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Professor Roy Green
Chairman
Queensland Competition Authority
Level 27, 145 Ann Street Brisbane QLD 4000

By email only: *electricity@qca.org.au*

Dear Professor Green,

CANEGROWERS response to QCA Draft Determination – Regulated retail electricity prices for 2016-17

Thank you for the opportunity to respond to QCA's regulated retail electricity price determination review for 2016–17.

Our interest and objectives in this matter

Electricity for irrigation use is a major cost for CANEGROWERS membership. Electricity retail prices that are excessive relative to costs of supply reduce our competitiveness and success as an industry. This in turn harms other businesses and communities across regional Queensland, reducing productivity, profitability, investment and economic growth.

Relevant criteria for assessing the Draft Determination

The *Electricity Act 1994* clearly sets out the requirements the QCA must meet in establishing notified retail prices:

(a) set a framework for all electricity industry participants that promotes efficient, economical and environmentally sound electricity supply and use; and
(b) regulate the electricity industry and electricity use; and
(c) establish a competitive electricity market in line with the national electricity industry reform process; and
(d) ensure that the interests of customers are protected; and
(e) take into account national competition policy requirements.

In addition, Section 90 (5) of the Electricity Act requires QCA to have regard, among other things, to the actual costs of making, producing or supplying the goods and services.

CANEGROWERS considers that the proposed increases in notified retail electricity prices for 2016-17 of between 10.3 and 11.5 per cent for transitional tariffs are not consistent with the requirements of the Act. The method adopted by the QCA in making its Draft Determination sets notified prices, including for obsolete and transitional tariffs, materially above the actual costs of making, producing or supplying electricity services in Ergon's retail market. With retail prices substantially above efficient costs, and in the absence of retail competition, substantial adverse economic efficiency, productivity and social impacts can be expected. These include suppression of demand and inefficient by-pass of the electricity grid.

Substantive issues that need to be addressed in the QCA's final determination are set out in the following sections.

Definition and setting of irrigation tariffs

CANEGROWERS supports retaining the transitional and obsolete tariffs (T62, T65 and T66) and is concerned that the proposed increases in regulated retail electricity prices for 2016-17 of between 10.3 and 11.5 per cent for these tariffs exacerbates an already unsustainable regulated price structure. The Draft Determination undermines the little remaining confidence irrigators have that the electricity pricing framework is delivering fair prices that are reflective of the true costs irrigators are placing on Ergon's distribution network.

QCA sought new information on whether QCA's proposed approach for transitional and obsolete tariffs is appropriate in the consultation paper issued at the commencement of its determination. In response, CANEGROWERS provided evidence (this evidence was also provided to Ergon, QPC and AER) that demonstrates irrigators should be treated as a separate customer class and the introduction of network tariffs that support continuing irrigation tariffs is consistent with national electricity rules. It is disappointing that QCA has not acknowledged this work, its consistency with the NER, or the consultations with Ergon and the AER presently underway.

Inappropriate definition of costs for calculation of the "R" component

QCA should set the "R" component of the retail price using the "R" related costs that apply in the Ergon retail market. For the reasons set out in the following sections, the two major "R" related costs (wholesale and retail) are substantially higher in the Energex market compared with the Ergon retail market.

Our understanding is that, unless existing legislation is changed following a review by the Queensland Productivity Commission, notified or regulated prices will apply only in Ergon retail markets. In the Energex retail market, retailers will set standing offer prices and the regulated prices determined by the QCA in its final determination will not in fact apply.

Against this development, in our view the purpose of Uniform Tariff Policy (UTP) in the future is to address equity issues arising from the fact the "N" component for Ergon is substantially higher than for Energex.[1]

In markets open to competition, it may be reasonable to set notified prices substantially above efficient supply costs. Under these conditions, "headroom" in regulated tariffs may encourage competition for the ultimate benefit of consumers. The available evidence is that customers are remarkably "sticky" due to high search costs and other factors. We understand the great majority of customers remain on regulated prices in the Energex network area many years after the introduction of competition. As the Ergon retail market is not open to competition and competition is unlikely to emerge, there is no case whatsoever for setting regulated retail prices above cost.

CANEGROWERS recommend that QCA set the "R" component of the retail price using the "R" related costs that apply in the Ergon retail market, <u>not</u> the Energex retail market.

Excessive allowances for wholesale costs

The QCA has substantially over-estimated the actual cost of supplying wholesale energy in the Ergon retail market. The method used by the QCA to estimate wholesale costs is not reliable or valid in terms of QCA's obligation to refer to the actual costs of making, producing or supplying electricity.

