Lower Namoi Cotton Grower's Association Inc.

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Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: NSWACT@aer.gov.au

Dear Mr Anderson,

RE: Essential Energy Distribution Determination (2015-16 to 2018-19)

Members of the Lower Namoi Cotton growers Association have been greatly affected by the spiralling cost of electricity over the past decade, and we are acutely aware that a very large proportion of this increase is due to the massive increases in network charges.

Over 60% of Australia's cotton is grown within Essential Energy's northern and southern distribution networks. As such, our members have a keen interest in the Essential Energy Revenue Determinations.

We acknowledge the work of the Australian Energy Regulator (AER) in conducting their assessment of Essential Energy's revenue and addressing some areas of concern for consumers in the Draft Decision for Essential Energy's distribution determination. We welcome the reduction in Essential Energy's revenue allowance as a step in the right direction, in particular the significant recommended cuts in operating expenditure and capital expenditure. However, we remain concerned that the current levels of network charges are unsustainable for cotton growers in regional NSW. We therefore call on the AER to remain firm in resisting any pressure from the networks or government to revise their determination upwards, and ask that they place even more scrutiny on the RAB (regulated asset base) and WACC (weighted average cost of capital).

We note the AER benchmarking studies show that Essential Energy has significant room for improved efficiencies – with conservative efficiency targets of 78% requiring a 35% reduction on 2013 level operating expenses. We therefore call on the AER to ensure that these network providers are not rewarded for their inefficiencies.

As reported, Essential Energy aims to invest $3.8 billion over the next five years on network infrastructure, this follows on from the $2.1 billion invested over the preceding five years.

We have been informed that these large investments were required to meet growth in demand in country and coastal centres which was expected to drive greater demand across both summer and winter. However this demand has not materialised, resulting in over investment and consumers paying for assets that are idle or underutilised.

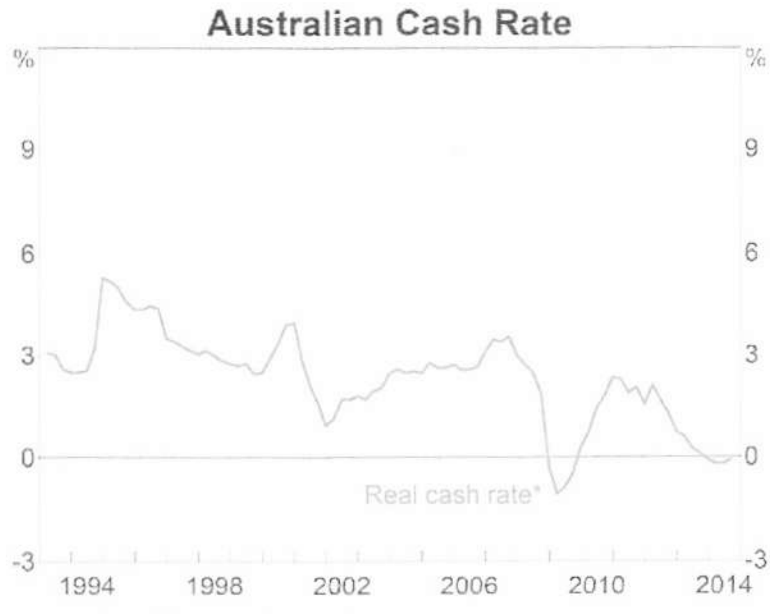
As we understand the RAB is a factor of its opening status, plus additional capital expenditure, less depreciation, plus an allowance for inflation. Therefore we call on the AER:

1. to very closely examine the proposed capital expenditure of Essential Energy, and only approve that which is prudent and efficient. In particular regard should be given to the veracity of any demand forecasting, and the ability to meet any rising demand through new, cheaper technology, or through active demand management programs.
2. to examine, and provide comment, around the current rules for determining the RAB. We struggle to understand the rationale around applying depreciation, but then increasing the RAB for inflation. We believe that these provide the very real possibility of long-life, low depreciation assets (such as poles), maintaining a significant value even at the time of replacement, and then having the new pole added to the RAB.

Closely related to the RAB, and what we understand can contribute up to 60% of the allowed revenue, is the Weighted Average Cost of Capital (WACC).

We understand in the previous period the WACC was set at a whopping 10.02%, due, partly at the time to the uncertainty in financial markets caused by the Global Financial Crisis.

The nominal risk free rate, which impacts upon both the debt and equity risk premiums, has changed substantially since that time. As the following Reserve Bank graph shows, interest rates collapsed in the wake of the crisis rather than soared, leading to significant profits for Essential Energy. Continued economic stability and downward forecasts of the cash rate and ten year bond rate forecast, should lead to a reduction in the WACC.



* Calculated using average of weighted median and trimmed mean inflation

Sources: ABS, RBA

Recent WACC decisions in 2013 were 7.50% (ElectraNet) and 7.87% (SP AusNet) noting that the transitional arrangements for the cost of capital did not apply. We anticipate that the transitional arrangements, combined with the nominal risk free rate provide a strong justification for significant downward movement of the WACC.

We would also like to make the point that we understand that the Networks consider themselves BBB credit rated organisations, reflecting what they argue is a high degree of financial risk.

We ask that the AER closely examine that claim, as it appears to us, that Essential Energy represents a low risk organisation, with regulated pricing, a monopoly position, and very strong payment protections backed by NSW State Treasury provided debt.

It is our understanding that Essential Energy intends to continue high levels of operating expenditure over the coming determination period. For example, we would ask the AER to closely consider the forecast costs related to vegetation management. Anecdotally we have heard that more stringent vegetation management practices would alleviate the requirement for continuous / spot based management regimes. We believe the introduction of systems and procedures to improve the vegetation management undertaken by Essential Energy would impact significantly on ongoing operational costs. Given this, we call on the AER to keep the results of the benchmarking, where it was demonstrated that Essential Energy has considerable room for improvement in operating efficiency, front of mind.

Finally, we call on the AER to closely examine any additional allowances provided to these organisations such as income tax equivalents.

We have heard that in cases of privately owned networks, the taxation allowances have often far exceeded the amount paid by these organisations. This should be completely unacceptable.

Thank you for this opportunity, and we look forward to the Final Determination.

Yours sincerely,

Philip Firth

Secretary

Lower Namoi Cotton Growers Association