CENTRAL IRRIGATION TRUST
Trustee: Central Irrigation Pty. Ltd. ACN 075 446 810
4 Fowles Street PO Box 34
Barmera SA 5345
Telephone 08 8580 7100

30 January 2015

Mr Sebastian Roberts
General Manager, Network Regulation
Australian Energy Regulator
GPO Box 520
Melbourne 3001

Sent by email to SAelectricity2015@aer.gov.au

CIT Submission to SA Power Networks Regulatory Proposal (2015 – 2020)

As a large energy consumer in South Australia I would like to thank the Australian Energy Regulator for allowing us to make a submission on SA Power Networks Regulatory Proposal 2015-2020. Whilst we have had very good service from SA Power Networks we are an unhappy SA Power Networks customer as a result of the unsustainable price increases imposed on our business by SA Power Networks over the last pricing period. We strongly oppose the current proposal and believe that there is justification for significant reduction in the revenue proposals presented by SA Power Networks.

Please feel free to contact me if you would like to discuss our submission further.

Regards

Gavin McMahon

Gavin McMahon
Chief Executive Officer

Submission
To
The Australian Energy Regulator
By
Central Irrigation Trust
on
SA Power Networks Regulatory Proposal 2015-2020

Recommendations

1. We believe that a 25 % reduction in SA Power Networks revenues in the first year of the regulatory period is justified with only CPI increases necessary from the new base in the subsequent years.
2. For a low risk business with a guaranteed revenue stream the Weighted Average Cost of Capital should be at the lower end of the AER recommended range. This is significantly lower than the 7.62% proposed.
3. The regulated asset base should not increase in real terms over the life of the pricing path or in transition from the current regulatory period to the new one. As most consumers (79% surveyed) are satisfied with the reliability of the network, and demand static or falling, there is no justification for significant increases in capital investment.
4. SA Power Networks should identify cost savings within the business that can be passed on to customers. This would be consistent with the National Electricity Objective which mandates efficiency for the long term interest of customers. The trend of increasing capital expenditure, increased operational expenditure combined with no productivity improvements is at odds with the realities that most Australian businesses and Governments are facing.
5. The increase in safety capital expenditure is very difficult to justify considering it was a minor capital expenditure item in 2010 and becomes the major augmentation capital expenditure in 2018.
6. Many of the non-essential infrastructure upgrades should be on a user pay basis. For example visual amenity, sms messaging of outages, advice on solar systems, monthly meter readings could be on a fee for service and the true value of those services would then be understood by those who use them.
7. Much of the SA power Networks proposal refers back to the customer consultation process for justification or guidance of new expenditure. We believe that this process was flawed and was a “push” process rather than a truly engaging conversation with customers. Subsequently the information should be ignored by the AER as a justification for expenditure increases.
8. We would like to see the Marginal Loss Factors for the interconnectors to be spread across all users in the state rather than discriminating against those who are unfortunate enough to be geographically located at points close to the interconnector.

Who is CIT

Central Irrigation Trust (CIT) is a company that extracts water from the River Murray and supplies it to 1500 family farms, 3500 residences and 35 businesses in the Riverland of South Australia. The region is a major horticultural region producing wine, citrus, almonds, stone fruit and various other crops with a regional farm gate value of $540 million. Much of the regions produce is exported and competes against other producing countries such as Argentina, South Africa, Chile, Peru, Turkey and the US. Consequently our industries must be cost competitive internationally.

