22 March 2013

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Via email: electricity@qca.org.au

Dear Sir / Madam,

Re: Regulated Retail Electricity Prices 2013/14

Thank you for the opportunity to comment on the "Draft Determination for Regulated *Electricity* Prices 2013 /14" (the Draft Determination).

MSF Sugar Limited (MSF) agrees with the Australian Sugar Milling Council that this *"is not an equitable method of calculating electricity prices for regional Queensland".*

We are also concerned that the impact on the Australian sugar industry is exactly the opposite of what the Queensland Government is aiming to achieve by *"growing a 4 pillar economy"* and to *"double food production by 2040".*

Summary

This brief paper will address four key issues in relation to the Draft Determination:

1. Past and future price increases will undermine productivity and sustainability of the entire sugar industry
2. Large electricity retail companies are the only winners in this process – at the expense of all business customers and farmers in regional Queensland
3. Given that there is not a competitive electricity retail market outside South East Queensland, electricity users located within Ergon's distribution area with annual usage greater than 100MWh should not have to pay acquisition costs and headroom
4. If electricity prices were determined within a broader policy environment, there is no reason why Queensland cannot achieve efficiency and competition while maintaining the Uniform Tariff Policy for electricity customers.

Further details are provided overleaf.

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Discussion of the Four Key Issues

1. An unintended consequence of the Draft Determination (taking into account significant price increases in 2012 as well as every year for at least 7 years for certain tariffs) is to undermine productivity and sustainability of the sugar industry:

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- Revenues earned by sugar cane growers and millers are largely determined in the export markets for raw sugar, and therefore, it is essential for the industry to remain globally cost competitive. At the present time all sugar cane farmers are negatively impacted by the strong Australian dollar as well as higher costs on insurance, fertilizer, contract labour and fuel

- A significant cost component of irrigation is electricity used to drive the pumps. We have received clear indications from growers and MSF owned farms that irrigation will be discontinued when it becomes cost prohibitive and uneconomic. This will have the immediate impact of reducing sugar cane yield and productivity

- The combination of reduced tonnages, higher costs and lower revenues present serious concerns to farmers that are struggling to recover from weather related events in the previous 3 years (including recent floods that will further impact the 2013 crop)

- A further impact of lower yields and productivity is that farmers will reduce replanting in the current cane growing areas. We are also concerned that higher costs will make it uneconomical to reclaim previous cane land, and prevent further investments in modern irrigation equipment. Hence, when the output continues to decline, the sustainability of the entire industry will remain under threat

- These outcomes are clearly contradicting the stated policy objectives of the Queensland Government to grow the 4 pillar economy of agriculture, construction, resources and tourism, and it appears that the ambition to double food production by 2040 will never be realised.

2. The approach to setting prices appears to create clear winners and losers, which is contrary to the objective of regulation:

- We note that the electricity retailers are the clear winners. They continue to receive the benefits of guaranteed returns, conservatively calculated costs and margins (refer item 3 below), and support for a market design that is likely to generate monopoly returns [1]

- All business customers outside South East Queensland are clear losers, as they will pay significantly higher network charges (i.e. the cost of infrastructure) than their counterparts in South East Queensland. They will also pay higher energy

[1] There are obvious similarities between the approaches to price regulation in all states across Australia. We understand that the three incumbent electricity retailers in Victoria (which is held up to be the most successful state to deregulate energy markets) have enjoyed 30-40% margins in the residential market over a very long period of time. This is a clear indication that competition does not work in the residential segment.

costs than what is available in a competitive market, as well as an inequitable share of the cost of solar panels for residential customers [2]

3. QCA has not demonstrated that the long term benefit of competition outweighs the cost to consumers of paying more for electricity in the near term. Hence, the cost elements for customer acquisition & retention (CARC) and the 5% headroom should be removed or refunded to customers in Ergon's distribution area with annual usage greater than 100 MWh:

   - MSF is not aware of any regulator in any jurisdiction that has allowed for the inclusion of CARC and headroom in a market in which there is no competition [3]

   - Conversely, the Independent Competition and Regulatory Commission (ICRC) concluded that it would not be in the interest of customers in the ACT to pay a higher price for electricity. The Commission discussed competition issues in detail when regulated prices for small electricity customers were determined for 2010-12 and 2012-14 [4]

   - For the avoidance of doubt, prices for customers within Ergon's distribution area with annual usage greater than 100MWh are based Ergon's network tariffs, so the argument to remove cost elements for CARC and headroom is straightforward [5]

4. It is unfortunate that electricity prices are determined in isolation from the broader policy environment, because it prevents QCA from setting prices that are consistent with the key objectives of (i) promoting efficiency and competition, and (ii) maintaining the Uniform Tariff Policy for electricity customers:

   Both of these objectives can be achieved by making fairly simple changes to network tariffs and marketing arrangements:

   - Network tariffs: As the owner of both Ergon and Energex it is feasible for the Queensland Government to establish a mechanism to equalise network tariffs across the state.

   - Marketing arrangements: Retailers should be required to unbundle energy costs and network costs when marketing contestable electricity contracts to residential and small business customers. This will improve transparency and reduce the risk

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[2] The latter point illustrates that tariffs are not cost reflective when networks are permitted to spread costs across customer classes. Furthermore, as noted in our submission to the QCA dated 7 January 2013, the current arrangements may create incentives to increase network tariffs to business customers relative to residential customers in order to reduce the burden of CSO payments for the Government.

[3] 95% of residential and business customers in Ergon's distribution area remain on regulated electricity tariffs, and the situation will be no different in 2015. The reason is that there is virtually no competition in this significant segment of the market.

[4] ICRC Final Report "Retail Prices for non-Contestable Electricity Customers 2010-12" Section 8 (page 49-55). This approach was recently confirmed in the ICRC Final Report "Retail Prices for Franchise Electricity Customers 2012-14" Section 2.1 (page 4-6).

[5] The assessment for small customers is more complex. However, with a clear reference to the current status in Victoria, there is little evidence to suggest that full competition in the South East Queensland residential market will lead to lower prices unless changes are made to both market design and to the marketing of electricity. Regulators should also consider how the introduction of smart meters may further reduce transparency and competition in the market.

of price offerings being deliberately designed by retailers to (i) confuse customers that have limited understanding of the complexity of the market, and (ii) take advantage of residential customers' reluctance to make frequent changes to their electricity supply

This approach will in turn allow the Government to review the structure and effectiveness of Community Service Obligations (CSO) which is a burden for the state budget. The mechanism to equalise network tariffs may eliminate the need for CSO payments altogether.

Concluding Remarks

MSF is an integrated grower, processor, marketer and exporter of raw sugar. Our suppliers are sugar cane farmers in Far North Queensland and Maryborough. Electricity for milling purposes is predominantly sourced internally by producing renewable energy from bagasse (a bi-product of our sugar production), and by importing a small amount of electricity from the grid when our production plants are not operating.

MSF believes it is essential to reconsider the Draft Determination with a view to address each of the issues raised above. We are concerned that failure to do so will have serious negative implications for regional Queensland and for the state's sugar industry upon which we rely as a business.

Should you wish to discuss any details of this submission please call myself on (07) 4043 3324 or email gunnarandresen@msfsugar.com.au.

Our CEO Mike Barry can be contacted direct on 0401 896 999.

Yours sincerely,

[redacted]

Gunnar Andresen
Commercial Manager