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3 March 2014

Mr Malcolm Roberts
Chairman
Queensland Competition Authority

By email: electricity@qca.org.au

Dear Mr Roberts

CANEGROWERS response to QCA Draft Determination

Thank you for the opportunity to make a submission on the QCA's Draft Determination on Regulated Retail Prices 2014-15. As you are aware, CANEGROWERS is very concerned about the recent price increases and the impact of these increases on irrigated sugarcane production in Queensland.

In previous submissions to the QCA, CANEGROWERS has identified that irrigators using the existing suite of tariffs (T62, T65, T66) are caught in a sharp, adverse price spiral. In a falling world sugar price environment, irrigators are seeking to avoid rising prices by changing irrigation practices, using alternative sources of energy, or simply reducing the amount of water they apply to crops. Some farmers are not irrigating at all, resulting in significant crop losses.

Electricity consumption by irrigators is very responsive to price. It is clear that the current prices applied in rural and regional Queensland are unsustainable for both Ergon and its irrigation customers. The proposed price increases will further discourage electricity use and reduce revenue to government.

CANEGROWERS' submission proposes a price reduction in the retail price of electricity for irrigation tariffs in 2014-15. Reducing prices will increase utilization of the Ergon network, maximize revenues to the Queensland Government and provide much needed price relief for irrigators. A 33% reduction in price for 2014-15 would be a revenue neutral outcome.

The price reduction in 2014-15 is a short-term measure only and is based on the elasticity of consumption in 2013-14 only. For the long term, CANEGROWERS and Ergon are currently in preliminary discussions regarding the development of a suite of tariffs for food and fibre production which would include a number of network tariffs for irrigation, based on the actual cost of supplying irrigation customers. CANEGROWERS expects that the actual cost of supply is significantly lower than the current cost.

Thank you for the opportunity to respond to your Draft Determination. If you have any further questions, do not hesitate to contact me on (07) 3864 6444.

Yours sincerely

Brendan Stewart
CHIEF EXECUTIVE OFFICER

CANEGROWERS submission to QCA Draft Determination *Regulated Retail Electricity Prices 2014-15*

Summary

- Existing notified retail electricity tariffs are too high. The network (N) component includes the impact of rapidly rising costs not associated with the delivery of electricity to irrigators, estimated to be 50% of N.
- The 25% price escalation and the 10% price floor for irrigation tariffs artificially (and unnecessarily) increase the price and should be removed.
- QCA's proposal of a "cost pass-through" mechanism for retailers to recover RET costs should not be included.
- CANEGROWERS supports QCA's proposal to not "catch-up" lost revenue from the 10% price cap for irrigation tariffs in the 2013-14 Gazette.
- Demand for electricity is very responsive to prices – CANEGROWERS analysis of Ergon data shows that irrigators are responding, efficiency gains are being pursued and some are looking at alternative energy sources.
- Increasing the tariffs for electricity used in irrigation will not increase total revenues to the Queensland Government.
- A revenue neutral solution for the 2014-15 electricity price determination would be to reduce the price of the existing irrigation tariffs, T62, T65 and T66.
- CANEGROWERS analysis shows reducing prices will increase consumption on the Ergon network, increase revenues to the Queensland Government while providing much needed price relief for irrigators.

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Preamble

T20, T22 and T44 not reflective of actual cost of supplying irrigators

In the Minister for Energy and Water Supply's delegation to the QCA, the Terms of Reference clearly state that:

> 3. *in accordance with section 90(5)(a) of the Act, in making a price determination for each tariff year QCA must have regard to all of the following:*
>   a. *The actual cost of making, producing or supplying the goods and services*

CANEGROWERS remains concerned that the price of electricity on the notified business tariffs overstate the actual cost of making, producing or supplying electricity, especially to irrigation customers.

As raised in previous CANEGROWERS submissions to the QCA, there are a range of embedded costs in the network, energy and retail components of the QCA notified prices that do not reflect the actual cost of supply and unnecessarily inflate the prices paid by irrigators. For example, the following components do not reflect the actual cost of supplying irrigators:

- costs associated with the Solar Bonus Scheme
- network investment to meet a N-1 security standard and network augmentation to accommodate increased embedded generation (primarily from solar panels)
- unrealistic allowed returns from networks to the Queensland Government
- lack of acknowledgement of existing capital contributions by irrigators
- retail headroom and a regulated retail margin, and
- the use of a LRMC energy price, as opposed to reflecting the spot price in the NEM.