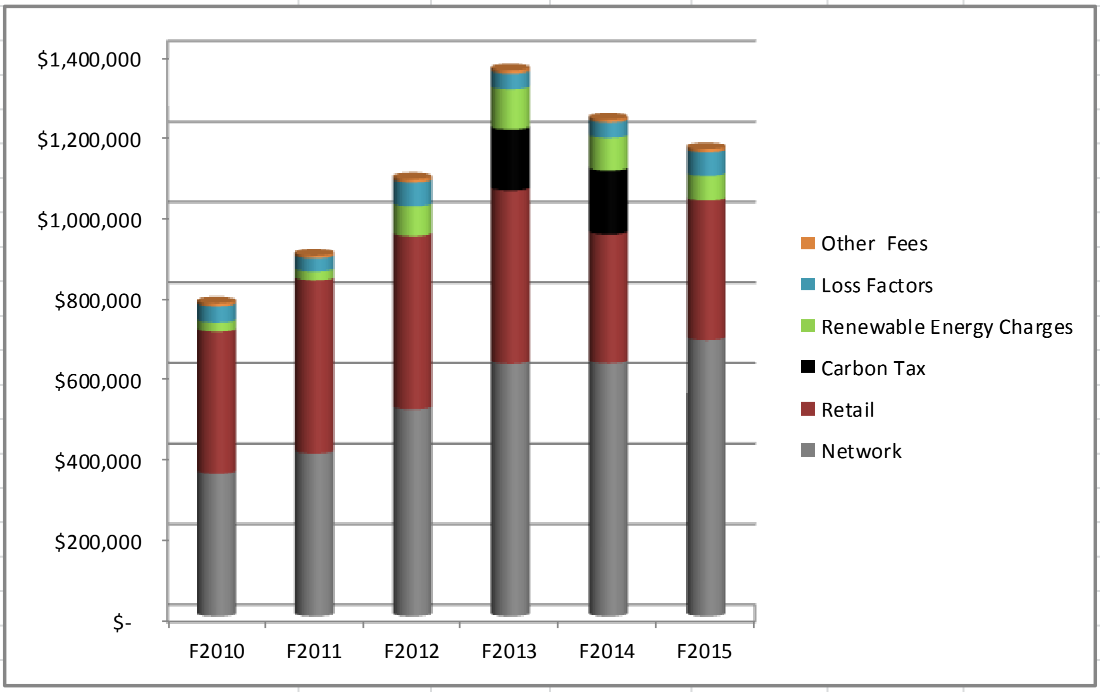
In seeking to be a leader in water management our water is supplied through fully automated pumping stations and pressurised pipeline systems. Our entire pumping infrastructure uses electricity as its source of energy and our total energy spend in 2013/2014 was approximately $4.5 million.

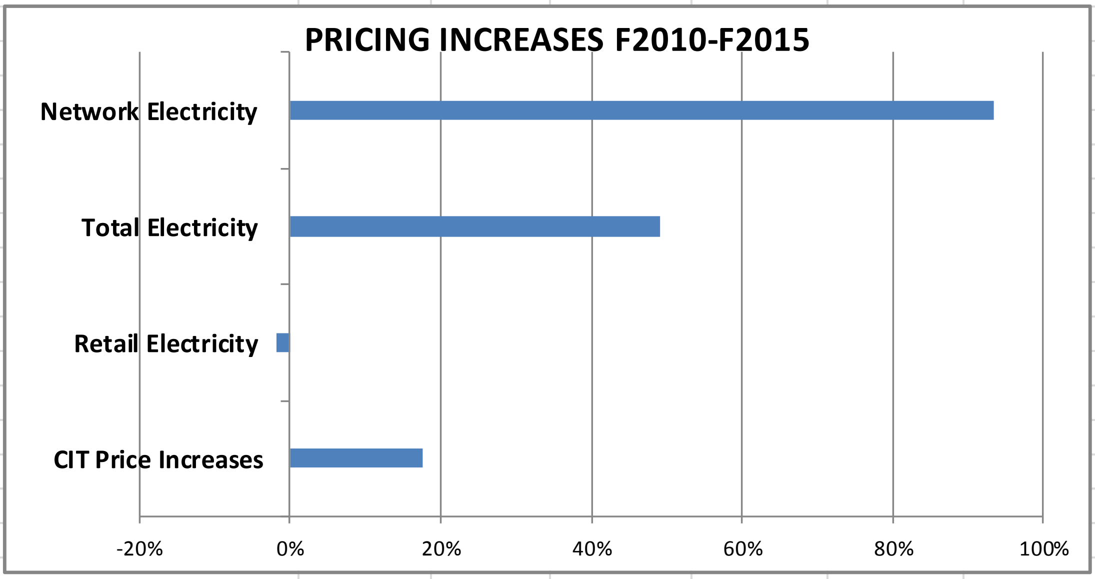
CIT has seen significant and unsustainable increases in its electricity network charges over the last 5 years. We have seen network charges almost double over that period which is substantially greater than was forecast in the 2010-2015 SA Power Networks' Regulatory Proposal. No other input cost in our business has risen anywhere near these levels and in comparison the retail component of our bills has reduced over the same period.

