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Submission

8 December 2017

Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Via email: aerinquiry@aer.gov.au

Dear Sir/Madam

Re: AER Discussion Paper: Profitability Measures for Regulated Gas and Electricity Network Businesses

The Queensland Farmers' Federation (QFF) is the united voice of intensive agriculture in Queensland. It is a federation that represents the interests of peak state and national agriculture industry organisations, which in turn collectively represent more than 13,000 primary producers across the state. QFF engages in a broad range of economic, social, environmental and regional issues of strategic importance to the productivity, sustainability and growth of the agricultural sector. QFF's mission is to secure a strong and sustainable future for Queensland farmers by representing the common interests of our member organisations:

- CANEGROWERS
- Cotton Australia
- Growcom
- Nursery & Garden Industry Queensland (NGIQ)
- Queensland Chicken Growers Association (QCGA)
- Queensland Dairyfarmers' Organisation (QDO)
- Burdekin River Irrigation Area Irrigators Ltd (BRIA)
- Central Downs Irrigators Ltd (CDIL)
- Bundaberg Regional Irrigators Group (BRIG)
- Flower Association
- Pioneer Valley Water Cooperative Ltd (PV Water)
- Pork Queensland Inc.
- Queensland Chicken Meat Council (QCMC)
- Queensland United Egg Producers (QUEP).

QFF welcomes the opportunity to provide comment on the AER discussion paper 'Profitability measures for regulated gas and electricity network business. Given QFF is a Queensland-based organisation and only represents the interests of Queensland's intensive agricultural industry, this submission only refers to regulated electricity network businesses. QFF provides this submission without prejudice to any additional submission provided by our members or individual farmers.

QFF is also a member of the Agricultural Industries Energy Taskforce which has provided a more detailed response to the discussion paper.

QFF is pleased to see that the AER is investigating suitable profitability measures for the regulated electricity network businesses. QFF, like other advocacy organisations, has previously raised concern regarding the profit levels of the regulated network businesses. QFF believes that excessive profitability of regulated electricity network businesses is a particular issue for Queensland given our ownership structure.

Background

The Queensland Government has a high degree of control over Queensland's electricity prices, with 100% ownership of the Queensland networks, 65% ownership of the Queensland generators and 100% ownership of the regional Queensland retailer.

The key driver of Queensland's excessive electricity prices is the excessive prices of Queensland's monopoly electricity networks. The charges of the Queensland's networks are now the highest of any network both nationally and internationally.

Numerous reviews have identified that the majority of the Queensland networks' price increases over the past decade were unnecessary, and are the result of the networks exploiting deficiencies in the NEM regulatory framework, gaming the AER to achieve revenue allowances well above the efficient levels.[1]

Queensland's electricity networks are particularly profitable. The Queensland Government is realising returns from the Queensland networks of many multiples of the returns being achieved by the best blue-chip companies in all other sectors of the Australian economy.[2]

The regulated electricity networks receive guaranteed returns on their regulatory valuations – their Regulatory Asset Bases (RABs) – which in turn drive most of the networks' revenues and prices. Importantly, the RABs of the Queensland networks have grown at much higher rates than the networks in the other states. As a result, the Queensland networks' returns on their RABs are driving their prices to a greater degree than other Australian energy networks.

For example, over the previous regulatory period, the Queensland networks' returns on their RABs accounted for: [3] [4]

- 77 % of Powerlink Queensland's revenue allowances
- 75% of Ergon Energy's revenue allowances
- 74% of Energex's revenue allowances.

Queensland's networks have also been cited in the literature as over-investing in their RAB. [5]

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[1] Assets or Liabilities? The Need to Apply Fair Regulatory Values to Australia's Electricity Networks, Hugh Grant, 5th May 2016
EUAA: Australia's rising prices and declining productivity: the contribution of its electricity distributors
EUAA: A comparison of outcomes delivered by electricity transmission network service providers in the NEM, Oct 2012
Electricity Network Regulatory Frameworks: Productivity Commission Inquiry Report, 9 April 2013
Putting the customer back in front: How to make electricity cheaper. Grattan Institute, December 2012
The Energy Market Death Spiral - Rethinking Customer Hardship, Paul Simshauser and Tim Nelson
PIAC: Privatisation and the regulatory valuation of electricity distribution network service providers in New South Wales: Evidence and Issues
Utilities Policy: Independent Regulation of Government–Owned Monopolies: An Oxymoron?
The Garnaut Review Update Paper 8: Transforming the Electricity Sector. Garnaut R. (2011)
[2] Assets or Liabilities? The Need to Apply Fair Regulatory Values to Australia's Electricity Networks, Hugh Grant, 5th May 2016
[3] 'Return on capital' plus 'return of capital' (depreciation) allowances
[4] Assets or Liabilities? The Need to Apply Fair Regulatory Values to Australia's Electricity Networks, Hugh Grant, 5th May 2016
[5] Assets or Liabilities? The Need to Apply Fair Regulatory Values to Australia's Electricity Networks, Hugh Grant, 5th May 2016

The Queensland networks’ excessive RABs are the result of them exploiting deficiencies in the regulatory framework to secure capex allowances from the AER well in excess of efficient levels. The levels of overinvestment in the Queensland networks are the highest in Australia, resulting in them having the lowest capital efficiency levels in the NEM. [6]

Returns on the Queensland networks’ RABs will continue to drive the networks’ excessive prices and profits as their RABs continue to grow in future.

