

7 March 2014

Malcolm Roberts
Chairman
Queensland Competition Authority

By email: electricity@qca.org.au

Dear Mr Roberts,

QCA Issues Paper: Retail Electricity Price Regulation in Regional Queensland

Thank you for the opportunity to make a submission on the QCA's Issues Paper on Retail Electricity Price Regulation in Regional Queensland. As you are aware, the cost of electricity is a very important input cost for irrigators in the sugarcane industry. The future design of the Uniform Tariff Policy (UTP) and the application of the Community Service Obligation (CSO) will have an enduring impact on the viability of irrigated sugarcane production in Queensland.

CANEGROWERS supports the application of the CSO at the network level.

It is clear that the efficiency and effectiveness of the UTP is linked to the efficiency of Queensland's electricity networks. Network costs across the state have increased sharply as a result of over investment.

A prudency review of Queensland's electricity networks is required. It is important that network expenditure be reined in and that network costs that are passed on to users are limited to those required to meet user needs. This approach will alleviate the burden of the CSO on the Queensland budget and provide much needed electricity price relief to electricity users.

Thank you for the opportunity to respond to your Issues Paper. CANEGROWERS is committed to working with the QCA and the Queensland Government to ensure reforms to the UTP and regional price regulation deliver for regional Queensland. If you have any further questions, do not hesitate to contact me on (07) 3864 6444.

Yours faithfully,

Brendan Stewart
CHIEF EXECUTIVE OFFICER

CANEGROWERS submission to QCA Issues Paper: *Retail Electricity Price Regulation in Regional Queensland*

Summary

There is a clear role for government in providing infrastructure necessary to facilitate the growth and development of regional Queensland. If the objective of doubling agricultural production by 2040 is to be realised, the Queensland government must create conditions that enable the sugar and other agricultural industries, building on their underlying strengths, to invest and expand within a stable business enabling policy framework.

Uniform Tariff Policy

The government's uniform tariff policy recognises the role of government. It addresses the impact of the tyranny of distance and makes an important contribution to the Queensland government's strategy of promoting a four-pillar economy.

- Define the Uniform Tariff Policy (UTP) as means of removing the "tyranny of distance" in the costs of electricity supply.
- Move the focus of the UTP from uniform retail prices to uniform network, energy and retail costs. The Community Service Obligation (CSO) can be targeted at the network to:
 - equalise transmission charges
 - remove difference in energy losses across the network
 - equalize the cost of delivery between the Energex and Ergon supply areas.
- Conduct a prudency review of past network expenditure to ensure network tariffs reflect the true and prudent cost of supply.

Retail price regulation

- Continue retail price regulation with N+R tariffs, based on:
 - prudently incurred network costs
 - the current rate of headroom, retail margin and retail operating costs (not higher).
- Allow market contracts to enable other retailers to enter the market.

Targeted rebates

- Include a rebate to ensure the cost of electricity is not a prohibiting factor for optimal water application and maximum crop production.

Preamble

There is a clear role for government in providing the infrastructure necessary to facilitate the growth and development of regional Queensland.

While private sector jobs are not created by government, if the objective of doubling Queensland's agricultural production by 2040 is to be realised, the Queensland government must create conditions that enable the sugar and other agricultural industries, building on their underlying strengths, to invest and expand within a stable business enabling policy framework.

At its heart, Queensland's uniform tariff policy recognises the role for government in providing the necessary electricity infrastructure, infrastructure that would not otherwise have been provided by the private sector. CANEGROWERS supports the continuation of the uniform tariff policy (UTP).

The establishment and development of agricultural irrigation schemes in North and Far North Queensland would not have occurred without public investment in infrastructure, both in the construction of irrigation channels and supplying the electricity necessary to pump irrigation water. Irrigation schemes have underpinned the development of agricultural precincts in regional communities like Ayr and Mareeba. Their growth has supported the wider communities and the fabric of economic activity well beyond the farm gate.

