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Committee Secretary
Senate Select Committee on Electricity Prices
Parliament House
Canberra ACT 2600

By email: electricityprices.sen@aph.gov.au

Select Committee on Electricity Prices

Thank you for the opportunity to make a submission to the Select Committee on Electricity Prices.

Recommendation

CANEGROWERS seeks the introduction of an electricity pricing system and tariff structure that establishes efficient and prudent prices and requires network providers to achieve ongoing efficiency gains. Prices and tariffs should provide performance incentives, encouraging reductions in costs across the supply chain through both productivity gains and improved demand management. The establishment of efficient and prudent price signals will enable users to remain internationally competitive.

CANEGROWERS recommends the establishment of an integrated regulatory pricing framework.

Specifically, CANEGROWERS is calling for:

- Australian distribution network operators (i.e., Ergon and Energex in Queensland) to introduce network tariff structures for agriculture that recognise primary producer usage patterns (base load and during off-peak periods, principally for crop irrigation).
- A National Energy Framework that encourages
  - greater retail competition
  - cost reflective pricing of the Transmission / Distribution Use of Service TUOS and DUOS) charges for different consumer types.
- Better scope and scale of powers for the Australian Energy Regulator (AER) to determine regulated network prices based on its independent examination of the optimal level of network investment.
- The AER to apply binding productivity targets for distribution and transmission operators during its capital regulatory determination process.
- The AER and Australian Energy Market Commission (AEMC) to establish more appropriate standards for service delivery in regional Australia that reflects the needs of rural and regional communities.

Background

Sugarcane is Queensland's largest agricultural crop by volume and by value. Production is export focused. Prices for sugarcane are linked closely to the world determined raw sugar price. Of all agricultural commodities, the world sugar price is one of the most volatile. By way of illustration, in the twelve month period from mid- September 2011 to mid-September

2012, the world sugar price (as measured by the ICE11 October-12 raw sugar futures contract) has fallen 20%. In the same period, the Australia dollar has appreciated by 5%.

In the highly competitive world sugar market, prices are not determined on a regulated cost reflective basis. Cane growers and the sugar millers they supply do not have an ability to pass cost increases onto final consumers. Unless offsetting productivity gains can be achieved, all input price increases flow directly to the growers' bottom line, reducing income and profitability throughout the industry. This exacerbates the combined effect of the commodity price downturn and currency appreciation on producer incomes.

To enable electricity and water users to compete internationally it is important that regulated prices are set at the level that would result from the forces of a competitive market. Such a price outcome would be consistent with the Australian Government's agricultural policy and the Queensland Government's long term vision for agriculture in the state. The current network charges, reflecting the behaviour of a monopoly supplier, are far higher than the prices a competitive market would deliver.

Agricultural irrigation network tariffs

In Queensland, agricultural irrigation tariffs exist and are popular and well used. However as there is no underlying network tariff structure, the state regulator – the Queensland Competition Authority – describes the tariff structures as obsolete (in their methodology of a determined on a Network+Retail (N+R) cost build up basis). While this is an important issue for sugarcane irrigators in Queensland, it is also an important issue for all Australian agriculture.

Inclusion of a network tariff structure for agricultural irrigation purposes would recognise agriculture's role as a base load and off-peak electricity user and, in doing so, would provide an efficient price signalling mechanism for demand management. A worthwhile determination using peak and off-peak tariff structures could be created by removing the network charge during off-peak demand times when there is ample spare capacity.

Put simply, it is important that the price difference between peak and off peak periods is structured in a way that provides financial incentives for sugarcane growers and other businesses to move their energy use and network load from peak to off-peak periods. Without demand management, over time electricity use will concentrate in peak periods, increasing peak loads and with it accelerate the need for additional investment in generation and network capacity. Higher generation and network costs will follow, increasing upward pressure on prices in future periods from an already growing peak demand.

National Energy Framework

A National Energy Framework is needed to standardise the energy sector between the States. In competitive markets, prices are determined by the forces of both demand and supply, where there are a large numbers of competitors. Given the supply side technical constraints of electricity network and distribution, the market for energy must be structured appropriately.

CANEGROWERS supports efforts to encourage and foster competition in both the generation and retail sectors. However, the network and distribution businesses (still State owned in Queensland and New South Wales) should be recognised as natural monopolies and be allowed to operate as regulated natural monopolies with cost-reflective pricing structures to suit. As presently applied, the competitive neutrality constructs of the national competition policy framework systematically and unnecessarily adds to network costs.