The increases are illustrated below using data from the Loxton Pumping Station, which is 1 of the 13 pumping stations that we manage.

LOXTON PUMPING STATION ELECTRICITY COSTS F2010 to F2015

Annual Expense	F2010	F2011	F2012	F2013	F2014	F2015
Network	$ 354,614	$404,794	$ 514,720	$ 627,484	$ 628,701	$ 686,383
Retail	$ 352,669	$430,008	$ 430,008	$ 430,008	$ 319,779	$ 346,095
Carbon Tax	$ -	$ -	$ -	$ 151,483	$ 159,093	
Renewable Energy Charges	$ 22,789	$ 21,930	$ 73,950	$ 100,927	$ 81,669	$ 61,252
Loss Factors	$ 40,388	$ 32,643	$ 59,307	$ 37,823	$ 37,576	$ 58,821
Other Fees	$ 7,787	$ 7,297	$ 8,465	$ 8,491	$ 7,711	$ 8,164
Total	**$ 778,246**	**$896,672**	**$ 1,086,449**	**$1,356,216**	**$1,234,530**	**$ 1,160,714**





N.B. based on 3,219,920 kwh Peak and 4,098,080 kwh Off Peak usage and 4,545 Kvar Demand each year

The Loxton Pumping Station is our largest energy use site but the trends exhibited at Loxton are replicated at all 13 sites.

At the commencement of the 2010 financial year network and retail charges were approximately the same with each representing 50% of the account. Now network charges make up 75% of the account if the new additional charges, such as the RET charges are excluded. CPI increases over the same time have been less than 15%. How can such increases be justified or more importantly allowed?

Such increases are negatively impacting on the businesses of South Australia and affecting companies' investment decisions. In fact the recent announcement of the closure of the Bradken foundry in Adelaide stated that "After 65 years of operation the Bradken foundry at Kilburn will close at the end of next year because the company says the <u>high cost of power</u> and wages has made the plant globally uncompetitive." (*Alexandra Economou Business Reporter* From*:* The Advertiser December 04, 2014, 4:09PM). Professor Goran Roos – who is on the South Australian Economic Development Board and was a member of the Gillard Government's Manufacturing Leaders Group – said labour and <u>energy costs</u> were crippling the country's manufacturing sector, not the high dollar. (This was reported by Jared Lynch the business reporter in the Sydney Morning Herald on October 13, 2014.) We strongly agree with these sentiments.

As a customer what have we received for this massive increase in investment? Our supply and reliability at the 13 CIT sites has not changed and in fact we are happy with the reliability and supply.

We do understand that SA Power Networks is a company that seeks to maximise its return for shareholders. Thus the company's management and board would seek to maximise the profit for the business within the rules and the framework provided. This is a common goal for most companies. However the question that must be answered has the company reverse engineered the pricing process. We believe this to be the case.

As a small regional business employing less than 30 people we find it difficult to dissect the 371 page summary or 16,807 page Regulatory Proposal of SA Power Networks who has a workforce of thousands and annual revenue of many hundreds of millions of dollars. However we will provide the following comments in the belief that substantial price reductions could be achieved by SA Power Networks in the 2015-2020 regulatory period.

<u>Weighted average cost of capital</u>

Network and Transmission businesses are low risk enterprises with relatively inelastic demand. As a monopoly supplier there are no other suppliers from which the customers can seek similar services and hence the consumers must accept the pricing regime imposed. The demand is relatively inelastic as the only other options available for consumers are business closure or substitution for which the costs are well known. Even more alarming with the new regulatory proposals the network companies are now setting revenue caps. This means that their revenue is guaranteed irrespective of demand or circumstances that other businesses have to contend with. This transfers even more risk to the consumers from the distribution companies.

Consequently their return on capital should reflect the low risk investment environment. Many benchmarks exist in the investment arena that reflects low risk returns. The SA Power Networks pricing path proposal for 2015-2020 uses a rate of return (nominal vanilla Weighted Average Cost of Capital) of 7.62% based on a return on equity of 10.45%. This is higher than the AER guidelines for WACC or an equivalent risk return in government or corporate bonds. We believe that these values are too high for the risk profile of the business and a reduction would see a significant drop in the price for consumers. Decreasing prices we believe may stimulate demand benefiting both customers and SA Power Networks. In fact reducing prices and increasing demand may halt the disconnection risk outlined in chapter 26 of the proposal.