In a modern economy, electricity is an important service. The Queensland government recognises that the service would not be provided in rural and remote Queensland in the absence of its intervention. The UTP and the accompanying community service obligation (CSO) payment should be viewed as an investment. The objectives of the Queensland Plan are complimentary to those of the UTP, namely: increased export income to regional Queensland, growth in general tax receipts, new job opportunities, development of secondary processing and support industries, population movement towards regional Queensland and broader regional economic development.

CANEGROWERS agrees that the UTP and CSO could be better targeted. Despite the UTP, the price of electricity used on Queensland farms has increased faster than the price of any other farm input (figure 1). This is largely a reflection of the present supply side focussed electricity pricing mechanism. Electricity prices, set to provide a guaranteed return on investments, have resulted in rapid investment growth in electricity network assets. Under the current regulatory framework, the risks of the investment decisions have been passed to users in the form of higher prices, rather than being borne by the network owner. The consequence is lower network use and the risk of electricity assets being stranded as users, driven by high prices, have looked to alternative solutions to meet their energy needs.

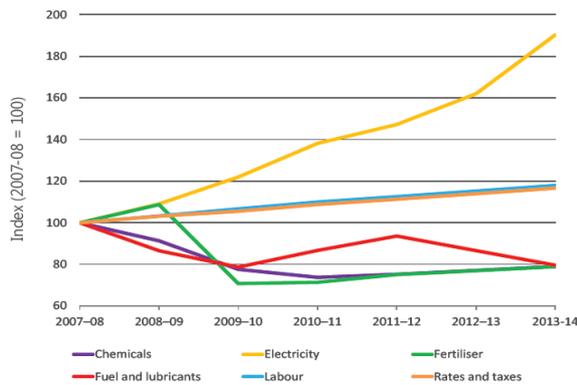
Despite the success of the current UTP in providing retail price parity for all Queenslanders, the financial burden of the CSO has significantly increased (figure 2). This is a reflection of network investment decisions made in response to government policy decisions (N-1 security standard) and direct costs imposed on network operators as a consequence of government policy decisions (feed-in tariff payments under the solar bonus scheme (SBS)). The investments and cost increases are not a response to the electricity demands of regional Queenslanders.

It is clear that unsustainable network investments have a direct impact on the size of the CSO. Going forward, it is important that the prudence of the costs incurred in supplying electricity to regional Queensland is closely examined and the impact of government policy decisions be funded from consolidated revenue rather than as a charge on electricity users.

Review of the UTP provides an opportunity to reflect on electricity price determination in Queensland. Including demand side factors such as the international competitiveness of business in regional Queensland, capacity to pay and the responsiveness of demand to price changes will produce different and more optimal price outcomes. Such a pricing regime will ensure full account is

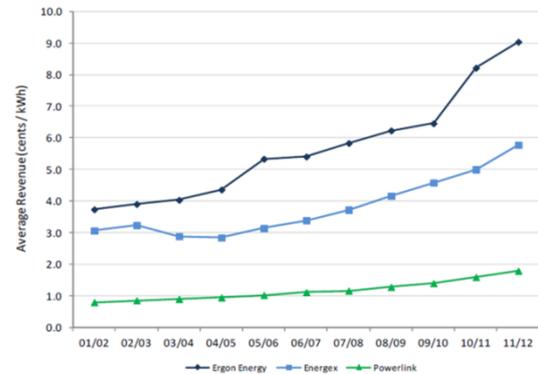
taken of market circumstances and provide a better reflection of the true size of the government's CSO investment in the provision of electricity in regional Queensland.

Figure 1 Farm input prices



Source: QCA, ABARES

Figure 2: Average network charges – Queensland



Source: Independent Review Panel on Network Costs

The UTP could be an important mechanism to deliver on several objectives outlined in the Queensland government's four-pillar economic policy and in the Queensland Plan. For example, increased export income to regional Queensland leading to growth in general tax receipts, new job opportunities outside of the South East Corner, development of secondary processing and support industries as well as population movement towards regional Queensland can all be achieved by an innovative combination of establishing uniform electricity tariffs across the state, undertaking prudency reviews into the efficiency of Queensland's electricity networks and ensuring the costs of government policy are borne by taxpayers rather than imposed on electricity users, especially those such as irrigators competing in the state's traded goods (export and import competing) sector.

