

Submission addressed to:
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CANEGROWERS submission to the 30-year electricity strategy

Summary

In this submission measures that can be taken to reform tariff structures and build the 4-pillar economy are outlined, how the cost of the electricity network can be reduced (including analysis on the subsequent impact on retail prices) are analyzed and broader reform issues are discussed.

In summary, CANEGROWERS calls on the Queensland Government to:

- Recognize irrigators as a separate class of users in the 30-year strategy;
- Develop irrigation tariffs for food and fibre production that reflect the low cost of supply;
- Use the upcoming AER Regulatory Re-set to slow the rate of increase and significantly reduce the effective prices of network charges in Queensland.

Preamble

Until recently, electricity supply in Queensland has been viewed as an enabler. As a source of energy, electricity enables intensification of agricultural production - in the case of the sugarcane industry, this is primarily through expansion of irrigation by electricity powered irrigation pumps. For example, affordable supply of electricity has enabled sugarcane growing regions to move from a dry land to a supplementary irrigation cropping system, which has increased production and provided economic sustainability. In the Burdekin and the Tablelands, irrigation is essential to ensure sugarcane to be grown.

The doubling of electricity prices over the past seven years is posing a threat to irrigated agriculture in Queensland, particularly in sugarcane producing areas. Just as low cost electricity has enabled supplementary irrigation and intensification of agricultural production in the sugarcane industry, a high cost electricity supply is now undermining the international competitiveness of irrigated sugarcane production. In a growing number of cases, irrigators can no longer afford to turn on their pumps to irrigate their crops.

In the 30-year electricity strategy, the Queensland Government must ensure that the state's electricity supply should be used to encourage economic growth. The primary purpose of the 30-year electricity strategy should be to deliver electricity at the lowest prudently incurred cost of supply, while ensuring the development of Queensland's 4-pillar economy.

As the discussion paper rightly identifies, the short-term reform decisions made by the government today in reigning in the costs of supplying electricity will determine the long-term future of the electricity sector in Queensland. If action isn't taken to reduce costs, develop tariffs for irrigators and reform Queensland's electricity supply, the consequences will be severe. Irrigators will either go "off grid" or will be forced to close their farming operations; networks will have a large quantity of stranded assets and the Queensland Government will face an unsustainable financial return from the state's network assets. Conversely, if the rate of price increases can be capped to CPI and the non-prudently incurred costs of supply (for example: network augmentation and the feed-in tariff for solar integration and the N-1 security standard, etc) can be removed and the effective price significantly reduced, there can be a renaissance of agricultural development in Queensland. Significantly lowering the cost of electricity supply for irrigators will ensure that the Queensland Government achieves its objective of doubling agricultural production by 2040.

CANEGROWERS engagement in electricity sector reform

The price of retail electricity is threatening the viability of irrigated sugarcane production in Queensland. CANEGROWERS, on behalf of the sugarcane growers, has been actively engaged in the electricity sector for the past two years. Over this time, CANEGROWERS has established an Electricity Committee and has been actively engaged in the Queensland Competition Authority's Annual Retail Electricity Price Determinations, the Australian Energy Regulator's *Better Regulation* work program and other electricity sector reform programs to date.

CANEGROWERS is currently developing a Memorandum of Understanding with Ergon to better share information on irrigation consumption patterns and to develop a work plan that can lead to a suite of tariffs for food and fibre production.

Development of a suite of irrigation tariffs for food and fibre production

To ensure the unique needs and aspirations of irrigators are met in the 30-year strategy, irrigators need to be recognised as a separate and distinct group of consumers. This distinction is particularly relevant with regards to the development of network-based irrigation tariffs. Electricity used by irrigators is almost exclusively base-load or off-peak, a unique use profile when compared to industrial, commercial and/or residential customers.

Irrigators as a separate customer class

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. The Queensland Competition Authority (QCA) labels these electricity tariffs as “transitional” and “obsolete”. This characterisation is because without tariffs designed for agricultural irrigation in the Ergon and Energex network tariff structure, QCA has no basis on which to apply the mandated N+R methodology retail pricing regulation. The tariffs will be phased-out by 2020 unless network tariffs that will support their continuation are introduced.

The cost reflective Notified Prices that replace T62, T65 and T66 provide much weaker signals to customers. An important characteristic of the “obsolete” irrigation tariffs was their recognition of irrigation as a base load and off-peak activity. The price signals encouraged irrigators to maximise off-peak consumption. Ergon’s network tariff review provides opportunity to re-introduce structures that enable the QCA to use the N+R methodology to notify 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.

Cost reflectivity for irrigation tariffs

The prices users should pay for the network should be the *prudently and efficiently incurred* costs of supply, net of the 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 QCA’s existing N+R retail 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.

