Submission to the Queensland Competition Authority

Draft Determination Regulated Retail Electricity Prices 2013-14

March, 2013

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Cotton Australia

Cotton Australia is the key representative body for the Australian cotton growing industry. It helps the industry to work together to be world competitive and sustainable, and also tell the good news about the industry's achievements. Cotton Australia determines and drives the industry's strategic direction, retaining its strong focus on R&D, promoting the value of the industry, reporting on its environmental credibility, and implementing policy objectives in consultation with its stakeholders.

Cotton Australia works to ensure an environment conducive to efficient and sustainable cotton production. It has a key role in Best Management Practices (myBMP), an environmental management program for growers. This work has seen a significant improvement in the environmental performance of the industry, with huge improvements in water use efficiency, significant reductions in pesticide use, and millions of dollars invested into R&D.

The Australian cotton industry directly employs thousands of Australian's and this year will contribute over $1 billion to the Queensland economy.

Cotton Australia welcomes the opportunity to provide this submission to the Queensland Competition Authority's (QCA) on its *Draft Determination - Regulated Retail Electricity Prices 2013-14*.

Cotton Australia is a member of the Queensland Farmers Federation (QFF).

Cotton Australia is aware that QFF will also be making a submission on this Draft Determination, and while Cotton Australia is confident that this submission will reflect the views of QFF, if there is any divergence of views expressed then Cotton Australia's position is the one outlined in this paper.

For further information on this submission please contact Cotton Australia's Queensland Policy Manager Michael Murray – 0427 707 868 or michaelm@cotton.org.au .

Recommendations

1. **That the QCA recommend to the State Government that it should call for a thorough, joint Federal/State Review of the electricity pricing framework.**

2. **QCA undertake a robust analysis of the impact on price increases on the business profitability of business electricity users, and the analysis includes the effect of all State controlled price increases.**

3. **That the Queensland Government instructs the QCA to fully investigate the true cost differential between peak and off-peak electricity supply, and establish tariffs which reflect these true differentials.**

4. **That QCA adopt the use of a12-year Transition period based on the ATO's determination of the estimated life of irrigation infrastructure.**

5. **That the QCA, electricity suppliers and irrigators develop tariffs attractive to "large" users, whose primary use of electricity is to pump available riverflows when they occur, acknowledging that these flows are both intermittent and unpredictable in nature.**

6. **That the QCA removes the "headroom" allowance from its pricing recommendations, as it is a flawed and "dishonest" pathway towards improved competition.**

7. **That the QCA recommend that the Queensland Government redirect its current subsidy payment from Ergon Retail to Ergon Network, as a cost neutral way of encouraging competition within the Ergon area at a retail level.**

8. **QCA removes the escalation charge for 2013-14, and prior to the next electricity price setting thoroughly models the impact of increase prices on business profitability, and user behaviour when faced with increased charges, and take into account those finding when next considering the implementation of "escalation".**

9. **That the QCA recommends to the Queensland Government that existing business deemed either as "Very Large" customers, or those that may one day be categorised as 'Very-Large" customers continue to be able to access "Non-Site Specific" Network charges, this would not limit the option of offering "Site Specific" network charges.**

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General Comments

Cotton Australia calls on the Queensland Competition Authority (QCA), the Queensland Government and the Australian Government to publicly acknowledge that something is very wrong with the pricing of electricity, when prices year-on-year increase at a rate that is many times greater than the cost of inflation.

Irrigation tariffs in 2013-14 are facing increases of 17.5% this coming financial year, for the current financial year it was 10%, 2012 7%, 2011, 13% and 2010 16%, while during this whole period annual inflation rates did not exceed 3%.

Cotton Australia acknowledges the limited scope the QCA has in determining retail tariffs, including its requirement to “pass through” the network charges, but strongly urges it to note in its final report any concerns it has about the price determination for the “N” component, and make recommendations on how these concerns can be addressed.

Further, while the QCA may be oblige to determine “cost reflective” pricing and tariff structures; it should also be acutely aware of the impact of its pricing recommendations on the viability of businesses and the communities they support.