A role for the Uniform Tariff Policy

The Queensland Plan recognises a clear role for government in providing infrastructure necessary to facilitate the growth and development of regional Queensland. The government has recognised this role in the development and implementation of policy underpinning the provision and delivery of electricity around the state at a uniform price to customers.

Electricity infrastructure has high social and regional economic value but due to low profit margins, without government intervention is unlikely to be provided by the private sector. The government's uniform tariff policy addresses this issue, overcomes the impact of the tyranny of distance and makes an important contribution to the Queensland government's strategy of promoting a four-pillar economy.

1. Tyranny of distance

Previous interpretations have been based on establishing a set of uniform retail tariffs. Going forward, CANEGROWERS supports establishing uniformity in the underlying network charges rather than retail prices. The CSO could be targeted to remove the "tyranny of distance" associated with moving electricity across the network to geographically isolated areas of the state by equalising transmission and network charges to take account of energy losses in transmission and distribution system.

2. Four-Pillar Economy

The review of the UTP should be used as an opportunity to examine how electricity can be used to promote the development of Queensland’s four-pillar economy. The Queensland government has a long history of supporting economic growth and development across the state, not just in the south-east corner. The UTP could be designed to encourage economic development in cases where the limiting factor on realising economic opportunities is the high price of electricity. Designing the future objectives of the UTP in this way is complimentary to the Queensland Governments’ four-pillar economic policy and target to double agricultural production by 2040.

One way in which the UTP could be used to deliver on the Queensland Government’s four-pillar economic objectives would be to ensure on-farm energy use is cost effective to maximise agricultural production.

Application of the CSO to distributors

Transmission Use of System (TUOS) charges

TUOS charges vary according to geographic location across Queensland (figure 3). Equalising these charges would be an important step towards removing the impact of the tyranny of distance from electricity pricing. This could be done by charging all standard asset customers (SAC) and connection asset customers (CAC) TUOS charges at the level of the EVLT1 Network Tariff Code. Following this approach, the applied CSO would be the difference between EVLT 1 and either EVLT2 or EVLT3, depending on which rate would otherwise have been applied.

Figure 3: Transmission Use of System charges (SAC customers)

	Fixed charge (c / day)	Variable charge (c / kWh)
EVLT 1	13.7	1.348
EVLT2	22.2	1.558
EVLT3	33.9	1.951

Source: Ergon Energy

Energy and distribution losses

Similar to TUOS charges, energy and distribution losses vary between geographic locations across Queensland. Accounting for energy and distribution losses is the second part of removing the impact of the tyranny of distance in electricity pricing. Energy losses are nearly three times higher in North Queensland (ELVT3) than in South East Queensland (Energex) (figure 4). The targeting of the CSO at the network needs to account for these losses, and reflect a “uniform” network charge that is inclusive of energy and distribution losses.

Figure 4: Energy and distribution losses by zone

	Losses (% of energy)	Value of losses (c / kWh)
Energex	7.2%	0.624
EVLT 1	9.341%	0.660
EVLT2	18.664%	1.469
EVLT3	22.679%	1.878

Source: QCA

Distribution Use of System (DUOS) charges (options for the CSO)

The current difference in the Distribution Use of System (DUOS) charges between Ergon and Energex requires further investigation. The prudence of past investments in the distribution network has a direct impact on the efficiency of the UTP going forward. The size of the inefficiency in the network will impact on the need for and size of a CSO to equalise network charges.

Option 1: Prudence review required (preferred)

CANEGROWERS is concerned that the price of electricity on the notified business tariffs does not reflect the actual cost of making, producing or supplying electricity, especially to irrigation customers. A prudence review of the Regulatory Asset Bases (RABs) of Network Service Providers (NSPs – Ergon Energy, Energex and Powerlink) is urgently required. The prudence of previous CAPEX is directly related to the efficiency of the UTP.