Developing a network tariff for irrigators

CANEGROWERS understands the QCA's constraints in developing a suite of regulated retail tariffs for irrigators, namely the lack of a network tariff in Ergon and Energex's network tariff schedules. To resolve this issue, CANEGROWERS is working in partnership with Ergon to develop a suite of network tariffs for food and fibre production, including tariffs for irrigation use. CANEGROWERS will be seeking to ensure these tariffs take account of prudently incurred costs of supply, the impact on Ergon's revenues and irrigators' capacity to pay.

The pricing framework being developed recognises both network supply and demand considerations. It recognises that recent network investment decisions have been driven in large part by the demands of urban and industrial users, not by the demands of irrigation users. It reflects irrigation demands on the network in terms of base load and off-peak use and includes worthwhile time-of-use incentives for irrigation during off-peak periods and over the weekend.

- Base Load Irrigation Tariffs – include an N-Component that excludes costs associated with rapidly rising cost structures that are not associated with delivery of electricity to irrigators, estimated to be 50% of N.
- Off-Peak Irrigation Tariffs – would provide a worthwhile incentive for off-peak use by further reducing the N-component (set N to zero) to encourage use in low network usage periods.
- Weekend Irrigation Tariffs – would be set at an equivalent to Off-Peak Irrigation Tariffs to encourage weekend use.

It is envisaged that these network tariffs will be ready for the 2015-16 QCA Determination.

Transitional arrangements for irrigation tariffs

For the 2014-15 Determination, CANEGROWERS respectfully asks that the QCA consider three changes to the transitional arrangements for irrigation tariffs:

1. Remove unnecessary artificial price increases

The Draft Determination proposes a range of artificial mechanisms that will increase the price of retail electricity used for irrigation. These mechanisms do not reflect the actual cost of supply and will inflate the retail prices and provides a disincentive to irrigate and reduces demand across the Ergon network.

Specifically, CANEGROWERS calls on the QCA to remove the arbitrary price escalations designed to transition irrigation tariffs to what the QCA believes are cost reflective prices. The 25% escalation in the carbon-inclusive price and the 150% escalation in carbon-exclusive price (to deliver a minimum 10% price increase) are excessive. This is particularly the case for tariffs, such as those used for irrigation, where Ergon has not provided QCA with data to support the price increases.

As reflected in electricity futures prices, there is a strong market expectation that the federal government will remove the carbon tax on or soon after 1 July 2014. The lower prices are being captured by those hedging their purchases in the present policy environment. Setting carbon-inclusive regulated prices for electricity, on the assumption that removal of the carbon tax may be delayed, without taking account of market expectations will deliver a potential windfall gain to those who have forward purchased electricity at the expense of retail customers.

2. No additional increase due to price relief in 2013-14

The Queensland government capped price increases for transitional tariffs at 10% in 2013-14. The QCA acknowledges this government policy decision to provide necessary price relief for irrigators. CANEGROWERS strongly supports the Queensland Government's decision to cap the 2013-14 price increase. CANEGROWERS also supports the QCA's proposal not to further escalate prices in 2014-15 to catch-up tariffs for irrigation to the level they otherwise may have been.

As argued elsewhere in this submission, QCA's decision does not go far enough. A significant price reduction, by stimulating demand, would benefit irrigators without reducing revenues received from irrigation tariffs by Ergon.

3. No pass throughs for retailers

The Draft Determination proposes a "cost pass-through" mechanism for the 2014-15 pricing period with regards to marginal changes in network costs and small-scale renewable energy scheme (SRES) costs. CANEGROWERS believes that retailers are already significantly compensated for the level of risk inherent in the retail electricity market in Queensland, particularly with the allowances made for retail operating cost (ROC), headroom and a guaranteed margin.

Risk is an inherent part of doing business. Prices for sugar and sugarcane are determined in a highly volatile world market environment. Irrigators in the sugarcane industry do not have an ability to pass on the impact of unforseen increases in electricity or other input prices on their costs to customers. Similarly electricity retailers already compensated should bear the consequences of unexpected cost increases in their cost structures. CANEGROWERS does not support the inclusion of a cost pass-through mechanism.

Electricity demand for irrigation is price responsive

The first step in developing a suite of network tariffs for irrigation has been sharing of data and analysis between Ergon and CANEGROWERS. CANEGROWERS has conducted modelling based on historical consumption and revenue data for all irrigation tariffs across the Ergon South, Central and North network zones.

Sharing data has helped CANEGROWERS appreciate the variability in irrigation consumption and the challenges this would pose to Ergon as a network manager. Similarly, analysis of the data by CANEGROWERS has helped Ergon understand the impact of their pricing policy on irrigators, particularly with regards to consumption and revenues.