Regulated Asset Base

The regulated asset base for the network continues to increase significantly each year as the capital programs spiral upwards. There has also been conjecture whether the original determination for the regulated asset base was inflated. We are concerned that the regulated asset base in South Australia has increased by approximately 30% in 2010-2015 pricing path and will almost double over the decade 2010-2020. All of this is occurring during a period of static or falling demand. This is the opposite of what would occur in other competitive business faced with similar circumstances.

Unfortunately the rules reward the network companies for increased asset bases. However it is an insidious position for consumers as inflated asset bases increase the costs of power and the problem is compounded each year. There also appears to be no avenue for a reduction in the asset base due to revaluations, writing off redundant infrastructure or more efficient lower cost assets.

We have endured significant price increases with the promises of upgrading an aged network. We now expect a significant drop in capital expenditure and subsequent network prices. There is no justification for increasing capital expenditure when total demand is decreasing and this trend continuing. Some big energy users such as Holden, the Bradken foundry and others will close their doors soon and recognition of further demand decreases must occur.

As a customer we find the reliability of the network satisfactory and do not see the need for further upgrades, for changed bushfire prevention activities or hardening of the network against lightening and storms.

SA Power Networks Regulatory Proposal states in 4.1 “South Australians have enjoyed the benefits of one of the most reliable distribution systems in Australia over a long time………. Whilst over the last 4 years South Australia has experienced an increase in the number of severe weather events the underlying reliability performance has remained stable.” This would support our view.

Technological advances can have significant impacts for a business. Whilst we do understand the necessity to invest in technology it should only be undertaken where it will lead to a cost reduction in the networks operation. We are seeing significant increases in funding for technological improvements but not the corresponding reduction on business operating costs that should be passed on to the consumer.

Costs

CIT is expecting a significant decrease in network costs over the 2015 -2020 pricing path. This is in contrast to the small decrease proposed for the first year and CPI increases thereafter.

We have endured significant price increases with the promises of upgrading an aged network and from this pricing path we expect a significant drop in capital expenditure and subsequent network prices. SA Power Networks is making what has been described by the South Australian Government as Super Profits (SA Treasurer ABC radio) at the expense of our communities. There is no justification for increasing capital expenditure when total demand is decreasing or static and this trend appearing to continue into the future. We also do not expect the current expenditure to be the stepping point or baseline for the expenditure in the next pricing path.

CAPEX

SA Power Networks proposal shows the gross capital expenditure (June 2015 $) of around $400 million per year during the 2010 -2015 pricing period increasing to around $600 million per annum in the 2015 – 2020 pricing period. We find it difficult to justify such a significant increase in capital expenditure particularly in a time of falling or static demand. The increase in safety capital expenditure is very difficult to justify considering it was a minor capital expenditure in 2010 and becomes the major augmentation capital expenditure in 2018.

OPEX

Operating expenses (SCS operating expenditure) in the same proposal are rising from less than $250 million per annum in the 2010 -2015 period to $329 million per annum in 2019/2020. In their proposal SA Power Networks forecast no productivity improvements being made and employee costs rising significantly greater than CPI.

This trend of increasing capital expenditure, increased operating expenditure combined with no productivity gains is at odds with the realities that most businesses and governments must face.

ABC rural posted the following "Mining companies report cost savings of 30 per cent, want mine suppliers to follow suit." (David Claughton 24 November 2014, 12.59 pm). The Advertiser reported "Treasurer Tom Koutsantonis has predicted a return to surplus by 2016, driven by a sustained cost-cutting drive, in his Mid-Year Budget Review released on Tuesday." (State Political Editor - Daniel Wills, The Advertiser, December 23, 2014, 11:14PM) SA Power Networks needs to play its part in a rebalancing economy.

We believe that if increasing capital expenditure is required there should be a reduction in expenditure in other areas.

<u>Vegetation Management</u>
We oppose the vegetation management strategy outlined and would like to see a more efficient and cost effective process employed. As a customer we find the reliability of the network satisfactory and do not see the need for further upgrades, changed bushfire prevention activities or hardening of the network against lightening and storms.

