**Submission to**

**AUSTRALIAN ENERGY REGULATOR (AER)**

**on the**

**Preliminary Determination for the Ergon Energy and Energex Regulatory Proposals for 2015-2020**

**3 July 2015**

QFF welcomes the opportunity to make a submission on AER’s Preliminary Determination on both the Ergon Energy and Energex Regulatory Proposals for 2015-2020.

The Queensland Farmers’ Federation (QFF) collectively represents primary producers in Queensland’s intensive agriculture industries: sugarcane, cotton, horticulture, dairy, nursery, chicken meat, flowers, eggs and pork. We also represent local irrigator groups and emerging industry groups such as organics and aquaculture. QFF engages in a range of economic, social, environmental and regional issues of strategic importance to the growth, profitability and sustainability of the sector.

As outlined in our January submission, spiralling electricity prices over recent years is having significant impacts on the productivity of irrigation enterprises. While transitionary tariffs have been implemented, it is fully expected that many irrigation enterprises in regions across the state will be unable to transition to regulated tariffs by 2020. The alternative is for them to make significant investments to shift off the grid as much as is possible.

The AER Preliminary Determination does little to address this problem. As outlined in our prior submission, the revenue allowances for both Ergon Energy and Energex for the last regulatory period were excessive and encouraged opex and capex expenditure far in excess of what could be regarded as efficient levels of operation. AER’s efficiency benchmarking confirms this by showing a significant ‘gap in performance’ between both Ergon and Energex and the efficiency levels achieved by most other distributers across Australia. QFF is concerned that the Preliminary Determination has not gone far enough to bring both networks back to efficient levels of operation over the next five years.

It is recommended that the revenue caps outlined in the Preliminary Decisions be further lowered based upon consideration of the following issues.

1. **Assessment of Regulated Asset Base**

It is questioned whether capital investment by both Ergon and Energex over the past five years can be justified as being necessary and efficient. Both distributers have undertaken significant investment programs during this period which is in contrast to most of the programs for southern distributers. It is recommended that the AER reassess the significant investment programs for prudency and efficiency and review the RAB totals to take account of the findings of the analysis.

1. **Weighted Average Cost of Capital**

QFF submits that the AER should examine further reductions in the WACC rate proposed of 5.85% for the following reasons:

1. 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
2. A low market risk premium should apply in assessing return on equity.
3. 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.’
4. **Operating Expenditure**

AER has accepted Energex opex proposals but found that Ergon must make significant efficiency gains. Both networks increased opex significantly over the past regulatory term. QFF remains concerned that AER’s preliminary findings will be insufficient to drive both entities to reduce opex to acceptable efficiency levels within the next five years. The Deloitte Access Economics report of opex performance highlights very low labour productivity in both Ergon and Energex compared with other networks. QFF recommends 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.

1. **Other Issues**
   1. ***Metering*** – While QFF understands the reasons for ‘unbundling’ of metering services, it is submitted that there has been inadequate consultation on the decision to implement this change in 2015-16. QFF expects that there will be significant confusion and reaction once the networks begin implementing metering charges in addition to regulatory charges just determined by the Qld Competition Authority. A delay of implementation by twelve months would allow better consultation on the implementation of this initiative.
2. **Conclusion**

QFF submits that there is a significant risk that AER’s preliminary determination will be insufficient to drive both networks to take the action required to achieve efficient levels over the coming five year regulatory period. QFF recommends that AER reduce the revenue caps to ensure efficiency targets are met.