Replacement of Framework & Approach 2022−27

Powerlink

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1 Introduction

The Framework and Approach paper (F&A) is the first step in a process to determine efficient prices for electricity transmission services. The F&A facilitates early public consultation on the incentive schemes that will encourage efficient network expenditure.

Powerlink's F&A will have a bearing on its next regulatory determination commencing 1 July 2022.

1.1 Why is the F&A important for consumers?

The F&A sets out information around incentive schemes that will apply to network service providers to encourage efficient investment and performance. It also sets out how the AER will apply the Expenditure Forecast Assessment Guidelines and the depreciation methodology for the next regulatory control period.

The F&A is important because it provides an opportunity for interested parties, including consumers, to have a say.

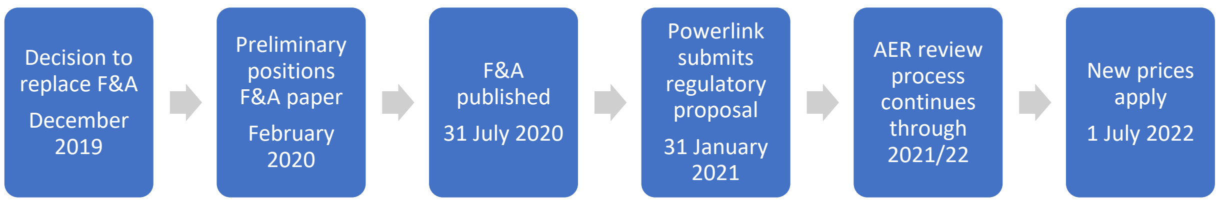
The sorts of issues we will consider in the F&A include:

- whether incentive schemes will apply, for example, to service quality, improvements in network reliability or capital and operating expenditure. The purpose of incentive schemes is to encourage network service providers to manage their business in a safe, reliable manner that serves the long term interests of consumers. The schemes provide network service providers with incentives to only incur efficient costs and to meet or exceed service quality targets. In some instances, network service providers may incur a financial penalty if they fail to meet set targets
- whether depreciation for establishing the regulatory asset base the network service provider's opening regulatory asset base for the next regulatory control period is to be based on actual or forecast capital expenditure.

We consider that consumers should be actively involved in the F&A process as the decisions made will apply for a five-year period before they are reviewed.

Diagram 1 provides an overview of where the F&A sits in Powerlink's revenue determination process for the 2022–27 regulatory control period, commencing 1 July 2022 to 30 June 2027. Stakeholder consultation occurs throughout the process.

Diagram 1: Powerlink's 2022–27 revenue determination process



1.2 Our decision

We consider it necessary to replace the F&A paper for Powerlink for the next (2022–27) regulatory control period, commencing 1 July 2022 to 30 June 2027. We expect to issue a preliminary positions F&A paper in February 2020 outlining preliminary views on the matters outlined in this decision. We must then publish the final F&A paper by 31 July 2020.

Appendix A lists the specific matters we will include in the F&A paper.[1] We will also consider any other relevant matters appropriate or convenient for us to address in the F&A paper.[2]

The 2017–22 F&A paper for Powerlink was published on 22 June 2015.[3]

In accordance with the National Electricity Rules (NER), we intend to publish a replacement F&A paper for Powerlink by 31 July 2020.[4] Before reaching this decision to replace Powerlink's F&A paper, we issued a notice under the NER,[5] inviting submissions on whether it is necessary or desirable to amend or replace the current F&A paper for Powerlink. Submissions closed on 3 December 2019. We received one submission from the Consumer Challenge Panel (CCP) Sub-Panel CCP23.

On 31 October, Powerlink submitted a request to us to address a number of issues in its F&A paper that we are required to consider.[6] This is because the NER includes a provision that permits a network service provider to specify certain issues that must be addressed in its F&A.[7] A copy of Powerlink's request is published on our website alongside this decision.[8]

1 NER, cl. 6A.10.1A(c)(3).

2 NER, cl. 6A.10.1A(g). The AER would consult appropriately on any additional matters it wishes to include in the F&A.

3 See https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/powerlink-determination-2017-2022/initiation.

4 NER, cl. 6A.10.1A(e).

5 NER, cl. 6A.10.1A(c)(2). We issued this notice on 5 November 2019.

6 Powerlink, *Letter to AER on* Framework *and Approach*, 31 October 2019. https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/powerlink-determination-2022-27/initiation.

7 Powerlink's written request was submitted in accordance with NER, cl. 6A.10.1A(c)(1).

8 As required under NER, cl. 6A.10.1A(c)(3)(ii).

2 Our reasons

This section sets out our reasons for deciding to replace Powerlink's F&A paper for the next (2022–27) regulatory control period, commencing 1 July 2022 to 30 June 2027. The sections below correspond to the various components of the F&A.

2.1 Application of incentive schemes

We have developed several mechanisms that provide incentives for network service providers to invest efficiently and therefore be more likely to operate in the long term interests of consumers. These schemes include the service target performance incentive scheme (STPIS), efficiency benefit sharing scheme (EBSS) and capital expenditure sharing scheme (CESS). The overall objectives of the schemes are to:[9]

- incentivise network service providers to spend more efficiently on capital and operating expenditure
- reduce the risk of consumers paying for unnecessary capital expenditure
- share efficient improvements and losses between network service providers and consumers
- encourage appropriate levels of service quality
- maintain network reliability as appropriate.

