DRAFT DECISION

Directlink Transmission Determination 2020 to 2025

Overview

October 2019

AUSTRALIAN ENERGY REGULATOR

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About our decision

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. We regulate energy networks in all jurisdictions except Western Australia. We set a maximum revenue that network businesses are allowed to recover from customers in providing network services.

The Directlink interconnector is a 59 kilometre, 180 MW high voltage direct current cable between the NSW and Queensland wholesale electricity markets. Directlink submitted a revenue proposal for its electricity transmission network on 31 January 2019.[1] The proposal sets out the revenue Directlink proposes to recover from its electricity customers through transmission charges for the period 2020–25.[2]

Following release of this draft report Directlink will now have the opportunity to submit a revised proposal by 10 December in response to our draft findings. Submissions from interested stakeholders on both the draft decision and revised proposal are invited by 15 January 2020.

The table below sets out the key milestones for our review of Directlink's proposal:

Milestone	Date
Directlink submitted its proposal	*31 January 2019*
AER issues paper published	*28 March 2019*
Public forum on Directlink's proposal held in Sydney	*9 April 2019*
Submissions on AER's issues paper and Directlink's proposal close	*16 May 2019*
AER draft decision published	8 October 2019
Public forum on draft decision	23 October 2019
Directlink submits revised proposal	10 December 2019
Submissions on draft decision and revised proposal due	15 January 2019
AER final decision to be published	30 April 2020

[1] The revenue proposal was submitted by Energy Infrastructure Investments Pty Ltd on behalf of the Directlink Joint Venture. Directlink is managed by the APA Group.

[2] This includes a pricing methodology which allocates the regulated revenue associated with its transmission network and determines the structure of prices that Directlink may charge for its transmission services.

Invitation for submissions

Interested parties are invited to make submissions on our draft decision by 15 January 2020.

We will consider and respond to all submissions received by that date in our final determination.

Submissions should be sent to: Directlink2020@aer.gov.au

Alternatively, submissions can be sent to:

Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

(1) clearly identify the information that is the subject of the confidentiality claim

(2) provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the *ACCC/AER Information Policy* (June 2014), which is available on our website.[3]

[3] https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information

Note

This overview forms part of the AER's draft decision on Directlink's 2020–25 transmission determination. It should be read with all other parts of the draft decisions.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Pricing methodology

Attachment 12 – Pass through events

Contents

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
EBSS	efficiency benefit sharing scheme
MAR	maximum allowed revenue
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
WACC	weighted average cost of capital

Executive summary

Our draft decision allows Directlink to recover $79.2 million ($nominal, smoothed) from its customers over the five years from 1 July 2020 to 30 June 2025. This outcome is $10.6 million ($nominal, smoothed) lower than Directlink's proposal.

Directlink's revenue accounts for about 0.2 per cent of customers' total electricity bill.[4] Although Directlink has a small impact on the overall end price that customers pay, it is our role to review Directlink's spending proposal to ensure that it covers only what is needed and is reasonable.

Having assessed Directlink's proposal, we consider a lower amount of revenue should be recovered from customers using its network. This is driven predominately by our forecast of lower capital expenditure (capex).

Safe and reliable network

We consider the importance of providing safe and reliable electricity via the networks we regulate. Our role is largely to assess whether the proposal is a reasonable and realistic forecast of what is needed to provide safe and reliable operation of the network over the next regulatory control period (2020–25).

The difference between Directlink's proposal and our draft decision relates to the capex proposal. We have substituted a lower forecast capex estimate.

The Directlink interconnector has a finite technical life with the asset to be fully depreciated by 2041. It is now half way through its intended asset life, with assets making up the interconnector in need of replacement or refurbishment, due to age or obsolescence. Our draft decision recognises that Directlink will need to incur additional asset replacement in the next regulatory control period to enable the continued operation of a reliable and secure supply across the interconnector. Although we accept the need for asset replacement, we consider Directlink can maintain its service without the need to spend as much as it proposed.

While lowering overall costs through greater efficiencies, the decision does allow for increased spending to maintain safety, reliability and security of supply, including the costs for replacing obsolete transistors. These transistors are a key component to Directlink's high voltage direct current interconnector and make up the bulk of the replacement capex for 2020–25. We have approved $30.6 million ($2019–20) in total forecast capex, $17.3 million of which is for replacing the obsolete transistors. This is $9.9 million ($2019–20) (or 24 percent) less than Directlink's proposed $40.5 million ($2019–20) of capex.

We had regard to a range of material provided by Directlink, including the regulatory proposal, submissions received and additional analysis undertaken and published

[4] The estimated bill impact is set out in section 1.3 below and Attachment 1 of our draft decision for Directlink.

by us. Our assessment process included a good engagement process with Directlink, including discussions with operations staff and further information gathering. Directlink now has the opportunity to consider our draft decision and put forward its revised proposal and supporting material.

We are satisfied that the revenue we have determined Directlink can recover from its customers for the 2020–25 regulatory control period is in the long-term interests of consumers and that its customers are paying no more than they should for safe and reliable electricity.

Engaging customers

The long term interests of consumers are at the centre of our decisions. Given it is the customer that ultimately pays for network services, their input is important. Consumers need to be provided with a genuine opportunity to collaborate, inform and influence Directlink's regulatory proposal.

Directlink took some steps to engage with consumers. Directlink's approach, in comparison to previous regulatory proposals, is a welcomed acknowledgement of the value of stakeholder engagement and the need for a change in practice for Directlink and the APA Group more broadly. As highlighted in our issues paper, we encourage Directlink to continue to work with stakeholders during the course of the regulatory determination and beyond to ensure that stakeholder views are reflected in its proposals to the AER.

The key concern with Directlink's engagement was that it occurred at the last minute and there was no attempt to reflect stakeholder views in the proposal before it was submitted to us. This was highlighted in the submission from the Public Advocacy Interest Group (PIAC).[5]

We continue to highlight the importance of consumer and stakeholder engagement as an ongoing process. We are encouraged to see Directlink recently embrace a changed approach and broaden its stakeholder engagement and support its decision to implement a program. However, we iterate our view that stakeholder engagement should occur well in advance of a revenue proposal and not be simply left to the regulatory determination process.

We expect Directlink to take the next stage of the review as an opportunity to engage with stakeholders and ensure these views are reflected in its revised proposal to us.

[5] Public Advocacy Interest Centre, *Submission to Directlink 2020–25 revenue proposal*, 16 March 2020, pp. 2–3.

1 Our draft decision

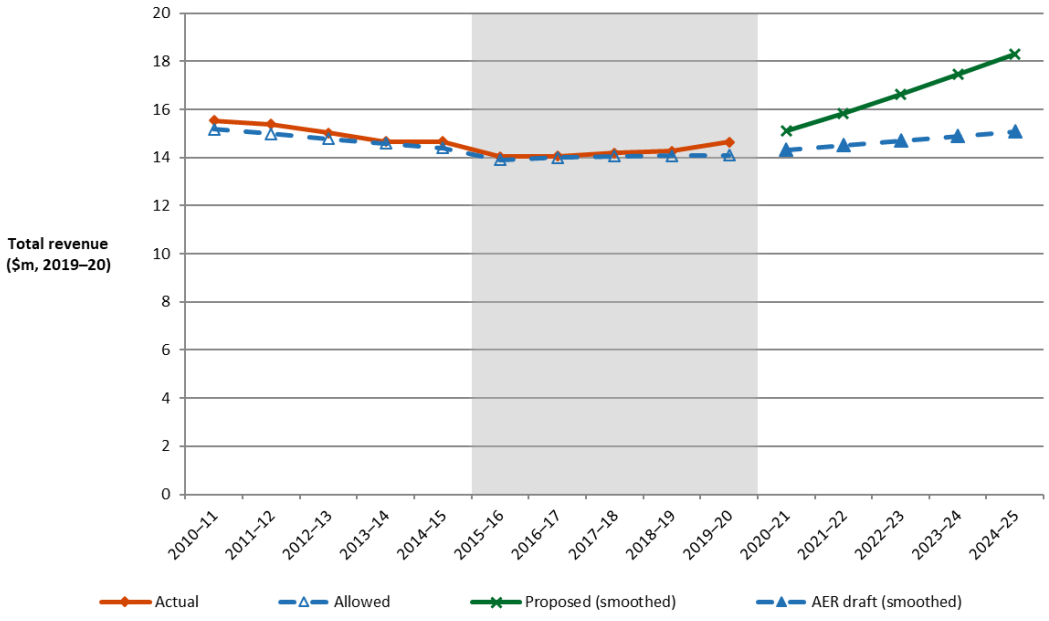
In this section we briefly outline what is driving Directlink's revenue, key differences between our draft decision revenue of $79.2 million ($nominal, smoothed) compared to Directlink's proposed $89.8 million ($nominal, smoothed) and what the potential bill impacts on customers are likely to be.