In the first place, for reasons set out in the previous section, QCA should adopt the Ergon net system load profile (NSLP) for estimating the wholesale cost component of notified prices for

[1] We understand that the UTP is also intended to support Ergon supply in remote and non-grid connected areas. Note 3 from the Ergon Annual Report indicates that most of the CSO relates to network charges (the 'N' component).

Ergon's retail market. This significantly reduces wholesale costs relative to the Draft Determination. This reduction is because the Energex NSLP has a lower load factor (it is "peakier"). In this regard, CANEGROWERS understand that, previously, issues around selection and definition of the load profile have gone to appeal and the QCA's original decision was overturned.[2]

QCA should review the effect of recent changes to the rules around generator rebidding recently finalised by the AEMC. These changes are in response to clear evidence that Queensland generators in particular took advantage of the previous rules around rebidding in order to exercise market power and increase wholesale energy prices, including a prudent allowance for energy trading risk. While the Queensland sector will remain concentrated, the AEMC adopted the rule change for rebidding on the basis that, overall, the additional costs from adopting the new rules would be exceeded by the benefits, in the form of lower wholesale prices than otherwise. Against this background, QCA needs to reconsider its implicit finding that the AEMC conclusions on this point are incorrect.

CANEGROWERS agree with the methodology for estimating prudential capital costs (or including them in the wholesale component). However, QCA should change the allowance for this component in its cost estimate. This is because the allowance incorporates and indeed magnifies the errors in the methodology for determining the efficient wholesale price identified above (incorrect NSLP and incorporating excess generator profits attributable to rebidding).

QCA should reduce the allowance for LRET to reflect efficient costs of producing large scale renewable energy. The Draft Determination adopts a market based approach to estimate LRET costs. Due to the current "hiatus" in renewable energy project construction, recent LRET market prices do not reflect the actual cost of producing renewable energy. Instead, they reflect the post-tax effect of the penalty applicable to liable entities that fail to meet their renewable energy obligations.[3] If retailers are allowed to pass through almost in full the costs of failing to meet their LRET obligations, this further weakens incentives for retailers to procure sufficient LRET certificates or physical output and hence undermines the integrity of LRET. The Draft Determination undermines the integrity of the LRET and this is inconsistent with the relevant statutory criteria.

CANEGROWERS recommend that QCA reviews and substantially reduces its estimates of wholesale costs in its final determination.

Excessive allowances for retailer costs

The proposed allowance for retailer costs in the draft determination is excessive. The previous methodology for setting retailer costs was already flawed and yielded an excessive allowance. The approach, for example, ignored market consolidation, increased automation and outsourcing. The available evidence indicates substantial reductions in retailer costs due to a combination of modern customer information and billing systems and economies of scope and scale. In other words, the QCA's current allowance for retailer costs already exceeds efficient costs.

The previous QCA methodology can be traced to the methodology applied by IPART in its 2008 determination. Since that time, there has been substantial industry consolidation with three major dual fuel (gas and electricity) and vertically integrated retailers (sometimes called 'gentailers') replacing the multitude of smaller single fuel retailers in 2008. All major retailers

[2] See AGL Energy Ltd v Queensland Competition Authority & Anor; Origin Energy Retail Ltd v Queensland Competition Authority & Anor (No 2) [2009] QSC 116
http://archive.sclqld.org.au/qjudgment/2009/QSC09-116.pdf
[3] This is because penalties are not tax-deductible for liable entities.

have made substantial investments in integrated customer information systems replacing multiple legacy systems. They have also outsourced key activities to lower cost jurisdictions.

As the QCA is aware, network prices have more than doubled over the last seven years. Under the previous QCA methodology, the increase in network costs was incorporated into an allowance for retail operating margins and hence added on to the cost base. However, the only impact of rising network prices relates to working capital costs, due to the lag between payments to networks and receipts from customers. Working capital is, however, a small portion of the retailer costs that need to be recovered from retail operating margins. Overall retailer costs are not scaling with rising network costs.

The market "benchmark" methodology now adopted by the QCA no longer seeks to estimate efficient retailer operating costs but simply estimates total retailer cost (exclusive of prudential capital costs). We understand this benchmark is based on deriving retailer costs by starting with price observations from across the NEM for market and standing contracts, and then deducting non-retailer costs to arrive at a total residual retailer cost.

The market benchmark incorporates substantial competition related costs (previously referred to as customer acquisition and retention costs) that simply are not incurred in Ergon's retail markets where Ergon retail has an effective retail monopoly.

For these reasons, the market benchmark incorporates substantial excess cost recovery in some NEM retail markets, especially Victoria, South Australia and regional NSW. In its first national review of the effectiveness of retail competition, for example, the AEMC concluded that Victorian retail prices substantially exceeded prices in other markets, when normalised for differences observable in supply costs. While concluding that retail competition was effective, it did not entertain the possibility that retail prices incorporated excess cost recovery, reflecting the existence of market power on the part of retailers.

