



15 October 2014

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Lodged electronically

Dear Sir

National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 (ERC0161)

CANEGROWERS is the peak representative body for Australian sugarcane growers and represents around 80% of cane growers. CANEGROWERS and its members are very concerned about rapidly escalating electricity prices. Driven by a poorly designed and failing electricity price framework that rewards over investment in networks and discourages an efficient approach to demand management, network costs and electricity prices are spiralling higher. Tightening national electricity rules relating to distribution network pricing provides an important opportunity to break the underlying spiral in electricity network prices.

In recent months, CANEGROWERS has been engaging distribution network service providers (DNSPs) both directly and indirectly via the Australian Energy Regulator (AER) regarding their regulatory proposals. Throughout this process it is clear that the DNSPs use all avenues available to them to increase their profitability, taking full advantage of Australia's seriously flawed electricity pricing framework.

The current electricity pricing framework, unnecessarily distorting Australia's electricity market, is failing electricity consumers and is directly and adversely affecting the international competitiveness of Australia's traded goods sector. Nowhere is this more evident than in the sharp electricity price increases faced by irrigated agriculture and food and fibre producers more generally. Since the framework was first introduced, electricity prices are increasing at a faster rate than anywhere else in the developed world. This is a bizarre turn of events for the energy rich Australian economy.

By guaranteeing a return on network investment decisions, the cost recovery approach to network prices shields distribution network service providers (DNSPs) from the commercial risks associated with their network investment decisions and passes that risk to electricity users.

CANEGROWERS welcomes the proposed rule changes that will see network tariffs and charges be more thoroughly examined. It is important that network tariffs are set on a truly cost reflective basis taking account of the characteristics, needs and viability of particular user groups. There is an urgent need for consumers to be more actively engaged by DNSPs in network tariff design and price setting. There is an equally important need for DNSPs to take full and proper account of the impact of their network tariff design and pricing

proposals on all classes of consumers before those proposals are submitted to the Australian Energy Regulator (AER) for approval. To be effective, these consumer consultations should be fully documented and transparent on the likely impact of network pricing proposals on consumer groups fully detailed as part of each DNSP's submission to the AER.

Cost reflective tariffs

CANEGROWERS supports the concept that *"Each network tariff should reflect the efficient cost of providing services to consumers assigned to the tariff"* as outlined in the draft rules. However, we do seriously question the way in which this principle is applied by DNSPs when designing network tariff structures and setting the associated network tariffs – particularly those servicing rural and regional Queensland (Ergon).

For example, while Ergon's customers on average consume more than others in the NEM (it has the highest energy density in the NEM), Ergon's allowed maximum revenue per connection is far higher than that of any other DNSP and its average price is the second highest in the NEM (Carbon Market Economics (CME), 2014). The key driver of this a high regulated asset base per connection and high operating costs per connection. This suggests that Ergon's operating conditions are much more onerous than other DNSPs. However this does not appear to be the case.

As CME reports "45% of Ergon's network is single wire earth return, a far cheaper technology than others. It also has a predominately overhead network (more than 99% by length) not unlike other DNSPs that service sparsely populated areas in the NEM".

CME also reports "in the period that Ergon's costs have risen so much, its network density has actually improved".

Ergon is one of the NEM's most profitable DNSP, delivering more than twice as much to the Queensland Government per connection than SA Power Network delivers to its shareholders and more than nine times as much as the United Kingdom's Power Networks delivers to its shareholders.

Ergon and Energex do not have a network tariff structure that caters for the needs of Queensland's irrigators. This means that the Queensland Competition Authority (QCA) is not able to develop regulated retail prices for irrigations tariffs on an N+R build-up basis. QCA initially deemed irrigation tariffs as obsolete. They subsequently categorised the tariffs as transitional and began a process of increasing prices, encouraging consumers to switch to less suitable tariffs that apply to the broader business community. The artificially high price outcome this approach has generated in recent years has dramatically reduced the competitiveness of irrigation to such an extent that many are questioning the economic viability of irrigation.

Currently the DNSP alone decides whether a particular tariff is required. The rules need to be changed so it is no longer a one-sided process. Networks are shared resources with different classes of consumers placing different demands and therefore different cost pressures on the network. The rules need to enable consumers groups such as irrigators to actively participate in the development of tariffs that align with their needs and capacity to pay.

With every other product, consumers have a choice in paying a price for the service or good based on the quality and other parameters.

It is important that the proposed rule changes result in the proper treatment of irrigators as a separate class of customers in the food and fibre production system. 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 (this is more important than the geographic location of a customer on the network). Reliability and quality of supply (voltage and frequency parameters) are not as critical for irrigators as they are for urban users. Irrigators are flexible enough to switch off during the critical peak demand periods that occur for 40 to 50 hours per year. 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. A separate tariff structured to provide worthwhile incentives for off-peak and weekend use, reflecting irrigation practices and enabling better energy demand management, would benefit both DNSPs and irrigators.

There is no evidence to support the assertion that irrigation tariffs are below the actual cost of supply. In recent years growth in Ergon's network expenditure has been driven by investments to meet the needs of its urban and industrial users – not irrigators' demands. The evidence shows that Ergon's irrigation customers, currently on regulated tariffs determined under Queensland's Uniform Tariff Policy, use more electricity than Ergon's "average" customers. Yet, they currently pay 37% more than Ergon's average price. Ergon's irrigation customers consume 17.4% more electricity than Ergon's average customer, but if they were transitioned to paying Ergon's current network tariffs, they would be paying two-and-a-half to three times Ergon's average price, despite making significant direct investments and providing revenue guarantees to be connected to the grid.

Ergon's big High Voltage (HV) customers, numbering less than 100, use more than 30% of the energy but only pay 4% of the revenue. The prices they face have fallen by 400% since 2006. An interesting result in light of a 2013 report prepared by Frontier Economics that noted it is the HV network that drives Ergon costs.

Ergon's network prices make little sense because if consumers actually paid those prices, then Ergon would be receiving several times more than the AER allowed revenue.

Costs of implementation

DNSPs are large profitable entities taking full advantage of a regulatory pricing regime that rewards expenditure. The rule changes and their implementation are one means by which the flaws of the previous regime can be addressed. It is therefore important that the AEMC requires the DNSPs to bear the cost of implementing the rule changes and not pass these on to consumers through higher network tariffs. To do otherwise would be counterproductive.

Measuring the asset base

A significant driver of the network charges is the size of the regulated asset base (RAB). The rules enable DNSPs to revalue their RAB annually and to earn a regulated return on the revalued RAB. No sector of the competitive economy enjoys the same opportunity. Ergon's balance sheet for 2012-13 reveals that \$2.082bn of its \$3.715bn in equity arises from an asset revaluation reserve rather than either retained earnings or subscribed capital. The growth in Ergon's asset base is inconsistent with the decline in energy demand that is occurring across its network.

Conclusion

Electricity is an essential input for all sectors of the economy and driving electricity costs and prices as low as possible has clear benefits for the whole economy. There are many reasons why electricity prices are high and continuing to rise. A key reason is the seriously flawed regulatory pricing framework exploited by DNSPs.

AEMC has an opportunity to make a difference by tightening the rules. CANEGROWERS calls on the Commission to do so in the interests of getting a better outcome for irrigators and electricity users across the country. Reforming the regulated electricity pricing framework will make an important contribution to lifting the competitiveness of the Australian economy, particularly the competitiveness of those in trade exposed irrigated agricultural.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Brendan Stewart', with a large, sweeping flourish at the end.

Brendan Stewart
Chief Executive Officer