CANEGROWERS hopes that future data sharing and analysis will lead to finding mutually beneficial solutions for irrigators and the networks.

Consumption and revenues of the Ergon network falling

At the most basic level, the CANEGROWERS analysis of the Ergon data has shown that there has been a demand side response to rapid increases in price over the past seven years. Many irrigators are exploring (increasingly viable) options to go off grid and, sadly, for others this means simply turning off their irrigation pumps.

As Attachment 1, 2 & 3 show, trend consumption has shown a rapid decline in electricity consumption since the start of high price increases in 2007/08. One of the most important findings of this analysis is that off-peak consumption is falling faster than peak consumption in nearly all instances across T62 and T65.

Trend consumption is significantly lower in the South and Central distribution regions, compared to the average. Trend consumption has been used to remove seasonal variability of irrigation.

The proposed increases in price will reduce consumption and lessen Ergon's total revenue

Rapid increases in price have caused a proportionately larger reduction in demand for electricity by irrigators. For all irrigation tariffs, average demand has been price elastic since 2010-11. This means that irrigation tariffs are in an adverse price spiral. Simply increasing prices to irrigators will not increase revenues from irrigators. In some cases (notably with T65), off-peak consumption is more price responsive than peak consumption.

In 2014-15, both the proposed carbon-inclusive and carbon-exclusive price increases will cause demand and revenue to continue to fall. The only way to break the negative price cycle and to grow Ergon's revenue from irrigation tariffs is to reduce prices.

A revenue neutral solution in 2014-15

Impact of elasticity on 2014-15 Retail Price Determination

Following the existing approach to setting prices for irrigation tariffs is clearly not sustainable. Irrigators are becoming more and more sensitive to price increases and demand is becoming increasingly price elastic. The adverse price spiral, leading to the increasing elasticity of demand on irrigation tariffs is a major challenge for Ergon as the network provider, the Queensland Government as network owner and policy maker and irrigators as consumers.

Simply increasing the price of retail electricity to recover non-prudently incurred costs will further reduce demand and not deliver increased revenues for the Queensland Government. To increase demand (and subsequently, increase revenue) in a price elastic market, prices must fall. Lowering the price of retail electricity for irrigators in 2014-15 will break the negative price and demand spiral – this means trend consumption can be expected to increase and revenues from irrigation tariffs for the 2014-15 financial year can be maintained.

Reduce retail prices for irrigation tariffs to stabilise revenues in 2014-15

Based on CANEGROWERS analysis of Ergon data, the QCA's proposed price increases of 16.3% (carbon inclusive) and 10% (carbon exclusive) will cause a reduction in total revenues from irrigation tariffs. A price reduction is needed to reverse the fall in consumption and fall in revenue. Attachments 4, 5 & 6 illustrate the CANEGROWERS findings.

Attachment 4 shows that:

