the Australian Sugar Industry Alliance

Submission to

Queensland Competition Authority

Interim Consultation Paper

Regulated Retail Electricity Prices for 2015-16

Executive Summary 2

Executive Summary 2

1. Introduction 4

2. The current situation 5

2.1. Sugar millers 6

2.2. Cane growers 7

3. Our understanding of QCA's proposals 9

3.1. Sugar millers 9

3.2. Cane growers 9

4. Our concerns 11

4.1. Sugar millers 11

4.1.1. Our tariffs are already too high 11

4.1.2. Tariff 48 applied to our members will result in indefensible price increases 12

4.1.3. Escalation of Tariff 22 (Large) as part of transition to Tariff 48 is unacceptable 13

4.2. Cane growers 14

4.2.1. Our tariffs are already too high 14

4.2.2. Escalation of Tariffs 62 and 65 as part of transition to Tariff 22 is unacceptable 14

4.3. Common concerns and way forward 14

5. Next steps 17

Executive Summary

The Australian Sugar Industry Alliance (ASA) has developed this submission in response to the Queensland Competition Authority's (QCA) proposed approach determining electricity prices for regional Queensland in in 2015-2016. Advice developed for CANEGROWERS and ASMC, as prepared by CME, is used to inform this submission.

Regional Queensland is prescribed to an outdated model of supplying electricity, using one of the most technically and economically inefficient distribution networks in Australia: technically inefficient, as electricity is sent from one end of the state to the other with significant losses; and economically inefficient as the high operating costs are disproportionate to the low cost technology and comparable networks around Australia. For the sugar industry, the results are increasingly retarding industry productivity. Sugar mills pay more than twice the price, per kilowatt hour (KWh), compared with similar scale users in Victoria. Queensland cane farmers are paying between 23-25.5 cents per KWh – and are increasingly unable to afford the cost of irrigating their crop. These concerns are not unique to the sugar industry – and are particularly common for agriculture across similar tariffs. The transactional cost of business in regional Queensland is increasingly uncompetitive with the rest of Australia.

The proposed methodology for price determination by QCA will inevitably lead to further price escalation, as QCA progresses towards a "Network + Retail" pricing methodology, and migrates both sugar mills and irrigators towards higher cost tariffs. This is the fundamental issue. Basing a pricing methodology on an uncompetitive, inefficient network with opaque costs is not an equitable cost recovery model. Through this paper, ASA demonstrates that:

Ergon is a profit-maximising corporation

Ergon is able to improve its profits by increasing the CSO payment it receives.

A large part of the CSO payment is based on the difference between Ergon and Energex's network tariffs.

Ergon has an incentive to increase the network tariffs for those consumers connected to its network who pay tariffs based on Energex's network service charges. This is because

Ergon's tariffs do not actually affect the prices that these customers pay, but they do affect the level of the CSO.

ASA is seeking structural reform of the pricing approach to electricity in regional Queensland. In the short term, this must take the form of price relief – but the longer term requires the redesign of Ergon tariffs. ASA recommends establishing a working group with Ergon, CANEGROWERS and ASMC to establish agreed positions on the reduction of tariffs, and ultimately tariff redesign. This submission is just the first of many necessary steps towards equitable electricity pricing for regional Queensland.

1. Introduction

This document is the Australian Sugar Industry Alliance (ASA) submission to the Queensland Competition Authority's Interim Consultation Paper in respect of regulated retail electricity prices for 2015/16.

The Australian Sugar Industry Alliance (ASA) was formed in 2007 to bring together supply chain participants on whole of industry matters. Founding members CANEGROWERS, representing some 80 per cent of the 4,000 Australian sugarcane farmers, and Australian Sugar Milling Council, representing 95 per cent of raw sugar production and 100 per cent of Australian raw sugar exports, recognised the need for collaborative efforts in research, development and extension (RD&E), trade liberalisation, environmental and resource management programs, and community engagement. Sugarcane production and processing is the lifeblood of many regional towns and communities along the east coast of Australia from northern New South Wales to Far North Queensland.

