

22 February 2008

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Sir

Re: CANEGROWERS submission on BRCI for electricity 2008-9

Thankyou for the opportunity to make a submission on the draft electricity BRCI for 2008-9. Electricity is a major cost item for cane production and is up to 20 percent of total cane growing costs for irrigation cane growers in Queensland. Consequently any increase in electricity costs are a major concern for the sugar industry.

Cost of energy

There is a clear disparity between the market price and LRMC. In the past, QCA has used a different methodology to calculate the cost of energy. It appears inconsistent to change methodology year to year to the detriment of consumers in this case. Will the same methodology be used in the future to average LRMC and the market price? One of the reasons for choosing LRMC for an efficient electricity supplier is to try and limit upward pressure on the cost of electricity. A move to a market based system will reduce the incentive for retailers to attempt to limit this upward pressure.

Also, another reason for choosing LRMC is to ensure that there is a smooth change in the cost of energy rather than wild fluctuations from year to year. If a move to a more market based system is implemented which will reduce risk for retailers, will the retail margin be reduced to reflect this lower risk?

Another approach may be to redefine LRMC to be the top quartile of efficient power generators in Australia rather than the most efficient in Queensland as use this as the cost of energy and use this as the cost of energy. This would overcome one of the reasons for the inconsistency between the LRMC and market price.

If this is not possible, then a different weighting between LRMC and a market based system should be considered. Retailers would prefer a 100% market based system to completely eliminate the risk on the cost of electricity. This would clearly require retail margins to be reduced to account for this lower risk since the 5percent retail margin was based on a cost of energy largely determined by the LRMC.

I would advocate a system where there was more consistency and certainty in long term retail electricity prices. Therefore a weighting of 75 percent LRMC and 25 percent market price would be a preference.

Another concern I have with a market based system for the cost of energy is the ability of retail electricity prices to fall. If the drought breaks across Australia and causes the cost of energy to halve and the retail cost of electricity to fall by 20 percent, will that be passed onto consumers? Or will prices remain unchanged or CPI added as the minimum price increase on government related charges?

Network costs

This is obviously the major driver for increased retail electricity prices. The reason for this is the massive expenditure on networks for a number of reasons. Firstly, due to massive underspending in the past. This extra cost due to past government underspending is not efficient and should be borne by government with the proceeds of retail deregulation rather than a cost passed onto consumers.

Also, the extremely generous salary increases to staff as a political ploy to alleviate the crisis in electricity distribution a few years ago. Again, this is not efficient and should be borne by government with the proceeds of retail deregulation rather than a cost passed onto consumers.

In addition, the extremely conservative approach being implemented by government re distribution systems to minimise political risk is not efficient especially given the modest increase in electricity demand in the coming years. Higher throughput should generate greater economies of scale and size and reduce per unit costs not increase them by 10 percent in 1 year. Once again, the cost of this should be borne by government with the proceeds of retail deregulation rather than a cost passed onto consumers overspending

There is little value in partially deregulating the electricity but burdening it with inefficiencies imposed by government that greatly outweigh any efficiency gains.

Retail costs

The level of the retail margin appears excessive at 5 percent. Many other high volume industries rely on margins of 2-3 percent and rely on market share to generate throughput and significant profits rather than making large profits on individual customers. In a regulated market with low risk and guaranteed steady growth in demand such as electricity this makes a lower retail margin even more appropriate.

In addition, the retail margin is around the same as the retail operating costs that appears extremely excessive. This appears out of step with commercial reality in other industries and explains why so many retailers are keen to enter the Queensland electricity market.

The network cost item will be finalised before the BRCI is set and therefore there is no risk on this cost item. Consequently, charging a 5 percent margin for this no risk item makes little sense.

Excluding the retail margin, around 72 percent of costs bear no risk for the electricity retailer. That is, all distribution costs are certain and half of the cost of energy is based on a market price in the draft paper. If we assign a nominal retail margin of 2 percent on this no risk cost, then to get an average retail margin of 5 percent retailers would earn a margin of 12.7 percent on the 28 percent of costs that they face risk on. This appears wildly excessive.

The assumption that electricity retailers are stand alone Queensland businesses is clearly flawed. All retailers have interests in other states and clearly have economies and scale and size that would reduce their retailing operating costs below levels for stand alone Queensland businesses. The retail operating costs should be recalculated and reduced to take account of this.

I look forward to hearing back from you on my submission. I can be contacted on 3864 6444 or eric_danzi@canegrowers.com.au. Thankyou

Yours sincerely

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CANEGROWERS