1.1 What is driving revenue

The changing impact of inflation over time makes it difficult to compare revenue from one period to the next on a like for like basis. To do this, we use ‘real’ values based on a common year (in this case, 2019–20), which have been adjusted for the impact of inflation.

In real terms, the total revenue allowance in this 2020–25 draft decision is 4.9 per cent higher than the allowed revenue in our 2015–20 final decision. Figure 1 shows real revenues decreasing from 2019–20 levels by 2.1 per cent in 2020–21, followed by increases of 1.3 per annum over the remaining years.

Figure 1 Changes in transmission revenue over time ($millions, 2019–20)

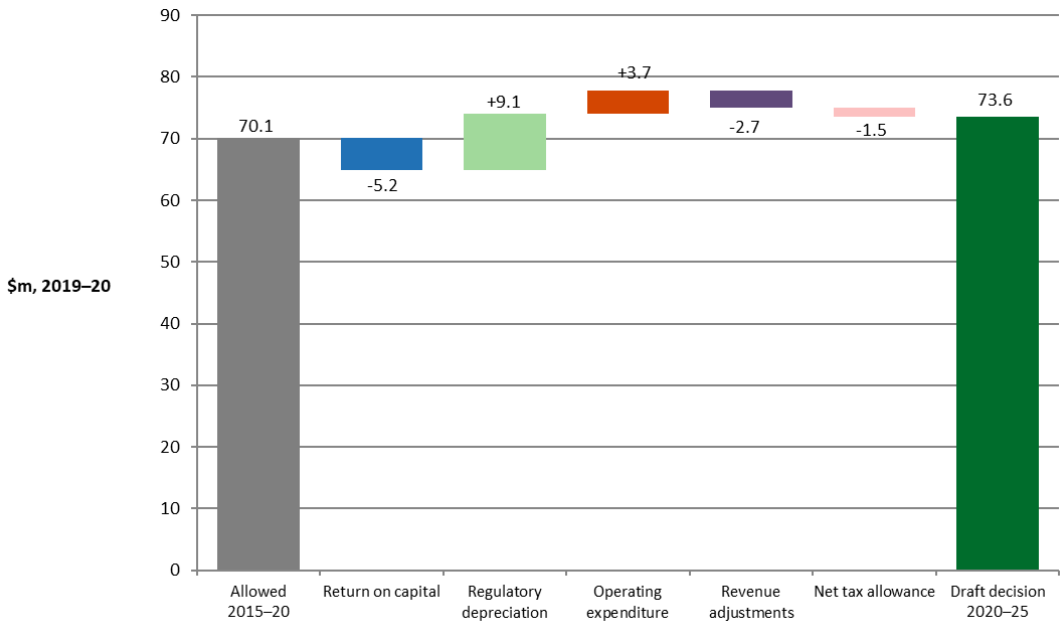


Source: AER Final decision PTRM for 2006–15 and 2015–20 regulatory periods; Directlink Regulatory Proposal PTRM 2020–25 regulatory period. AER draft decision PTRM for 2020–25 regulatory period.

Figure 2 highlights the key drivers of the increase in Directlink's revenue that would result from this draft decision, by reference to the revenue 'building blocks' that form the basis of our assessment. This figure compares our draft decision against the allowance for the previous regulatory control period. Key drivers are:

- return on capital, which includes capex and its financing cost (see Figure 6 below). This has reduced largely due to a lower rate of return being applied in the next regulatory control period
- regulatory depreciation has increased due to increases in capex
- opex has increased due to increases in insurance costs, which is a reasonable proportion of Directlink's opex
- revenue adjustments have led to a reduction in revenue because there is a negative efficiency benefit sharing scheme (EBSS) carryover and also this is the first time a capital expenditure sharing scheme (CESS) adjustment has been calculated, which resulted in a penalty to Directlink (see section 2.6)
- the net tax allowance has fallen predominately as a result of lower return on equity, higher gamma, and our new regulatory tax approach following the recent tax review.

Figure 2 Change in transmission revenue from 2015–20 to 2020–25 ($million, 2019–20 - unsmoothed)



Source: AER Final decision PTRM for 2015–20 regulatory period; AER draft decision PTRM for 2020–25 regulatory period.

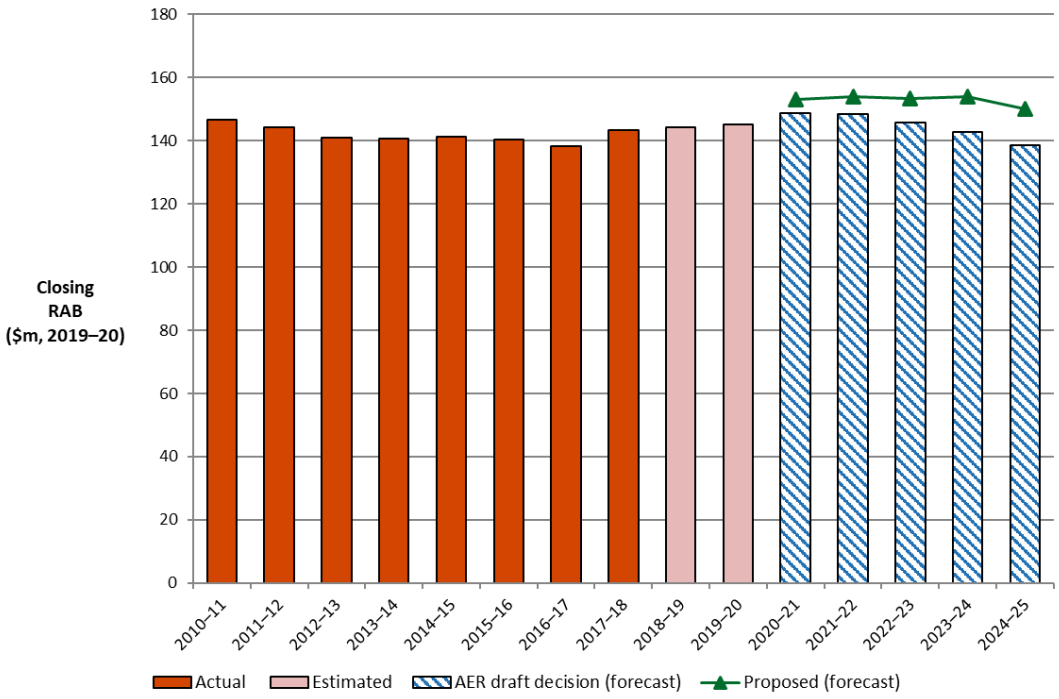
Figure 3 shows the value of Directlink's regulatory asset base (RAB) overtime. RAB growth is a key issue for many stakeholders because the value of the RAB substantially impacts Directlink's revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and depreciation (return of capital) components of the revenue determination.

This is recognised in PIAC's submission:[6]

> Halting, and indeed reversing, RAB growth is, perhaps, even more important than short-term price paths. Expenditure allocated to the RAB results in higher prices paid by consumers for the life of the relevant asset, through higher return on capital and regulatory depreciation allowances.

As can be seen from Figure 3, our draft decision results in a declining RAB over the 2020–25 regulatory control period and also provides the lowest closing RAB value compared to the previous two regulatory control period.

Figure 3 Value of Directlink's RAB over time - actual RAB, proposed forecast RAB and AER draft decision ($million, 2019–20)



Source: AER Final decision PTRM and RFM for 2015–20 regulatory period; Directlink Regulatory Proposal PTRM and RFM for 2020–25 regulatory period; AER draft decision PTRM and RFM for 2020–25 regulatory period.

[6] Public Advocacy Interest Centre, *Submission to Directlink 2020–25 revenue proposal*, 16 March 2020, p. 7.

1.2 Key differences between our draft decision and Directlink's proposal

Our draft decision does not reflect the full $89.8 million in revenue ($nominal, smoothed) proposed by Directlink for its network services and instead allows a lower total revenue of $79.2 million, a reduction of 11.8 percent. In a number of areas, the information provided has not justified expenditure proposed by Directlink.

These include:

- Directlink's total forecast capex includes provision for a level of capital investment that we consider goes beyond what is efficient and prudent for the maintenance and operation of its network.

  The lower capex forecast we have substituted for the purposes of this draft decision will lower the value of Directlink's RAB over the 2020–25 regulatory control period resulting in a reduction in the regulatory depreciation allowance. We have approved $30.6 million in capex ($2019–20), a reduction of $9.9 million ($2019–20) or 24 per cent compared to Directlink's proposed value of $40.5 million ($2019–20) (Section 2.4)

- a $1.5 million reduction in the depreciation allowance (Section 2.3)
- a $1.0 million reduction in the corporate income tax (Section 2.7).