Section 2 outlines the current situation in terms of the electricity consumption and prices of our members. Section 3 summarises the ASA understanding of the proposals set out in the Interim Consultation Paper. Finally, Section 4 sets out concerns specific to cane growers, sugar millers, and concerns common to both. The submission concludes with suggestions for QCA action.

The information and analysis cited in this submission draws on the report "Advice to CANEGROWERS and the Australian Sugar Milling Council on Ergon electricity tariff issues" prepared by Carbon and Energy Markets (CME) for us. A copy of that report is provided at Attachment 1.

2. The current situation

The Queensland Competition Authority (QCA) is once again investigating the price determination for retail electricity pricing. This year, however, there is a notable difference. For the first time, south east Queensland will not be part of this determination – limiting the uniform retail tariff to a significantly smaller pool of electricity users. This 'pool', QCA claims are Queensland's 'highest cost users'- rural and regional Queensland.

The current methodology for price determination continues to reward the outdated model of supplying regional Queensland through a ribbon network. That is, transporting generation from one end of the state to the other, with an inflated overbuild of network assets to transport electricity. Yet clearly Ergon has more recently identified that not only is this model not sustainable, but that it will be cheaper for the average Ergon customer to disconnect from the grid and supply their own electricity with solar PV and storage by 2020. Consequently, existing price determination methodology treats this likely outcome as a threat to the network profit model, increasing the fixed price component, simultaneously discarding incentives for customer, and critically, network efficiency. As it exists, the price determination pathway will punish Queenslanders for living in regional Queensland.

The Ergon network has been found by the Independent Review Panel on Network Costs (2012) to be inefficient, with: poor management of overhead costs; higher capital expenditure per customer for comparative customer density compared with interstate services; and higher than efficient levels of operating expenditure ("among the least efficient" of service providers nationally). Ergon's network charges relative to average have increased by over 60% from 2010/11 to 2013/14 compared with all other Australian networks.[1]

Rewarding these commercial failings is profoundly impacting the cost of living – and the transactional cost of doing business - in regional Queensland. The Community Service

[1] Productivity Commission. 2013. Electricity Network Regulatory Frameworks

Obligations (CSOs) paid to Ergon, to moderate the electricity price differential between regional and south east Queensland electricity prices, are held up as a 'subsidy' to regional Queensland, intended to stifle further questioning of the preferred approach of QCA.

QCA makes reference in its discussion paper to national competition policy as part of its legislative requirements. Yet there is significant evidence, as presented in the 2013 *Productivity Commission Inquiry into Electricity Network Regulatory Frameworks*, that government owned network services have an uncompetitive advantage as a result of their structure, which network operators appear to actively preserve. This translates as additional cost to their customer base. Ergon is identified as one of these networks.

The "uniqueness" of Queensland's regional distributional service is not an excuse for lesser scrutiny of its costings and operation. It has been argued in recent price determination exercises that QCA, Ergon and the Queensland Government are limited by the decision making of the Australian Energy Regulator (AER). ASA contests this view, recognising that the AER sets maximum pricing arrangements; other Australian state governments have opted to receive less than the maximum possible revenue.

Arguably, there is no more important time to scrutinise Ergon's operation than when considering its price component in a price determination. The remainder of this paper is intended to start that scrutiny, by consideration of Ergon's tariff structure in relation to Queensland sugar millers and irrigation users.

2.1. Sugar millers

Most sugar millers purchase electricity on Tariff 22 (Large), a transitional tariff. A small number are on market contracts or Tariff 48.

In order to develop our advocacy of member interests on tariff issues, we have analysed the consumption and prices of those of our members on Tariff 22 (Large). In particular we have obtained monthly peak demand and annual consumption data for 15 sugar miller sites. We have processed these data to obtain information on consumption and prices. Relevant information is summarised in Table 1 below.

