Network Determination Review Panel
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
By email: NSWACTelectricity@aer.gov.au

10 July 2014

Dear Review Panel

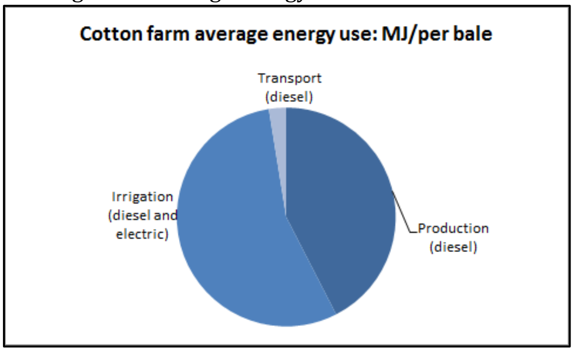
Cotton Australia welcomes the opportunity to comment on Essential Energy's regulatory proposal for the period 1 July 2014 to 30 June 2019.

Cotton Australia is the key representative body for Australia's cotton growing industry. The cotton industry is a small but integral part of the Australian economy, worth over $2 billion in export earnings and employing 10,000 people. The industry's vision is: Australian cotton, carefully grown, naturally world's best. Cotton Australia works with industry to achieve this vision by providing a policy and advocacy role, research direction, stewardship and building our farmer's capacity in their own communities. We are proud of our efforts to ensure an efficient and sustainable cotton industry. Our 'myBMP' is a voluntary farm management system which provides self-assessment mechanisms, practical tools and auditing processes to ensure that Australian cotton is produced with in line with best practice.

As we highlighted in our submission to Essential's transitional regulatory proposal, over 60% of Australian cotton is grown within Essential's northern and southern distribution networks. As such, Essential's regulatory proposal directly impacts the profitability of a substantial proportion of Australia's cotton production.

Since the millennial drought, irrigators throughout NSW have made significant improvements in water use efficiency (up to 40% in a decade) as a result of capital investments to upgrade and improve irrigation equipment. However, in many cases, the irrigation equipment is more energy intensive and there is a clear trade-off between water use efficiency and energy efficiency in irrigated production. Irrigation now represents between 40-60% of the on-farm energy use (Figure 1).

Figure 1: Average energy use on cotton farms.



As a result of the recent network price rises (of up to 300% over five years), we are becoming increasingly aware of drastic measures being taken by irrigators to minimise their exposure to electricity network charges. For example, we are aware of growers who have placed locks over their pumps to avoid unintentionally switching on their irrigation equipment and incurring demand charges. We are also aware of growers who have sold permanent water rights to pay electricity bills. However, most disturbingly there is an apparent trend away from irrigation methods that conserve water but have a higher energy consumption (drip and centre pivots), in favour of methods that draw heavily on water resources but minimize energy consumption (flood furrow and bankless channels).

Together with the NSW Irrigators' Council (NSWIC), Cotton Australia has met regularly with Essential Energy to discuss tariff structures for irrigators, demand management opportunities, as well as the network's transitional and full regulatory proposals.

In our submission to the transitional proposal, we expressed concerns about the revenue allowances sought by Essential and were pleased to see the AER determination did not to approve the revenue requirement proposal, but instead approved a revenue requirement of $1.3 billion, per annum (approximately 5% less than requested per year).

In the full regulatory proposal, Essential has identified a revenue requirement of $7.1 billion over the five year period unsmoothed, with a capital and operating expenditure program of $2.8 billion and $2.8 billion, respectively. The proposal also provides Essential with a weighted average cost of capital of 8.83%, compared to the AER transitional ruling of 7.01%.

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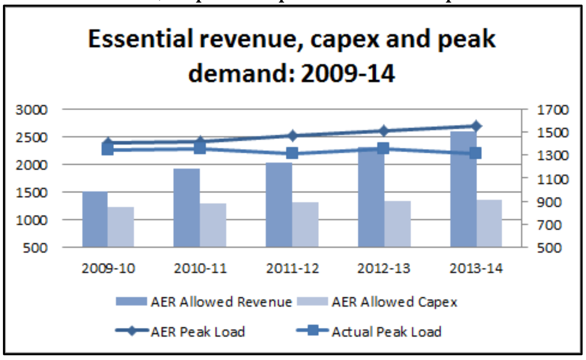
Despite the significant upgrades to network assets in the previous control period, Essential's proposal identifies the need for continued capital investment to replace aging assets and meet "pockets of demand growth." We accept the need for upgrades to network assets in order to maintain reliable and safe supply of electricity, but we question whether the network has invested sufficient into demand management tools and opportunities, as an alternative to capital upgrades to augment or supplement the network for what amounts to be 4 hours per year in peak demand. As highlighted on page 43 of the proposal, peak demand estimates for the previous regulatory period were inaccurate by 5–23% (see figure 2), which led to over investment in the network and resulted in a higher than necessary regulated asset base ($6.5 billion).

