NSWIC
NEW SOUTH WALES IRRIGATORS' COUNCIL

PO Box R1437
Royal Exchange NSW 1225
Tel: 02 9251 8466
Fax: 02 9251 8477
info@nswic.org.au
www.nswic.org.au
ABN: 49 087 281 746

Submission

Australian Energy Regulator

Essential Energy - Transitional Regulatory Proposal

140303

Contents

Introduction

NSW Irrigators' Council (NSWIC) represents more than 12,000 water access licence holders across NSW. These licence holders access regulated, unregulated and groundwater systems. Our Members include valley water user associations, food and fibre producers, irrigation corporations and community groups from the rice, cotton, dairy and horticultural industries.

This submission represents the views of the Members of NSWIC with respect to Essential Energy's *Transitional Regulatory Proposal*. However, each Member reserves its right to independent policy on issues that directly relate to their areas of operation, or expertise, or any other issues that they may deem relevant.

Executive Summary

NSWIC is concerned about Essential Energy's proposed revenue requirement for the transitional and subsequent regulatory control period. It appears that Essential Energy's overall revenue requirement will remain fairly constant compared to the 2009 - 2014 regulatory period, despite the reduced capital expenditure proposal, reduced electricity consumption and increased efficiency measures that are being requested by both policy makers and stakeholders.

NSWIC requests that the Australian Energy Regulator (AER) closely scrutinizes Essential Energy's revenue proposal including the amounts of operating and capital expenditures. Such scrutiny must occur irrespective of the short timeframe for this transitional regulatory period. Without the confirmation that Essential Energy's revenue proposal is both accurate and efficient, we have little confidence that future electricity prices will be cost reflective.

Key Recommendations;

- *NSWIC submits that Essential Energy's overall revenue requirement, OPEX and CAPEX are thoroughly scrutinized to ensure that customers are only paying network charges that reflect the true and efficient cost of Essential Energy's operation.*

- *NSWIC submits that Essential Energy must provide further detailed information on the underlying drivers for OPEX and CAPEX in order to provide stakeholders with an understanding of their necessity.*

- *NSWIC submits that further information on Essential Energy's intent to implement a demand management scheme over the next regulatory period must be made publically available.*

- *NSWIC proposes that further AEMC rule changes are considered that would broaden the AER's regulatory responsibility to also allow for the assessment of Essential Energy's current tariff structure.*

General Comments

NSWIC welcomes the opportunity to make a submission to the AER on Essential Energy's *Transitional Regulatory Proposal*. Together with Cotton Australia (CA) and the National Irrigators' Council (NIC), NSWIC has met and discussed Essential Energy's transitional regulatory proposal as well as explored options for improving existing network tariffs and demand side management tools.

While NSWIC acknowledges that the determination for the transitional regulatory period will be conducted with less time and fewer resources than a full regulatory determination, we expect the AER to assess this transitional period thoroughly to ensure that customers only pay the true and efficient cost of Essential Energy's network services.

It is important to note that electricity has become a vital input factor in irrigated agriculture as more irrigators have undertaken structural adjustment on-farm to remain competitive. These structural adjustments, which have been supported by the Commonwealth Government, have led to productivity gains and water efficiencies but have caused overall electricity use to rise. Greater electricity use and higher electricity rates have been a significant financial burden for irrigators throughout NSW.

The trade-off between water efficiency and energy intensity has been extremely difficult to reconcile in irrigated agriculture and as a consequence, many irrigators have found it difficult to continue using their electricity intensive irrigation equipment. The losses in terms of efficiency and productivity have been immense.

An electricity trial conducted by NSWIC and Cotton Australia has found that overall electricity costs for selective irrigators have increased by up to 300 per cent over the last five years. Network charges have been the most significant drivers of electricity cost increases, as they make up between 55 and 65 per cent of an irrigator's electricity costs. The biggest network cost increase was $263,575 by one trial participant (between 2008/09 - 2012/13).

Given Essential Energy's current transitional regulatory proposal, we are not convinced that any improvements or efficiency gains have taken place that would lead to any downward pressure on network charges. In particular, should Essential Energy not fundamentally alter its overall revenue proposal and undertake an urgent tariff and demand management review, we believe that electricity use in irrigation will become unviable in the future. Not only would this cause significant financial hardship for irrigators who have invested large sums to upgrade their equipment on farm, it will also have an impact on irrigators' future productivity and water use as many will have to consider reverting back to more water intensive irrigation practices.

Specific Comments

NSWIC would like to make the following specific comments to Essential Energy's transitional regulatory proposal;

Revenue Requirement

NSWIC is extremely concerned about Essential Energy's proposed revenue requirement. As *table 3-1 Indicative range of smoothed revenue requirement ($M, nominal)* states, Essential Energy's actual/estimated revenue for 2013-14 is 1,361 while its proposed revenue for the next regulatory period ranges between 1,346 and 1,396 (with a WACC of 9.1%) or between 1,293 and 1,341 (with a WACC of 8.52%). We consider Essential Energy's proposal to not be much different to its current revenue requirement which suggests that there are no fundamental changes proposed within Essential Energy's operation. Given that the current determination is characterised by significant price increases that caused significant financial hardship for customers, we strongly question how that overall revenue requirement can remain approximately constant if Essential Energy's CAPEX is reduced by $1.4 billion for the 2014-19 period.

