NSWIC
NEW SOUTH WALES IRRIGATORS' COUNCIL

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Draft Submission

Australian Energy Regulator

Better Regulation - Draft Rate of Return Guideline

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Introduction

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

This submission represents the view of the Members of NSWIC in respect to the Australian Energy Regulator's (AER) *Better Regulation - Draft Rate of Return Guideline*. However, each Member reserves the right to independent policy on issues that directly relate to their areas of operation, or expertise, or any other issue that they may deem relevant.

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General Comments

We appreciate the opportunity to provide comment to the Australian Energy Regulator's (AER) *Better Regulation - Draft Rate of Return Guideline* for electricity and gas transmission and distribution network service providers.

Electricity is a vital input into irrigated agriculture and our Members have - in some instances - experienced an exponential increase in the cost of electricity over the previous years. Such cost increases have significantly constraint irrigators, changed their business operations and has led to considerable inefficiencies in the utilisation of energy related equipment on-farm. Any further price increase will be detrimental to the sector and we urge the AER to thoroughly consider the impact any further amendments to the determination of NSW Transmission Network Service Providers (TNSPs) and Distribution Network Service Providers (DNSPs) will have on irrigators.

Large investments in energy intensive irrigation equipment on-farm have led to increased energy use and increased input costs due to recent price rises. As a matter of background, these capital investments on-farm were necessary for many irrigators to remain financially viable and competitive, especially in light of large scale water conservation policies by both State and Federal policymakers. The push towards more water efficient irrigation equipment has however come at a trade-off - in the form of higher electricity use - which has often contributed significantly to overall input costs.

Without sufficient alternatives to substitute away from electricity use in the short term, irrigators are vulnerable to future electricity price rises. This is particularly importance since alternative forms of energy are also projected to increase in the near future. As such, the cost of energy (electricity or otherwise) has a direct impact on the revenue and profit margins in irrigated agriculture since irrigators are generally price takers in domestic and international markets. With increasing input costs and no adjustment mechanism to amend revenue, irrigators are continuously asked 'to do more with less and pay more for it'. Such an outcome is unsustainable for irrigated agriculture in the long run.

As the explanatory statement to the *Draft Rate of Return Guideline* outlines, the AER is charged with focusing on promoting the long term interest of consumers, which irrigators are part of. NSWIC considers the current network charges to be not sustainable and not in the long interest of irrigators. Further amendments must be made to ensure that the next determination of network service providers will not lead to further price rises and consequential detrimental outcomes for consumers.

Specific Comments

NSWIC would like to provide the following specific comments to the AER's *Better Regulation Draft Rate of Return Guideline*;

AER Regulatory Responsibility

NSWIC considers it the prime responsibility of the AER to ensure that all of the Draft Guidelines - including the *Draft Rate of Return Guideline* - will assist in the regulation of network service providers (NSP) that is in the long term interest of consumers. Whilst we congratulate the AER on commencing a review of its current regulatory practices (through the Better Regulation Reform Program), we have found little evidence within the Guidelines so far that will insure adequate consumer protection from further unsustainable price rises.

As we have previously outlined, network charges are the single most important cost component of an irrigator's electricity bill and we believe that any further price rises in this regard will have detrimental consequences for the sector. For this reason, NSWIC submits that the *Draft Rate of Return Guideline* must incorporate a mechanism that will insure that consumer protection is the guiding principle of any future allowed rate of return determinations.

In addition, NSWIC considers it vital that the *Draft Rate of Return Guideline* puts in place a process that allows the AER to determine a future allowed rate of return that leads to effective and efficient future investments by NSP. NSWIC does not believe that the current system operates in consumers' long term interest. Consumers have therefore been burdened by unjustified cost increases over recent years. We submit that the *Draft Rate of Return Guideline* must be include an appropriate mechanism that ensures no inefficient investments will be made in the future.

Complexity

NSWIC understands that the AER is instructed under clauses 6.5.2(n) and 6A.6.2(n) of the National Electricity Rule (NER) to provide an overview of the methodologies and estimation methods for determining the NSP allowed rate of return, we consider the AER's approach highly complex and not transparent for consumers.

Given that the AER proposal refers to multiple models, reports and valuation techniques as well as a range of data sources, NSWIC submits that the AER must provide a detailed analysis of the trade-offs between accuracy and transparency in applying such a complex methodology. In particular, we are concerned that the use of multiple different models (as proposed by the draft guidelines) will lead to contradicting outcomes which will further confuse consumers.

Benchmark entity

NSWIC has concerns about the usefulness of determining a benchmark efficient entity that holds similar risk as the current NSP. In NSWIC's opinion, NSP have similar characteristics as a natural monopoly (in their own service area) and hence a comparison between the operation of NSP in a monopoly environment to a competitive environment will be more useful.

Such a comparison would be particular important as it would highlight the difference in costs and ultimately prices for consumers in providing network services. It should be remembered that the NSP are government owned in NSW and that the current nominal vanilla WACC of 8.78% - 8.83% provides a significantly higher return for the NSW Government than the return enjoyed by customers of NSP.

Demand Forecasting

NSWIC concurs with the AER's assessment that the overall rate of return should promote *"efficient investment in, and efficient operation and use of, electricity and natural gas services for the long term interests of consumers",* however we are concerned that the current *Draft Rate of Return Guideline* allocate the majority of demand forecasting risk to consumers. As the rate of return is only one component that is factored into the decision making process for further investment decisions, NSWIC would like to stress that the previous demand forecast errors has lead to large scale investment by NSP. The costs of these investments have been reflected in recent price increases.

NSWIC submits that the Draft Guideline has not provided sufficient evidence how such demand side risk will be mitigated.

Intra-period adjustment of the WACC

NSWIC is concerned with the AER's proposes to annually adjust the WACC based on the trailing average portfolio approach. We believe that such an approach will lead to less transparent outcomes for customers.

In addition, we are not convinced that a one-sided re-evaluation of the return on debt is effective and submit that the WACC should be set for the entire determination period to provide clarity and consistency.

Return on debt

NSWIC submits that the seven year trailing average portfolio approach will provide less clarity and transparency for the overall determination of the allowed WACC parameter. As such, NSWIC submits that the allowed WACC should be set for the entirety of the regulatory period instead of being re-evaluated every time period.

Should a trailing average approach be adopted however, NSWIC submits that the weights should reflect the approximation to the present regulatory period, instead of having equal weights for each year of the seven year period.

Consistency between regulators

NSWIC would like to point out that the Independent Pricing and Regulatory Tribunal (IPART) is conducting a review into the methodology for determining WACC in NSW. This review is targeted to deal with uncertainty and changing market conditions. While a final decision has not yet been made, it appears that IPART deviates from the AER's assessment on how to calculate the WACC parameter.

NSWIC acknowledges that the industries IPART will be regulating are in some instances different to those relevant for the AER, however we believe that a consistent approach between state and federal regulators will be beneficial and show greater transparency. As such, NSWIC urges the AER to coordinate with state based regulators to establish one common methodology that is consistent across all jurisdictions.

Conclusion

While NSWIC welcomes the AER's *Better Regulation Reform Program*, we urge the AER to prioritise the protection of consumers in its final decision about the Rate of Return Guidelines. The importance of network charges in irrigated agriculture must not be underestimated and we hope that the next determination of NSP will lead to more efficient and affordable charges for consumers.