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Mr Malcolm Roberts
Chairman
Queensland Competition Authority
Level 27, 145 Ann Street
BRISBANE QLD 4000

By email: electricity@qca.org.au

Dear Mr Roberts

CANEGROWERS response to QCA Draft Determination 2015-16

Thank you for the opportunity to make a submission on the QCA's Draft Determination on Regulated Retail Prices 2015-16. As you are aware, CANEGROWERS is very concerned about the impact of sharp increases in electricity prices. The price increase of 96 per cent compounded over the past seven years, on the electricity used for irrigated sugarcane production in Queensland is unsustainable.

Measured in Australian dollar terms, world sugar prices have fallen by more than 12 per cent in the past twelve months. In this context, increasing electricity prices for irrigation by a further five per cent for 2015-16 as foreshadowed in the QCA's draft determination will make an already difficult position for irrigated agriculture in Queensland much worse. It is a concern that QCA considers that a further ten per cent increase would not have been "*unreasonable*".

Electricity prices are revenue reflective, not cost reflective

CANEGROWERS is aware of and understands the issues and constraints imposed on the QCA by the terms of its Ministerial Direction and by the constraints of Australia's deeply flawed electricity regulatory pricing framework. The requirement to treat the network (N) component of the price build up as a "pass-through" means that the prices contained in QCA's electricity price determinations for Queensland are not cost reflective. They are **revenue reflective**.

The analysis presented by members of the Australian Energy Regulator's (AER) Consumer Challenge Panel and other independent experts' reports suggests that Ergon and Energex submitted inflated claims for the N component of their costs to the AER for their pricing reset to establish a revenue cap for the period 2015-20 (copies of reports commissioned by CANEGROWERS are attached along with a copy of CANEGROWERS submission to the AER and CANEGROWERS submission to Ergon's network tariff review).

Optimistic demand forecasts, an overvalued regulatory asset base (RAB), inflated capex and opex proposals and contrived estimates of a weighted average cost of capital (WACC) combine to produce network proposals that well exceed prudent and efficient operating costs.

Without effective market disciplines, Ergon and Energex operate in isolation of their users. The supply-side focus is not tempered by the demand side incentives to drive efficiency gains or deliver productivity improvements. The present network pricings framework means all cost increases, whether the result of changing user needs or new regulatory demands, are passed through to consumers as higher network prices. Counterintuitively, higher cost structures deliver higher profits for DNSPs and their owners.

Both companies then develop network tariff structures that enable the recovery of the allowed revenue from their customer base. Ergon and Energex cost allocation models are opaque. Neither company has presented evidence that supports the premise that their network tariffs are based on the cost of supplying electricity. The available evidence suggests the network tariffs are designed to ensure the companies collect the maximum receipts their revenue caps allow.

It is important that regulated retail electricity prices are reflective of prudent and efficient operating costs and not, as is presently the case, reflective of inflated revenue claims encouraged by a flawed electricity pricing framework.

Faced with declining demand, businesses in other competitive sectors of the economy would write down the value of under-used assets; work to cut costs and drive efficiencies; re-price their product offerings; and engage with customers to understand their needs and competitor's offerings. With real-world commercial drivers they actively work to reinvigorate their businesses.

These competitive forces are not at work in the Queensland electricity market. The State's regulated electricity pricing framework rewards Ergon and Energex for inflated cost structures therefore exacerbating the problem. The level of electricity prices in Australia, an energy rich economy is unsustainably high. Driving users from the network to alternative technologies, it is creating the so called electricity "death spiral".

In the face of declining network reliability standards and declining network use, the rapid growth in Energex and Ergon's network investments is being driven by the peak network demands of urban and industrial users, not by Queensland's irrigators. Ergon's network use data shows that electricity use for irrigation has declined sharply in recent years. The size of the RAB is being driven by asset revaluation, increasing by the consumer price index annually and by augmentation capex driven by the peak use needs of urban and industrial users. It is clear that QCA is required to treat the AER's determination as a pass through. Given the AER's timetable, it is important that QCA acts on the findings contained in the AER's interim decisions and is not delayed in doing so by the distribution network service providers.

CANEGROWERS is encouraging Ergon to modernise its network tariff structure through the development of network tariffs that recognise irrigators' largely base-load and off-peak use of the network. This would deliver lower electricity tariffs, lift network use and deliver real benefits to irrigators while being revenue neutral to Ergon. It would also enable QCA to reinstate irrigation tariffs (T62, T65 and T66) as core tariffs for irrigation use.

CANEGROWERS supports the government's uniform tariff policy (UTP) because it recognises a *bona fide* role of government in providing the infrastructure necessary to facilitate the growth and development of regional Queensland. Its application requires that irrigation users across Queensland have access to competitively priced electricity.

Irrigation tariffs deliver revenues equivalent to business tariffs

After the price increases proposed in the QCA's draft determination 2015-16, irrigation and farm tariffs (T62, T65 and T66) will deliver Ergon higher revenues than either the general business supply tariff (T20) or the general business supply time of use tariff (22A) (table 2). This observation is based on a 100 day irrigation plan applying 5.34 ML/ha of irrigation water annually. The number of irrigation days used in the cycle is based on monthly average rain rainfall levels and the average water demand of a cane crop in the Bundaberg district (table 1). It assumes a 16.5 hour irrigation day with irrigators using the maximum off-peak time available and the optimal combination of week and weekend day use.

