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3 October 2013

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

By email: electricity@qca.org.au

Dear Dr Roberts

Regulated Retail Electricity Prices 2014-15

Thank you for the opportunity to make a submission to QCA's *Electricity Price Determination 2014-15.*

CANEGROWERS has consistently argued that failures in the regulatory framework and the requirement placed on Ergon and Energex to deliver corporate dividends, debt fees and tax equalisation payments to the government have encouraged over-investment; with users, not the asset owners, bearing the risk of investment decisions. Simply increasing prices to provide a guaranteed return on electricity network investments is not an efficient response to escalating costs associated with ageing assets, changing peak demand loads and the impact of rapidly changing generating and storage technologies on demand. This pricing strategy is failing both users and network service providers.

Rapidly rising electricity prices are undermining the profitability of irrigated agricultural production. Regulated electricity prices have reached upper bound making alternative energy sources more cost effective than electricity. That consumers are switching and network demand is declining in a growing in economy suggests the price elasticity of demand for electricity is greater than one. In this environment further price increases will reduce rather than enhance revenues.

CANEGROWERS is seeking a standstill on underlying regulated electricity prices for irrigation use in 2014-15.

As base load and off-peak users, irrigators do not contribute to the network's critical peak. Therefore irrigation tariffs should be volume based, reflecting irrigation demands on the network in terms of base load and off-peak use and include worthwhile time-of-use incentives for irrigation during off-peak periods and over the weekend.

- ***Base Load Irrigation Tariffs*** – would 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.

In recognition of CANEGROWERS' submissions to government and reflecting its own concerns about the unsustainability of electricity price increases on irrigators, the Queensland Government capped the 2013-14 electricity price increase for irrigators at 10%, half of the QCA's determined increase.

Combined with previous increases, regulated electricity prices faced by irrigators have doubled over the past seven years. In the last year before the N component of electricity prices is reset, there are compelling arguments supporting a standstill in regulated electricity prices for 2014-15.

- Network (N) costs are set to fall
  2014-15 is the last year before the next AER reset into what is likely to be a lower cost environment. Key drivers for an expected sharp decline in N are a sharp reduction, perhaps by as much as 30%, in the weighted average cost of capital used in the calculation and a significant reduction, expected to be in the order of $1.5 billion, in the expected capital spend in the next period.

  Failure to take this into account in the 2104-15 regulated price determination would likely result in another significant price increase to be followed in 2015-16 by a significant downward price adjustment.

- Critical peak demand and N-1 network security standards
  Irrigators in Queensland do not contribute to critical peak demand and do not demand the mandated N-1 network security standards designed to meet the needs of urban and industrial users. These standards have resulted in over-investment in network assets and inflated the RAB. Agricultural users have not required the system upgrades, yet are being asked to pay for them. In a truly cost reflective environment this would be taken into account in the prices irrigators faced for their electricity use.

- Prospective removal of the Carbon Tax
  The future of the carbon tax is in question following the 2013 federal election, with the newly elected government's commitment to remove the tax. In the context of this policy uncertainty, it is important that the impact of the tax be separately identified and immediately removed from QCA determined electricity prices upon implementation of the federal government's new policy.

- Community Service Obligations (CSO)
  Ergon has a variety of CSOs covering supply to rural and remote communities, streetlights and isolated networks. On the basis of publicly available information, it is not possible to disentangle the incidence of the CSO payment across Ergon's business. Nonetheless it is clear that the CSO payment also contributes to Ergon's obligations under the solar bonus scheme, helps offset the impacts of inefficiencies in Ergon's retail operations and, according to the Inter-Departmental Committee report, disproportionately benefits very large non-residential customers including mining companies.

- Increasing electricity prices and falling sugar prices
  World sugar prices have fallen sharply over the past two years and the cane crop has been slow to recover from a series of adverse weather patterns. The combined effect is that industry revenues have fallen at a time when regulated prices have sharply risen, reducing the industry's international competitiveness.

The N+R electricity pricing framework shifts the risk of poor network investment decisions from the asset owners to consumers. The 2014-15 price determination provides opportunity for QCA to pause the recent price spiral, providing irrigators with some respite from input price pressures and further erosion of their international competitiveness.

CANEGROWERS concerns are reflected in ACCC comments

"We have seen recently that poor electricity regulation rules and reliability standards that do not properly reflect what consumers wish to pay for have cost us dearly. Consumers are paying too much for electricity and our competitiveness has suffered."

"Infrastructure networks are built for the peaks, which are infrequent. It is often best to try to dampen peak demand and spread usage to non-peak times so that more services are provided for a given cost."

ACCC Chairman, Rod Sims (September 2013)

CANEGROWERS is working with Ergon as part of its consultation initiative "to identify and implement the most appropriate structures and sustainable network tariff solutions". It is clear that a new approach for setting electricity tariffs for irrigated agriculture is needed if Queensland's agricultural production is to double by 2040, enabling agricultural production in northern Australia to become the food bowl for Asia envisioned by federal and state governments alike.