Rapidly rising electricity tariffs for irrigation in the face of stagnant NMI growth and slowly falling total consumption across irrigation tariffs over the last 15 years, at the same time as record capital and operational expenditure programs, provides evidence to suggest a large cross-subsidy has developed from irrigation users towards household/industrial and customer classes. 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 household demand.
- Investments in network expansion to connect new mining and resource customers.
- Augmentation to enable access of embedded generators (solar panels) to the network.
- Cost of delivering the 44c/kWh rebate under the Solar Bonus Scheme.

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 at peak times 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 Ergon, the Queensland Government as shareholder or irrigators in the Queensland sugarcane industry.

In summary, the 30-year strategy needs to ensure that:

- Irrigators are recognised as a separate customer class, both in the 30-year strategy and in network tariff development
- Irrigation tariffs that recognise and reward the off-peak and base load use patterns of irrigators are developed before the AER 2015 – 2020 Regulatory Reset
- Any and all irrigation tariffs reflect the low cost of supply and only accrue the *prudently and efficiently incurred costs*.

Removing unnecessary pressure on prices

The current price path for network prices in Queensland is undermining the State Government's 4-pillar economic policy. If the rate of price increase is not capped at CPI and the effective price is not significantly reduced, the price of electricity will continue undermining the international competitiveness of sugarcane irrigators and other food and fiber producers. In this environment, it will be a struggle to maintain the existing level of irrigated sugarcane production in Queensland, let alone double production by 2040.

However, there are actions that the Queensland Government can take to reduce the rate of increase and the effective prices in the short- and long-term. The AER's 2015-2020 Regulatory Reset for Queensland DNSPs is an opportunity for the Queensland Government to place significant downward pressure on prices.

For example, the Queensland Government (as primary shareholder of Ergon and Energex) can:

- Instruct Ergon and Energex to develop network tariff schedules for electricity use in food and fibre production that recognises only the prudently incurred network costs of supply to base load and off-peak irrigators

- Use the real (risk free) cost of debt and realistic equity beta instead of the AER's benchmarking approach for a private firm
- Set realistic demand forecasts that do not inflate the TOTEX expenditure programs
- Stop building network infrastructure to the N-1 security standard
- Return corporate tax equalization payments to network businesses, to further reduce the price of network charges
- Reduce the burden of the artificially inflated Regulated Asset Base by removing the Return on Assets on non-utilized assets.

As network owner, the government has an obligation to supply electricity at the prudently incurred costs of delivery. It also has the power to implement these recommendations. The “revenue cap” under the AER's regulatory framework is designed to set the absolute maximum revenue that can be collected in each year. There are no limits on any “under-recovery” by Ergon or Energex.

Implementation of these recommendations will reduce prices for all consumers in Queensland. Gross receipts to the Queensland Government may fall in the short term if these recommendations are implemented. However, if they are not, revenues are likely to fall over the longer term as users seeking alternative electricity solutions turn away from the grid, risking the stranding of assets and an even faster electricity price spiral.

The intent of a 30-year electricity strategy should be about establishing a low cost electricity supply system that will encourage economic growth. Securing this objective will also optimize long term returns to the Queensland Government from both the electricity network and from stronger economic activity across the state, which can be driven by lower electricity prices.

Electricity sector reform

The current regulatory structures underpinning the Queensland electricity sector are broken and in desperate need of reform. The costs and benefits of short-term reforms will determine electricity supply into the future. The Community Service Obligation (CSO), as a part of the Uniform Tariff Policy (UTP) needs to be better targeted to provide a greater return on the investment for the Queensland Government, while allowing improved retail competition for customers in both the Ergon and Energex supply areas.

Future of CSO and UTP

The UTP has enabled electrification of regional Queensland by ensuring that access to electricity is equitable. Under the current policy setting, the CSO is an important investment for irrigation in Queensland. Based on data provided by Ergon and analysed by CANEGROWERS, irrigators on T62, T65 and T66 will receive only \$20 million of the total \$615 million CSO in 2013/14.

Development of a suite of irrigation tariffs will play an important part in how the UTP applies to irrigators. CANEGROWERS recognises that reform of the UTP and allocation of the CSO is necessary to improve the allocative and distributive efficiency of the state's energy sector. As a general principle, the UTP can be maintained by targeting the CSO in two stages, first at the distribution level to equalise distribution costs across Queensland and second at the transmission level to account for

energy losses and to equalise the TUOS component of the network charge. Applying the CSO at the network level would also enable retail competition in the Ergon distribution area.

Although this submission outlines some general principles, CANEGROWERS would like to reserve its right to comment “in full” on the UTP and CSO until the QCA releases a draft of its investigation into this part of the reform process.

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