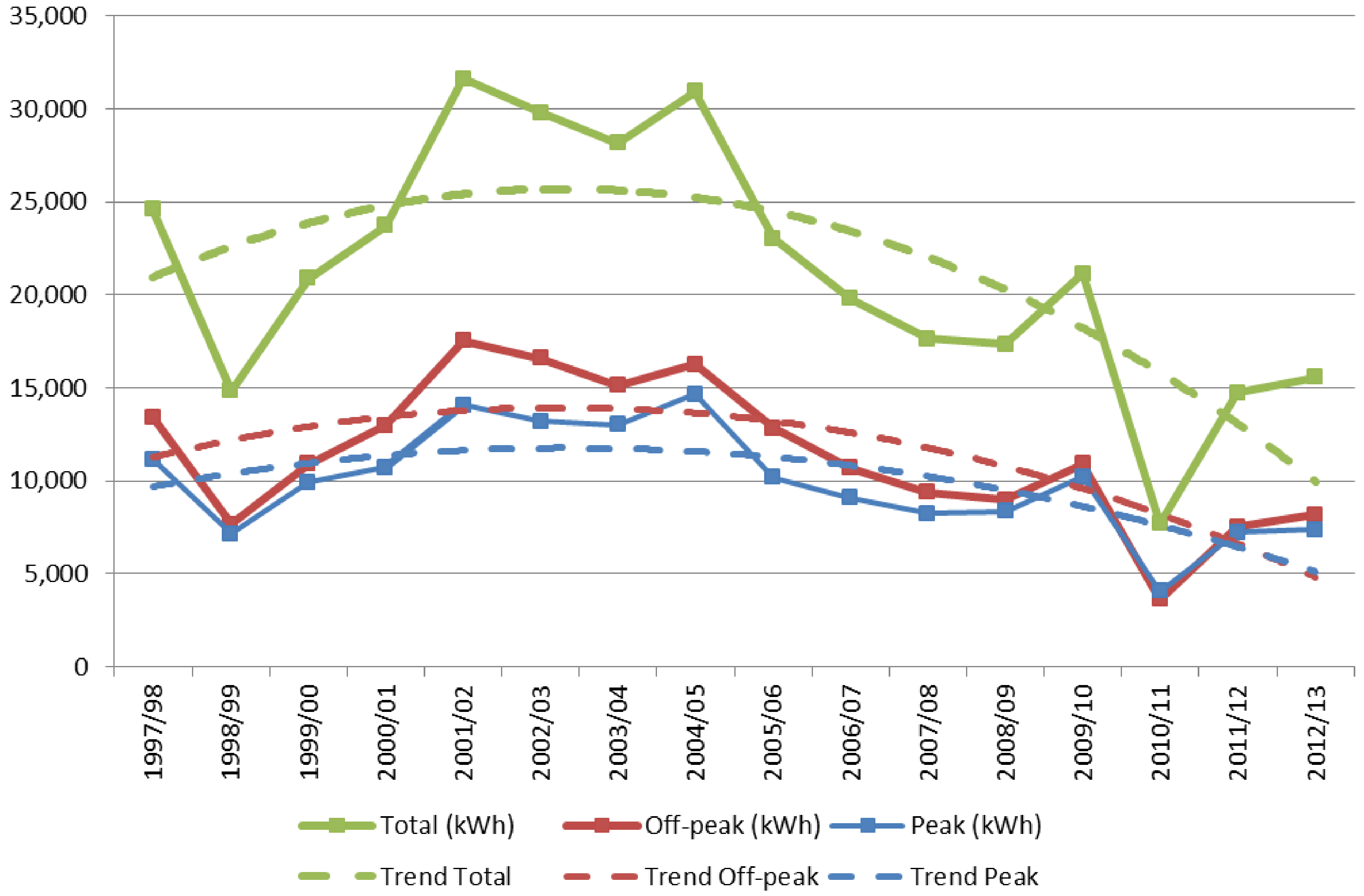
- Increasing the price of irrigation tariffs by 16% in 2014-15 will cause revenue to fall by $4 million (-9.62% of total revenue from irrigation tariffs);
- Increasing the price of irrigation tariffs by 10% in 2014-15 will cause revenue to fall by $2 million (-4.76% of total revenue from irrigation tariffs);

- Reducing irrigation tariffs by 33% would stimulate demand and be revenue neutral for Ergon.

Attachments 5 and 6 show:

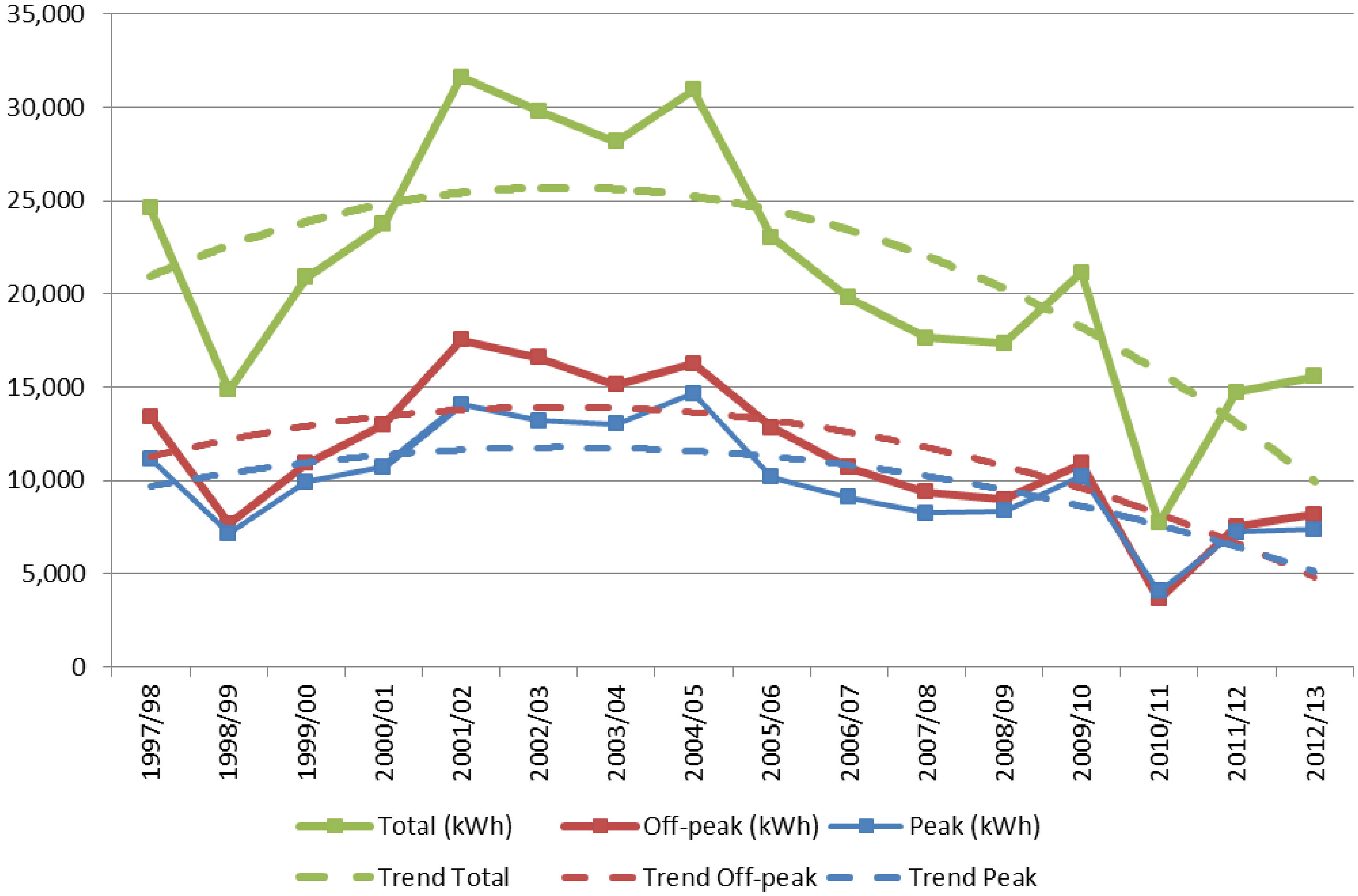
- Trend consumption (attachment 5) has been falling since 2005-06 and trend revenue (attachment 6) has been falling rapidly since 2011-12;
- A price increase will continue this downward trend in consumption and revenue however a price decrease will break the adverse trend and increase consumption and revenue (as shown in detail in attachment 4).

Attachment 1: Consumption of average T62 irrigator in across Queensland.



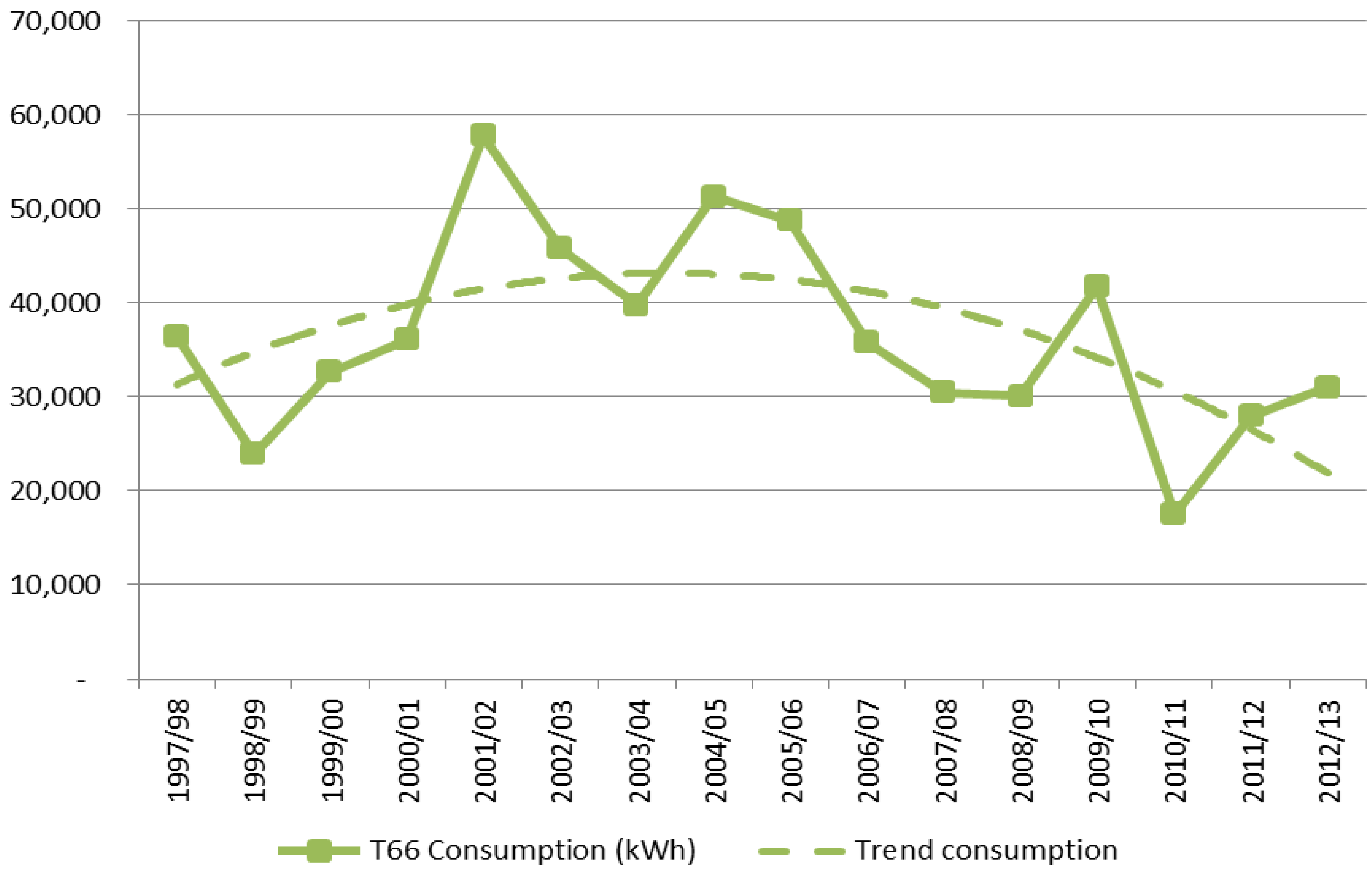
Source: Ergon Energy Data, CANEGROWERS analysis

