Draft Decision

Murraylink Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Overview

September 2022

AUSTRALIAN ENERGY REGULATOR

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Invitation for submissions

Murraylink has the opportunity to submit a revised proposal in response to this draft decision by **2 December 2022**.

Interested stakeholders are invited to make a submission on both our draft decision and Murraylink's revised proposal (once submitted) by **20 January 2023**.

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

Submissions should be sent to: Murraylink2023@aer.gov.au

Alternatively, submissions can be sent to:

Warwick Anderson
General Manager
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Submissions should be in Microsoft Word or another text readable document format.

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. We will treat submissions 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 the AER's website.[1]

[1] 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: 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 Murraylink's 2023–28 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

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

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Executive summary

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia. The regulatory framework governing electricity transmission and distribution networks is the National Electricity Law and Rules (NEL and NER). Our work is guided by the National Electricity Objective (NEO).

A regulated network business must periodically apply to us to determine the maximum allowed revenue it can recover from consumers for using its network. On 31 January 2022 we received a revenue proposal from Murraylink, for the period 1 July 2023 to 30 June 2028 (2023–28 period). The Murraylink interconnector delivers electricity between the South Australian and Victorian regions of the National Electricity Market. Its regulated revenue is recovered through ElectraNet's transmission charges in South Australia, and AEMO's transmission charges in Victoria. Charges are allocated according to the value of Murraylink's assets in each State.

This draft decision would currently allow Murraylink to recover an estimated $87.4 million from consumers over the 2023–28 period. We have largely accepted Murraylink's proposal, including its initial forecasts of capital and operating expenditure. Both are reductions from our determination for the current, 2018–23 period. However, movements in market variables such as interest rates, bond rates and expected inflation have acted to increase the return on Murraylink's regulatory asset base relative to its January proposal. Updates for these movements are a standard part of our determination process and will be made again in Murraylink's revised proposal and our final decision. Their impact at the time of this draft decision is that total revenue would be $11.7 million (15.4%) higher than presented in Murraylink's proposal.

Following this draft decision, Murraylink has the opportunity to respond in its revised proposal. We are aware that Murraylink is undertaking research and consulting stakeholders about a piece of equipment it needs which is no longer in production. Insulated Gate Bipolar Transistors (IGBTs) are an integral part of the operation of the Murraylink converter stations, and the main system component used to convert alternating current to direct current, and vice versa. In December, shortly before submission of Murraylink's proposal, the sole provider of IGBTs advised that the relevant units are no longer in production. Murraylink is yet to arrive at a recommended solution to this issue. No expenditure for this has been included in its initial proposal or this draft decision. In making this draft decision, our expectation is that Murraylink will explore all potential options before seeking to recover additional funds from consumers.

Murraylink's engagement with stakeholders on this issue is ongoing, and its proposed approach will likely be put to us for the first time in its revised proposal. We made clear in our issues paper on Murraylink's proposal that we expect its engagement on this issue to go beyond informing stakeholders of its preferred option. It should involve genuine collaboration and partnership with consumers to identify the risk to be addressed, explore with them the costs and benefits of a range of credible options to address that risk, and arrive at a solution that reflects consumer preferences identified through that engagement.

1 Our draft decision

In the sections below we briefly outline what is driving Murraylink's revenue, and the key differences between our draft decision revenue of $87.4 million ($nominal, smoothed) compared to the $75.7 million in its January proposal.

On face value, it may seem peculiar that we are determining a revenue allowance that is higher than Murraylink initially proposed. We have carefully reviewed Murraylink's proposal and have accepted the core parts of its proposal in respect of capex and opex. However, since Murraylink lodged its proposal, we have seen increases in interest rates. In this draft decision we have employed current interest rates rather than the placeholder values in Murraylink's proposal. It is important that we update for the latest market data so that Murraylink's determination reflects current financial market conditions. This enables Murraylink to attract the capital it needs to provide the services that consumers want.

Moreover, the return investors receive on their assets should reflect the risks of their investment. These risks include the prospect of inflation eroding the investor's purchasing power. An allowance for expected inflation provides compensation for this risk.