1.3 Expected impact of our draft decision on electricity bills

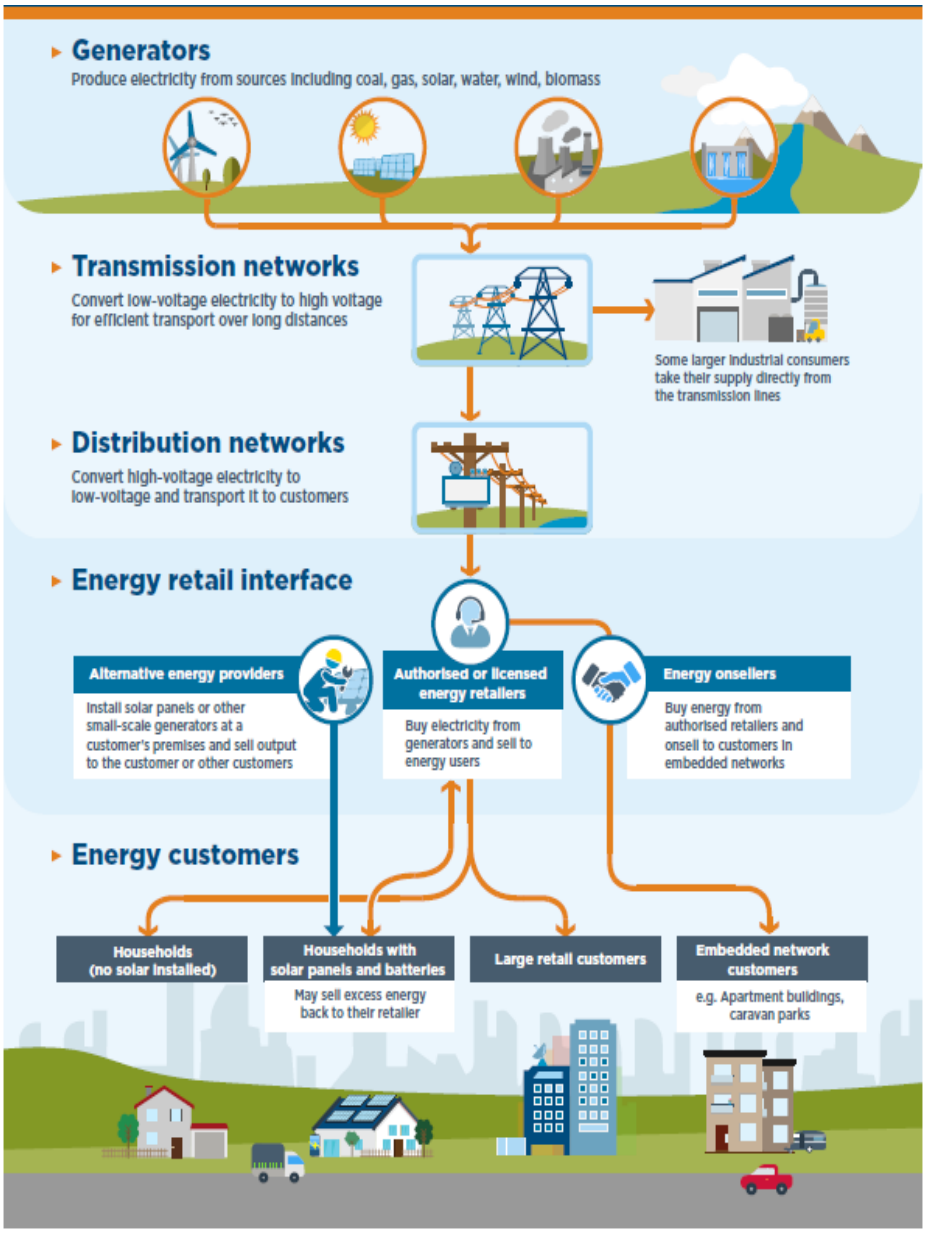
Directlink's revenue is recovered from NSW customers through TransGrid who is the main TNSP for the NSW and ACT region. This revenue does not directly translate to changes in annual electricity bills, principally because Directlink is a small component of the broader transmission network that serves NSW and the ACT.

Transmission charges make up around 11 per cent of a typical total electricity bill in NSW[7] and Directlink's revenue accounts for approximately 1.7 per cent of total NSW transmission revenues. Therefore, Directlink's revenue would be expected to account for 0.2 per cent of the total electricity bill in NSW.

The transmission network tariffs that will be set by reference to our draft decision are only one contributor to electricity bills, other components of the electricity bill include environmental policy costs, wholesale electricity costs and retail costs. Figure 4 illustrates the different components of the electricity supply chain. Each of these costs contributes to the retail prices charged to customers by their chosen electricity retailer.

[7] Transmission proportion of the total electricity bill as per AEMC's 2018 price trend report.

Figure 4 Electricity supply chain



Source: AER, *State of the Energy Market*, December 2018, p. 28.

Transmission charges

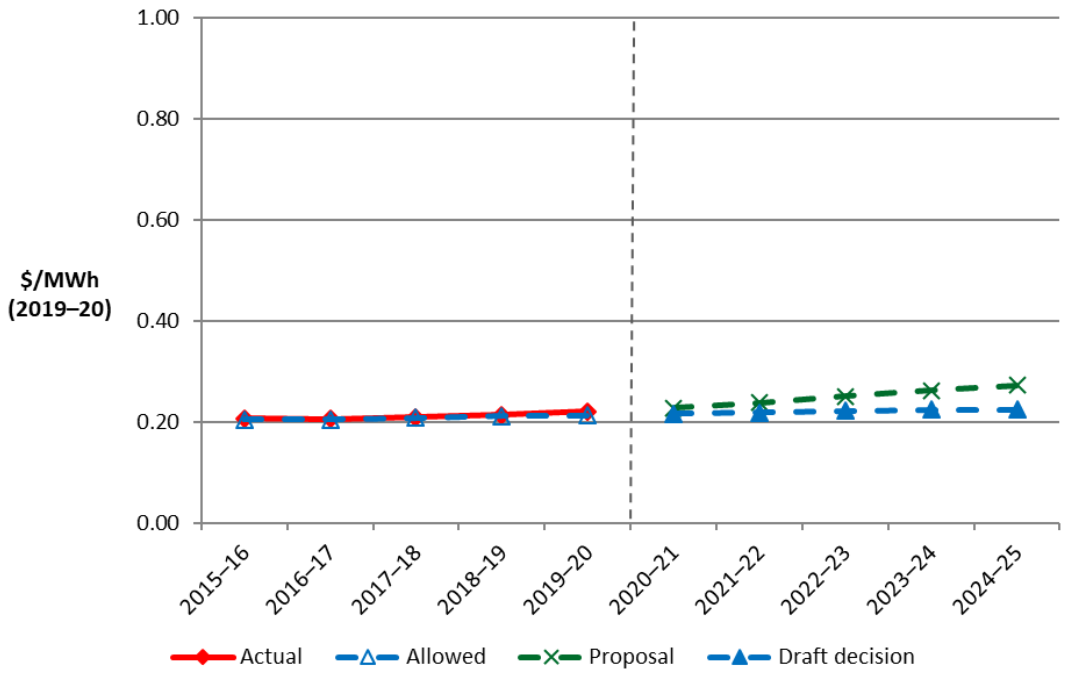
Figure 5 below shows the indicative average transmission charges over the period 2015–16 to 2024–25 in real 2019–20 dollar terms. These amounts are an approximation of transmission charges (measured in MWh).[8] Based on this

[8] We estimate the forecast average transmission charge by taking the sum of TransGrid (and Ausgrid and Evoenergy's for transmission assets) and Directlink's expected revenue and dividing it by the forecast annual energy delivered in NSW and ACT as published by AEMO.

approach, we estimate that this draft decision will result in a negligible increase in annual average transmission charges over the next regulatory control period.

The average transmission charges for Directlink are expected to increase from around $0.21/MWh for the 2015–20 regulatory control period[9] to $0.22/MWh for the 2020–25 regulatory period, in real 2019–20 terms.

Figure 5 Indicative transmission price path for Directlink ($/MWh, 2019–20)



Source: AER analysis.

Notes: The price path plots for the transmission network are based on actual and forecast energy throughput amounts for TransGrid's transmission network across NSW and ACT. This reflects that Directlink provides a small incremental transmission services to the broader TransGrid transmission network services.

Potential bill impact

We expect that the transmission component of the average annual residential electricity bill in 2024–25 will have increased by about $0.50 ($nominal) from the 2019–20 total bill level. By comparison, had we accepted Directlink's proposal, the expected transmission component of the average annual residential electricity bill in 2024–25 would have increased by about $1.20 ($nominal) from the 2019–20 total bill level.

[9] Transmission charges for 2015–16 to 2018–19 are based on actual revenue, while 2019–20 transmission charges are based on estimated revenue.

Similarly, for an average small business customer in NSW, we expect the transmission component of the average annual small business electricity bill in 2024–25 will have increased by about $2.00 ($nominal) from the 2019–20 total bill level. By comparison, had we accepted Directlink's proposal, the expected transmission component of the average small business customer electricity bill in 2024–25 would have increased by about $5.40 ($nominal) from the 2019–20 total bill level.

