CANEGROWERS
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Queensland Competition Authority
GPO Box 2257
BRISBANE Q. 4001

3rd April 2017

Dear Sir/Madam,

Re: Response to Draft Determination– Regulated Retail Electricity Prices for 2017-18

CANEGROWERS Isis is the local organisation representing sugarcane growers supplying the Isis Central Sugar Mill near Childers. The Isis Central Sugar Mill is grower owned and therefore the sugarcane growers, for whom CANEGROWERS Isis acts, have a large investment not only in primary production but also in manufacturing. Viability of the Isis sugar industry is heavily dependent upon having access to a reliable electricity supply at affordable prices.

Almost all farms supplying the sugar mill are irrigated properties with access to either surface and groundwater supplies or both. Seasonal climate variation and limited water storage means the Isis growers must use irrigation to supplement approximately half the crop's water requirement, this reliance is most prevalent in dry years. The reliance upon irrigation water, in most cases, equates to a reliance upon cost effective electricity supply as an input to the sugarcane crop for productivity and profitability. This reliance on cost effective electricity supply is exacerbated by our grower's considerable investment in irrigation systems and the associated infrastructure required to deliver maximum benefit and efficiency aligned to existing tariff constraints, as such electricity is a vital input to the Isis sugar cane industries production. This reliance on electricity and the growing affordability crisis for the same drives CANEGROWERS Isis to implore QCA to protect our industry from further price rises and consider this submission on the Draft Determination-Regulated Retail Electricity Prices for 2017-18.

CANEGROWERS Isis welcome the decrease in network costs and commend QCA on ensuring any rise in pricing is kept to a minimum we also reiterate our ongoing support for the retention of uniform tariff policy (UTP) for regional Queensland customers. However, we remain strongly opposed to and in question as to the veracity of charging a rate of return on network assets.

The network was originally conceived as an exercise in nation building to provide for the common good and to give our industries a comparative advantage over our international rivals. The network is not an appropriate vehicle to raise revenue for government spending as it adds to the cost of doing business. A commercial enterprise can only survive if it makes a profit, which can then be taxed. A tax imposed on profits does not affect the viability of a

business in the same manner as a tax on inputs does. A tax on inputs, in this case a 'proxy' tax through electricity network charges, can lead to the failure of the business. An example of this is the current risk of Boyne Island and Portland aluminium smelters closing, with the loss of energy subsidies and climbing electricity prices, the nation's four remaining smelters will be reduced to just 2. This loss has numerous stages of impact on the wider economy and business, at a primary level this will impact on the viability of bauxite mining, alumina refining. At secondary level this impact extends to Australian manufacturers risking key sectors of the market, including the construction, automotive and packaging, along with the peripheral businesses reliant upon the primary and secondary stages of business. The tertiary impact will consequently strip 50% of the aluminium export industry from our shores, this export alone is valued at over AUD$1.5B p.a. Ultimately this is a large failure of business from a proxy tax on inputs.
In the context of the sugarcane industry the impacts of this 'proxy' input tax for Government revenue raising on network assets again impacts businesses and communities at the local, regional, and international levels.
Farmers will continue to apply water and increase crop production until marginal costs equal marginal revenue to maximise profit. As the marginal costs rise due to increases in power prices production must decrease or the crop will cease to remain economically viable.

The rate of return (ROR) is approximately a third of the price of electricity and is determined by calculating the weighted average cost of capital (WACC) and then applying it to the regulatory asset base (RAB). The WACC includes a risk-free rate plus an estimate of the market risk premium needed to attract investors to the venture. It also includes debt neutrality fees levied on the cost of debt to ensure that private enterprises are not crowded out by state owned competitors.

This system distorts incentives for the efficient allocation of capital. The state owners of the distribution network service providers (DNSPs) borrow at the risk-free rate, overspend on infrastructure, and receive a much higher ROR. This system effectively creates a 'proxy' tax on Queensland citizens and uses threat of non-supply to enforce immediate payment without opportunity for review.

The regulator, the AER, has a duty to ensure that the DNSPs are adequately financed for OPEX and CAPEX and a return on capital. There is also a return of capital by way of the depreciation component in the regulated price. This effectively means that they have no market risk as there are no uncertainties with regard to their ability to operate profitably and return capital to investors. There is a small regulatory risk that the rules may change or the regulator might miscalculate but this can be remedied either by the courts or a change in the price.

