COTTON AUSTRALIA
Advancing Australian Cotton

Committee Secretary
Senate Standing Committees on Environment and Communications
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Dear Committee Secretary

Cotton Australia welcomes the opportunity to comment on the Senate Inquiry on the manner in which electricity network companies have presented information to the Australian Energy Regulator (AER) and whether they have misled the AER (the Inquiry).

Cotton Australia is the key representative body for Australia's cotton growing industry. The cotton industry is an integral part of the Australian economy, worth over $2.5 billion in export earnings and employing 10,000 people.

Electricity prices, particularly network costs, on the profitability and financial sustainability of the industry, and the agricultural sector. Cotton Australia has been working closely with the New South Wales Irrigators' Council (NSWIC), National Irrigators' Council (NIC), National Farmers' Federation, Queensland Farmers' Federation (QFF) and NSW Farmers and the Energy Users Association of Australia (EUAA) in relation to escalating network costs. We are actively engaged in the debate and in the past twelve months we have regularly met with Essential Energy (NSW) and Ergon (Qld), as well as making the following submissions to Government processes:

- Essential Energy revenue determination 2015–19 (transitional and full proposals) (Attachments A & B)
- Energy White Paper (Issues Paper and Green Paper) (Attachments C & D)
- AEMC network pricing principles (Attachment E).

Over 65% of the Australian cotton crop is grown within the Essential Energy network in NSW, the remainder is grown in Queensland in the Ergon network. For the most part our comments specifically relate to the Essential Energy revenue determination process, but also will apply to the Ergon revenue determination (commencing October 2015).

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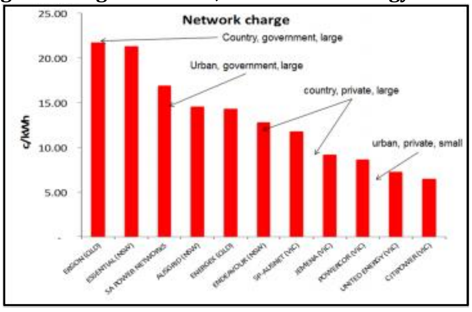
There is no question the scale of operations puts cost pressures on regional networks which in turn translates to higher network charges for regional consumers.

Figure 1 shows a clear imbalance in network charges between the regions and urban areas. The network charge for regional Queensland and NSW is around 30% more than the network charge for urban areas of those states. In NSW, Essential Energy maintains 1.4 million poles, 400 substations and 200,000 kilometers of power lines for 800,000 consumers. By way of comparison, Ausgrid maintains 500,000 power poles, 200 substations and 50,000 kilometers of power cable for 1.6 million consumers in the Sydney, Hunter and Central Coast area.

Figure 1: Network charges are higher in regional areas, Carbon and Energy Markets 2013



Nevertheless, the manner in which the networks have invested, derived costs of capital and operating expense is cause for significant concern.

Terms of Reference A

In the current NSW revenue determination process, Essential Energy has provided the AER with over 22,000 pages of documentation. The other three networks have provided similar levels of documentation, in a variety of formats, providing information of varying quality. While regulatory proposals provide a useful summary of revenue requirements, detailed information on investment decisions, demand forecasts, the revenue base and the WACC are contained in attachments to the proposals.

The Better Regulation and Power of Choice processes focused on increasing consumer engagement and participation in the energy market. But the information that is provided by the networks on revenue proposals is largely impenetrable.

That said, despite the 22,000 pages of information provided we remained unconvinced proposed increase in revenue is justified.

The AER must develop a standard set of requirements and templates for information provided to it (that are easy to use and easy to understand), particularly in relation to investment decisions, operating expenditure and the calculation of the WACC.

Further, we question whether the resourcing of the AER, particularly in light of current Commonwealth funding cuts, is sufficient to adequately consider and analyse this level of information. We would further question whether the resourcing is sufficient to make determinations that are fair and balance the investment and expenditure needs of the networks, with the community's need for reliable, secure and affordable electricity supply.

Terms of Reference B

We have previously highlighted concerns with Essential's calculation of the WACC. We also note the recent media reports relating to the calculation of the Energex WACC.

Cotton Australia considers that Essential's proposed WACC of 8.83% and the equity beta of 0.82 are unjustified. The AER's data indicates equity betas between 0.3 and 0.8 are adequate. Further, the recent determination of the NSW State Water Corporation resulted in an equity beta of 0.7 and WACC of 6.72%. We support NSWIC's argument that State Water and Essential face similar levels of risk.

Terms of Reference C & J

The AER has responsibility for regulating and enforcing the energy market rules and legislation. The AER's responsibility includes setting the revenue cap for networks, as well as monitoring the electricity market more broadly.

As highlighted in response to Terms of Reference A, Cotton Australia is concerned about the adequacy of resourcing of the AER. It is not clear that the organisation is sufficiently equipped to undertake the significant body of work involved in network determinations, as well as monitor and enforce the energy market rules.

The COAG Energy Council has announced a review of the effectiveness of the governance structure of the energy market (including the AEMC, AER and

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AEMO). We consider thought should be given to establishing the AER as its own statutory authority, separate to the ACCC.