- The return on capital building block applies a nominal rate of return to the RAB. As the nominal rate of return includes expected inflation, part of that building block compensates for expected inflation. Higher expected inflation increases the return on capital mainly due to RAB and capex.
- The return of capital building block removes expected inflation indexation of the RAB from forecast depreciation. This avoids compensation arising from the effects of inflation being double counted by including it in the return on capital building block and also as a capital gain (through the indexation of the RAB). Higher expected inflation therefore reduces the regulatory depreciation allowance.
- Other building blocks (such as operating expenditure or opex, and revenue adjustments) include an inflation component, as the costs forecast in real dollar terms are escalated to nominal dollars using expected inflation in determining the required nominal revenues. Higher expected inflation will increase opex and revenue adjustments.

Murraylink recovers its regulated revenue through transmission charges, set annually in accordance with the pricing methodology we approve as part of this decision. These are recovered through ElectraNet's transmission charges in South Australia, and AEMO's transmission charges in Victoria. Charges are allocated according to the value of Murraylink's assets in each State and we estimate contribute less than 2% to those charges.

Our decision on Murraylink's proposal will set the revenue allowance that forms the major component of its transmission charges for the 5-year period. It provides a baseline or starting point for those five years. Transmission charges are determined annually by Murraylink in accordance with the pricing methodology we have approved in this draft decision.

This draft decision marks the mid-point in our assessment of Murraylink's proposal. We have largely accepted the initial proposal. However, final decision outcomes may differ as we continue to update our final decision for movements in market variables such as interest rates, bond rates and inflation.

Over the 2023–28 period there are several additional mechanisms under the NER that may operate to increase or decrease those charges. These may include projects defined by the Australian Energy Market Operator (AEMO) as necessary to its Integrated System Plan (ISP), and cost pass through events defined in the NER. If Murraylink were to pursue and gain our acceptance of a contingent project as part of its IGBT solution, this would also be a source of potential tariff increases within the 2023–28 period.

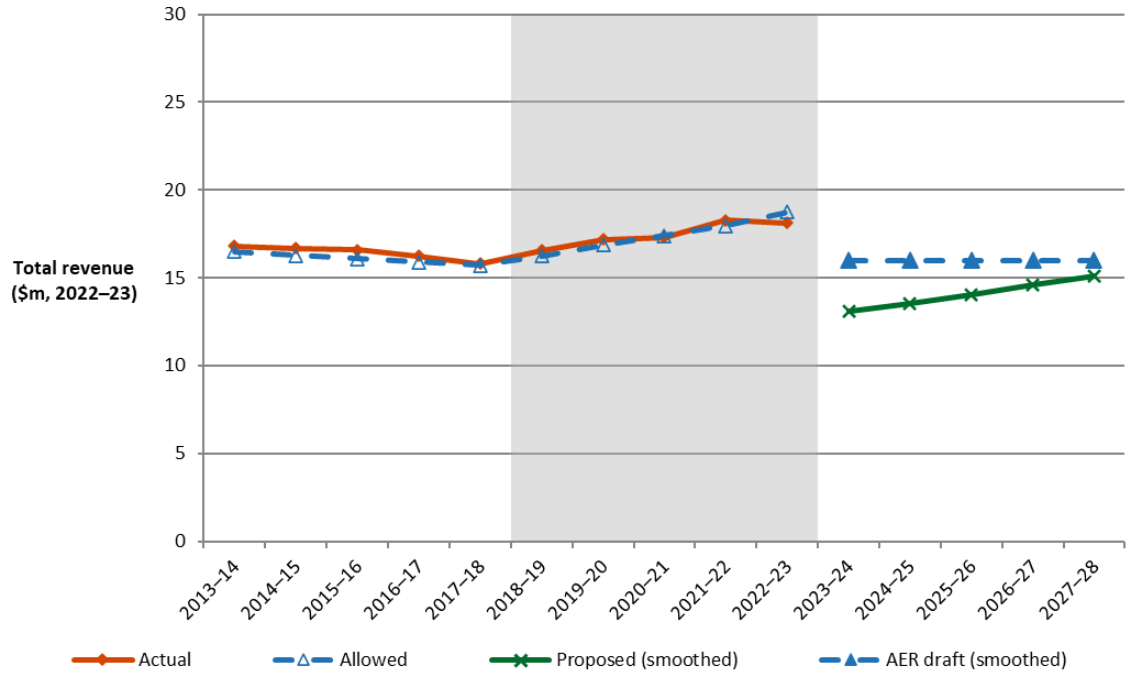
Should Murraylink provide negotiated services during the 2023–28 period, the terms and conditions of those services are governed separately by a negotiating framework and negotiated transmission services criteria, also approved as part of this decision.

