

# STATEMENT OF REASONS

## INDEPENDENT PRICING AND REGULATORY TRIBUNAL OF NEW SOUTH WALES

### Statement of Reasons for Decision

**Matter:** Integral Energy's revised application of 21 December 2007 for price increases for the construction, maintenance and asset management components of its public lighting business.

Application is made under clause 2.3 of the Regulation of Excluded Distribution Services Rule 2004/01.

### Details of Decision:

**Members:** Mr James Cox (Chief Executive Officer and Full-time member) and Mr Eric Groom (committee member)

**Decision:** IPART approves Integral Energy's revised application dated 21 December 2007 to increase public lighting charges by 5.5 per cent as from 1 March 2008.

### Reasons:

#### Background

On 1 June 2007, Integral Energy submitted an application to IPART under clause 2.3 of the *Regulation of Excluded Distribution Services Rule 2004/01* ("Rule") to increase its charges for the construction, maintenance and asset management components of its public lighting business. Integral Energy proposed an increase in its public lighting charges of 5.5 per cent from 1 August 2007. The increase was designed to lift the revenue earned from public lighting charges closer to the economic costs of providing those services.

On 21 December 2007, after further research that elaborated on the 1 June proposal, Integral Energy revised its application by removing corporate overheads of \$3.366m and including additional operating costs of \$2.411m for 2007/08.

Public lighting charges are an "Excluded Distribution Service" within the meaning of the Rule that is appended to the IPART's NSW Electricity Distribution Pricing 2004/05 to 2008/09, Final Determination. Pursuant to clause 2.3 of the Rule, on each occasion that there is a change in prices IPART must be satisfied that the Distribution Network Service Provider's (DNSP's) proposal complies with clause 2.3 (which incorporates the requirements of clause 2.2(a)(1) and (2) of the Rule). If not satisfied, IPART may require the DNSP to submit alternative prices.

#### Decision

IPART is satisfied that Integral Energy's proposed nominal increase in its public lighting charges of 5.5 per cent complies with the Rule in all relevant respects. IPART approves the price increase sought by Integral Energy as from 1 March 2008.

## Reasons for IPART's Decision

In reaching its decision, IPART had regard to the requirements of the Rule including:

- the DNSP must use its reasonable endeavours to ensure that prices signal the economic costs of service provision (clause 2.2(a) (1) of the Rule); and
- if the DNSP's prospective price changes would reasonably be expected to impose significant adjustment costs on those that must bear those price changes, the DNSP must implement transitional price options, a phased approach or other measures (whether as part of its prospective price changes or otherwise) which in IPART's opinion are reasonably necessary to mitigate the effects of those adjustment costs, having regard to the nature and extent of those adjustment costs and the prospective changes (clause 2.3(c) of the Rule).

In making its decision IPART considered all material provided by Integral Energy in support of its application. IPART also considered all submissions put forward by stakeholders, including concerns raised by the Local Government and Shires Association of NSW as to the customer impacts flowing from the size and date of the increases, and as to whether the prices reflected Integral Energy's economic costs.

In addition, IPART engaged an independent consultant, Wilson Cook & Co, to assist it to assess whether Integral Energy's past and forward public lighting capital and operating expenditure was prudent and/or efficient.

### *Integral Energy's original proposal of 1 June 2007*

Integral Energy submitted its proposal on 1 June 2007. IPART engaged the services of Wilson Cook to assess the prudence and efficiency of the operating and capital expenditures provided in the proposal. Wilson Cook reported to IPART in October 2007 ("Wilson Cook Report"), concluding that "the amended amounts of capex spent by Integral Energy on public lighting in FY2005 to FY2007 was prudent and that its proposed levels of operating and capital expenditure in FY 2008 to FY2009 as amended by Wilson Cook are efficient and reasonable". The original and amended operating and capital expenditure figures are shown in Table 1. The Wilson Cook Report is available on IPART's website.