Further details regarding the calculation of Directlink's revenue and the impact on network charges are set out in attachment 1.

1.4 Directlink's consumer engagement

Directlink took some steps to engage with consumers. Directlink's approach, in comparison to previous regulatory proposals, is a welcome acknowledgement of the value of stakeholder engagement and the need for a change in practice for Directlink and the APA Group more broadly. As highlighted in our issues paper,[10] we encourage Directlink to continue to work with stakeholders during the course of the regulatory determination and beyond to ensure that stakeholder views are reflected in its proposals to the AER.

The key concern with Directlink's engagement was that it occurred at the last minute and there was no attempt to reflect stakeholder views in the proposal before it was submitted to us. PIAC stated:[11]

> Given the importance of robust and early consumer engagement in forming a strong and supportable revenue proposal, the level of consumer engagement conducted by Directlink thus far is not acceptable.
>
> …Too little time allowed for stakeholders to realistically consider and provide informed feedback on Directlink's revenue proposal.
>
> Too late for Directlink to realistically incorporate any feedback from stakeholders into the proposal submitted to the AER in January.

Stakeholders are increasing looking for early and more frequent engagement and for opportunities to respond to preliminary revenue proposals. As a regulated business, Directlink needs to undertake good consumer engagement. The AER's consumer engagement guidelines[12] identify the best practise principles for engagement. The NER also requires us to consider the extent to which the proposed expenditure addresses consumers' relevant concerns identified during the network service provider's engagement with consumers.[13]

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10 AER, *Issues Paper – Directlink electricity transmission revenue proposal, 1 July 2020 to 30 June 2025*, March 2019, p. 9.

11 Public Advocacy Interest Centre, *Submission to Directlink 2020–25 revenue proposal*, 16 March 2020, pp. 2–3.

12 AER, *Better Regulation: Consumer engagement guideline for network service providers*, November 2013.

13 NER, cl. 6A.10.1(g)(2).

Good consumer engagement also means talking to customers on an ongoing manner. This increases the likelihood of customers' views being heard. It is important to consult with a range of customers and others to understand their needs now and in the future. Good consumer engagement gives service providers an understanding of customers' views and insights regarding what they want and value and what they would like a service provider to prioritise in the future.

Beyond regulatory proposals, there is a consistent view that Directlink, and the APA Group more broadly, should engage on an on-going, business-as-usual basis with its stakeholders.[14] We recognise that Directlink is a modest asset compared to other TNSPs and that this should factor into what is considered to be a reasonable targeted and low cost engagement program, but it does not absolve Directlink of engagement responsibility.

Directlink stated that:[15]

> in recognition of the need to commence stakeholder engagement earlier and to build it into the decision making of the interconnector before a transmission determination period, the ongoing consultation during this transmission determination period will feed into the next Transmission Determination proposal from Directlink.

We agree with the views of PIAC that:[16]

> Waiting for the next revenue proposal is too late. We urge Directlink to find opportunities to effectively engage within this revenue determination process and not wait for the next revenue determination for the 2025-30 period.
>
> Furthermore, we strongly support Directlink embedding robust, open and honest consumer engagement as part of its business as usual and not something to be conducted only when preparing a revenue proposal.

We continue to highlight the importance of consumer and stakeholder engagement as an ongoing process. We are encouraged to see Directlink recently embrace a changed approach and broaden its stakeholder engagement and support its decision to implement a program. However, we iterate our views that stakeholder engagement should occur well in advance of a revenue proposal and not be simply left to the regulatory determination process.

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[14] Newgate Research, *Stakeholder expectations for engagement on APA's interconnectors*, 27 November 2018, p. 15.

[15] Directlink, *Revenue Proposal 2020–25*, January 2019, p. 30.

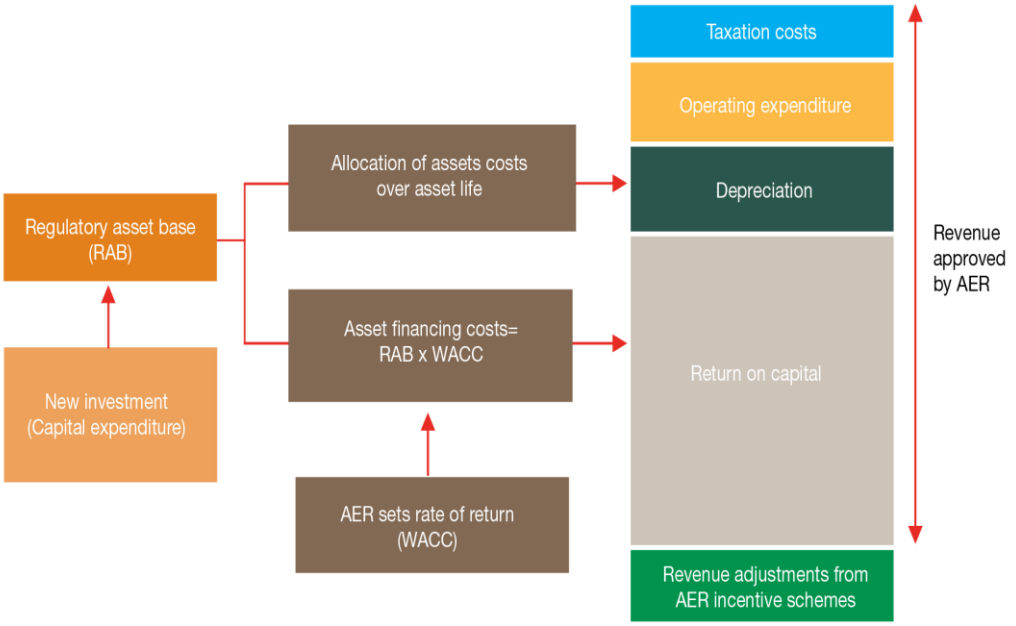
[16] Public Advocacy Interest Centre, *Submission to Directlink 2020–25 revenue proposal*, 16 March 2020, p. 4.

2 Key components of our draft decision on revenue

The total revenue Directlink has proposed reflects its forecast of the efficient cost of providing its transmission network services over the 2020–25 regulatory control period. Directlink's proposal, and our assessment of it under the NEL and NER, are based on a 'building block' approach to determine a total revenue allowance (see Figure 6) which looks at six cost components:

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business) (section 2.2)
- depreciation of the RAB (or return of capital, to return the initial investment to investors over time) (section 2.3)
- capex—the capital costs and expenditure incurred in the provision of network services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. The forecast capex approved in our decisions directly affects the size of the RAB and therefore the revenue generated from the return on capital and depreciation building blocks (section 2.4)
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services (section 2.5)
- revenue increments or decrements carried over from the previous regulatory control period, including the application of the incentive schemes, such as the EBSS and CESS) (section 2.6)
- the estimated cost of corporate income tax (section 2.7).

Figure 6 The building block approach for determining total revenue



We use an incentive approach where, once regulated revenues are set for a five year period, networks who keep actual costs below the regulatory forecast of costs retain part of the benefit. This benchmark incentive framework is a foundation of the regulatory framework which aims to promote the NEO. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

Our draft decision on Directlink's transmission revenues for the 2020–25 regulatory control period is set out in Table 2-1.

Table 2-1 AER's draft decision on Directlink's transmission annual building block revenue requirement, annual expected MAR, estimated total revenue cap and X factor ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Return on capital	6.8	7.0	7.1	7.0	6.9	34.8
Regulatory depreciation[a]	3.4	3.9	4.3	4.7	5.2	21.5
Operating expenditure[b]	4.7	4.9	5.1	5.2	5.4	25.3
Revenue adjustments[c]	–0.7	–1.4	–0.5	–0.1	–0.1	–2.8
Net tax allowance	0.2	0.1	0.1	0.1	0.1	0.6
Annual building block revenue requirement (unsmoothed)	14.3	14.5	16.0	16.9	17.6	79.3
Annual expected MAR (smoothed)	**14.7**	**15.2**	**15.8**	**16.4**	**17.0**	**79.2**[d]
X factor (%)[e]	n/a[f]	–1.30%	–1.30%	–1.30%	–1.30%	n/a

Source: AER analysis.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.

(b) Includes debt raising costs.

(c) Includes revenue adjustments from EBSS and CESS.

(d) The estimated total revenue cap is equal to the total annual expected MAR.

(e) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.

(f) Directlink is not required to apply an X factor for 2020–21 because we set the 2020–21 MAR in this decision. The MAR for 2020–21 is around 2.1 per cent lower than the approved MAR for 2019–20 in real terms, or 0.3 per cent higher in nominal terms.

In the sections below, we discuss each component of our decision on Directlink's revenue for 2020–25 in turn. Incentive schemes, including the EBSS, CESS and service target performance incentive scheme (STPIS) are discussed in section 3.