In Queensland Ergon and Energex are able to finance their capital expenditure through the Queensland Treasury Corporation (QTC) at the State government's borrowing rate. However, in the name of competitive neutrality, QTC charges Ergon and Energex commercial rates for this finance. While QTC captures the margin, Energex and Ergon's financing charges are reflected in higher network costs and higher regulated electricity prices. These higher prices, in turn, produce higher profits which are paid to government. This phenomenon encourages State dividend payments. State owned energy companies have become sources of revenue for the States, away from their traditional role of service provision.

Applying principals of competitive neutrality to the operations of a natural monopoly increases cost and price structures, while generating significant revenue for government. It is important that the network price regulation framework takes account of the underlying market structure. Introducing a mechanism that requires independent assessment of the prudent and efficient level of network investment and establishing a cost reflective price path for a notionally optimised network structure would constrain the current rent seeking behaviour of the network suppliers.

The Australian Energy Regulator needs to be more than a rubber stamp

The way to achieve cost reflective pricing and remove monopolistic behaviour and "gold-plating" of network and distribution operators is through increasing the regulatory power of the AER. The most effective way to minimise the present systemic incentives for over-investment and establish efficient pricing boundaries, is for the AER to be given responsibility to determine network price structures that take account of both efficient network costs and efficient network demand management strategies.

For example, the retention of a tariff structure for agricultural irrigation would take account of both the base load nature of the activity and the importance of providing incentive to shift load to off-peak hours.

To contain capital cost structures and "gold-plating" the AER needs to be able to determine prices within a regulated framework that requires a rigorous assessment of the prudence and efficiency of investment in network structures and analysis of changing electricity market conditions (in terms of both electricity generation and consumption) and the cost of capital. This should take into account swings in demand such as those resulting from distributed power generation. At present, such changes result in a smaller base of demand to carry a higher cost of supply; in a competitive business this would never occur.

It is important that the calculation of the cost of capital take account of the environment in which assets were established. The AER's present practice of reviewing the Weighted Average Cost of Capital does not take account of the rapidly changing market environment and places high risk premiums on what are low risk investments, especially when made in a regulated price environment.

There is evidence that the AER's acceptance of network prices that fall within their acceptable guideline (the upper and lower bounds of the present network price framework) are less than efficient as the approval band is too broad. The upper-bound of the efficient price structure is in place to ensure that network charges do not result in electricity prices so expensive that users seek alternate sources of energy. In Queensland, the regulated electricity price increases over the last five years, driven by ever increasing network charges, has seen irrigators contemplate the conversion of their irrigation pumps from electricity to diesel as a means of avoiding widely anticipated future increases in electricity prices.

Continuing the current trajectory for electricity prices is unsustainable for agricultural irrigation users and many sectors of the Australian economy.

The emerging incentive for base load and off-peak electricity users such as for the application of agricultural irrigation water users will, in time, result in lower base load network use with minimal reduction on peak load demand. Under the current system ever increasing network costs will be borne by fewer users, resulting in higher network prices and creating greater incentives for others to switch to less efficient energy sources. The AER needs greater regulatory capacity to engage with industry groups to ensure these perverse outcomes do not occur.

An alternative approach is required

The current system provides few, if any, incentives to monopoly owned providers to find alternate and potentially more efficient methods to expand their networks. For example distributed generation options for the provision of electricity to rural and remote areas has not been pursued (there is no incentive for government owned entities to explore these potentially lower cost pathways). Unless alternatives to the current idea of network expansion are explored, higher consumer prices will follow.

Productivity targets

Agricultural industries are required to increase their productivity every time input prices go up to remain economically viable in a fiercely competitive world market. Regulated price structures in the electricity sector should face the same downwards pressure on operating costs as other competitive industries. This productivity target should be administered by AER at the start of every five year price determination. This must also be an integral part of a more rigorous regulatory framework that covers both network and retail sectors.

Operating without effective market disciplines, electricity network providers operate in isolation of their users. The supply-side focus is not tempered by the demand side incentives to drive efficiency gains or deliver productivity improvements. The present network pricings framework means all cost increases, whether the result of changing user needs or new regulatory demands, are passed through to consumers as higher network prices approved with little scrutiny by the AER.

The system needs change.

CANEGROWERS recommends the establishment of an integrated regulatory pricing framework that establishes efficient and prudent prices and requires network providers to achieve ongoing efficiency gains by discounting annual price increases by an amount equivalent to an annual productivity dividend.

Yours sincerely

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