Cotton Australia’s primary concerns with the draft recommendation on electricity prices can be summarised as follows:

- The cumulative increases in irrigation tariffs between 2000 and 2013 of around 260% are not sustainable, and will only be further exacerbated by a 2014 increase of 17.5%, and expected future increase of the same order, as prices march towards “cost reflectivity.
- The QCA’s modelling of the impact of the recommended price increases has been totally inadequate.
- There is no incentive in the non-obsolete tariffs to encourage off-peak, despite the fact that many irrigators have designed and installed their systems to maximise the use of off-peak power.
- While the recognition of a seven-year transitional period at least demonstrates that the QCA has some appreciation of the potential impact of tariff reform, seven years is entirely inadequate given the effective service life of equipment that has been invested in to best much the tariff structures that were available at the time of installation.
- Regardless of the transition period, any move to force “large” irrigation customers onto demand charges, will simply force those users “off the grid” and have them adopt alternative energy sources, leading to “stranded” electricity supply assets.

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- The inclusion of a "headroom" allowance in Ergon area defies rational explanation, and undermines the intent of the Universal Tariff Policy and should be scrapped. It is an unjustifiable 5% impost.
- A more effective way to foster completion would be to direct the current government subsidy from Ergon retail, to Ergon network, which would give other retailers the opportunity to compete.
- The inclusion of an "escalation" component of 25%, to encourage transition from obsolete tariffs is unjustified, and in fact will only lead to unsustainable electricity prices, resulting in irrigation users swapping to alternative energy sources and causing the "stranding" of electricity supply assets.
- If adopted "Site-Specific" charges for Very Large customers will make regional cotton gins completely uneconomic, putting the industry's $1 Billion contribution to the Queensland economy at risk.

Each of the above "Bullet Points" are addressed in further detail below

- ***The cumulative increases in irrigation tariffs between 2000 and 2013 of around 260% are not sustainable, and will only be further exacerbated by a 2014 increase of 17.5%, and expected future increase of the same order, as prices march towards "cost reflectivity.***

While Cotton Australia notes that the QCA's task is to recommend "cost reflective" tariffs and transitional arrangements, it strongly urges QCA to make comment on the failures of a system that delivers cost increases far in excess of CPI year, on year, on year.

While QCA may have no choice to pass through Network costs, which are regulated by the Australian Energy Regulator, it is almost beyond believe that electricity consumers should wear the cost of failure to correctly match demand with infrastructure capital expenditure, and a decision to apply a return on capital of 9.83%. This simple rewards poor planning at the cost of consumers.

Electricity consumers, including irrigators, are wearing the cost of systemic failure in the electricity price mechanism. If an irrigator, producing peanuts for instance, produces more peanuts than the market can bear, then the irrigator will bear the cost through greatly reduced returns on his or her product. If a housing developer builds more houses than the market can bear, then the developer will bear the cost by either not being able to sell the house or only being able to sell them at a discounted prices, but in the electricity industry failure to match demand, with the distribution system, sees the loss borne by the consumer.