For the sugarcane industry, Ergon's development of a suite of effective and efficient electricity tariffs for irrigation use in "food and fibre" production is of critical importance and is urgently needed.

Irrigators as a customer class

Electricity used by irrigators in rural and regional areas is almost exclusively base-load or off-peak, a unique use profile when compared to urban, industrial, commercial and/or residential customers. Drawing from high voltage lines through their own transformers, irrigators are not as deeply imbedded in the network as their urban counterparts. Reliability and quality of supply (voltage and frequency parameters) are not as critical for irrigators as they are for urban users. Compared to a typical urban or CBD business, irrigators have made a significant capital contribution to access power. Taken together these factors reduce the cost of supplying irrigators relative to the cost of supplying urban users.

There is no evidence to support the assertion that irrigation tariffs are below the actual cost of supply and no justification to escalate irrigation tariffs by 25%. These tariffs, developed in the seventies, were designed by power utilities to meet network demands and build off-peak load patterns for the benefit of both generators and networks.

Irrigators can be grouped as a customer class based on the nature and extent of their usage, the nature of their connection to the network and the similarity of metering technology. T62, T65 and T66 were developed to reflect network system operational needs, the needs of generators and those of irrigators. These tariffs have been popular and well used since their introduction, with irrigators making on-farm investment decisions on the basis of the tariff

structures. CANEGROWERS is working with Ergon and Energex to ensure their network tariff structures support a suite of irrigation tariffs that deliver effective price signals.

Seasonal weather variability impacts on the requirement to irrigate. In wetter years, some irrigators may use less electricity than the 100MWh, but in drier years the same irrigators may use more than the 100MWh threshold. Therefore the 100MWh threshold for classifying irrigators as either small users or large users does not sit well with the development of electricity tariffs for irrigation. Removing this threshold requirement for irrigation tariffs and identifying irrigators as a separate customer class is an important step in ensuring all irrigators have access to the same suite of irrigation tariffs.

Designing irrigation tariffs in this way will provide continuity between tariff class segments for irrigators, avoid unnecessary transaction costs and appropriately allow for seasonal variability in demand.

Cost-reflective irrigation tariffs

The prices users pay for the network should be the *prudently and efficiently incurred* costs of supply, net of sum of the benefits of utilising the network and engaging in network load management. Both the costs and benefits need to be taken into account when determining a worthwhile supply signal. The current gaps in the existing N+R primary tariff structures do not recognise and fully reward customers that are using energy at off-peak times and not contributing to demand peaks.

Irrigators as a class of users have lower costs of supply than almost any other class of consumer due to capital contributions for the development of distribution lines by farming enterprises. Irrigators are also able to engage in network load management to a greater extent than any other class of consumer. Historically, irrigation tariffs reflected the capital contribution growers were required to pay to be connected and the importance of increasing utilisation of the network in times of low-usage – the capacity to shift load away from peak times and engage in critical peak pricing/load control. It is important that these benefits of network management are all recognised and reflected in irrigation tariffs as reduced fixed and variable (particularly off-peak) charges.

Increases in network costs are principally due to:

- Network investment based on inflated and under-realised demand forecasts.
- Heavy capital investment to meet growing peak urban demand.
- Investments in network expansion to connect new mining and resource customers.
- Augmentation to enable access of embedded generators (solar panels) to the network.
- Less efficient network delivery than occurs in other jurisdictions in Australia and internationally.
- The cost of delivering the 44c/kWh rebate under the Solar Bonus Scheme.
- Payment to government to pay for escalated debt fees, corporate tax equivalent payments and a higher weighted average cost of capital than would be incurred in the private sector.

These cost pressures do not stem from irrigated agricultural production. If the costs are not caused by irrigation and irrigators do not share in the associated benefits, agricultural irrigators should not be asked to bear the associated costs in the form of higher electricity

prices. The costs should be applied to those customer classes that either cause the cost increase or benefit from the investment. Irrigators as a customer class are currently paying the cost of these investment and policy decisions without realising any of the intended benefits.

Rising electricity prices and the narrowing of the peak/off-peak tariff differential (or time-of-use signal) in recent QCA price determinations for irrigation tariffs is changing irrigator behaviour. This change in behaviour, if sustained, is encouraging irrigators to explore alternative energy supply options, including diesel generators and switch from off-peak to peak period usage. Although the overall level of electricity consumption may fall, the demand on network capacity may increase, leaving Ergon with the risk of stranded assets and a higher cost structure to be borne by remaining users. This would not be an optimal result for the provision of electricity, the Queensland government, or irrigators in the Queensland sugarcane industry.

CANEGROWERS seeks a suite of tariffs for food and fibre production, principally irrigation, that are comparable with those which would result in a competitive market. The prices should provide incentives to optimise electricity use and not hinder the growth and development of strong internationally competitive export oriented industries such as sugar.

Yours sincerely

Warren Males
Head-Economics