1.1 What is driving revenue?

Over time, inflation impacts the spending power of money. To compare revenue from one period to the next on a like-for-like basis, in this section we use 'real' values based on a common year (2022–23) that have been adjusted for the impact of inflation instead of the nominal values above.

In real terms, this draft decision would allow Murraylink to recover $80.1 million ($2022–23, unsmoothed) from its consumers over the 2023–28 period. This is 8.2% lower than our decision for the 2018–23 period. Changes in Murraylink's revenue over time are shown in Figure 1.

Figure 1 Changes in regulated revenue over time ($ million, 2022–23)



Source: Murraylink regulatory accounts 2013–14 to 2020–21; AER Final decision PTRM for the 2013–18 and 2018–23 periods; Murraylink regulatory proposal PTRM for the 2023–28 period; AER draft decision PTRM for the 2023–28 period.

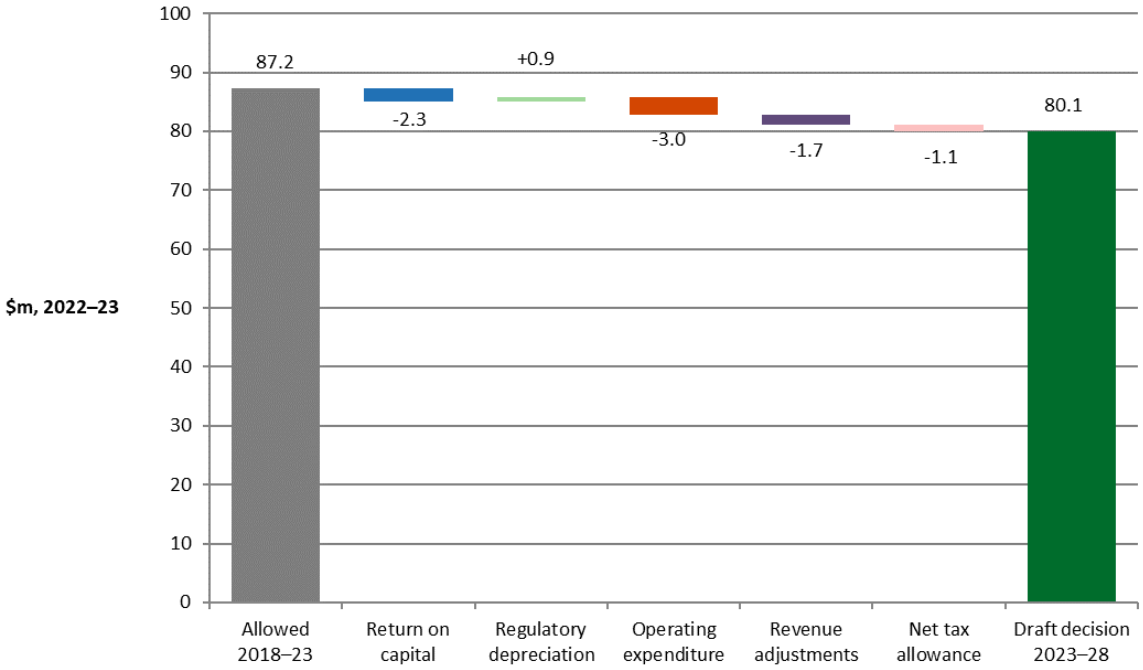
This real reduction in revenue reflects reductions in forecast operating expenditure (opex) since our last decision and a lower return on capital due to a declining regulatory asset base (RAB). The total forecast capital expenditure (capex) accepted in this draft decision for the 2023–28 period is $17.5 million (57.8%) lower than Murraylink's expenditure in the current

period. Murraylink has signalled that it may seek additional capex to manage the risk of obsolescence of its IGBTs.