Powerlink has set out its preliminary views on the matters requiring consideration relating to the application of incentive schemes.[10] These are as follows:

<u>Service Target Performance Incentive Scheme</u>

The STPIS is designed to provide performance incentives for transmission network service providers (TNSPs) to improve or maintain a high level of service for the benefit of customers and National Electricity Market (NEM) participants. Version 5 of the STPIS, finalised in 2015, currently applies to Powerlink.

Powerlink seeks to explore changes to two elements of the scheme:

1. Market Impact Component (MIC)

   Powerlink's view is that significant changes have occurred in generation diversity and location with subsequent impacts on system utilisation in Queensland since 2015. The current scheme utilises historic performance for target setting purposes. Given the changing environment for the operation of the network, it is Powerlink's view this may no longer provide a meaningful future performance benchmark.

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9 AER, *Electricity distribution network service providers, Service target performance incentive schemes*, June 2008, p. 2; AER, *Better Regulation, Draft expenditure incentives*, 9 August 2013.

10 Powerlink, *Letter to AER on* Framework *and Approach*, 31 October 2019. https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/powerlink-determination-2022-27/initiation.

2. Service Component (SC)

   As a consequence of improvements in customer loss of supply events, Powerlink considers there is potential for Powerlink's existing "large" threshold target for the loss of supply event frequency measure to be set at zero for the upcoming regulatory period. Powerlink considers this would appear to be contrary to the intent of the scheme, which aims to provide service-level improvement and benefit to customers. Given this, Powerlink considers there may be an opportunity for the target setting arrangements for the SC to be reviewed to avoid a potential zero target outcome.

Powerlink's view is that similar issues may also be experienced in other NEM jurisdictions and it is important to explore these issues with customers, the AER and other TNSPs to ensure the STPIS, and its target setting mechanisms, remain fit-for-purpose within the current and expected future operating environment.

AER Response

The AER will consider the application of the STPIS scheme in its F&A preliminary positions paper in February 2020.

<u>Demand Management Incentive Scheme and Innovation Allowance Mechanism</u>

At the time the AER received the notification from Powerlink on the need to replace its F&A, the Australian Energy Market Commission (AEMC) was considering a proposal from Energy Networks Australia (ENA) to introduce a Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance Mechanism (DMIAM) to apply to transmission networks. Both schemes currently apply to distribution networks and were introduced to encourage innovation in non-network solutions for the benefit of customers. At the time of writing its notice, Powerlink recognised that the AEMC's draft position was to apply the DMIAM only, to transmission service providers.

Powerlink's view is that extending a DMIS/DMIAM to TNSPs will encourage innovation in non-network solutions at a transmission level, for instance demand management contracting with end-use customers and coordination of Distributed Energy Resources (DER). These types of innovations may lead to benefits for customers through lower transmission and total system costs over time. Powerlink seeks to have DMIS/DMIAM apply in its next regulatory period if introduced by the AEMC.

AER Response

On 5 December 2019, the AEMC published its final determination for a rule change to apply the DMIAM, and not the DMIS, to TNSPs.[11] As a result, the AER must develop and publish the first transmission DMIAM under the NER by 31 March 2021.[12]

In light of the issues raised above, we consider that the application of all incentive schemes should be reviewed in Powerlink's F&A paper.[13]

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11 AEMC, Demand management incentive scheme and innovation allowance for TNSPs, Rule determination, 5 December 2019

12 NER, cl. 11.[118].2.

13 NER, cl. 6A.10.1A(b)(1)-(5).

2.2 Other matters

Powerlink formally advised the AER of its intention to apply a 'Hybrid+' approach to forecast its capital expenditure. Powerlink has had initial discussions with its customers and the AER in relation to this methodology. Powerlink will outline its approach further, within its Expenditure Forecasting Methodology, which must be lodged with the AER in June 2020.

Powerlink seeks further discussion on the expected treatment of the outcomes of other key reforms and/or consultations that are either underway or proposed to impact electricity network service providers during Powerlink's next regulatory period. For example, implementation of the Coordination of Generation and Transmission Investment (COGATI) reforms from 1 July 2022, and implementation of the Transmission Ring-fencing Guideline Review in 2021.

Powerlink also seeks to explore the potential application of regulatory sandbox arrangements, as proposed by the AEMC,[14] to Powerlink's 2022–27 regulatory control period.

The NER require us to consider these matters in developing the F&A for Powerlink for the next regulatory control period. However, we may consider it unsuitable to state a specific position on matters in the F&A paper. This may be because, for example, our position may be dependent on information that will only become available once Powerlink submits its regulatory proposal.

[14] AEMC, *Final Report – Regulatory Sandbox Arrangements to Support Proof-of-Concept Trials,* 26 September 2019.

Appendix A – Matters to be addressed in the F&A

The replacement Powerlink F&A paper will address the following matters:

- application of a range of incentive schemes that encourage things like service quality, improvements in network reliability or efficient capital and operating expenditure. This includes application of the:
    - service target performance incentive scheme (STPIS)
    - efficiency benefit sharing scheme (EBSS)
    - capital expenditure sharing scheme (CESS)
    - small-scale incentive scheme (SSIS)
    - demand management innovation allowance mechanism (DMIAM)
    - expenditure forecast assessment guidelines
    - whether depreciation for establishing the regulatory asset base for the network service provider's opening regulatory asset base for the 2027–2032 regulatory control period is to be based on actual or forecast capital expenditure.