

INDEPENDENT PRICING AND REGULATORY TRIBUNAL OF NEW SOUTH WALES

Statement of Reasons for Decision

Matter: EnergyAustralia application for proposed price increase of public lighting charges for the construction, maintenance and asset management components of its public lighting business

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

Details of Decision:

Tribunal members: Dr Michael Keating AC (Chairman), Mr James Cox (Chief Executive Officer and Full Time Member) and Ms Cristina Cifuentes (Member)

Decision: The Tribunal is satisfied that EnergyAustralia's revised proposal of June 2005 complies with Rule 2004/01.

Reasons:

Background

On 12th November 2004, EnergyAustralia (EA) submitted an application to the Tribunal (under clause 2.3 of the Regulation of Excluded Distribution Services Rule 2004/01) to increase its public lighting charges for the construction, maintenance and asset management components of its public lighting business. The Tribunal decided in February 2005 not to accept EA's application, in which EA had sought an initial (early 2005) average price increase CPI+26%, with subsequent increases spread over three years involving a total increase CPI+62%.

In June 2005, EnergyAustralia (EA) submitted a revised application to the Tribunal. The key differences between EA's revised application and its earlier application are as follows:

- EA reduced the size of the proposed price increases to CPI+10% in the first year and an average of CPI+5% in the three subsequent years, giving a total average increase of CPI+25%;
- While EA's *initial* proposal involved significantly different price increases for different customers (with some councils likely to see price increases of well over 100% over the 4 year period) EA's *revised* proposal involves a CPI+10% increase across the board for all customers in the first year. EA stated its intention to begin to address the cross subsidies that exist between customers from the second year of its proposals onwards, but stated that it would limit the increase in the total bill faced by any customer to CPI+7.9% for each of the years 2006-2008.¹

¹ That is, EA would be able to increase the bill by up to CPI+7.9% for some customers (those with the greatest current shortfall between the cost of the services supplied and the price that they pay) but it

The Tribunal consulted on EA's revised proposals, and commissioned independent consultants, Wilson Cook, to assess the efficiency of the operating and capital expenditure assumptions underlying EA's revised proposals. Wilson Cook's report is available on IPART's website.² The Tribunal also conducted further analysis and financial modelling of its own to assess EA's proposal and the implications of that proposal for prices.

Public lighting charges are regulated as an excluded distribution service under clause 2.3 of the Regulation of Excluded Distribution Services Rule 2004/01 appended to the Tribunal's NSW Electricity Distribution Pricing Determination of June 2004. Under clause 2.3 the Tribunal must be satisfied that the Distribution Network Service Provider's (DNSP's) proposal complies with the Rule 2004/01 or if it is not satisfied to require the DNSP to submit alternative prices³.

Decision

The Tribunal is satisfied that EA's revised application (for a price increase of CPI+10% in 2005 (effective from 1 September 2005), followed by average increases of CPI+5% in each of the financial years 2006 to 2008, with the maximum increase in bill to be faced by any individual customer to be capped at CPI+7.9% for each of the financial years 2006 to 2008) complies with Rule 2004/01.

Reasons for the Tribunal's Decision

- In reaching its decision, the Tribunal had regard to the requirements of Rule 2004/01 including that:
 - the DNSP must use its reasonable endeavours to ensure that prices signal the economic costs of service provision (clause 2.2(a) (1) of Rule 2004/01); 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 the Tribunal'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 Rule 2004/01).
- The Tribunal's consultants, Wilson Cook, undertook a detailed assessment of EA's operating and capital costs. Wilson Cook concluded that:
 - EA's capital expenditure forecasts for 2005-2008 are reasonable and efficient for the services to be delivered. The prudence of EA's decision to spend less in recent years on replacement expenditure compared to its forecasts for 2005-08 can be explained by a number of factors;⁴

would have to increase the bill for other customers by less than CPI+5% to ensure that price increases did not *on average* exceed CPI+5%.