Smaller reductions to revenue adjustments—under the capital expenditure sharing scheme (CESS) and opex efficiency benefit sharing scheme (EBSS)—and the net tax allowance (a result of our 2018 tax review) relative to the current period also contribute to falling revenue.

Figure 2 shows how these key drivers are reducing real revenue that approved for Murraylink's current, 2018–23 period to that approved in this draft decision for 2023–28:

Figure 2 Changes in total revenue 2018–23 to 2023–28 ($ million, 2022–23, unsmoothed)



Source: AER Final decision PTRM for the 2018–23 period; AER draft decision PTRM for the 2023–28.

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

Our draft decision accepts the core components of Murraylink's January 2022 proposal, including its forecasts of opex and capex.

The total revenue of $87.7 million ($ nominal, unsmoothed) approved in this draft decision is $12 million (15.9%) higher than Murraylink's proposal. This is largely driven by our draft decision approving a return on capital building block that is $13.0 million higher than presented in Murraylink's proposal. The higher return on capital is due to a higher rate of return based on updated market data, applied to a higher opening RAB as at 1 July 2023 reflecting more up-to-date consumer price index (CPI) rates.

Other changes this draft decision makes to Murraylink's proposed building blocks include:

- a reduction in regulatory depreciation of $0.4 million
- an increase in the cost of corporate income tax of $1.1 million

- a reduction in the revenue adjustments under the CESS and EBSS of $2.1 million.

At the time of making this draft decision, we have used placeholder values for certain components such as the rate of return and expected inflation. These will be updated again for our final decision. The conclusions we have reached on Murraylink's initial opex and capex forecasts in this draft decision may also need to be revisited if Murraylink looks to include material changes in expenditure as part of its IGBT solution in its revised proposal. The implications of any additional expenditure proposed as part of that solution for other parts of its initial proposal and this draft decision will require careful consideration in any such revised proposal.

1.3 Murraylink's consumer engagement

Genuine, high quality consumer engagement by Murraylink remains essential to ensuring its proposal is driven by consumer preferences, supports delivery of services that meet the needs of consumers, and does so at a price that is affordable and efficient. Our framework for considering consumer engagement in network revenue determinations is set out in the Better Resets Handbook. We've seen through experience that a regulatory proposal developed through genuine engagement with consumers is more likely to be largely or wholly accepted in our decisions.

Murraylink's engagement with consumers in the preparation of this proposal is an improvement from its proposal for 2018–23, for which no engagement was undertaken. It established a Community Engagement Group in August 2021, which included a good cross-section of interests with advocates for large and small users. Representatives from Victorian and South Australian transmission network services providers (ElectraNet, AusNet Services) and from South Australian and the Victoria Government also attended. Stakeholders were encouraged to nominate topics they wanted to discuss at Murraylink's workshops, and resultant discussions appeared to be responsive to this.

It is less clear to what extent, if at all, the proposal submitted to us in January was influenced or driven by that engagement. Submissions to us in this review have highlighted challenges to stakeholders in understanding the basis for Murraylink's initial forecasts. A common theme was the open question of how Murraylink should best manage the risk of obsolescent IGBTs, and what level of investment is appropriate in the context of the evolving roles of Murraylink and other transmission networks and interconnectors in the market.

Murraylink's engagement on this issue is an important opportunity for it to demonstrate its sincerity in arriving at a consumer-driven solution to that risk, and one that genuinely reflects consumer preferences. Its engagement on this issue and any resultant changes to the proposal currently before us will need to go beyond informing stakeholders of how Murraylink has arrived at any additional capex sought in the revised proposal, and should involve genuine collaboration and partnership with consumers to:

- identify the risk to be addressed
- explore the costs and benefits of a range of credible options to address that risk, and
- arrive at a solution that reflects consumer preferences identified through that engagement.

To date Murraylink has kept its Community Engagement Group informed of its progress in procuring independent engineering and then economic advice on potential solutions, and its consideration of the key threats and opportunities to the operation of the interconnector presented by different approaches. The outcomes of that engagement and the impact it has on Murraylink's selection and proposal of a solution will be of particular interest in our assessment of its revised proposal.

