QUEENSLAND FARMERS' FEDERATION

SUBMISSION TO
AUSTRALIAN ENERGY REGULATOR (AER) ON THE ERGON ENERGY REGULATORY PROPOSAL (REVISED) 2015-2020

24 July 2015

The united voice of intensive agriculture

Queensland Farmers' Federation

The Queensland Farmers' Federation (QFF) is the united voice of our state's intensive agriculture industries. We are a federation that represents the interests of 16 of Queensland's peak rural industry organisations, which in turn collectively represent more than 13,000 primary producers across Queensland. Our member organisations are:

- CANEGROWERS,
- Cotton Australia,
- Growcom,
- Nursery & Garden Industry Queensland,
- Queensland Chicken Growers Association,
- Queensland Dairyfarmers' Organisation,
- Burdekin River Irrigators Area Committee,
- Central Downs Irrigators Limited,
- Fitzroy Basin Food & Fibre,
- Flower Association of Queensland Inc,
- Pioneer Valley Water Co-operative Limited,
- Pork Queensland Inc,
- Queensland Chicken Meat Council,
- Queensland United Egg Producers,
- Australian Organic; and
- Queensland Aquaculture Industries Federation,

Our agricultural sector is critical to the success of the Queensland economy making up around 5.1% of the State's GDP, or $14.5 billion. Agriculture in Queensland has bright future and is well placed to take advantage of the expanding population in key Asian markets.

QFF engages in a broad range of economic, social, environmental and regional issues of strategic importance to the growth, profitability and sustainability of the agricultural sector. Our aim is to achieve a strong and sustainable agricultural industry that can capitalise on future opportunities.

Ergon Energy's Revised Regulatory Proposal for 2015-2020

QFF welcomes the opportunity to make a submission to the AER on Ergon Energy's Revised Regulatory Proposal for 2015-2020.

Ergon Energy revised submission rejects the AER assessment that they are operating inefficiently and proposes to accept a revenue reduction of 26% this financial year provided that an increase of 29% is allowed in the 2016-17 leading to a flattening of increases to 1% in the final two years of the regulatory period. Ergon's case continues to push for achieving a level of charges at or below 2014-15 levels which they consider is the best possible price that can be delivered.

This approach questions the analysis undertaken by the AER including benchmarking and errors in assessment of cost items.

It is difficult for QFF to accept that Ergon Energy is operating at efficient levels at the end of the last regulatory period particularly in view of the benchmarking undertaken by the AER. Our submission on the AER Preliminary Determination expressed the view that AER had not gone far enough to bring both networks back to efficient levels of operation over the next five years. It is questioned whether there will be any impetus for Ergon to push to implement efficiency measures if revenue levels are set at levels above that reached in 2014-15.

It is recommended that AER specifically investigate the following aspects of the Ergon Energy response:

1. Treatment of capital contributions, removal of assets due to disposals and service calculations in assessing the opening RAB

2. The revised estimation of an allowed rate of return on capital of 7.41%. QFFs submission on the AER preliminary determination argued that AER should examine further reductions in the WACC rate proposed of 5.85% for the following reasons:
    a. Both distribution entities are able to manage debt funding risk, base interest risk, credit cost risk and inflation risk completely independently from one another allowing them more flexibility to reduce debt costs and manage risks compared with private sector borrowers. Also the cost of debt has fallen significantly and is not expected to vary significantly over the coming term
    b. A low market risk premium should apply in assessing return on equity.
    c. The AER Consumer Challenge Panel's survey of actual debt and equity costs shows that 'investors are valuing regulated businesses significantly more highly than their regulated asset bases, and that lenders are lending to the regulated business at significantly lower rates than consumers are being charged.'

3. Revised operating expenditure forecasts. AER found that Ergon must make significant efficiency gains. QFF questioned whether AER's preliminary findings would be sufficient to drive Ergon to reduce opex to acceptable efficiency levels within the regulatory period. It was also noted that the Deloitte Access Economics report of opex performance highlighted the very low labour productivity in both Ergon and Energex compared with other networks. QFF recommended that AER review their preliminary determination on opex levels for each entity and set revised efficiency targets for each to meet over the regulatory period.

4. Proposals for under or over recovery of revenue collected through DUOS charges, carryover for incentive schemes and avoiding double recovery of costs for shared assets

5. Ergon's revised Annual Revenue Requirement

6. Ergon's preferred approach to establishing X factors exclusive of feed-in-tariffs

7. Application of the EBBS during the new regulatory period and the implications for the application of the CESS in this period.

QFF submits that if Ergon Energy proposals for a revised Annual Revenue Requirement are accepted there will be insufficient direction to Ergon to take the action required to achieve efficient levels over the coming five year regulatory period.

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