Before the proposal is approved, Essential should be asked to demonstrate that recent network augmentations have been appropriately utilized before further capital expenditure is authorized. We also suggest that the AER work with Essential (using the network's asset management, regional planning and investment plans) to revisit the network's prioritisation of capital works. The AER must be assured that only genuinely urgent capital upgrades or augmentations in the network are pursued in this regulatory period, and that spending on any non-critical capital investment is deferred.

Figure 2: Essential revenue, capital expenditure and peak demand 2009–2014



We would also encourage the AER to carefully consider the advice from its Consumer Challenge Panel (CCP), particularly in relation to concerns raised that Essential's actual net profit result in the last regulatory control period was approximately double the amount the AER had intended.

Essential states that this proposal will result in network price increases held below CPI every year, with an average increase in household bills of $153 per annum. Existing electricity prices have escalated by as much as 300% in the past five years, mainly driven by network costs. As it is Essential's customers are already exposed to the second highest network costs in the country ($1120 per

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year). It is our view that even an increase of CPI will have a lasting and unsustainable impact on farm profitability.

As such, we would like to see the AER's final revenue determination for this period set at a rate at least 5% lower per year than proposed by Essential. We also support a lower WACC, based on early analysis from CCP which indicates the actual cost of capital to be around 5-6%. Regardless, Essential should be held to their commitment to hold price rises to less than CPI for all customer classes, not just households.

Cotton Australia and NSWIC have met with the Australian Energy Market Commission, as well as ministerial and departmental officials from NSW's Department of Trade and Investment to highlight our concerns about the impact of rising network prices on the profitability and sustainability of irrigated food and fibre production in NSW.

The key concerns relate to the high demand charges and complex structure of the tariffs irrigators are generally assigned to (BLND3AO and BLNS1AO). Both are demand tariffs comprised of seven components and offer little incentive to switch between peak/shoulder/off peak periods. While a Low Voltage Rebate is available to customers on BLND3A0, the eligibility criteria (including network costs must exceed an average of 35 cents per kWh and the irrigator must have a power factor level of 0.9). We are particularly concerned that irrigators are often transferred onto these tariffs with no consultation.

In this regulatory proposal Essential states it will undertake an annual review of the appropriateness of the tariff for connection points, with a view to re-assigning consumers between tariff classes. We would ask that the AER require Essential to provide consumers with an analysis of the costs and benefits to both the consumer and the network of any proposed changes before the consumer's tariff class is 're-assigned.' We particularly ask that Essential be prevented from 're-assigning' tariff classes without first engaging with the affected consumer. Especially as the network itself has identified fair pricing and the provision of timing and accurate information as key components of its customer value strategy.

Cotton Australia would welcome AER consultation on the changes to the Demand Management Incentive Scheme (DMIS) rules and principles as they are developed later in 2014. We are concerned that Essential's current proposal contains little detail on the network's planned action to encourage demand side participation. We are also concerned that the network's demand management operational procedures (CEOP1121) place the onus on demonstrating why demand management investments should be made, rather than placing that onus on demonstrating why demand management investments should not be made.

Nevertheless, Cotton Australia would welcome the opportunity to work with Essential to develop a demand side participation program that is specifically targeted at irrigators to encourage more productive and mutually beneficial utilization of the Essential network. A program that is aimed at identifying power factor corrections, irrigation scheduling techniques as well as simple analysis of the efficiency of irrigation equipment such as pumps and motors, could result in significant savings for the irrigator (in terms of electricity bills), as well as savings for Essential in terms of potentially avoided or deferred network augmentations. Such a program would help smooth the load profile of some irrigators which would in turn assist Essential with managing and planning for peak demand events.

In the regulatory proposal, Essential highlights equity concerns associated with household solar schemes. The 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 would strongly encourage the AER to work with State and Federal governments and the networks to resolve the circular nature of Essential's argument.

In summary, Cotton Australia asks the AER not to approve the Essential Energy regulatory proposal. Instead, we would ask the AER to:

- consider a lower revenue requirement and WACC for Essential Energy
- require Essential to demonstrate that previous network augmentations have been utilized
- identify urgent capital upgrades or augmentations in the network and defer spending on any non-critical capital investment
- oblige Essential to keep network price rises under CPI for all consumers, not just households in the regulatory period
- prevent Essential from 're-assigning' customers to new tariff classes without consultation
- encourage Essential to work with segments of the community to develop mutually beneficial demand management programs
- work with Government to resolve equity issues raised by Essential in relation to household solar scheme customers driving a death spiral in the network.

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We would further encourage the AER to work with the state and federal governments to improve the overall regulatory oversight of the entire electricity market, particularly the networks.

Thank you again for the opportunity to comment on Essential's regulatory proposal. Please do not hesitate to contact me on 02 9669 5222 or leahr@cotton.org.au if you wish to discuss this submission in more detail.

Yours faithfully

Leah Ross
Policy officer