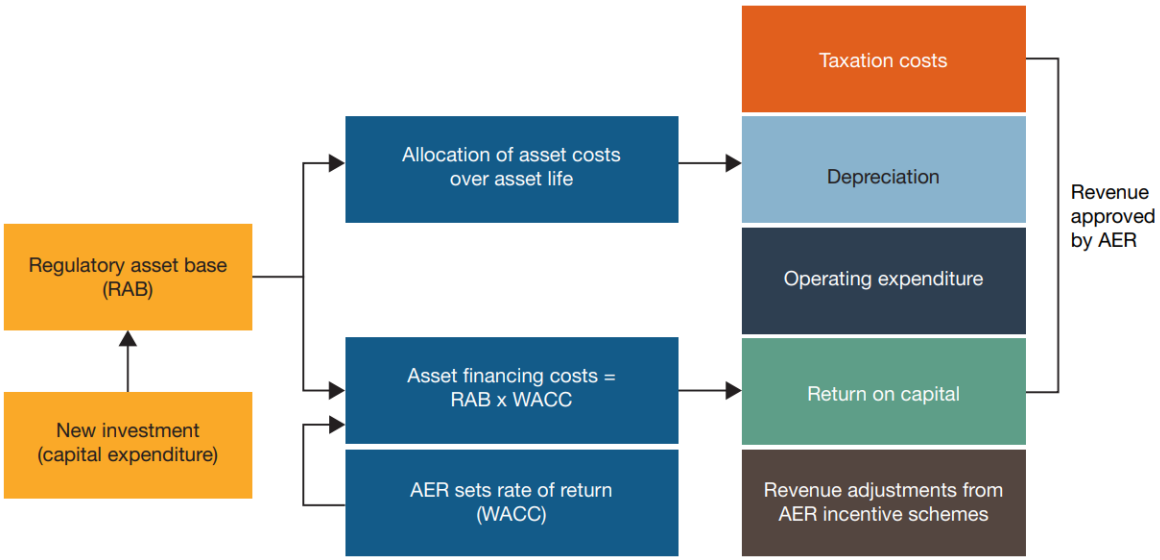
2 Key components of our draft decision on revenue

The foundation of our regulatory approach is a benchmark incentive framework to setting maximum revenues: once regulated revenues are set for a five-year period, a network that keeps its actual costs below the regulatory forecast of costs retains part of the benefit. This provides an incentive for service providers to become more efficient over time. It delivers benefits to consumers as efficient costs are revealed and drive lower cost benchmarks in subsequent regulatory periods. By only allowing efficient costs in our approved revenues, we promote delivery of the NEO and ensure consumers pay no more than necessary for the safe and reliable delivery of electricity.

Murraylink's proposed revenue reflects its forecast of the efficient cost of providing transmission network services over the 2023–28 period. Its revenue proposal, and our assessment of it under the Law and Rules, are based on a 'building block' approach which looks at five cost components (see Figure 3):

- return on the RAB – or return on capital, to compensate investors for the opportunity cost of funds invested in this business
- depreciation of the RAB – or return of capital, to return the initial investment to investors over time
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services
- revenue increments/decrements – resulting from the application of incentive schemes, such as the EBSS and CESS
- estimated cost of corporate income tax.