Attachment 2: Consumption of average T65 irrigator in across Queensland.



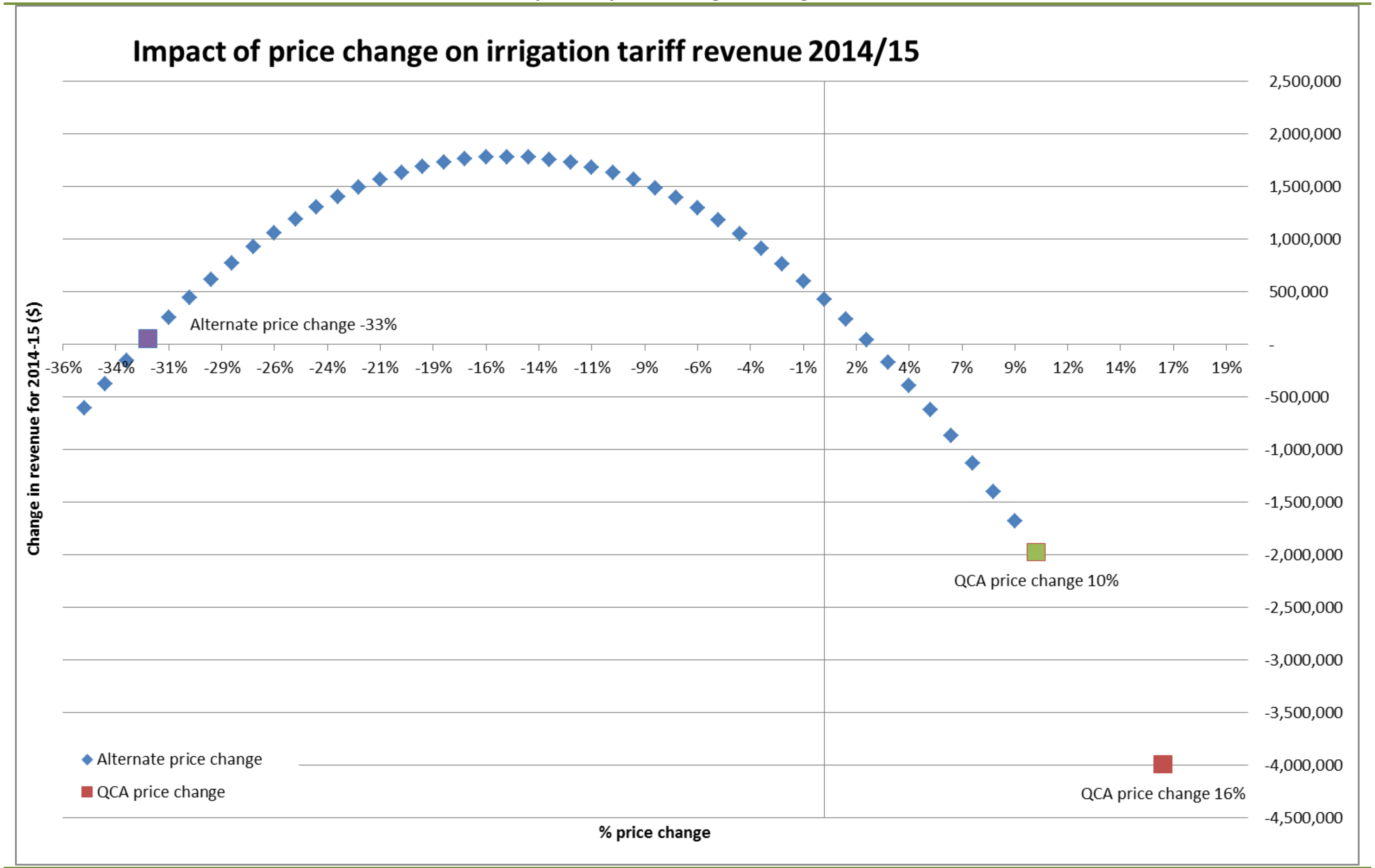
Source: Ergon Energy Data, CANEGROWERS analysis