Table 1. Relevant sugar miller electricity information

Average annual consumption per site	2,200 MWh
Proportion of average consumption in peak periods	49%
Proportion of average consumption in off-peak periods	51%
Average annual export to the grid	38,000 MWh
Average annual price for network services	12.4 cents per kWh
Average annual price for non-network services	17.9 cents per kWh
Average annual price	30.3 cents per kWh

The table shows that while milling companies export much more electricity to the grid than they import, they are also very significant customers. Their annual consumption puts them in the very largest tariff category. Millers' average consumption of grid-supplied electricity is 2,200 MWh per year. To put this into perspective, this is 142 times higher than the amount of electricity that Ergon delivers on average per customer.

The highest price for network services for mill companies (assuming Energex's 8800 network tariff) is 12.9 cents/kWh and the lowest is 11.8 cents/kWh.

The total average price paid by sugar mills (network plus non-network) – 30.3 cents per kWh –is comparable to the average price for electricity paid by households in Queensland. Elsewhere in the National Electricity Market, customers that consume as much electricity as sugar mills are typically paying a total price for electricity that is well less than half the price that sugar mills are paying in Queensland. [2]

2.2. Cane growers

Ergon supplied various consumption and price data for 2012/13 to CANEGROWERS. From this, we have concluded that in 2012/13, for 18,500 customers – most of whom are cane growers – the following applied:

- They paid just under $70m for 335 GWh of grid-supplied electricity;

[2] For example in their report (attached) CME noted that large electricity users in Victoria are currently paying around 13 cents per kWh.

- Around two-thirds of these customers are supplied on Tariffs 62 and 65 and the remaining third are on Tariff 66;
- About half the sales by dollar value are on 62 plus 65, and the remaining half are on 66; and
- Customers on 62 and 65 buy on average 16 MWh each per year and on Tariff 66 they buy on average around twice this amount.

The network charge for Tariffs 62 and 65 is based on Energex's 8800 network tariff. Our estimate of total, non-network and network prices (GST exclusive) – based on the information provided to CANEGROWERS by Ergon and also subsequent information for 2013/14 provided to our advisors by QCA - is summarised in Table 2 below:

Table 2. Relevant cane grower price information for 2013/14

Average annual (total) price	Tariff 62	24.5 cents per kWh
	Tariff 65	25.5 cents per kWh
	Tariff 66	23.0 cents per kWh
Average non-network price	Tariff 62	12.8 cents per kWh
	Tariff 65	13.8 cents per kWh
	Tariff 66	Not known
Average network price	Tariff 62	11.7
	Tariff 65	11.7
	Tariff 66	Not known

3. Our understanding of QCA's proposals

3.1. Sugar millers

Our understanding of the proposals in the Interim Consultation Paper as they relate to sugar millers is as follows:

1. Sugar millers that are on Tariff 22 (Large) will continue to be supplied on that tariff.
2. QCA's intention to move our members on Tariff 22 (large) onto Tariff 48 by 2020 remains.
3. Ergon may be creating a new Tariff 48 with seasonal time of use demand charges. If so, the QCA will build new retail tariffs in the same way as the QCA does currently.
4. The QCA intends to escalate Tariff 22 (Large) in the same way that it has in the 2014/15 determination. Based on the QCA's document we understand that this means escalating the charges based on the percentage increase in the charges in the alternative tariff (which for our members would be Tariff 48) that customers would otherwise pay. An additional escalation to ensure that charges under the transitional and obsolete tariffs do not fall further below what QCA considers to be the cost of supply, may also apply.

3.2. Cane growers

Our understanding of the proposals in the Interim Consultation Paper as they relate to cane growers is as follows:

1. Cane growers that are on Tariffs 62, 65 and 66 will continue to be supplied on these tariffs.
2. QCA's intention is to move cane growers that are on Tariff 62 and 65 onto Tariff 22. It is not so clear whether QCA also intends this for customers on Tariff 66.
3. The QCA intends to escalate Tariffs 62, 65 and 66 in the same way that it has in the 2014/15 determination. This means escalating the charges in each tariff based on the percentage increase in the charges in the alternative tariff (which

for sugarcane growers would be Tariff 48) that customers would otherwise pay. An additional escalation to ensure that charges under the transitional and obsolete tariffs do not fall further below what QCA considers to be the cost of supply, may also apply.