As raised in previous CANEGROWERS submissions to the QCA, there are a range of embedded costs in the network components of the QCA notified prices that do not reflect the actual cost of supply and unnecessarily inflate the prices paid by irrigators. For example, the following components do not reflect the actual cost of supplying irrigators:

- the costs associated with the Solar Bonus Scheme (SBS)
- network investment to meet a N-1 security standard and network augmentation to accommodate increased embedded generation (primarily from solar panels)
- unrealistic allowed returns from networks to the Queensland Government
- lack of acknowledgement of existing capital contributions by irrigators, compared with other users

If a prudence review is conducted and assets are found to be neither used nor useful, they should be removed from the RAB of the relevant network service provider, placed in a holding account and charges not accrued to consumers. If the prudent costs of supply can be established (and it is significantly below the current costs of supply), the need to apply a CSO to DUOS charges may be minimised or even removed.

Option 2: Equalisation of Ergon and Energex network tariffs

The current UTP equalises DUOS charges at the retail level. If a prudence review is not conducted into the efficiency of the distribution and transmission RABs, a CSO will continue to be needed to equalise the measured costs of supply from the Ergon to the Energex DUOS charges under the UTP. This process would create a set of Energex-equivalent tariffs for use in the QCA Annual Retail Price Determination process.

In this circumstance, the CSO must be calculated on the pre-SBS Energex network charge (the cost of supply in the Energex network, less the costs of the SBS) before it is applied to the relevant Ergon network charge. Changing the calculation of the CSO in this way will ensure that the UTP is no longer distorted by the costs of the SBS.

Further, without a prudence review into the past (and current) expenditure of NSPs, the size of the CSO needed to equalise the DUOS charges between Ergon and Energex can be expected to increase.

Option 3: Targeted rebates

If there is no prudence review of RABs of Queensland's NSPs and no allocation of the CSO to equalise the DUOS charges between Energex and Ergon, a set of targeted rebates is needed to ensure that

electricity remains affordable for consumers in regional Queensland, and that irrigators can afford to irrigate their crops. This rebate is outlined in further detail, later in the submission.

The Queensland Government could also use this review of the UTP to better examine how the price of electricity can be used to meet the Queensland government's four-pillar economic objectives.

Importance of network tariff development

Continued network tariff development for both Ergon and Energex areas is critically important for the success of the UTP. Development of a suite of electricity tariffs for food and fibre production, especially for irrigation, can complement the future design of the UTP and application of the CSO. Identifying irrigators as a separate class of customers within the food and fibre category and developing a suite of network tariffs for off-peak (including weekend) and base load consumption, QCA will be able to set notified prices, specifically for irrigators, in the Ergon supply area.

Separately identifying and setting dedicated network tariffs for irrigators benefits the whole electricity sector – it will ensure that the prices paid reflect only the prudently incurred costs of supply. This means:

- lower prices for irrigators;
- minimal CSO allocation to irrigators (for DUOS charges); and
- encouraging the development of the Queensland government's four-pillar economic policies.

Without a suite of irrigation network tariffs, it is unlikely that the changes to the UTP will provide sufficient price relief for irrigators across Queensland and deliver on the objectives outlined in the Queensland Government's four-pillar economy strategy. A new approach is required if the negative spiral of higher prices, lower consumption across the Ergon network and lower total revenues for the Queensland Government is to be avoided.

Retail Pricing Regulation

N+R “cost reflective” tariffs

CANEGROWERS supports the extension of the current N+R pricing framework to any new UTP structure. The CSO would be applied to the network and to retailers, as to ensure a uniform cost of supply, as opposed to the current retail tariff structure.

Network

The network charge would be the prudently incurred DUOS charge (the equalised network charge – option 2 above), combined with the prudently incurred TUOS charge (equalised by the CSO). These prudent network charges would be available to all retailers and used in the QCA's annual Regulated Retail Price Determination.

Energy

The cost of energy would be calculated via the existing methodology. The network prices paid by retailers would be discounted by the CSO to offset high energy losses incurred in supplying electricity to regional Queensland. Further analysis into the cost of purchasing energy for supply to irrigators will also need to be conducted as a part of the review of the UTP.