2.1 Regulatory asset base

The RAB is the value of the assets used by Directlink to provide regulated transmission services. The size of the RAB—and therefore the revenue generated from the return on capital and return of capital building blocks—is directly affected by our assessment of capex. Directlink's transmission proposal calculated its opening RAB as at 1 July 2020 and its closing RAB at 30 June 2025 in accordance with our roll forward model (RFM).

Our draft decision is to determine an opening RAB value as at 1 July 2020 of $145.1 million ($nominal). This value is $3.3 million (or 2.3 per cent) lower than Directlink's proposed opening RAB of $148.4 million ($nominal) as at 1 July 2020.[17] While we largely accept the proposed opening RAB, we made the following revisions:

- corrected minor input issues in Directlink's proposed RFM.
- updated inputs to the RFM as newer information has become available since Directlink submitted its proposal. These updates include:
    - actual CPI for 2018–19 and estimated CPI for 2019–20
    - actual capex for 2018–19
    - WACC input for 2019–20 following the return on debt update for that year in the 2015–20 post-tax revenue model (PTRM)
    - forecast straight-line depreciation for 2017–18 to 2019–20 following the return on debt updates to the 2015–20 PTRM.

Table 2-2 sets out our draft decision on the forecast RAB values for Directlink's network over the 2020–25 regulatory control period.

Table 2-2 AER's draft decision on Directlink's RAB for the 2020–25 regulatory control period ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25
Opening RAB	145.1	152.5	155.7	156.6	157.3
Capital expenditure[a]	10.8	7.1	5.2	5.5	4.3
Inflation indexation on opening RAB	3.6	3.7	3.8	3.8	3.9
Less: straight-line depreciation[b]	6.9	7.6	8.1	8.6	9.0
Closing RAB	**152.5**	**155.7**	**156.6**	**157.3**	**156.4**

Source: AER analysis.

(a) As-incurred, and net of forecast disposals. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling.

(b) Based on as-commissioned capex.

[17] Directlink, *Revenue Proposal 2020–25*, January 2019, p. 44. This RAB value is based on as-incurred capex.

Further detail regarding the roll forward of Directlink's RAB is set out in attachment 2.

2.2 Rate of return and value of imputation credits

The return each business is to receive on its RAB (the 'return on capital') continues to be a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB.

We estimate the rate of return by combining the returns of the two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest on its loans and give a return on equity to investors.

An accurate estimate of the rate of return is necessary to promote efficient prices in the long-term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and reliability may decline. Conversely, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

As required under the NEL, we have applied the 2018 Rate of Return Instrument (2018 Instrument)[18] and estimate a placeholder allowed rate of return of 4.68 per cent (nominal vanilla) for this decision which will be updated for our final decision on the averaging periods.[19] Directlink's initial proposal has adopted the 2018 Instrument.[20]

Our calculated rate of return, in Table 2-3, will apply to the first year of the 2020–25 regulatory control period. A different rate of return will apply for the remaining regulatory years of the period. This is because we will update the return on debt component of the rate of return each year in accordance with the 2018 Instrument to use a 10-year trailing average portfolio return on debt that is rolled-forward each year. Our draft decision is to accept Directlink's proposed risk free rate[21] and debt averaging periods because they satisfied the 2018 Instrument.[22]

Further detail on our draft decision in regarding Directlink's allowed rate of return is set out in Attachment 3.

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18 AER, *Rate of return instrument*, December 2018. See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline-2018/final-decision

19 The legislative amendments to replace the (previous) non-binding Rate of Return Guidelines with a binding legislative instrument were passed by the South Australian Parliament in December 2018. See, Statutes Amendment (National Energy Laws) (Binding Rate of Return Instrument) Act 2018 (SA). NGL, Chapter 2, Part 1, division 1A; NEL, Part 3, division 1B.

20 Directlink, *Revenue Proposal 2020–25*, January 2019, p. 49.

21 This is also known as the return on equity averaging period.

22 AER, *Rate of return instrument*, December 2018, clauses 7–8, 23–25, 36.

Table 2-3 Draft decision on Directlink's rate of return (% nominal)

	Previous Regulatory Period (2015-20)	Directlink's Initial Proposal (2020-25)	AER draft decision (2020-25)	Allowed return over regulatory control period
Nominal risk free rate	2.55%	2.45%	1.32%[a]	
Market risk premium	6.5%	6.1%	6.1%	
Equity beta	0.7	0.6	0.6	
Return on equity (nominal post–tax)	7.1%	6.11%	4.98%	Constant (%)
Return on debt (nominal pre–tax)	4.35%[b]	4.55%	4.47%	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	5.45%[b]	5.18%	4.68%	Updated annually for return on debt
Expected inflation	2.55%	2.41%	2.45%	Constant (%)

Source: AER analysis.

(a) Calculated using a placeholder averaging period of 20 business days ending 31 July 2019.

(b) Applies to the first year of the 2015–20 regulatory control period.

Debt and equity raising costs

In addition to providing for the required rate of return on debt and equity, we provide an allowance for the transaction costs associated with raising debt and equity. We include debt raising costs in the opex forecast because these are regular and ongoing costs. We include equity raising costs in the capex forecast because these costs are only incurred once and would be associated with funding the particular capital investments.

We determine debt raising costs using our benchmark based approach. However, we received a revenue proposal from SA Power Networks which did not support the AER's standard approach to estimating benchmark debt raising costs. SA Power Networks proposed a higher allowance for direct debt raising costs and stated that further examination of indirect debt raising costs should occur.[23] In support of this position it submitted a consultant report by the Competition Economists Group (CEG).[24] SA Power Networks alternative approach was relevant to how we estimate the benchmark debt raising cost for all regulated NSPs.

[23] Indirect costs refers to costs arising from management of liquidity and refinancing risk.

[24] SAPN, *2020–25 Regulatory Proposal, Attachment 3 - Rate of return*, 31 January 2019, pp. 10–11; CEG, *Debt transaction costs and PTRM timing benefits*, January 2019 (supporting document 3.1 to the SAPN proposal).

We have reviewed SA Power Networks' proposal and found that the evidence currently before us does not sufficiently support its alternative approach and resulting allowance for debt raising costs. However, we consider that it will be necessary to obtain more information from across the sector to inform potential changes to the benchmark. Our draft decision therefore reflects the information currently before us, including updated data provided in a report by Chairmont.[25]

Attachment 3 contains our draft decision reasoning on the benchmark calculation of debt raising costs. We have set total debt raising costs of $0.4 ($2019–20). We have set total equity raising costs at zero.

Imputation credits

Our draft decision applies a gamma of 0.585 as per the binding 2018 Instrument.[26] Directlink's proposal has adopted the 2018 Instrument for gamma.[27]

2.3 Regulatory depreciation (return of capital)

In our draft decision, we include an allowance for the depreciation of Directlink's asset base (otherwise referred to as return of capital). Regulated service providers invest in large sunk assets to provide electricity services to customers. While some of the cost of such assets may be recovered from customers upfront, a greater proportion is recovered over time. The depreciation allowance is used for this purpose.

In deciding whether to approve the regulatory depreciation allowance proposed by Directlink, we make determinations on the indexation of the RAB and depreciation building blocks for Directlink's 2020–25 regulatory control period.[28]

Our draft decision approves a regulatory depreciation allowance of $21.5 million ($nominal) for the 2020–25 regulatory control period. This is $1.5 million (6.5 per cent) lower than Directlink's proposed value of $22.9 million ($nominal).

This decrease occurs mainly as a consequence of our determinations on other components of Directlink's proposal that affect the forecast regulatory depreciation allowance. Specifically, they relate to the opening RAB as at 1 July 2020 (section 2.1), the expected inflation rate (section 2.2) and forecast capital expenditure (section 2.4) including its effect on the projected RAB over the 2020–25 regulatory control period.[29]

Our draft decision on other aspects of Directlink's regulatory depreciation is that:

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[25] Chairmont, *AER debt raising costs*, 28 June 2019.

[26] AER, *Rate of return instrument*, December 2018, clause 27.

[27] Directlink, *Revenue Proposal 2020–25*, January 2019, p. 50.

[28] NER, cll. 6A.5.4 and 6A.14.1.

[29] Capex enters the RAB net of forecast disposals. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2020–25 regulatory control period.

- we accept Directlink's proposed straight-line depreciation method used to calculate the regulatory depreciation allowance
- we accept Directlink's proposed asset classes and standard asset lives, with the following exceptions:
    - we largely accept Directlink's proposal to merge its current asset classes into a new single asset class labelled ‘Transmission assets’. However, we have separated out land and easements assets into new asset classes labelled 'Land' and 'Easements' respectively
    - we do not accept the proposed new 'Restoration and rectification' asset class and its associated standard asset life of 21.2 years. This is because we do not approve the proposed forecast capex associated with this asset class (section 2.4)
    - we have included a new 'Buildings' asset class to the PTRM to implement the changes arising from the tax review (section 2.7). We have assigned a standard asset life of 21.2 years to this asset class, consistent with the remaining technical life of Directlink.
- we accept Directlink's proposed remaining asset life as at 1 July 2020 for depreciating its existing assets. This is because the remaining asset life reflects the remaining technical life of Directlink. This approach is the same as that approved in our previous 2015–20 determination.

