMC Project Code ERC0134)

Thank you for the opportunity to comment in this first round of what is an important and essential review of the National Electricity Rule.

The Southern Sydney Regional Organisation of Councils (SSROC) is a not-for-profit incorporated association of sixteen local governments in southern Sydney.

In this case, SSROC is making its submission on behalf of 34 Councils participating in the SSROC Street Lighting Improvement Program (eg including both its own members and 18 other NSW Councils who have joined its SLI Program). Councils in the SSROC SLI Program have been working together for some years to seek better lighting, energy efficiency and pricing outcomes.

The Councils in the SSROC SLI Program encompass more than 226,000 street lights constituting approximately 94% of the streetlights in Ausgrid's distribution area. This is about 40% of the street lighting in NSW and just over 10% of all street lighting in Australia.

As in many other parts of Australia, almost all of the public lighting in Ausgrid's distribution area is both owned and maintained by the utility but paid for by Councils. Street lighting is almost entirely a non-contestable monopoly service with NSW Councils having no right to add, remove or modify existing lighting. Most Ausgrid street lighting is mounted on the distribution poles of the network service provider.

Total street lighting expenditure of SSROC SLI Program Councils in 2011/12 will exceed \$57,000,000. Of this, the cost of network services (including capital, maintenance and network distribution charges) constitutes some 85% of the total. As such, network pricing decisions have an enormous impact on Council street lighting costs and retail energy purchases are only a small portion of Council's total street lighting costs.

Lvl 2, Suite 2E, Hurstville House
34 MacMahon Street
Hurstville

PO Box 536
Hurstville NSW 1481

Ph: 9330 6455
Fx: 9330 6456
Email: ssroc@ssroc.nsw.gov.au
Web: www.ssroc.nsw.gov.au

Councils provided with street lighting services by Ausgrid were subjected to an average 49% increase in street lighting capital and maintenance charges from 1 July 2010 following an appeal by Ausgrid to the Australian Competition Tribunal and subsequent redetermination by the AER in April 2010.

On behalf of Councils, SSROC was an active participant at all stages of the AER pricing process including participating as an interested party in the appeals process. It is in this context that SSROC makes the following comments:

- **SSROC SUPPORT FOR AER PROPOSALS** - SSROC supports the Rule change proposals of the AER as its direct experience in the NSW network pricing decision substantiates the AER position that the current arrangements are not working efficiently and change is needed.

Having gone through a full determination, appeal and redetermination, SSROC's view of the pricing review process is that there was not an appropriate balance between the interests of the network and those of Councils as consumers of street lighting services.

- **APPEAL PROCESS NEEDS REFORM** - SSROC is one of the few consumer interest bodies to participate directly in an appeal process, and found this process to be both costly and largely ineffective for its members. Councils were grossly out-spent by the funding brought to bear by the utility in the appeal. It was also difficult to participate meaningfully as stakeholders because of the significant information asymmetry throughout the appeal process and the decision process leading up to it.
- **INFORMATION ASSYMETRY** – The current provisions of the Rule are manifestly inadequate to counter the superior access to information afforded to the network businesses as compared to street lighting customers.

SSROC's experience in the NSW pricing review was that key information about the street lighting pricing model and underlying assumptions were withheld at all stages of the review process. SSROC documented this in each of its submissions to the AER that are now a matter of public record. The result of this information disadvantage was that Councils' ability to play a meaningful role in the process was significantly undermined.

Determined effort was required to extract such information with some of it only released in the final stages of the review process. Much of what was requested was not released at all. And, key aspects of what was released were in 'redacted' form that left it substantially meaningless. Claims that information was commercial-in-confidence was the primary basis on which information was withheld even when comparable information for other network service providers or from street lighting technology suppliers (eg on indicative capital costs of key components) was available.

By way of example, SSROC formally requested the street lighting pricing model cited by Ausgrid on 16 July 2008. Ausgrid provided a partial non-working version of the model, and even that was issued only some 596 days later, on 4 March 2010 (ie, at the end of the redetermination process). This partial model was a spreadsheet covering only OPEX costs and had been stripped of asset quantities and key cost details leaving it of very limited value for Councils at this very late stage in the pricing process.

Street lighting is an essential but monopoly service and as such, there should be absolute transparency on the costing models that a decision on efficient costs is to be based on. This is particularly pertinent in the context of the large number of Ausgrid pricing assumptions that were ultimately found to be in error by the AER during the review of street lighting prices for Ausgrid.