4. Our concerns

In the first sub-section below, we set out concerns specific to the tariffs that apply to sugar millers; and in the second concerns relevant to cane growers. In the third sub-section we raise common concerns and then suggest a way forward.

4.1. Sugar millers

We set out three concerns that we would like the QCA to consider and respond to:

1. Our tariffs are already too high.
2. Tariff 48 applied to our members will result in indefensible price increases.
3. Escalation of Tariff 22 (Large) to facilitate transition to Tariff 48 is unacceptable.

4.1.1. Our tariffs are already too high

Network price

The average annual grid-supplied electrical demand by millers is 2,200 MWh or 142 times higher than Ergon's average connection. Yet the average price paid by millers for network services – 12.4 cents per kWh - is 48% higher than Ergon's current average regulated network services price; or about a quarter higher than the sum of Ergon and Powerlink's average regulated price for prescribed network services.

Total price

Sugar millers' overall average (total) price on Tariff 22 (Large) is 30.3 cents per kWh. As we noted this is comparable to the prices paid by average consumption households in Queensland. Yet average sized sugar millers are in Ergon's highest voltage tariff category and consume 440 times more per year than average Queensland households.

Larger consumers connected a very high voltages use less of the distribution networks than smaller consumers whose electricity is supplied at lower voltage and hence requires several additional transformations and greater circuit per connection. As a result, larger consumers should expect to pay lower average prices than smaller consumers.

Subtracting the average network services price (12.4 cents per kWh) from the average total price (30.3 cents per kWh) gives the average non-network charge of 17.9 cents per kWh.

Millers' demand and consumption profile is beneficially skewed so that their peaks are typically achieved over the lower demand periods on the power system from June to November. Lower system demand typically correlates to lower wholesale prices. Sugar miller peak demand in the periods from January to April are typically less than half that in the period from June to November. Sugar millers therefore present a highly advantageous load profile in the NEM and this should be reflected in their prices.

It would be difficult to imagine, therefore that the wholesale cost of supply could exceed 4 cents per kWh. This leaves 14 cents to cover renewable support and retail costs and other minor charges. It is implausible that these charges in total might approach anywhere near 14 cents per kWh. It is difficult to envisage that total non-network charges for sugar millers should be more than 6 cents per kWh.

Bringing these factors together we find it difficult to understand why millers should be paying even half as much as they are currently being charged.

4.1.2. Tariff 48 applied to our members will result in indefensible price increases

We have analysed how the network charges at the 15 sugar miller sites described earlier will change as a result of the adoption of Tariff 48. This is summarised in Table 3 below. It shows an extraordinary increase in fixed charges, the significant impact of demand charges and the inconsequential impact of consumption charges in Tariff 48.

Table 3. Network services charges on Tariff 22 (Large) and Tariff 48

	Tariff 22 (network)	Tariff 48 (network)
Fixed	$ 4,407	$ 1,966,193
Demand	0	$ 7,057,305
Consumption	$ 4,127,546	$ 342,601
TOTAL	$ 4,131,953	$ 9,366,099

In terms of the total charge (network plus retail), the difference between Tariffs 22 (Large) and Tariff 48 is shown in Table 4 below.

Table 4. Network plus non-network charges on Tariff 22 plus Tariff 48

	Tariff 22 (retail)	Tariff 48 (retail)
Fixed	$ 8,815	$ 2,490,511
Demand	0	$ 7,857,545
Consumption	$ 10,049,540	$ 3,685,920
TOTAL	$ 10,058,355	$ 14,033,976

Table 4 shows that electricity bills will rise by about 40% after the transfer from Tariff 22 to Tariff 48. The average (total) electricity price to millers will rise from 30.3 cents per kWh to 43.5 cents per kWh. Given that mills' current prices are already more than twice as high as they might reasonably be expected to be, to propose to transition mills to an even higher tariff is absurd.

In addition, the structure of Tariff 48 with no time of use differentiation, a massive (and hence strongly regressive) fixed charge, and no seasonal or time of use demand charge, means that describing Tariff 48 as "cost-reflective" - as the QCA and Ergon has - is not defendable.