Table 2-4 shows our draft decision on Directlink's depreciation allowance for the 2020–25 regulatory control period.

Table 2-4 AER's draft decision on Directlink's depreciation allowance for the 2020–25 regulatory control period ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Straight-line depreciation	6.9	7.6	8.1	8.6	9.0	40.3
Less: inflation indexation on opening RAB	3.6	3.7	3.8	3.8	3.9	18.8
Regulatory depreciation	**3.4**	**3.9**	**4.3**	**4.7**	**5.2**	**21.5**

Source: AER analysis.

Further detail on our draft decision regarding depreciation is set out in attachment 4.

2.4 Capital expenditure

Capital expenditure (capex) refers to the investment in assets to provide services. This investment mostly relates to assets with long lives and these costs are recovered over several regulatory periods. On an annual basis, however, the financing cost and depreciation associated with these assets are recovered (return on and of capital) as part of the building blocks that form part of Directlink's total revenue requirement.

Our draft decision on Directlink's revenue includes $30.6 million ($2019–20) in forecast capex for the 2020–25 regulatory control period. This is $9.9 million (or 24 per cent) lower than Directlink's proposed capex of $40.5 million. Table 2-5 shows our decision compared to Directlink's forecast.

Table 2-5 AER draft decision on total forecast capex ($million, 2019–20)

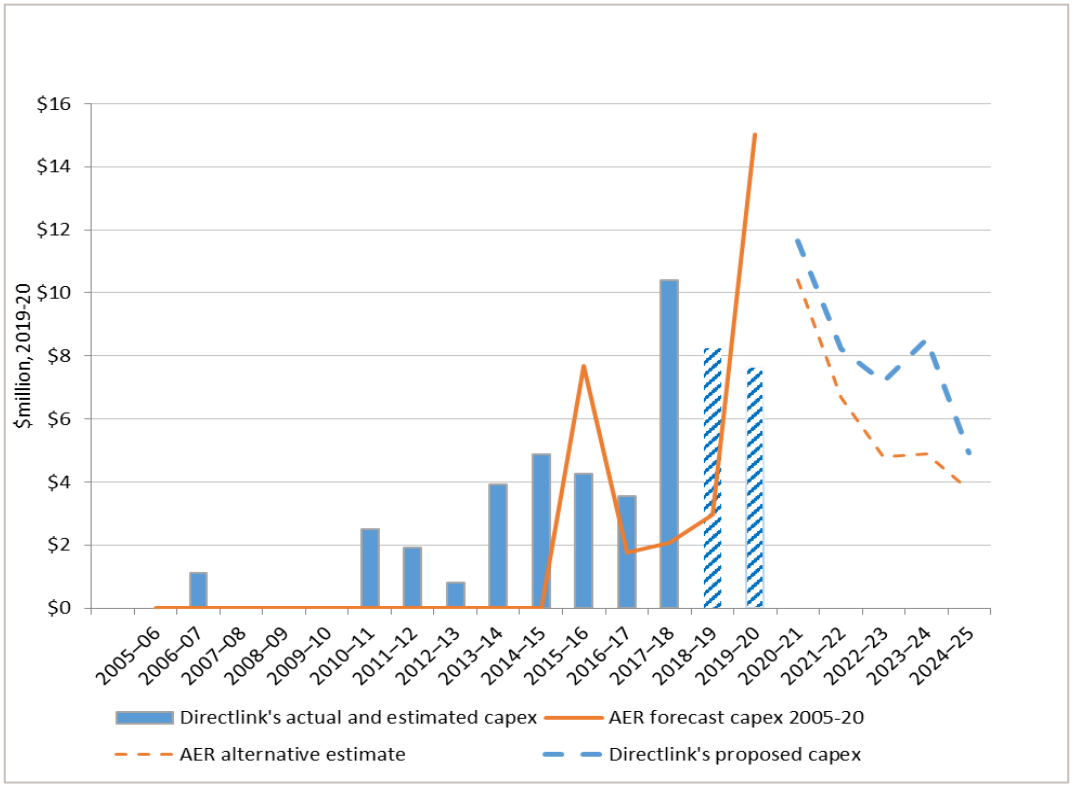
	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Directlink's proposal	11.5	8.2	7.2	8.5	4.9	40.5
AER draft decision	10.4	6.7	4.8	4.9	3.8	30.6
Difference	-1.1	-1.5	-2.4	-3.6	-1.1	-9.9
Percentage difference (%)	-9.6%	-18.3%	-33.3%	-42.4%	-22.4%	-24.4%

Source: AER analysis.

Note: Numbers may not total due to rounding.

Figure 7 shows our transmission capex final decision compared to Directlink's proposal, its past allowances and past actual expenditure.

Figure 7 AER draft decision on capex ($million, 2019–20)



Source: Directlink, *Revenue Proposal 2020–25*, January 2019, p. 53; AER analysis.

Directlink expects that demand for its services won't exceed its maximum capability and has therefore proposed a capex program directed at maintaining the capability and reliability of its network.

The most significant component of Directlink's proposed capex program ($17.3 million or 43 per cent) is for replacement of obsolete Insulated Gate Bi-polar Transistors (IGBTs). We consider that Directlink's proposed long term capex contract with ABB to manage the replacement of obsolete IGBTs is reasonable and ensures that the risk of technical obsolescence is the responsibility of ABB (the equipment manufacturer). While the need for investment is clear, the project will also be subject to a regulatory investment test for transmission (RIT-T) process which will provide an opportunity for alternative options to be considered.

We have accepted the majority of Directlink's proposed capex projects, but have made the adjustments set out below.

Cable partial relocation (underground) ($4.0 million)

We consider that Directlink has not demonstrated that its cable will need to be undergrounded to make it safe during the construction and operation of the proposed Northern Rivers Rail Trail (Rail Trail) because:

- Directlink has not yet undertaken a detailed study of the change in risk associated with the Rail Trail project
- any change in the risk of damage to Directlink's cable during construction of the Rail Trail can be addressed using temporary methods such as requiring the construction contractor to adopt practices that would reduce or avoid the risk of damage to or contact with the cable
- if risk arising from exposure of the asset to damage or interference during operation of the Rail Trail is material, such that mitigation is reasonably required, then options such as permanent fencing or additional signage could also be considered to address this risk rather than the single option of undergrounding the relevant cable section.

We also consider that costs related to the relocation of network assets driven by a third party construction project such as the Rail Trail would typically be a cost to the project proponent rather than electricity consumers.

Variable Speed Drive for Phase reactor and cooling pumps ($3.1 million)

We consider that although a Variable Speed Drive is likely to increase the longevity of a phase reactor, Directlink has not provided evidence that its phase reactors require the proposed cooling system upgrades, or that the project provides a net benefit to consumers. Based on information provided by Directlink, we consider that Directlink's phase reactor is able to maintain the quality, reliability, security and safety of supply without the need for further upgrade.

Land rectification and restoration ($2.1 million)

Directlink has identified a future requirement to return the easements it uses back to the condition they were in when Directlink commenced construction. However, we are not satisfied that the inclusion of forecast capex in relation to this need is necessarily justified in the 2020–25 period, including with regard to the methodology Directlink has proposed to establish and recover this fund for future costs, and the basis of estimation of efficient costs. We consider there is a need for further consideration and explanation of how these costs have been derived and how Directlink may address forecasting uncertainty, including any under or over-recovery of actual future costs. We have also identified concerns as to whether the proposed expenditure should be characterised as capex, or can be included in Directlink's RAB under the current regulatory framework.

In addition to the above adjustments, we have also made minor adjustments to two additional proposed capex programs, noise monitoring equipment ($0.5 million) and regulatory costs ($0.3 million).

The full detail on our draft decision regarding capex is set out in attachment 5.

2.5 Operating expenditure

Operating expenditure (opex) is the forecast of operating, maintenance and other non-capital costs incurred in the provision of prescribed transmission services and distribution standard control services. Forecast opex is one of the building blocks we use to determine Directlink's total regulated revenue requirement.

Our draft decision is to include total forecast opex of $23.5 million ($2019–20) in Directlink's revenue for the 2020–25 regulatory control period.

This amount is based on an updated opex forecast that Directlink submitted to us on 21 August 2019, which rectifies several modelling errors in its original opex forecast of 31 January 2019.[30] We have not accepted Directlink's original opex forecast of $24.7 million that it had initially included in its revenue proposal.