Terms of Reference D

The NSW Government has indicated it will not lease Essential Energy, but will look to lease the Ausgrid, Endeavour distribution networks and the Transgrid transmission network. The Queensland Government has indicated it will consider leasing the Ergon network.

Reliability standards are set by the states and territories. Reliability standards are also the basis for investment in the networks. If the leasing arrangements are pursued by governments, the new owners of the leases would be liable to meet existing reliability standards.

In 2005, the reliability standards in NSW were increased above the level required by most consumers for reliable supply. The high standards triggered the overinvestment by the networks in that state during the previous regulatory period (2009–2014), which ultimately led to the higher network costs.

The AEMC has recently completed a review of reliability standards in the National Electricity Market (NEM) which recommended that governments improve the transparency with which the standards are set. Additionally the AER has been tasked with determining the 'value customers place on reliability to inform reliability requirements for the five year regulatory cycle beginning 2019.'

The Commonwealth's Energy Green Paper recommends the establishment of a national advocacy body, Energy Consumers Australia to provide guidance to the AER on consumer preferences for reliability standards. The AER must be empowered to act on those preferences and ensure that governments do not increase standards beyond what consumers are willing to pay for.

Terms of Reference E

As highlighted above, we do not support Essential's WACC calculations and believe a WACC of 8.83% would only add to the already significant cost burden imposed on consumers by networks.

Again, we are concerned that the AER is not adequately resourced to effectively analyse the cost of capital requirements for the four distribution networks and two transmission networks it is concurrently assessing.

Terms of Reference F & G

Without an appropriate and responsive efficiency sharing mechanism, consumers may not realise any significant benefit from decreasing or modifying the pattern of energy consumption as networks will continue to recover the same revenue over the regulatory period.

The Australian Energy Regulator's Efficiency Benefits Sharing and the Demand Management Incentive schemes should be reviewed and updated to ensure that the benefits of consumers participating in demand management are shared and are not eroded by the networks revenue recovery process.

The Essential proposal seeks capex of $2.57 billion, much of which will be used to refurbish existing assets. According to Essential, around one-third of its customer base is in decline and one-third is increasing. Essential must be required to consider demand management options for these areas.

We understand the AER will be making changes to the Demand Management Incentive Scheme rules and principles as they are developed later in 2014.
We consider the onus should be placed on networks to demonstrate why demand management investments *should* be made, rather than placing that onus on demonstrating why demand management investments *should not* be made.

But importantly, we are concerned these changes will not occur in time to be incorporated into the current NSW network determination process, particularly as a draft decision is due at the end of November 2014. Similarly, we are concerned that any findings and recommendations from the Inquiry will come too late to be incorporated into the AER's final determination for Essential (and Endeavour, ActewAGL and Ausgrid) due on 30 April 2015.

Additionally, we support NSWIC's recommendation for a full review of the efficiency and usefulness of Essential's (and Ergon's) asset base. Any assets identified as idle or inefficient must be written down and retired from the asset base.

Terms of Reference H

Cotton Australia supports a simple and transparent NEM regulatory structure that supports and empowers consumers.
Recommendations for improvement are noted in this submission and include:

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- The AER must be appropriately resourced to ensure scrutiny of network revenue proposals, including developing consistent standards for investment and operating material provided by networks.
- Representatives from irrigated agriculture should be appointed to the national advocacy body Energy Consumers Australia.
    - The Energy Consumers Australia should be tasked with identifying consumer reliability needs by distribution feeders.
- Without an appropriate and responsive efficiency sharing mechanism, consumers may not realise any significant benefit from decreasing or modifying the pattern of energy consumption as networks will continue to recover the same revenue over the regulatory period. The AER should:
    - review the effectiveness Efficiency Benefit Sharing Scheme and Demand Management Incentive Schemes and ensure any changes are incorporated into the current network revenue determinations
    - ensure recommendations and findings from the Inquiry are incorporated into the current network revenue determinations.
- The COAG Energy Council's review of the effectiveness of the governance structure of the energy market should consider establishing the AER as its own statutory authority, separate to the ACCC.

Terms of Reference I

There are approximately 1.2 million photovoltaic systems installed on households in Australia, the likely result of generous feed-in tariffs and grants. In addition, the Grattan Institute estimates the energy used by these households is effectively being subsidised by households without photovoltaic systems by approximately $350 per year, as a result of the mismatch between the electricity generated by the photovoltaic system (daylight hours) and the peak in most households energy consumption (4.00–8.00pm).

Another concern is as high income households install solar technology and switch away from grid-supplied electricity, those customers remaining on the grid will face higher fixed prices as the network seeks to recover the allowed revenue from a smaller base. Commonly known as the death spiral, regional electricity consumers and communities are at significant risk as large consumers of electricity turn to alternative energy sources to minimise their electricity costs.

We recognise the immense value in renewable energy sources, particularly in regional Australia. We have previously advocated for the Government to prepare a report on demand and transmission line modelling of the regional network that includes options for investing in renewables, rather than grid supplied electricity. We are delighted that this work is being prepared by ARENA.

Cotton Australia looks forward to the findings of this Inquiry. Please do not hesitate to contact Michael Murray to discuss this submission in more detail, or if you would like Cotton Australia to present to the inquiry.

Yours faithfully

Michael Murray
Policy Manager

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