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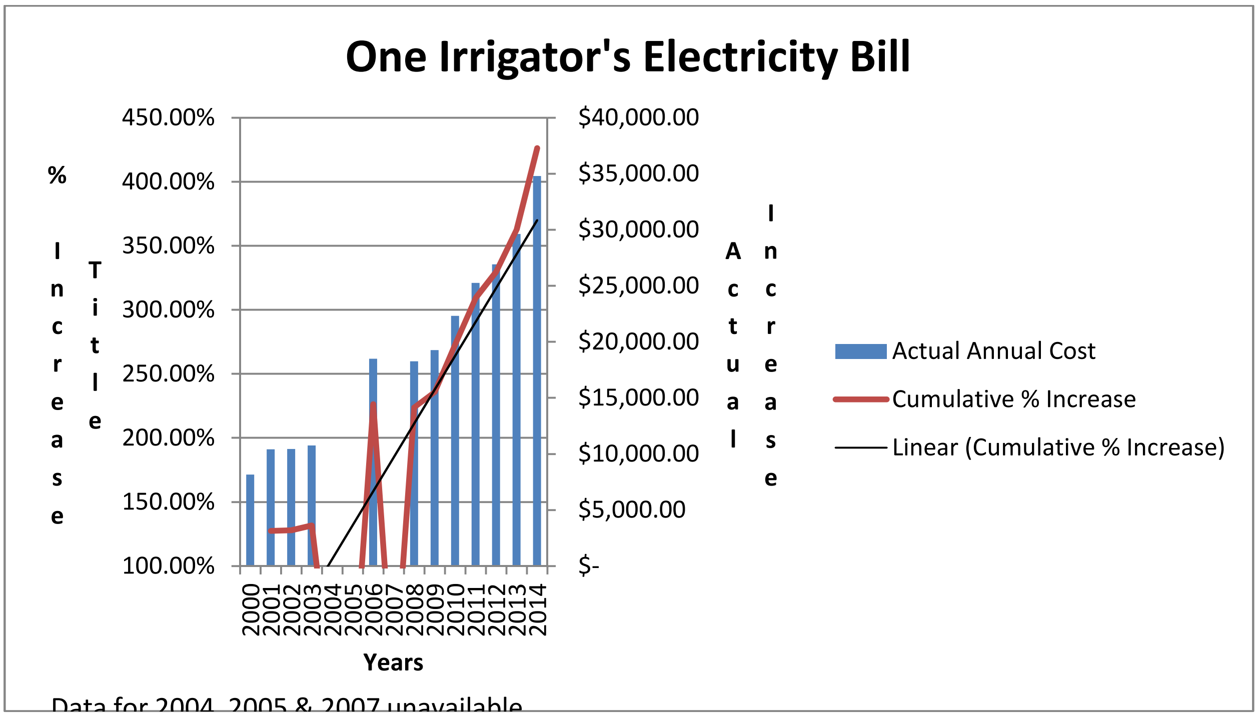
For the cotton industry we have seen power bills increased in the order of 350% since 2000. Graph 1 illustrates the effect of electricity price on one grower in the Emerald district. It should be noted that this graph reflects cost of a particular quarter's bill in 2000, extrapolated using the Tariff prices for the particular year, multiplied by the usage experienced in that quarter in 2000.

Graph 1



Graph 2 shows the average price of cotton per bales since 1990, and clearly demonstrates that apart from a couple of significant spikes, cotton values have held within a very narrow band, and there has only been a very slight upward trend in the price.

It will be impossible for the cotton industry to continue to electricity price increases at rates that both far exceed inflation and increase in product price.

Cotton producers will have little choice but to either cease production or source cheaper forms of energy, which will only exacerbate the problem for remaining electricity users as costs will have to be recovered from fewer users.