Figure 3 The building block model to forecast network revenue



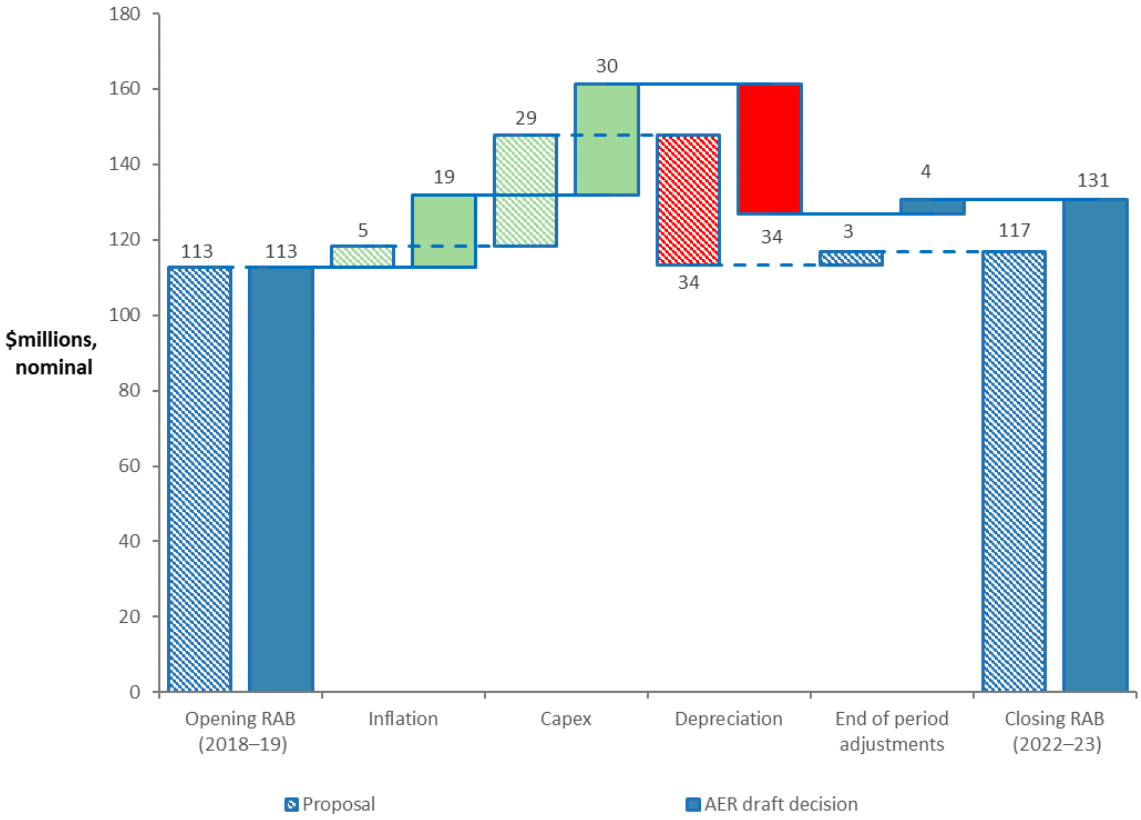
Source: AER.

2.1 Regulatory asset base

The RAB accounts for the value of regulated assets over time. To set revenue for a new regulatory period, we take the opening value of the RAB from the end of the last period and roll it forward year by year by indexing it for inflation, adding new capex and subtracting depreciation and other possible factors (such as disposals). This gives us a closing value for the RAB at the end of each year of the regulatory period. The value of the RAB is used to determine the return on capital and depreciation building blocks. It substantially impacts Murraylink'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 components of the revenue determination.

For this draft decision, we have determined an opening RAB value of $130.7 million ($ nominal) as at 1 July 2023. This value is $13.9 million (11.9%) higher than Murraylink's proposed opening RAB of $116.8 million. This increase is largely due to the updates we made to the inflation inputs for 2021–22 and 2022–23 in the roll forward model (RFM) to reflect more up-to-date values. Figure 4 shows the key drivers of the change in Murraylink's RAB over the 2018–23 period compared to Murraylink's proposal.

Figure 4 Key drivers of changes in the RAB over the 2018–23 period – Murraylink's proposal compared with AER draft decision ($ million, nominal)