SSROC urges the AEMC to ensure that a complete street lighting cost model along with all key financial and technical assumptions is publicly released at the outset of future pricing reviews so that it can then be validated and revised in an open process.

Public release of a complete street lighting cost model would appropriately place the evidentiary burden with the network to prove that the proposed opex and capex forecasts reasonably reflect prudent and efficient costs. It would also facilitate proper benchmarking across service providers.

- **IMPROVED BENCHMARKING OF EFFICIENCY** - At present, the AER is required to accept a network pricing proposal if it provides an outcome that is within the range of being acceptable. This is a weak test of efficiency and encourages inflated network opex and capex claims, with underlying assumptions raised to the maximum possible extent.

Rule changes are needed that encourage networks to build cost models based on efficient costs of service and enable the AER to test the efficiency of cost claims against appropriate benchmarks. And, having conducted a variety of tests of efficiency, the Rule changes should allow the AER sufficient power to require networks to make appropriate expenditure adjustments.

- **INFLATED COST OF DEBT** - Street lighting is an essential monopoly service and payments for street lighting services in NSW (and many other states) are a risk free transfer of funds between one branch of government overseen by the State and another State government-owned entity. Given the absence of risk and the monopoly nature of the service, the cost of capital for street lighting should be considerably closer to the risk free rate of return. The use of a commercially-derived WACC in this context is entirely inappropriate. SSROC therefore supports the views expressed by the Energy Users Rule Change Committee¹ that the regulatory allowance for the return on debt is substantially higher than it should be, particularly for distribution networks owned by state governments.
- **ASSET BASE REVIEW URGENTLY NEEDED** – SSROC recognises that consideration of the underlying asset base may be beyond the scope of the Rule changes called for by the AER. However, this issue is fundamental to the Ausgrid street lighting pricing determination and it cannot be ignored in this submission, and should be addressed in AEMC's revisions.

Notably, the 2010 AER Ausgrid street lighting pricing redetermination followed an appeal to the Australian Competition Tribunal by Ausgrid that concluded that the AER did not have the power to revisit the extremely high and inaccurate valuation claimed by Ausgrid for the historic street lighting assets as the AER's original decision in 2009 had proposed.

The key conclusion of the Australian Competition Tribunal was that the National Electricity Rule locked in the claimed historic value of the assets ***irrespective of the view of the AER that a substantial revaluation was in order***. As a result, the AER was compelled to adopt a revised and much higher valuation and resultant pricing. And, the AER acknowledged in the Executive Summary to its April 2010 decision that one key implication of the high valuation of old assets in its revised decision was that it, "*...may act as a disincentive to the early installation of energy efficient lighting*".

That the AER has been constrained in this manner is particularly troubling for Councils in view of:

- **substantial evidence of misinvestment** in obsolete lighting assets by Ausgrid over a sustained period as documented in SSROC's 10 March 2010 submission to the AER pricing redetermination for Ausgrid street lighting charges;
- findings by the AER that many **Ausgrid labour assumptions were substantially too high**. The AER's review concluded that Ausgrid's assumed labour rates were up to 77% too high,

¹ Energy Users Rule Change Committee Briefing to AEMC Forum 23 Nov 2011

assumed travel times were 31% too high and overall, that a number of significant adjustments to pricing assumptions were required to bring Ausgrid labour productivity to an efficient level. Importantly, the same inappropriate labour assumptions have been used by Ausgrid historically as the basis of its claimed capex and the corresponding basis of its claimed asset base revisions over many years.

- **The inability to properly consider the historical funding of the assets in the pricing review** and in particular, the implicit Ausgrid assumption that it provided the original capital for street lighting where as the tariffs should more appropriately be based on Councils and the County Councils they owned until 1990 having provided the original capital for most lighting on Ausgrid's current network. Councils were not compensated for these assets at corporatisation of the utilities.

Importantly, the previous regulatory regime under IPART was viewed as a "light-handed" one, i.e., where limited regulatory oversight was applied in assessing the actual value or in the appropriateness of Ausgrid's investments. That neither IPART nor the AER had or has the power to properly review Ausgrid's claimed street lighting asset valuation is clearly inappropriate and warrants change.

SSROC welcomes further discussion on any of the items raised in this submission.

Yours faithfully



Alan Northey
General Manager
Southern Sydney Regional Organisation of Councils