As pointed out by the CEO of Victoria's Essential Services Commission (ESC), the AEMC findings are not evidence based.[4] Indeed, several public and private studies, including those produced by the ESC, have produced clear evidence that Victorian retail margins exceed those in other markets.[5] In its most recent Issues Paper for its current retail review, the AEMC no longer addresses retailer margins.[6] Given the balance of evidence, there is no basis for the QCA to conclude that the market benchmarks it is using reflect efficient costs in Ergon retail markets.

CANEGROWERS recommend that QCA reviews and substantially reduces its estimates of retailer costs in its final determination.

<u>Network prices</u>

While outside the scope of the present process, CANEGROWERS is concerned that the draft determination materially magnifies efficiency and equity problems caused by previous excess investment and poor risk management leading to excessive regulated network costs. Our members have not contributed to the factors that are driving rising network costs. We are

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[4] Dr Ron Ben-David, *If the retail energy market is competitive then is Lara Bingle a Russian cosmonaut?* Essential Services Commission, June 2015.
[5] Carbon and energy markets, *A critique of the Victorian retail electricity market - A report for the Brotherhood of St Laurence*, June 2015.
Gavin Dufty & May Mauseth Johnston, *The National Energy Market – Still winging it, Observations from the Vinnies' Tariff Tracking Project*, St Vincent de Paul Society, Victoria, September 2015.
Essential Services Commission, Retailer Margins in Victoria's Electricity Market — Discussion Paper, May 2013
SKA-MMA, Analysis of Electricity Retail Prices and Retail Margins 2006 - 2012 Report For Essential Services Commission May 2013.
[6] See page 16 of the AMEC's *Approach Paper, 2016 Retail Competition Review*, 22 October 2016.

pursuing the issue of network costs with Ergon itself and in other forums. We are concerned the draft determination will exacerbate these adverse cost drivers.

Overall implications of draft determination

In combination, the evidence set out above leads to the conclusion that the QCA's draft determination proposes to set notified retail prices substantially above efficient "R" costs for the Ergon retail market. The QCA seems to be systematically favouring suppliers over customers. This is clearly contrary to the QCA's obligations regarding the promotion of economic efficiency, protection of consumer interests and reference to the actual costs of making, producing or supplying the goods and services.

If retail prices are set substantially above efficient costs, and in the absence of retail competition, substantial adverse economic efficiency, productivity and social impacts can be expected. These include suppression of demand and inefficient by-pass of the electricity grid.

In its Draft Determination, the QCA states that the widespread adoption of solar PV has the effect of increasing network and wholesale costs, because it reduces load factors (for both generation and networks). If this were so, then a QCA decision to set notified prices in excess of efficient costs will materially contribute to further increases in network and wholesale costs in the future.

According to Andrew Cappello, Chairman of Mackay Sugar Ltd and Chairman of Pioneer Valley Water Co-operative Limited (PVWater), "The correlation between declining water use and increasing electricity price is direct and incontrovertible."

With only 95mm of rainfall registered, the December quarter 2014 was one of the driest periods in Mackay for more than 10 years. Despite this three month growing period being critical for crop yield, irrigation water use in the Pioneer River Water Supply Scheme was 40% lower than for the same period in 2001/02 when 176mm was recorded. The average electricity cost of pumping in the scheme is now $31.90/ML in 2016, an increase of 154 per cent over the period.

Irrigators' demand for electricity and use of the Ergon network has not increased since the completion of Paradise Dam in Bundaberg in 2005. Paradise Dam added 120GL of medium priority water for irrigation in the Bundaberg Regional Irrigation Scheme, of which just 20GL has been allocated for irrigation. Since 2005 electricity prices faced by irrigators have increased by more than 100 per cent compounded.

We recommend that QCA reviews and substantially reduces notified retail prices, in its final determination, to take into account the adverse economic and social effects of setting regulated prices well above cost.

Conclusion

CANEGROWERS urges the QCA to review its draft determination in light of the evidence presented in this submission that demonstrates the proposed notified prices are excessive and do not meet the statutory criteria. If the notified prices contained in the final determination do not conform with the statutory criteria, CANEGROWERS, as part of our broader campaign to secure lower and more sustainable electricity prices, may consider working with other Queensland and national consumer interests, and organisations, to launch a legal appeal against the final determination.

CANEGROWERS would like to have the opportunity to set out the issues above more extensively, and to marshal and record the supporting evidence more fully. We would welcome further opportunity to discuss our concerns in the period before the QCA releases its final determination.

CANEGROWERS recommend that QCA reviews and substantially reduces notified retail prices, in its final determination.

Yours sincerely

Dan Galligan
Chief Executive Officer