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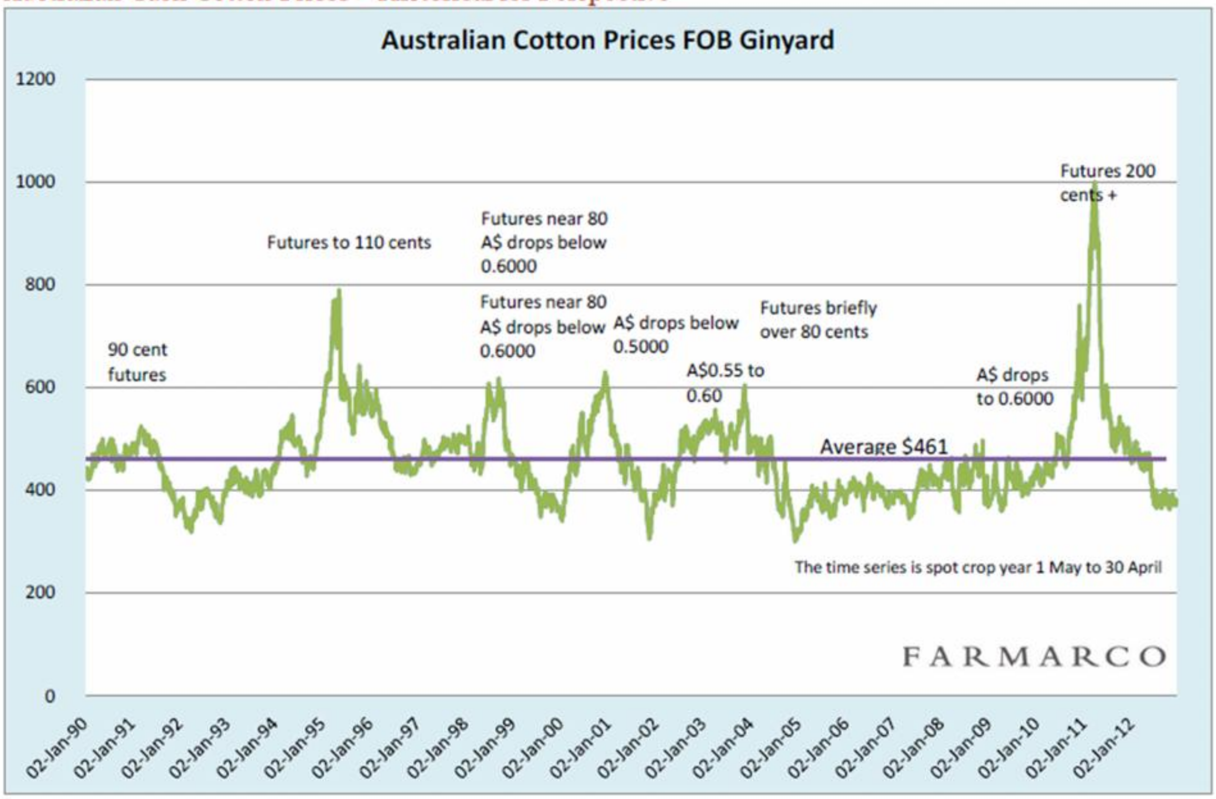
Graph 2

Australian Cash Cotton Prices – Historical for Perspective



Recommendation 1: That the QCA recommend to the State Government that it should call for a thorough, joint Federal/State Review of the electricity pricing framework.

- ***The QCA's modelling of the impact of the recommended price increases has been totally inadequate.***

It appears to Cotton Australia that the QCA's modelling of the impact on recommended prices is inadequate as Section 7.4 fails to address the impacts felt by customers using the popular farming and irrigation tariffs.

While some data is included in the Appendix C, nothing has been provided to put the significant price increases in context in terms of their impact on profitability.

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It is not uncommon for some of our growers to have annual electricity bills in excess of $100,000, and 17.5% increases may well be the difference between a profitable and unprofitable business.

If QCA is to take into account the financial impact on electricity users, then for business customers, it must consider the likely impact on profitability. The measure should also be cumulative, taking into account the impact of other State Government controlled services such as SunWater water delivery charges.

Recommendation 2: QCA undertake a robust analysis of the impact on price increases on the business profitability of business electricity users, and the analysis includes the effect of all State controlled price increases.

- ***There is no incentive in the non-obsolete tariffs to encourage off-peak, despite the fact that many irrigators have designed and installed their systems to maximise the use of off-peak power.***

Cotton Australia is very disappointed in the lack of incentive for off-peak use in the non-obsolete tariffs that QCA is recommending users to transition to.

Cotton Australia detailed in its previous submission to this inquiry the three broad use patterns of cotton irrigators reliant on electricity.

A large number of cotton irrigators have designed, invested in and installed irrigation systems with the express purpose of maximising use of off-peak or shoulder electricity.

This means that have built machines with larger deliver capacity, than what would be required if the plan was to pump 24 hours per day.

For decades electricity users have been encouraged to support-off peak, and it certainly makes sense that there should be a considerable difference in network costs between peak and off-peak, particularly when the electricity industry strongly argues that a high percentage of network charges result from the expectation that the industry can meet extreme peak demand.

It is clearly the case that the 'extreme peak" demand would even be higher if irrigators currently using off-peak migrate to peak.