Retail

CANEGROWERS supports the immediate introduction of retail contestability in regional Queensland. Changes to the delivery of the UTP (by targeting of the CSO at the network) would make this possible.

CANEGROWERS does not support increases in headroom, Retail Operating Costs (ROC) and the regulated retail margin beyond the current allowances. To further contain price increases for Ergon customers and to promote productivity growth, the QCA should introduce the requirement for an annual “efficiency dividend” in the retail components of the regulated retail price. With an annual “efficiency dividend” included, CANEGROWERS supports the continuation of the current approach to retail regulation in future Regulated Retail Price Determinations.

Targeted rebates

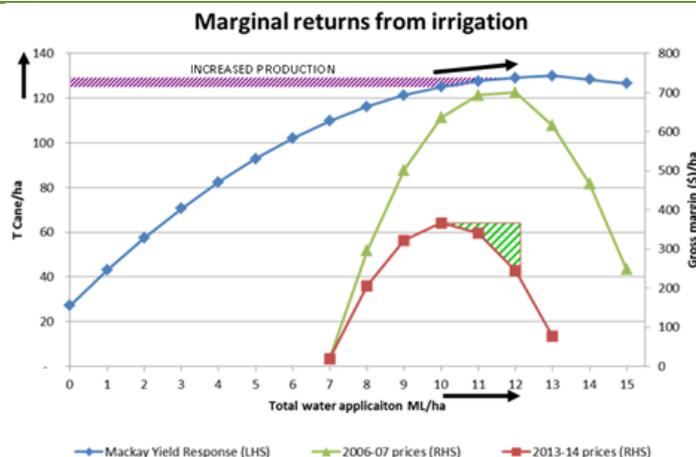
Four-pillar economic objectives

Rising electricity prices have had a direct and detrimental impact on irrigated agricultural output in Queensland. The high cost of applying irrigation water to crops is changing farm practices as growers reduce their water use in response to electricity price increases. This decision is counter to sustainable agronomic practices.

In the Central Region there is a strong yield response to irrigation water use. From an agronomic perspective, the optimal level of water application in the region is 12ML/ha (figure 5). Electricity prices in 2006-07 enabled irrigators in the Central region (Proserpine, Mackay and Sarina) to optimise production, matching economic efficiency with agronomic efficiency (APSIM model). As modelling 2013-14 electricity prices demonstrates, growers responding rationally to higher electricity prices and burgeoning electricity bills have changed their production systems. They are using less electricity and applying less water, losing approximately 3 tonnes of cane per hectare. These modelled outcomes are exacerbated in practice as growers take account of lower sugar prices.

The lost economic opportunity is significant. Assuming just 60% of the area in the central region is irrigated sub-optimally due to high electricity prices; the annual loss would be approximately 200,000 tonnes of cane. This equates to more than 28,100 tonnes of lost sugar production or more than \$12.6 million in foregone export revenue at current world sugar prices.

Figure 5: rebate to optimise crop production



Source: APSIM model and Ergon electricity price data

Optimising on-farm irrigation

Electricity prices set on the basis of supply side factors, without taking account of their impact on users and their likely response is causing suboptimal agricultural outcomes. In the absence of a price determination process that takes account of both demand and supply factors, one solution would be to provide a set of targeted rebates to irrigators to optimise food and fibre production. This would make a significant contribution to achieving the Queensland Government's target of doubling agricultural output by 2040. Increasing crop production through optimal irrigation will also increase export revenue and jobs across regional Queensland.

CANEGROWERS expects that targeting the CSO to TUOS and energy/distribution losses as well as conducting a prudency review into the TUOS and DUOS charges would remove the need to provide for a targeted rebate for sugarcane growing irrigators.

CANEGROWERS Queensland
ABN: 94 089 992 969

190 Edward Street (GPO Box 1032)

BRISBANE QLD 4001

T: 07 3864 6444 F: 07 3864 6429

enquiry@canegrowers.com.au

www.canegrowers.com.au