The inclusion of debt neutrality fees assumes that there is a potential investor willing to build another parallel network. This is unlikely, especially in regional Australia where the spatial distribution of a sparse population is unattractive commercially. As such, these additional charges should be dropped and used only in theoretical considerations until such an investor or likely circumstance does present to justify such charges. Should such an 'investor' appear they would not be building a parallel network, rather they would lease the current infrastructure and have the opposite outcome financially on the assets by injecting money into the system as demand would not increase just competition for pricing of the supply. This situation, as unlikely as it may be to occur, effectively negates the debt neutrality requirement.

We believe that if a ROR is to be charged it should be in accordance with [i]Helm's split cost of capital approach which proposes a risk-free debt rate for the RAB and different equity rates for OPEX and CAPEX. It recognises that an average cost of capital is too low for OPEX and CAPEX but too high for the RAB due to its low risk because of the regulator's obligation to honour the investor's financial commitments. That is, he gets a return on his investment and gets a return of capital. It provides the correct incentives for efficient OPEX and CAPEX but discourages financial engineering to exploit the current high risk rate on the RAB.

There is no doubt that this will lower the revenue received by the DNSPs and will be resisted by management if they overlook the crucial point that it also lowers the overall risk profile of the entity and therefore the cost of doing business. Failure to acknowledge this would indicate that the current arrangement is an exercise in rent seeking. The return on CAPEX will be higher to reflect the real risks incurred during the construction phase. By giving the correct marginal rate it ensures that the new infrastructure is built but removes the incentive for gold-plating as it is rolled over into the RAB soon after completion. The rate for OPEX will also be higher ensuring that the operational side of the entity is adequately financed to provide good and efficient management. This approach serves the public interest as it leads to lower electricity prices without impacting on the network's ability to supply power. Such an undertaking would not require change to legislation and as outlined by Hugh Grant on ABC national radio on 27/03/2017.

Whilst the Draft Determination of Regulated retail electricity Prices for 2017-18 document does not directly consider the above argument there are a number of points we would like to provide both comment and or clarity on.

In relation to proposed 2017-18 price increase (%) as outlined in Section 7.2, Table 14, we would like to implore QCA to ensure the proposed price increases do not rise any further than listed in this table for the Obsolete or transitional tariffs. With the ongoing rises of recent years' sugar cane production margins are already tight and unable to sustain further strain from a greater increase. The increases listed in the draft determination are at the limit many producers are able to tolerate and will prevent further growers reverting to 'dirty' diesel options such as generators to run their irrigation or from stranding assets exacerbating network costs for other users.

In Appendix G the new network tariffs are outlined, we would like to comment on the healthy structure identified for Tariff 24, this structure appears to be well suited to our growers during periods when average or above average rainfall are realised. On the downside, during periods of dry or drought this tariff will be unviable as the demand charge for peak usage will be engaged constantly and become prohibitively expensive. For example, in the Isis region we only have supplemental irrigation, as such, in even mildly dry years irrigation provides over 50% of the water to support crop growth. In the past year the region has experienced extremely dry conditions and is currently drought declared. Through this dry period irrigators water the crop 24 hours per day 7 days per week. The drought declaration bought with it some relief to irrigators by removing the fixed charge component of the tariff 66 charges. We note that Tariff 24 only has a monthly demand charge, as such without a fixed charge or application of the monthly charge as replacement to the fixed charge there would be no opportunity to provide drought relief for irrigators? Could QCA please provide advice as to the proposed system to provide drought relief when the 2020 Tariff changeover occurs as we suspect droughts will continue past 2020, if not more often

should climate change accelerate, and no accommodation appears to have been built into the new tariff structure.

While CANEGROWERS Isis applaud the retention of UTP and are pleased that the proposed price increases are minimal in this instance, we implore QCA to retain any price increase for 2017-18 at or below the figures listed in the draft determination. Our growers' reliance on energy consumption to meet production requirements for regional viability mean any further price rises challenge capacity to make profit. Any additional increases, even minor drive our growers toward an economic tipping point which may distress regional business away from sugar cane production or result in mass exodus to 'dirty' diesel. As such we ask that our comments on ROR be carefully considered in the context of pricing prior to the final determination.

Regards,

Donna P Sheehy
Manager
CANEGROWERS Isis

[i] Queensland Competition Authority 2014, *The Split Cost of Capital Concept*, Information Paper, February