**Table 1. Integral Energy Public Lighting Operating and Capital Expenditures (\$000s)**

Financial year ended 30 June (nominal dollars )	2007/08	2008/09
	\$m	\$m
<b>Capex</b>		
Integral's original pricing proposal	5.968	6.118
Wilson Cook recommended (October 2007)	5.003	5.128
Reduction	0.965	0.990
<b>Opex</b>		
Integral's original pricing proposal	10.290	10.547
Wilson Cook recommended (October 2007)	9.859	10.105
Reduction	0.431	0.442

Although the assessment undertaken by Wilson Cook related to the prudence and efficiency of public lighting expenditure, the Wilson Cook Report noted that:

“the uplift in opex from and including FY 2005 was found to be attributable mainly to the re-allocation to public lighting costs including corporate allocations and Asset Management business unit costs, that were previously carried out by the network business under the ‘prescribed services’ heading.” (at 4.2)

Wilson Cook drew this inference from the fact that no corporate costs had been allocated to the public lighting function during the 2004 Determination.

IPART considers that an appropriate level of corporate overheads should be included in the cost of providing the public lighting services. However, as the corporate overheads have already been included in the pricing of prescribed services, they should not be recovered again through public lighting charges during the period of the existing Determination for prescribed services. In response to IPART’s view and the Wilson Cook Report, Integral Energy revised its proposal.

### ***Integral Energy’s revised proposal of 21 December 2007***

Integral Energy submitted a revised proposal on 21 December 2007 (“Integral Energy Revised Proposal”) which varied from the original proposal as follows:

- the public lighting capital expenditure as recommended by the Wilson Cook Report was adopted;
- additional operating costs of \$2.411m to be recovered from public lighting charges in 2007/08 were proposed; and
- no corporate overheads were to be recovered from public lighting charges, which reduced the amount of opex to be recovered in 2007/08 by \$3.366m.

Wilson Cook was engaged by IPART to assess the efficiency of the additional costs proposed by Integral Energy. The February 2008 Supplementary Report by Wilson Cook (Wilson Cook Supplementary Report”) concluded that \$1.919m of additional costs was reasonable and efficient (Table 2). The Wilson Cook Supplementary Report is available on IPART’s website.

**Table 2 Integral Energy’s additional public lighting operating costs for 2007/08**

(Nominal \$’000)	Proposed by Integral Energy	Recommended by Wilson Cook
Above CPI labour cost increases	137.1	137.1
Pro rata maintenance cost for increase in number of lights	480.6	240.3
Additional inspections and resulting minor repairs	866.0	866.0
Reporting and consultation costs	251.5	-
Increase in piece rate payments for bulk change and emergency repairs	449.7	449.7
Share of outage management system (OMS) opex	226.4	226.4
	2,411.3	1,919.5

*Source: Wilson Cook Supplementary Report, February 2008, Table 1.*

IPART accepts the level of additional operating costs as efficient as recommended in the Wilson Cook Supplementary Report. IPART has therefore allowed operating costs of \$8.412m to be recovered from the public lighting charges for 2007/08.<sup>1</sup>

<sup>1</sup> The operating costs of \$8.412m are the \$9.859m in Table 1 minus corporate overheads of \$3.366m plus additional opex of \$1.919m in Table 2.

After weighing the available evidence, IPART is satisfied that the Integral Energy Revised Proposal meets the requirements of the Rule. In particular, IPART notes:

- that the proposed increase is necessary to move prices towards the economic costs of providing the public lighting services, excluding any allocation of corporate overheads.
- submissions by the Local Government and Shires Association and other stakeholders as to the size and/or timing of the price increases from a budgetary and financial planning perspective. On the information available, IPART is satisfied that the proposed price increases from 1 March typically represent a small percentage of Councils' 2007/08 budgets, and that increases of this size were foreshadowed by Integral Energy in its consultation with the Councils prior to the application.

Integral Energy first made its application for an increase in public lighting charges on 1 June 2007. While IPART acknowledges that Integral Energy's public lighting business is a small proportion of its overall distribution business, nonetheless it is a sizeable business unit with annual revenues in excess of \$14m. The present application process demonstrates the importance of fully specifying the cost structure underpinning the public lighting business at the earliest stage in the process. The quality and completeness of the information has a critical impact on the efficiency of the review process.

Any proposal for a reallocation of corporate overheads between prescribed services and public lighting should be held over until the next Determination of prescribed services (or their equivalent) to avoid the possibility of double counting.

The current Determination ends on 30 June 2009. If Integral Energy considers that prices will remain below economic costs excluding corporate costs and that further price increases are warranted, Integral Energy should prepare and consult on a revised plan for public lighting. Such a plan should specify the level of increase that Integral Energy considers is necessary and the time over which this increase is to be achieved. This strategy would provide a valuable reference point for any future submission to IPART.

27 February 2008