We have assessed Directlink's updated opex forecast by comparing it with our alternative estimate of total opex.[31] We used our standard 'base-step-trend' approach to develop our estimate.[32] Despite some differences in several elements of our opex forecasts, our alternative estimate is about $0.3 million lower than Directlink's updated opex forecast. This difference is immaterial and therefore we are satisfied that Directlink's updated opex forecast of $23.5 million reasonably reflects the opex criteria.[33]

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30 Including debt raising costs; Directlink, *Response to AER Information Request #014 - Updated PTRM and bill impact*, 21 August 2019.

31 Including debt raising costs.

32 AER, *Expenditure Forecast Assessment Guideline for Electricity Transmission*, November 2013.

33 NER, cl. 6A.6.6(c).

The details of our alternative estimate compared to Directlink's proposal are set out in Table 2-6.

Table 2-6 AER alternative estimate opex compared to Directlink's proposal ($million, 2019–20)

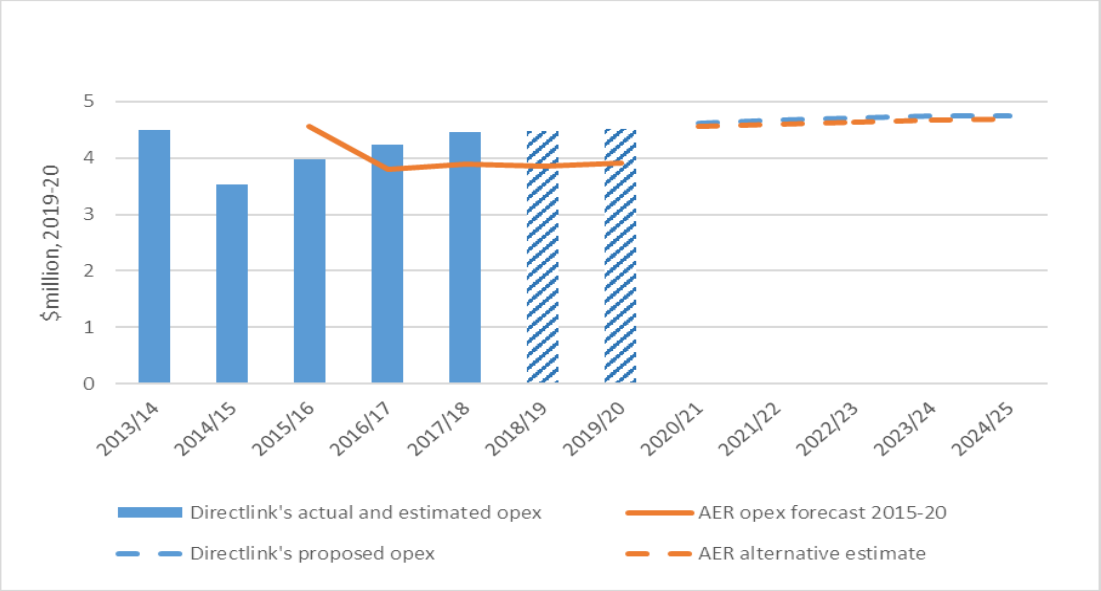
	Directlink	Our alternative estimate	Difference
Based on reported opex in 2017-18	22.3	22.2	-0.1
Efficiency adjustment	0.0	0.0	0.0
Remove insurance from final year estimate	-2.1	-2.1	0.0
2017-18 to 2019-20 increment	0.0	-0.2	-0.2
Output growth	0.0	0.0	0.0
Price growth	0.2	0.2	0.0
Productivity growth	0.0	0.0	0.0
Step changes	0.0	0.0	0.0
Insurance	2.8	2.7	0.0
Debt raising costs	0.4	0.3	-0.1
Total opex	**23.5**	**23.1**	**-0.3**

Source: Directlink, *Response to AER Information Request #014 - Updated PTRM and bill impact*, 21 August 2019; AER analysis.

Note: Numbers may not add up to total due to rounding.

Figure 8 shows Directlink's updated opex forecast, its past actual opex, our previous regulatory decision and our alternative estimate.

Figure 8 Historical and forecast opex ($million, 2019–20)



Source: Directlink, *Regulatory accounts 2013–14 to 2017-18*; Directlink, *Response to AER Information Request #014 - Updated PTRM and bill impact,* 21 August 2019; AER analysis.

Note: Includes debt raising costs.

Further detail on our draft decision regarding opex is set out in attachment 6.

2.6 Revenue adjustments

Our draft decision on Directlink's total revenue includes a number of adjustments:

- EBSS – Directlink has accrued a negative carryover amount under the EBSS which we applied in the current 2015–20 regulatory control period. Our draft decision includes a negative EBSS carryover amount totalling $2.0 million ($2019–20). This is more than the negative carryover amount of $1.5 million ($2019–20) proposed by Directlink because we have excluded the insurance costs from the calculation. The EBSS is intended to provide a continuous incentive for Directlink to pursue efficiency improvements in opex, and provide for a fair sharing of these between the business and its users. Consumers benefit from improved efficiencies through lower regulated prices. Further detail on our draft decision regarding the EBSS is set out in attachment 8
- CESS – Directlink has accrued a penalty under the CESS, which we applied in the current 2015–20 regulatory control period to incentive Directlink to undertake efficient capex throughout the period. The CESS rewards efficiency gains and penalises efficiency losses, each measured by reference to the difference between forecast and actual capex. In the 2015–20 period, Directlink overspent against our capex forecast, and our draft decision is to approve a CESS revenue decrement amount of $0.7 million ($2019–20). Further detail on our draft decision regarding the CESS is set out in attachment 9.

2.7 Corporate income tax

Our draft decision includes a decision on the estimated cost of corporate income tax for Directlink's 2020–25 regulatory control period as part of our revenue determination.[34] It enables Directlink to recover the costs associated with the estimated corporate income tax payable during the regulatory control period.

We determined an estimated cost of corporate income tax of $0.6 million ($nominal) for Directlink over the 2020–25 regulatory control period. This is $1.0 million (or 61.2 per cent) lower than Directlink's proposed value.[35]

The key reasons for the reduction are:

- application of the latest version of the PTRM (version 4) released in April 2019 which implements the findings in our final report on the review of the regulatory tax approach (the tax review). Specifically, for this draft decision, we have applied the diminishing value (DV) method for tax depreciation to all new depreciable assets except for forecast capex associated with buildings.[36] These changes have reduced Directlink's proposed corporate income tax allowance by about $0.5 million (or 32.1 per cent)
- we have separated out land and easements assets from the new proposed asset class of 'Transmission assets' into new asset classes labelled 'Land' and 'Easements' respectively, which do not depreciate for tax purposes
- we have removed Directlink's proposed new 'Restoration and rectification' asset class and its associated standard tax asset life of 21.2 years from the PTRM. This is because we do not approve the proposed forecast capex associated with this asset class.

We reduced the Directlink's proposed opening tax asset base (TAB) values as at 1 July 2020 by $1.7 million (or 1.5 per cent). While we accept Directlink's approach for establishing the opening TAB, we have updated the 2018–19 actual capex as it has become available since the proposal was submitted. The reductions on the opening TAB values have slightly increased the corporate income tax allowance.

We accept Directlink's proposal to assign the remaining tax asset life of its existing asset class and standard tax asset life of its forecast capex for the 2020–25 regulatory period to align with the remaining technical life of Directlink, which is 21.2 years. This approach is the same as that approved in our previous determination.[37]

Our adjustments to the return on capital (sections 2.1, 2.2 and 2.4) and the regulatory depreciation (section 2.3) building blocks affect revenues, which in turn

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34 NER, cl. 6A.6.4.

35 Directlink, *Attachment 12-1 - Post Tax Revenue Model*, 30 January 2019.

36 All assets acquired prior to 30 June 2020 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated.

37 AER, *Final decision, Directlink transmission determination 2015-16 to 2019-20, Attachment 8: Corporate income tax*, April 2015, p. 9.

impacts the tax calculation. The changes affecting revenues are discussed in attachment 1.

Table 2-7 shows our draft decision on Directlink's corporate income tax allowance for the 2019–24 regulatory control period.

Table 2-7 AER's draft decision Directlink's cost of corporate income tax for the 2020–25 regulatory control period ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Tax payable	0.4	0.3	0.3	0.3	0.3	1.6
Less: value of imputation credits	0.2	0.2	0.2	0.2	0.2	0.9
Net corporate income tax allowance	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**	**0.6**

Source: AER analysis.

Further detail on our draft decision regarding corporate income tax is set out in attachment 7.

3 Incentive schemes to apply for 2020–25

Incentive schemes are a component of incentive based regulation and complement our approach to assessing efficient costs. These schemes provide important balancing incentives under the revenue determination we've discussed in section 2, to encourage Directlink to pursue expenditure efficiencies, while maintaining the reliability and overall performance of its network.

The incentive schemes that might apply to an electricity network as part of our decision are:

- the opex efficiency benefit sharing scheme (EBSS)
- the capital expenditure sharing scheme (CESS)
- the service target performance incentive scheme (STPIS).