Outcomes

QFF understands that the profits generated by the government owned electricity network businesses provides the Queensland Government a substantial revenue windfall that can be used to do positive things in the economy. However, on the flipside, the unsustainable electricity price increases that have been experienced in Queensland have resulted in reduced business activity and closures in many sectors, which it could be argued negate the positive use of profits. Regardless, the Queensland Government’s reliance on this revenue has stifled the necessary energy policy reform which is urgently needed.

Having Queensland’s electricity prices driven by such extraordinary profits contradicts the advocated positions of successive Queensland Governments regarding the importance of ensuring efficient and fair electricity prices for Queensland consumers.

Queensland’s intensive agricultural sector relies heavily on electricity to power irrigation, refrigeration, processing and other equipment to maintain food quality to animal welfare standards. In response to the excessive electricity prices, Queensland consumers are exhausting all opportunities available to reduce their electricity costs. In addition to reducing consumption through energy efficiency, demand management and installation of renewables, consumers are increasingly investing in self-generation to avoid excessive network costs.

For example, Queensland’s irrigators are increasingly pursuing inefficient technology substitutions such as moving to the use of diesel pumps rather than electrical pumps and, in growing numbers are reverting to dryland farming practices. This inadvertently is now triggering a ‘death spiral’ of our irrigation assets including those owned and operated by the Queensland Government. Whilst these decisions are justified on the basis of current electricity prices, most of the decisions are actually highly inefficient as they are based on pursuing alternatives to artificially inflated electricity prices.

As a result, Queensland’s artificially inflated electricity prices are driving ongoing demand reductions and accelerating the industry death spiral, which if allowed to continue, will ultimately be much more destructive to the future viability of the Queensland Government-owned energy companies than the short-term implications of implementing more sustainable prices and reducing the currently levels of profitability.

Response to the Discussion Paper

QFF welcomes the AER’s action to identify profitability measures and the data required to calculate these measures. QFF believes that this data adds to the transparency of the revenue proposal process. That said, even with this data being made available, many consumers will still not have the relevant expertise to independently assess or usefully participate in the regulatory process.

[6] AER Annual Benchmarking Reports

QFF does not agree with the AER's presumption that 'if a network operator is able to deliver the regulated services at a lower cost than forecast, both consumers and the operator share the benefits' (page 3). This statement requires further clarification.

It is disappointing that both the data (reliability and validity) received and utilised by the AER is inconsistent and compromised, in part due to different methodologies utilised across the regulated network businesses. QFF welcomes the AER's approaches to address these issues.

The preferred profitability measures identified in the discussion paper are commensurate with standard business practices. QFF is unable to provide comment beyond this.

In addition to profitability measures alone, QFF would also welcome a 'benchmarking approach' against regulated network businesses and other external enterprises with which consumers would be familiar with. Over the past decade, Queensland's regulated electricity networks have undermined the AER's efforts to introduce benchmarking when setting opex allowances, resulting in the AER setting their opex allowances based on their historical costs, rather than 'benchmarked efficient costs'.

It is important to note that Ergon Energy's legal challenge on the AER's benchmarking[7] was a major factor in the recent Australian Competition Tribunal decision that will result in NSW and ACT consumers paying $3 billion above the AER's revenue determinations – a decision that will have further flow on effects in raising Queensland's network prices.

The Queensland networks' ability to prevent the AER from applying benchmarking to their opex determinations resulted in the following outcomes in the networks' most recent revenue determinations:

- the AER fully accepted Energex's proposed opex, despite the AER's benchmarking identifying that Energex's opex is 35-40% above the benchmark efficient level
- the AER only applied a 5% reduction to Ergon Energy's proposed opex, despite the AER's benchmarking identifying the need for reductions of 55-60%
- the AER fully accepted Powerlink's proposed opex, despite the AER's benchmarking identifying that Powerlink's opex is around twice the efficient level.

As a result, the Queensland electricity networks' total opex spend over the next five years will be $1.8 billion ($360 million per annum) above the efficient level, again increasing their profitability.

If there are any queries regarding this submission, please do not hesitate to contact Dr Georgina Davis at Georgina@qff.org.au.

Yours sincerely

Travis Tobin
Chief Executive Officer

[7] Ergon Energy Intervention to the Ausgrid, Endeavour Energy and Essential Energy Limited Merits Review (LMR) Appeal on the AER's 2014-19 revenue determination for the NSW distributors