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The recommended differential of less than 4 cents/kw (Tariff 22), simply is inadequate to encourage off-peak use, and Cotton Australia strongly believes that it is not cost reflective.

Recommendation 3: That the Queensland Government instructs the QCA to fully investigate the true cost differential between peak and off-peak electricity supply, and establish tariffs which reflect these true differentials.

- ***While the recognition of a seven-year transitional period at least demonstrates that the QCA has some appreciation of the potential impact of tariff reform, seven years is entirely inadequate given the effective service life of equipment that has been invested in to best much the tariff structures that were available at the time of installation.***

Cotton Australia recognises that it is a difficult task to set a robust transition time-frame. In our previous submission Cotton Australia argued for a 20-year transition period as it roughly reflected the likely effective life of electrical pumping infrastructure. Others argued for the Australian Tax Office (ATO) depreciation period of 12 years, and QCA while accepting this argument as valid chose to discount it to seven-years, on the basis that most of the installed infrastructure would have used up some of it ATO determined life.

It is clear that determining a reasonable life will not be precise, but Cotton Australia strongly urges the QCA to adopt the ATO measure as it is a mid-point between the real expect life of the infrastructure (used by irrigators when assessing their investment – 20 years), and the partly written-off life adopted by QCA in this draft recommendation.

The truth of the matter is most irrigation infrastructure will still have an effective life well in excess of 12-years, but Cotton Australia is prepared to concede that using the ATO figure is transparent and relatively robust.

Recommendation 4: That QCA adopt the use of a12-year Transition period based on the ATO's determination of the estimated life of irrigation infrastructure.

- ***Regardless of the transition period, any move to force "large" irrigation customers onto demand charges, will simply force those users "off the grid" and have them adopt alternative energy sources, leading to "stranded" electricity supply assets.***

Cotton Australia's previous submission provided significant detail on the impact of "large" users being force from their existing irrigation and farming tariffs, to tariffs 44, 45, and 46.

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In almost all cases examined and included in our previous submission, the adoption of demand based tariffs would see an immediate escalation in electricity costs of between 200% and 300%.

If forced on irrigators they will have no choice but to immediately transition to other, off-grid energy sources, not only at a significant cost to themselves, but at a cost to the energy suppliers and distributors as they will be left holding "stranded assets".

There appears to be a view within the QCA that the impact will not lead to an exodus off the grid, but Cotton Australia is not exaggerating when it claims that that is what will happen.

The intermittent and unpredictable nature of electricity use by most "large" irrigation users may make them unattractive customers to the electricity industry, but if this industry wants to get a return from its existing investments in servicing these customers then they and the QCA must develop a tariff structure that meets both the needs of "large" irrigation users and the energy industry.

Recommendation 5: That the QCA, electricity suppliers and irrigators develop tariffs attractive to "large" users, whose primary use of electricity is to pump available river flows when they occur, acknowledging that these flows are both intermittent and unpredictable in nature.

- ***The inclusion of a "headroom" allowance in Ergon area defies rational explanation, and undermines the intent of the Universal Tariff Policy and should be scrapped. It is an unjustifiable 5% impost.***

The inclusion of the 5% "headroom" allowance in the Ergon area, to encourage competition, appears to be nothing more than a 5% "free-kick" to Ergon. The reality is that the nature of the Universal Tariff Policy makes it highly unlikely that the Ergon area will be attractive to competition and consumers even with a 5% "headroom" allowance. That being the case, it will fail to deliver competition, but will provide Ergon with a "bonus" and unjustifiable extra profit margin.

The concept of providing a "headroom" allowance to stimulate competition appears dubious in any jurisdiction. Basically the argument appears to be – "Let's artificially inflate prices, that will attract competitors to the business, they will then offer discounts on the artificially inflated prices to attract customers, the customers will then enjoy the benefit of competition, by receiving discounted prices – which still maybe higher than if the "headroom" allowance was not applied."