Once we make our decision on Directlink's revenue cap, it has an incentive to provide services at the lowest possible cost, because its returns are determined by its actual costs of providing services. Our incentive schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. If networks reduce their costs to below our forecast of efficient costs, the savings are shared with their customers in future regulatory periods through the EBSS and CESS.

The STPIS is intended to balance a business' incentive to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to businesses to maintain and improve service performance where customers are willing to pay for these improvements. Businesses can only retain their rewards for sustained and continuous improvements to the reliability of supply for customers. Once improvements are made, the benchmark performance targets will be tightened in future years.

Our draft decision is that each of the EBSS, CESS and STPIS, should apply to Directlink for the 2020–25 regulatory control period.

We discuss our draft decisions on each incentive scheme further in attachments 8 (EBSS), 9 (CESS) and 10 (STPIS).

4 The National Electricity Law and Rules

The NEL and NER provide the regulatory framework governing electricity networks. Our work under this framework is guided by the National Electricity Objective (NEO):[38]

> "…to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system."

The NEL requires us to make our decision in a manner that contributes, or is likely to contribute, to achieving the NEO.[39] The focus of the NEO is on promoting efficient investment in, and operation and use of, electricity services (rather than assets) in the long term interests of consumers.[40] This is not delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision.[41]

Electricity determinations are complex decisions. In most cases, the provisions of the NER do not point to a single answer, either for our decision as a whole or in respect of particular components. They require us to exercise our regulatory judgement. Where there are choices to be made among several plausible alternatives, we have selected what we are satisfied would result in an overall decision that contributes to the achievement of the NEO to the greatest degree. [42]

Our determinations are predicated on a number of constituent decisions that we are required to make.[43] These are set out in appendix A and the relevant attachments. In coming to a decision that contributes to the achievement of the NEO, we have considered interrelationships of the constituent components of our draft decision in the relevant attachments. Examples include:

- underlying drivers and context which are likely to affect many constituent components of our decision. For example, forecast demand affects the efficient levels of capex and opex in the regulatory control period (see attachment 5 and 6)
- direct mathematical links between different components of a decision. For example, the level of gamma has an impact on the appropriate tax allowance; the benchmark efficient entity's debt to equity ratio has a direct effect on the cost

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38 NEL, s. 7.

39 NEL, section 16(1)(a).

40 This is also the view of the Australian Energy Markets Commission (the AEMC). See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

41 Hansard, *SA House of Assembly,* 26 September 2013, p. 7173. See also the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 7–8.

42 NEL, s. 16(1)(d).

43 NER, cl. 6A.14.1.

of equity, the cost of debt, and the overall vanilla rate of return (see attachments 3 and 7)

- trade-offs between different components of revenue. For example, undertaking a particular capex project may affect the need for opex or vice versa (see attachments 5 and 6).

In general, we consider that the long-term interests of consumers are best served where consumers receive a reasonable level of safe and reliable service that they value at least cost in the long run.[44] A decision that places too much emphasis on short term considerations may not lead to the best overall outcomes for consumers once the longer term implications of that decision are taken into account. [45]

There may be a range of economically efficient decisions that we could make in a revenue determination, each with different implications for the long term interests of consumers.[46] A particular economically efficient outcome may nevertheless not be in the long term interests of consumers, depending on how prices are structured and risks allocated within the market. [47] There are also a range of outcomes that are unlikely to advance the NEO, or advance the NEO to the degree than others would. For example, we consider that:

- the long term interests of consumers would not be advanced if we encourage overinvestment which results in prices so high that consumers are unwilling or unable to efficiently use the network[48]
- equally, the long-term interests of consumers would not be advanced if allowed revenues result in prices so low that investors do not invest to sufficiently maintain the appropriate quality and level of service, and where customers are making more use of the network than is sustainable leading to safety, security and reliability concerns.[49]

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44 Hansard, *SA House of Assembly,* 9 February 2005, p. 1452.

45 See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 6–7.

46 Re Michael: Ex parte Epic Energy [2002] WASCA 231 at [143].

47 See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

48 NEL, s. 7A(7).

49 NEL, s. 7A(6).

A Constituent decisions

Our draft decision on Directlink's transmission determination includes the following constituent components:[50]

Constituent component
In accordance with clause 6A.14.1(1)(i) of the NER, the AER's draft decision is not to approve the total revenue cap set out in Directlink's building block proposal. Our draft decision on Directlink's total revenue cap is $79.2 million ($nominal) for the 2020–25 regulatory control period. This decision is discussed in Attachment 1 of this draft decision.
In accordance with clause 6A.14.1(1)(ii) of the NER, the AER's draft decision is not to approve the maximum allowed revenue (MAR) for each regulatory year of the regulatory control period set out in Directlink's building block proposal. Our decision on Directlink's MAR for each year of the 2020–25 regulatory control period is set out in Attachment 1 of this draft decision.
In accordance with clause 6A.14.1(1)(iii) of the NER, the AER's draft decision is to apply the service component and market impact component of Version 5 of the service target performance incentive scheme (STPIS) to Directlink for the 2020–25 regulatory control period. The values and parameters of the STPIS that are approved by the AER are set out in Attachment 10 of this draft decision.
In accordance with clause 6A.14.1(1)(iv) of the NER, the AER's draft decision on the values that are to be attributed to the parameters for the efficiency benefit sharing scheme (EBSS) that will apply to Directlink in respect of the 2020–25 regulatory control period are set out in Attachment 8 of this draft decision.
In accordance with clause 6A.14.1(1)(v) of the NER, the AER's draft decision is to approve the commencement and length of the regulatory control period as Directlink proposed in its revenue proposal. The regulatory control period will commence on 1 July 2020 and the length of this period is five years, expiring on 30 June 2025.
In accordance with clause 6A.14.1(2) of the NER and acting in accordance with clause 6A.6.7(d), the AER's draft decision is to not accept Directlink's proposed total forecast capital expenditure of $40.5 million ($2019–20). Our draft decision therefore includes a substitute estimate of Directlink's total forecast capex for the 2020–25 regulatory control period of $30.6 million ($2019–20). The reasons for our draft decision are set out in Attachment 5 of this draft decision.
In accordance with clause 6A.14.1(3) of the NER and acting in accordance with clause 6A.6.6(c), the AER's draft decision is to not accept Directlink's proposed total forecast operating expenditure inclusive of debt raising costs of $24.7 million ($2019–20). Our draft decision therefore includes a substitute estimate of Directlink's total forecast opex for the 2020–25 regulatory control period of $23.5 million ($2019–20). The reasons for our draft decision are set out in Attachment 6 of this draft decision.
In respect of clause 6A.14.1(4) of the NER, Directlink did not propose any contingent projects.

[50] NEL, s. 16(1)(c).

In accordance with clause 6A.14.1(5A) of the NER, the AER's draft decision is that version 1 of the capital expenditure sharing scheme (CESS) as set out the Capital Expenditure Incentives Guideline will apply to Directlink in the 2020–25 regulatory control period. This is discussed in Attachment 9 of this draft decision.

In accordance with clause 6A.14.1(5B) and 6A.6.2 of the NER, the AER's draft decision is that the allowed rate of return for the 2020–21 regulatory year is 4.68 per cent (nominal vanilla), as set out in Attachment 3 of this draft decision. The rate of return for the remaining regulatory years 2021–25 will be updated annually because our decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.

In accordance with clause 6A.14.1(5C) of the NER, the AER's draft decision is that the value of imputation credits as referred to in clause 6A.6.4 is 0.585. This is set out in Attachment 3 of this draft decision.

In accordance with clause 6A.14.1(5E) of the NER, the AER's draft decision, in accordance with clause 6A.6.1 and schedule 6A.2, is that the opening regulatory asset base (RAB) as at the commencement of the 2020–25 regulatory control period, being 1 July 2020, is $145.1 million ($nominal). This is set out in Attachment 2 of this draft decision.

In accordance with clause 6A.14.1(5F) of the NER, the AER's draft decision is that the depreciation approach based on forecast capex (forecast depreciation) is to be used to establish the RAB at the commencement of Directlink's regulatory control period as at 1 July 2025. This is discussed in Attachment 2 of this draft decision.

In accordance with clause 6A.14.1(8) of the NER, the AER's draft decision is to approve Directlink's proposed pricing methodology, subject to several editorial amendments. This is set out in Attachment 11 of this draft decision.

In accordance with clause 6A.14.1(9) of the NER, the AER's draft decision is to apply the following nominated pass through events to apply to Directlink for the 2020–25 regulatory control period in accordance with clause 6A.6.9:

- Insurer's creditor risk event
- Terrorism event

These events have the definitions set out in Attachment 12 of this draft decision.

B List of submissions

We received one submission in response to Directlink's revenue proposal. This is listed below.

Submission from	Date received
Public Interest Advocacy Centre	16 March 2019