²<http://www.ipart.nsw.gov.au/Detailedsearch.asp?InquiryName=EnergyAustralias%20Public%20Lighting%20Pricing%20Proposals>

³ I.e., the Tribunal cannot nominate alternative prices itself.

⁴ For example, depending on the exact age profile and condition of assets, more replacement may be required in some years than in others. Deferral of capital expenditure can be efficient if it is not needed from a service performance perspective.

- EA's operating expenditure forecasts are reasonable and efficient for 2005/06 for the services to be delivered, but some efficiencies compared to EA's projections; should be achievable from 2007 onwards (starting at 5% and increasing over time)
- asset lives assigned to bracket arms and steel standards should be longer, implying a reduction in replacement expenditure and depreciation charges.

The Tribunal accepts the Wilson Cook conclusions, and included these conclusions in its own modelling of revenue requirements and price paths.

- The Tribunal considered that the appropriate asset base on which EA should be able to earn a return should be equal to the amount that the Tribunal removed from the prescribed services asset base in 2004 – that is, a figure of \$97.8m (\$2003/04) (adjusted for inflation and subsequent expenditure as deemed prudent by consultants Wilson Cook). This is consistent with the Tribunal's view that a "line in the sand" should be drawn under the asset base (as opposed to repeated revaluations at subsequent reviews), so that the asset base reflects the *financial valuation* of the business.

This decision is key to understanding why the Tribunal is satisfied that EA's revised application for price increases complies with the Rule 2004/01. The asset base figure assumed by the Tribunal is higher than that assumed by EA in its proposals – this difference serves to offset the impact of the lower opex costs and longer asset life assumptions identified by Wilson Cook. However, in taking this "financial valuation" approach, the Tribunal has indicated that, although it cannot bind a future decision maker, it does not support revaluation of the asset base.⁵

- EA have taken into account customer impacts by proposing transitional price increases over four years, as envisaged by Clause 2.3(a) (3) of Rule 2004/01. EA had submitted that the initial price increase of CPI+10% would be insufficient to bring revenues up to the same level as efficient costs, but that it had limited the proposed 2005 price increase to this level given Tribunal and council concerns about the customer impacts of a larger single year increase. EA's proposals therefore involve ongoing under-recovery relative to costs in the initial years, with subsequent price increases from 2006-2008 required to allow EA to recover all of its costs. The Tribunal's own modelling of revenue requirements and price paths confirmed EA's proposal. It therefore considers it appropriate to accept EA's proposed four year price path.⁶
- The Tribunal accepts EA's argument that at present, substantial cross subsidies exist between councils, with some councils paying significantly less than the cost of supply for the services that they receive. The Tribunal considers that these cross subsidies should gradually be addressed over a period of time. It agrees with EA that from a customer impacts perspective, it is preferable to begin to address these cross subsidies in 2006, rather than impose significant price increases on some councils of greater than CPI+10%

⁵ For example, EA notes in its submission that it intends to continue to advocate upward revisions to the asset base in the future for "dedicated assets" not currently included in the asset base. As EA's initial submission illustrated, the extra price rises associated with such an upward adjustment would be very significant.

⁶ However, it should be noted that were EA in subsequent years (2006 onwards) to seek *further* increases beyond the proposals discussed here (for example to reflect what they might argue to be costs associated with the introduction of the Public Lighting Code), the Tribunal would conduct a further assessment, again considering economic costs and customer impacts. The Tribunal would be at liberty to consult on these issues.

in 2005. It also agrees with EA that there should be a cap on the amount by which a customer's bill can increase of CPI+7.9% from a customer impacts perspective, even though this will mean some cross subsidies will still remain by 2009. Adopting a figure of CPI+7.9% implies a "headroom" of CPI+2.9% for addressing cross subsidies (i.e., CPI+7.9% minus the CPI+5% average). The Tribunal notes this headroom figure is consistent with that approved by the Tribunal for EA's prescribed services customers in its 2004 price determination.

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