4.1.3. Escalation of Tariff 22 (Large) as part of transition to Tariff 48 is unacceptable

On the basis of the evidence in the previous section, the proposed escalation of Tariff 22 (Large) in order to effectively bridge the gap to Tariff 48 is completely unacceptable. This is because Tariff 48 does not represent a cost reflective tariff - it will deliver average prices for our millers of 43.5 cents per kWh, compared to average costs that we would expect should not be more than a third of this, at the most.

4.2. Cane growers

4.2.1. Our tariffs are already too high

The network services charge that cane farmers paid in 2013/14 for Tariffs 62 and 65 was 11.7 cents per kWh. The AER's regulatory control for Ergon anticipates an average sales price for prescribed network services in 2013/14 of 8.3 cents per kWh, and 1.7 cents per kWh for Powerlink. Cane growers served by Ergon are therefore paying about a third more than Ergon's average regulated price, and about a fifth more than the sum of Ergon and Powerlink's average prices. This is despite the fact that cane growers consume on average 18.2 MWh per year, compared to average sales per customer on Ergon's network of 15.5 MWh per year.

The prices paid by cane growers can not be justified on the basis of load profiles either. Based on the data that Ergon provided to us, 59% of cane grower electricity consumption occurs during off-peak periods and the remaining 41% consumption occurs during peak periods (as peak and off-peak is defined in Tariff 22). This is a greater skew towards off-peak consumption than the system-average load profile.

4.2.2. Escalation of Tariffs 62 and 65 as part of transition to Tariff 22 is unacceptable

The gap between the average price on Tariff 22 and Tariff 62 and 65 was not large in 2014/15. Irrespective of this, since current prices are already excessive, raising the prices on Tariffs 62 and 65 in order to close the remaining gap to Tariff 22 is not acceptable.

4.3. Common concerns and way forward

It should be clear from the submission to this point, that sugarcane growers and sugar mills are extremely dissatisfied with the existing arrangements; that the proposal to shift them to even more expensive tariffs by 2020 is unsustainable; and hence that the proposal to bridge the gap between the current and proposed future tariffs is unacceptable.

We have raised these concerns with QCA in previous years, but our concerns have been rejected. QCA has suggested that, since the tariffs that cane growers and sugar mills pay is based on Energex's network tariffs, they would pay even higher prices if they were paying Ergon's "cost-reflective" tariffs. By implication, QCA has suggested, cane growers and sugar millers are being subsidised

In the case of cane growers, QCA's staff have confirmed to our advisors that the average network charge for cane growers, had these charges been based on Ergon's tariffs in 2013/14, would have been 21.4 cents per kWh. But Ergon's 2013/14 average sales price based on the AER's determination of the regulated prescribed services revenue is 8.3 cents per kWh and Powerlink's average price based on the AER's determination of the regulated prescribed services revenue is 1.7 cents per kWh. If we assume that cane growers are representative of an average Ergon connection, we might therefore assume that cane growers' average price for network services provided by Powerlink and Ergon should be around 10 cents per kWh.

However based on QCA's calculation of 21.4 cents per kWh, the application of Ergon's network tariffs to cane growers would mean that cane growers would be paying more than twice the average Ergon plus Powerlink network services price.

But cane growers consume more (on average) than the average Ergon customer and they have an advantageous load profile (around 60% consumption in off-peak periods). Furthermore 86% of cane growers are located in Ergon's eastern zones, and thus higher costs applicable to western zone consumption should only have a minor impact.

Therefore the cost to transmit and distribute electricity to cane growers should not be more than cost of serving the average connection to Ergon's network (i.e. not more than around 10 cents per kWh).

Therefore, while it may be true that tariffs would be even higher if Ergon's network tariffs were used, we suggest that this reflects problems with Ergon tariffs, not that cane growers are paying too little. Therefore we do not believe that Ergon's tariffs that apply to cane growers can be claimed to be cost reflective.

Cane grower and sugar miller concerns have been rejected by the QCA as the pleading of special interests. We reject that criticism. Our industry is highly trade exposed with over 80% of Australia's sugar production traded on the international market, where Australia is a price taker.. This means we do not have the ability to pass on higher electricity charges, in the prices we charge.