Attachment 3: Consumption of average T66 irrigator in across Queensland.



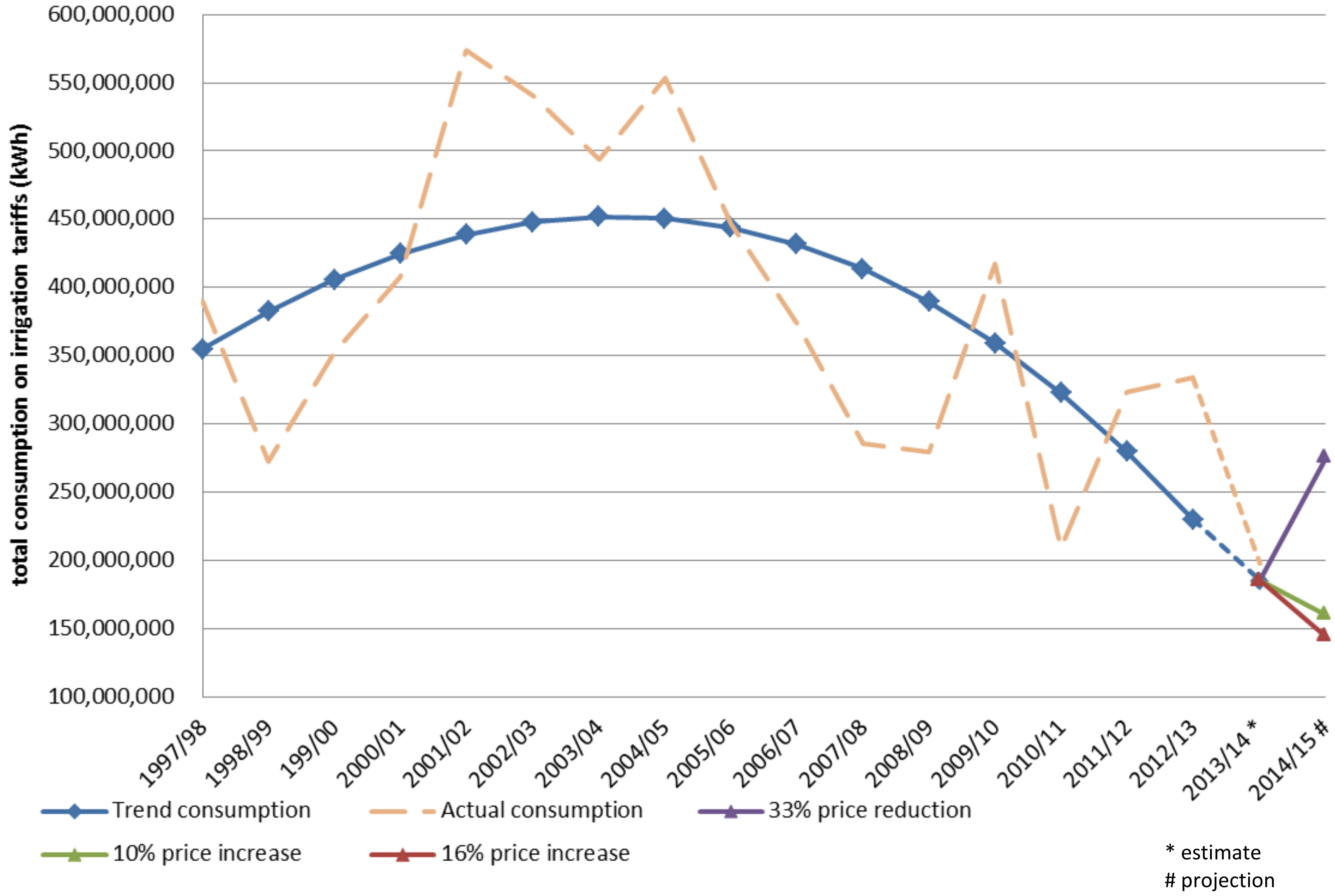
Source: Ergon Energy Data, CANEGROWERS analysis