This revenue outcome reflects the fact that the peak usage charges for irrigation and farm tariffs are significantly higher than the prices for T20 and higher than the off-peak and non-summer use prices for T22. On a revenue collection basis, farm tariffs are likely to deliver more revenue to Ergon than the so-called cost reflective tariffs. This is an odd outcome for tariffs that are obsolete and on a transition path to be cost reflective by 2020.

Table 1: Irrigation Days per month

Month	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Days	9	15	18	18	12	12	11	5

Table 2: Annual cost per tariff

Tariff	T20	T22A	T62 (including weekends)	T62 (weekdays only)	T65	T66
Annual cost		$13,160	$13,202	$15,205	$13,456	$14,367
$/ ML		$82.06	$82.32	$94.81	$83.61	$89.58
$/kW		$0.2215	$0.2222	$0.2559	$0.2265	$0.2418

CANEGROWERS calls on the QCA to:

- **Highlight**
  - **the deficiencies in the current electricity pricing framework,**
  - **the risk to Queensland Government that the current asset valuation approach places on the State's finances, and**
  - **the unsustainable burden revenue reflective prices places on electricity users.**
- **Recommend**
  - **Ergon works with Queensland's agricultural community to develop a suite of network tariffs that meet the needs of food and fibre producers, particularly those of irrigated agriculture and that take account of the fact that recent network investments have been driven by the needs of urban and industrial users.**
  - **QCA revisits proposed tariffs for transitional tariffs (T62, T65 and T66) to ensure they do not reach revenue collection targets until 2020 as per the terms of the Minister's Direction.**

Retail Headroom

As it has in previous determinations, QCA has again allowed a margin for retail headroom in notified prices to "*reward investors for a retailer's exposure to systematic risks associated with providing customer retail services"*. In previous determinations this allowance was designed to facilitate retail competition in Energex's South-East Queensland (SEQ) network. From 1 July 2015, electricity prices in SEQ will be monitored, not notified.

QCA's price comparator tool shows, in recent years, retailers across SEQ have responded to the evolution of the electricity market by developing a number of competitive price offerings and prices to attract customers. A common feature is that retailers across the board have consistently offered prices below QCA's notified prices. The change to price monitoring in SEQ is likely to trigger further changes to prices and innovation in the value propositions that retailers' offer customers connected the Energex network. It is likely that "*standing offer prices*" in SEQ will be below existing price levels and well below the prices foreshadowed in QCA's draft determination.

These competitive retail price offerings have not been and are not available to Ergon's retail customers. Without the opportunity to access prices lower than QCA notified prices, Ergon's retail customers continue to be at a price disadvantage to their SEQ counterparts.

The Ministerial Direction requires QCA to develop uniform tariffs for 2015-16. This direction can only be implemented if QCA removes the headroom allowance for the retail prices it determines for Ergon’s retail customers. Without this change, Ergon’s retail customers will continue to be disadvantaged from 1 July 2015.

- **CANEGROWERS calls on QCA to**
  - **Remove the headroom allowance from the regulated retail prices it determines for Ergon’s customers from 2015-16, and**
  - **Recommend to government that it target its CSO payment to Ergon’s network business to enable the development of retail price competition in regional Queensland.**

Conclusion

CANEGROWERS continues to be concerned that Queensland’s electricity pricing framework in fundamentally flawed. Its structure, supporting inflated asset values, unrealistically high return on those assets and unsustainable levels of investment in an underused network, is failing the Queensland economy. The proposed irrigation tariffs are threatening the viability and international competitiveness of irrigated agriculture across the state. Jobs in regional communities are being put at risk, not just in agriculture but across regional communities as local businesses contract and services are withdrawn.

The social and economic costs to regional communities of the revenue reflective prices QCA is proposing far outweigh the narrow benefits in terms of the additional profits the Ergon might generate.

CANEGROWERS supports that the recently elected Queensland Government’s plan to establish an independent Queensland Productivity Commission and make electricity pricing its first task. Its objective will be to develop policy solutions to lift our state’s productivity, improve living standards and drive growth.

The best way to drive the economic growth and development of rural and regional Queensland is enable the sugar and other agricultural industries across the state to build on their underlying strengths and invest and expand their activity within a stable business enabling policy framework. This can only be achieved if the regulated prices QCA recommends are at levels that reflect prudent and efficient cost structures and recognise the government’s *bona fide* role in providing the infrastructure necessary to facilitate the growth and development of regional Queensland.

Yours sincerely

Brendan Stewart
CHIEF EXECUTIVE OFFICER

Attachments

1. CME Report (May 2013), Rising electricity prices in Queensland: Evidence and Reasons for Action
2. CME Report (August 2014), Advice to Canegrowers and the Australian Sugar Milling Council on Ergon electricity tariff issues
3. CANEGROWERS Submission to the AER review of Ergon and Energex Network Tariff Reset Proposals
4. CANEGROWERS Submission to Ergon’s Network Tariff Review