<u>Corporate Overheads</u>
Corporate overheads and corporate sponsorship should be scrutinised and reduced. As a regulated monopoly operating in a low risk business environment there is no need to advertise your business and corporate overheads should be significantly lower than other businesses operating in a competitive environment. We would also like to see if the corporate overheads are benchmarked against other similar utilities internationally such as in the United Kingdom or New Zealand? In fact SA Power Networks total operations should be benchmarked against other similar businesses around the world. As the current owner of SA Power Networks also owns energy utility in the UK this may be a suitable comparison. Unfortunately benchmarking against other similar regulated utilities can be self-fulfilling.

<u>Safety</u>
Community safety is also a program where we have concerns over allocated expenditure. For example much of the SA Power Network infrastructure is above ground and has been in place for over 40 years. Most new developments have underground infrastructure installed. If other infrastructure owners, such as road transport authorities or councils have encroached closer to the SA Power Networks it should not be the responsibility of SA Power Networks to relocate their infrastructure. If the SA Power Networks infrastructure is to be relocated the cost should be borne by the encroaching infrastructure owner.

<u>Visual Amenity</u>
We also strongly oppose the visual amenity program that has commenced. In Adelaide we find it ironic that the visual amenity of a substation was changed by installing a graphic on the fence surrounding the substation with images of a

substation. We believe that if communities want the visual amenities improved the revenues should be recovered from that community and not all users. In fact many of the non-essential infrastructure upgrades should be on a user pay basis. For example visual amenity, sms messaging of outages, advice on solar systems, monthly meter readings could be on a fee for service and the true value of those services would then be understood by those who use them. It would also signify the worth of such services.

As a business we would also like to understand the total revenue returned to the owner of SA Power Networks from ownership and operation of the business. This would assist in determining if our communities are treated fairly in a business sense.

Consultation process

Much of the SA power Networks proposal refers back to the customer consultation process for justification or guidance of new expenditure. We believe that this process was flawed and was a “push” process rather than a truly engaging conversation with customers. Interestingly the more we meet and discuss this process with other consumers we find that they have a similar opinion of the process being a push process in favour of SA Power Networks.

CIT attended the focus group meeting in the Riverland, filled out the on line questionnaire and attended the customer meeting in Berri. Our experience is that the consultation process is flawed and biased toward influencing the outcomes in favour of the SA Power Network view. If the question was posed “would you like to see your bills decrease by 25%” I am sure that there would have been a unanimous response. In our experience the option of not providing works and significantly reducing power prices was not presented and it was difficult to input such a response to the discussions or questions posed.

Section 9.3 of SA Power Networks Proposal indicates that there is not a glowing endorsement for significant future investment and the pricing proposal.

As CIT see the consultation as a push process we do not accept the results of the surveys and any conclusions drawn from it even though they may be statistically valid.

We also question the reach of the program when there were only 378 soft copy downloads and 550 hard copy distributions of the Directions and Priorities program.

In a recent business forum in the Riverland (Riverland Energy Association Inc.) of major downstream processors all attendees were unaware of the consultation process that has been conducted by SA Power Networks and the subsequent impacts on their energy charges. All companies involved were unhappy with the recent dramatic increases in power prices.

Marginal losses

We also reside in an area that is influenced by the Murray Link Interconnector. In the 2014/2015 financial year we will see our marginal loss factor increase by 5.2% adding another significant cost to our business. The explanation for such an increase is that whist electricity demand has decreased in South Australia the generation capacity has not correspondingly decreased and as a result the excess power is being sent to Victoria. This situation increases losses on the lines providing the connection between the states and the customers on those lines must pay for the losses. Again we believe this is another unjust impost on those consumers connected to the Berri Node.

We would like to see the Marginal Loss Factors for the interconnectors to be spread across all users in the state rather than discriminating against those who are unfortunate enough to be geographically located at points close to the interconnector. The Berri node should be declared a virtual node and the loss factors subsequently adjusted.

Conclusion

We believe that a 25 % reduction in SA Power Networks revenues in the first year of the pricing path is justified with only CPI increases necessary from the new base in the subsequent years of the regulated period. We look forward with optimism the outcome of the determination.

Yours truly,

Gavin McMahon

Gavin McMahon
Chief Executive Officer