Attachment 4: impact of price change on irrigation tariff revenues



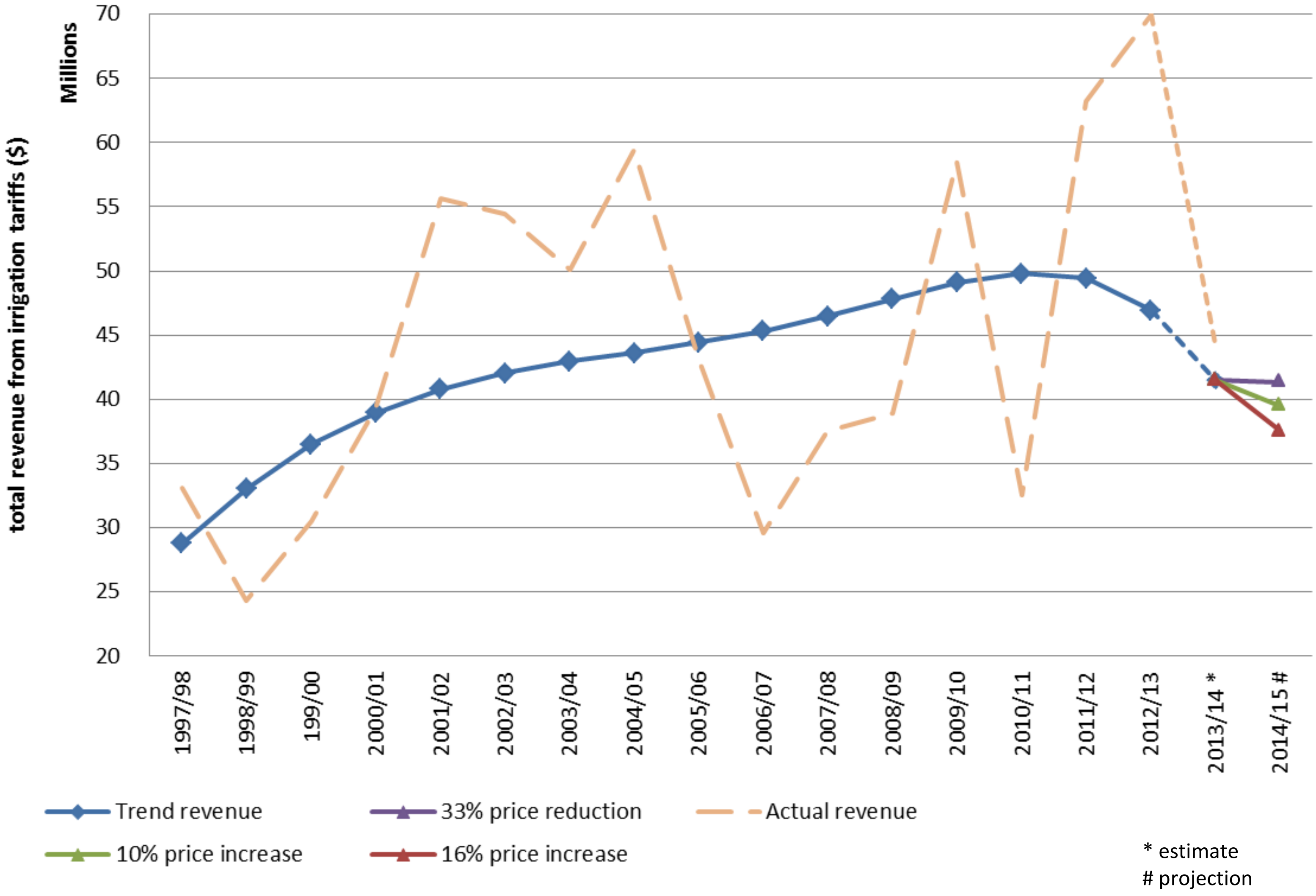
Source: Ergon Energy Data, CANEGROWERS analysis

Attachment 5: Trend consumption from irrigation tariffs



Source: Ergon Energy Data, CANEGROWERS analysis

Attachment 6: Trend revenue to Ergon from irrigation tariffs



Source: Ergon Energy Data, CANEGROWERS analysis