The severe increase in electricity prices over the past six years, combined with the appreciation of the Australian dollar, has therefore resulted in severe contractions in margins. Electricity prices have now risen to the point that crops are going unwatered with consequential loss in farm production, mill throughput and resulting knock-on effects throughout the rural Queensland economy.

The Australian sugar industry draws QCA's attention to this not to ask for subsidies or special treatment. Rather, our request is that cane farmers and mills pay a reasonable price for electricity. The current prices, albeit that they are based on Energex rather than Ergon's network tariffs, are unreasonable in comparison to Ergon's average regulated price. It is a hollow defence to suggest that our members would pay even more if their prices reflected Ergon's network tariffs.

We suggest that Ergon's network tariffs have been distorted by the incentives that exist under the Community Service Obligation payments. The logic underlying this suggestion is as follows:

Ergon is a profit-maximising corporation.
Ergon is able to improve its profits by increasing the CSO payment it receives.
A large part of the CSO payment is based on the difference between Ergon and Energex's network tariffs.
Ergon has an incentive to increase the network tariffs for those consumers connected to its network who pay tariffs based on Energex's network service charges. This is because Ergon's tariffs do not actually affect the prices that these customers pay, but they do affect the level of the CSO.

The Queensland Government pays the CSO but also receives Ergon's profits, which are increased, dollar for dollar, by the CSO that it receives. The very high CSO payment has meant that Ergon has become, per connection, the most profitable network service provider in the NEM.

Considering the incentives created by the CSO and the evidence of inexplicably big gaps between average network services prices based on Ergon's tariffs and Ergon's average regulated network services price, we suggest that Ergon's claim that its tariffs are cost reflective can not be sustained.

The QCA appears to have failed to critically assess Ergon's claims that their tariffs are cost reflective either as to level or structure. Instead it has accepted Ergon's claims at face value, and has pointed to the level of the CSO as evidence of subsidy, rather than as evidence of flawed tariffs.

We suggest that the QCA's failure to critically assess Ergon's tariffs has perpetuated the myth that cane growers and sugar mills are being subsidised, and hence that increases rather than decreases in their prices are justified. We submit that the evidence, as presented in this submission, does not support this.

5. Next steps

The evidence suggests substantial reductions in the prices paid by both cane growers and sugar millers are justified in order to bring these prices back into line with Ergon's current costs, albeit that these too need to be reduced as the Queensland Government has recognised. QCA is responsible for determining electricity prices in Queensland and we suggest the following for QCA's consideration:

1. We ask QCA to explain why cane growers and sugar millers should be paying so much more for network services than the average price of prescribed network services for Ergon plus Powerlink, in spite of the benign load shapes of our

members and the fact that they consume more (much more in the case of sugar millers) than the average connection.

2. In the case of sugar millers in particular the implicit non-network charge of 17.9 cents per kWh is inexplicable when considering that their wholesale energy costs can not reasonably be expected to exceed around 4 cents per kWh. Again we ask the QCA to justify the non-network charges in sugar miller tariffs.
3. In view of the evidence provided, we call on the QCA to immediately abandon proposals to transition cane growers and sugar millers to higher tariffs, and hence to increase existing tariffs in accordance with this transition strategy.
4. We request that the QCA convenes a working group consisting of cane grower, sugar miller, QCA and Ergon representatives, to develop agreed positions on the reduction of tariffs. This working group should also consider the design of tariff structures that reflect consumer preferences.

5. Although not discussed elsewhere in this submission, the following two issues have been canvassed at length in both CANEGROWER and ASMC submissions over the last 2-3 years, and will be discussed in more detail during the draft determination. However, given the uniform tariff policy applies specifically to regional Queensland this year, we recommend that QCA consider the following:
6. That until retail competition is actually introduced regional Queensland, any headroom provision in the electricity price be set at $0.00; and
7. Shifting the CSO payment to the network (instead of Ergon Retail) be fast tracked ahead of the July 2017 target, to encourage greater transparency between network and retail as soon as possible – and therefore network efficiency.