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This is just another form of a consumer store, inflating prices prior to having a discounted “sale”, where consumers are effectively duped into paying full price. Such actions should be and are roundly condemned, as should be the QCA “headroom” allowance.

Recommendation 6: That the QCA removes the “headroom” allowance from its pricing recommendations, as it is a flawed and “dishonest” pathway towards improved competition.

- ***A more effective way to foster completion would be to direct the current government subsidy from Ergon retail, to Ergon network, which would give other retailers the opportunity to compete.***

If QCA sees merit in attempting to foster competition within the Ergon area, while maintaining the benefits of the Universal Tariff Policy, then it should recommend that the current Queensland Government subsidy paid to Ergon Retail, be redirected to Ergon Network.

This would remove the competitive advantage Ergon retail gets from receiving the subsidy, and provide a more level playing field for retail competitors.

Recommendation 7: That the QCA recommend that the Queensland Government redirect its current subsidy payment from Ergon Retail to Ergon Network, as a cost neutral way of encouraging competition within the Ergon area at a retail level.

- ***The inclusion of an “escalation” component of 25%, to encourage transition from obsolete tariffs is unjustified, and in fact will only lead to unsustainable electricity prices, resulting in irrigation users swapping to alternative energy sources and causing the “stranding” of electricity supply assets.***

Cotton Australia strongly opposes the inclusion of the 3.5% “escalation” charge, which accounts for approximately 25% of the proposed increase of 17.5% for most of the tariffs used by irrigation and farming customers.

It appears to be a very cruel and blunt instrument, given the massive 17.5% proposed increase on top of the previous year’s increases that have been detailed in this submission.

Cotton Australia strongly argues that an adoption of the escalation charge will only encourage irrigators to go off-grid sooner, and as such believe its introduction will be counter-productive and rather than help meet cost reflectivity, will make it harder for suppliers to recover costs because consumption will drop further.

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Recommendation 8: QCA removes the escalation charge for 2013-14, and prior to the next electricity price setting thoroughly models the impact of increase prices on business profitability, and user behaviour when faced with increased charges, and take into account those finding when next considering the implementation of "escalation".

- ***If adopted "Site-Specific" charges for Very Large customers will make regional cotton gins completely uneconomic, putting the industry's $1 Billion contribution to the Queensland economy at risk.***

Cotton Australia is very concerned that if the concept of "Site-Specific" network charges are adopted for "Very Large" customers, it will have a disastrous impact on a number of regional business, that must be located where they are to service particular industries.

One cotton ginning company operating in south-west Queensland has received the following advice from Ergon estimating the likely cost impact on site-specific network charges for four of its sites – **Table 1**:

Table 1

Gins	Current Retail Tariff	Forecast 2012-13 Bill (Current Tariff)	Forecast 2012-13 Bill (Site Specific Tariff)	Change in Bill	% Increase
1	48	$600,411	$1,202,162	$601,750	110
2	48	$588,864	$1,445,070	$856,206	145
3	48	$271,882	$819,422	$547,540	201
4	48	$554,198	$1,387,192	$832,994	150

As can been seen in the above table increases of between 100% and 200% are expected, and these will be unsustainable for these established industries that play a pivotal role in supporting the Queensland cotton industry.

While the opportunity to access "Site Specific" network charge might be justified, particularly for new or expanding businesses, access to a Universal Tariff must be maintained for regional Queensland so businesses are not deterred from servicing regional and remote Queensland.

Once again it must be recognised that business have been invested in on the basis of the tariff structure of the day, and it would be grossly unfair to change the tariff structure after the decision to invest has been made.

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Further, in the case of cotton gins, the ginners would have little option but to pass costs back to growers, or are already struggling under the excessive electricity price increases that have been imposed on them over the past decade, and based on QCA's recommendations will continue to increase at a rate vastly in excess of inflation.

Recommendation 9: That the QCA recommends to the Queensland Government that existing business deemed either as "Very Large" customers, or those that may one day be categorised as 'Very-Large" customers continue to be able to access "Non-Site Specific" Network charges, this would not limit the option of offering "Site Specific" network charges.

ends

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