> *NSWIC requests that Essential Energy's overall revenue requirement, OPEX and CAPEX are thoroughly scrutinized to ensure that customers are only paying network charges that reflect the true and efficient cost of Essential Energy's operation.*

CAPEX

NSWIC welcomes Essential Energy's proposed reduction in its capital program from $4.2 billion to $2.8 billion. With a decrease in past and forecasted electricity consumption, this reduction appears prudent and sensible.

Despite this reduction, NSWIC remains concerned about investments which were made over the current determination. Any capital investment that is currently not fully utilised due to the reduced consumption figures ('excess' capital) will unnecessarily drive future electricity prices. This is not only because any past capital investment made by Essential Energy is part of Essential Energy's regulatory asset base (RAB) and hence earns a return on and of capital, but the previous capital investments will furthermore trigger future maintenance and asset replacement costs that could significantly drive up OPEX. This concern appears to be justified given Essential Energy's comment in its proposal that;

> *"While we have sought to minimise expenditure, we still need to incur capital expenditure to maintain the reliability and safety of the network. The majority of the proposed investment is to replace existing network assets that are reaching the end of life or exhibiting increasing risk of failure."*

NSWIC submits that only capital that is efficiently utilised should be part of Essential Energy's future regulatory asset base so that customers are not paying for inefficient investments. In addition, we believe it vital that Essential Energy makes its asset management plans and investment proposals available to the AER to assist in its decision making.

OPEX

NSWIC is concerned about Essential Energy's proposed OPEX over the next regulatory period. We believe Essential Energy has provided little and the information and the explanation that has been provided warrants very close scrutiny (i.e. 'vegetation management', 'emergency response' and 'other network costs').

> *NSWIC submits that further detail on Essential Energy's OPEX is provided to stakeholders. Without detailed and adequate information, NSWIC rejects Essential Energy's current OPEX proposal.*

Transparency

As outlined in the previous two points, NSWIC is extremely disappointed by the lack of detail provided by Essential Energy in its transitional regulatory proposal. NSWIC had expected greater transparency and effort by Essential Energy to justify its overall revenue requirement as well as its operating and capital expenditure.

Given the significant criticism that network service providers received with regard to the pricing over the current regulatory period, we had thought that Essential Energy would exert greater effort in explaining its operation and revenue requirements. In the absence of any real detail provided in the transitional regulatory proposal, NSWIC has to deduce that Essential Energy is either unable or unwilling to be transparent about its expenses.

> *NSWIC submits that the AER must request further information from Essential Energy on its operating and capital expenditure.*

Demand Management

NSWIC acknowledges that the proposed change in the AER's control mechanism from an average price cap to a revenue cap should provide further incentives for Essential Energy to increase its efficiency either through internal productivity adjustments, better utilisation of its capital or active demand side management The latter is of significant interest to NSWIC, as we believe demand side management could be beneficial to both customers and the distribution network service providers like Essential Energy. However, Essential Energy's proposal offers little information on the types of demand side management options under consideration for the coming regulatory period.

Further, we are concerned about the timing for the AER's Stage 2 Framework and Approach as well as the regulatory proposal prepared by Essential Energy for May 2014. The AER's Stage 2 Framework and Approach Paper acknowledges that rule changes required to facilitate 'incentives to pursue efficient alternatives to network augmentation' are still under consideration by the Australian Energy Market Commission (AEMC). We understand that these changes are unlikely to be in place before the end of 2014, which is well after the distribution network service providers are required to submit their proposal for the subsequent regulatory period. As such, we consider it unlikely that Essential Energy will have an opportunity to fully consider active demand side management options as part of this next regulatory period.

NSWIC submits that the AER should request more information from Essential Energy as to how it intends to implement a demand management scheme over the regulatory period.

Tariff Structure

While NSWIC acknowledges that the AER has only the regulatory capacity to determine Essential Energy's overall revenue requirement, NSWIC would like to highlight that we are extremely frustrated with Essential Energy's tariff setting. While we strongly support the AER's work in determine an efficient and cost effective revenue requirement for Essential Energy, it is not guaranteed that this will lead to any sensible tariff setting.

NSWIC hopes that the AEMC rule changes currently underway will assist in shedding light on the current tariff structure setting and possibly considers the extension of the AER's regulatory power to assess the efficiency of Essential Energy's tariff structure.

Conclusion

NSWIC strongly urges the AER to thoroughly scrutinize Essential Energy's transitional regulatory proposal to ensure that customers are only paying for the true and efficient costs of Essential Energy's operation in the next regulatory period.

In addition, NSWIC strongly urges the AER approaches Essential Energy for further information on its proposed CAPEX and OPEX. Both regulator and stakeholders will benefit greatly from greater transparency about Essential Energy's transitional regulatory proposal.