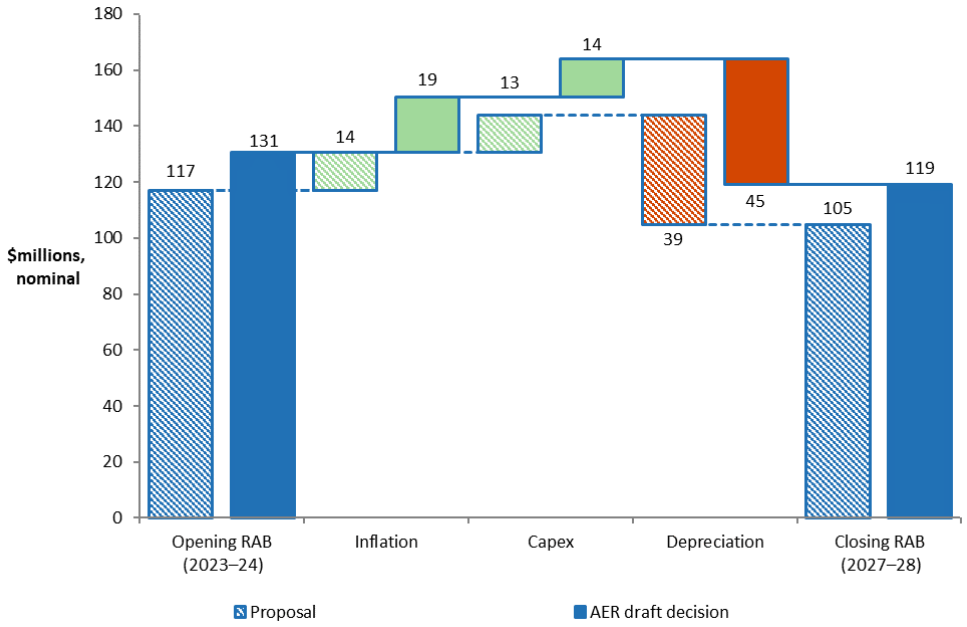


Source: Murraylink, *2023–28 Revenue proposal, Roll forward model*, January 2022; AER, *2023–28 Draft decision, Roll forward model*, September 2022.

Figure 5 likewise shows the key drivers of the change in Murraylink's RAB over the 2023–28 period compared to Murraylink's proposal. Our draft decision projects a decrease of

$11.5 million (8.8%) to the RAB by the end of the 2023–28 period compared to the $12.0 million (12.0%) decrease from Murraylink's proposal.

Figure 5 Key drivers of changes in the RAB over the 2023–28 period – Murraylink's proposal compared with AER's draft decision ($ million, nominal)



Source: Murraylink, *2023–28 Revenue proposal, Post-tax revenue model*, January 2022; AER, *2023–28 Draft decision, Post-tax revenue model*, September 2022.

We have determined a projected closing RAB of $119.2 million ($ nominal) as at 30 June 2028, which is $14.4 million (13.7%) higher than Murraylink's proposed $104.8 million. This increase is mainly due to our draft decision on the opening RAB as at 1 July 2023, but also reflects our draft decisions on the expected inflation rate and forecast straight-line depreciation, and our acceptance of Murraylink's forecast capex, discussed further in the sections below.

2.2 Rate of return and value of imputation credits

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

We estimate the rate of return by combining the returns of 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 rate on its loans and give a return on equity to investors. We have applied our 2018 Instrument to estimate the rate of return for this draft decision.[2] For our final decision we will apply the 2022 Rate of Return Instrument, which is scheduled to be published in December 2022. This may affect the estimate of the rate of return as well as the value of imputation credits.

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2 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

For the purposes of this draft decision, the placeholder rate of return is 5.56% (nominal vanilla). Updates to risk-free rate and the return on debt have resulted in an increase of 1.31 percentage points from the placeholder estimate of 4.25% in Murraylink's proposal.

Our estimate of expected inflation for the purposes of this draft decision is 3.00% per annum. It is an estimate of the average annual rate of inflation expected over a five-year period based on the approach adopted in our 2020 Inflation Review[3] and the forecast from the Reserve Bank of Australia's August 2022 Statement on Monetary Policy. This is a higher estimate of inflation than used in Murraylink's proposal (2.40%).

These variables will be updated again in Murraylink's revised proposal and in our final decision, which is part of our standard process.

Both Murraylink's proposal and our draft decision apply a value of imputation credits (gamma) of 0.585 as set out in the 2018 Instrument.[4]

2.3 Regulatory depreciation

Depreciation is a method used in our decision to allocate the cost of an asset over its useful life. It is the amount provided so capital investors recover their investment over the economic life of the asset (otherwise referred to as 'return of capital'). When determining Murraylink's total revenue, we include an amount for the depreciation of the projected RAB. The regulatory depreciation amount is the net total of the straight-line depreciation less the indexation of the RAB.

Our draft decision determines a regulatory depreciation amount of $25.1 million ($ nominal) for the 2023–28 period. This is a small reduction from the $25.5 million in Murraylink's proposal.

The key reason for the reduction from Murraylink's proposal is our higher expected inflation rate for the 2023–28 period, which increases the adjustment for indexation of the RAB that is offset against straight-line depreciation in determining regulatory depreciation. Forecasts of expected inflation and components that make up the projected RAB will be updated again in Murraylink's revised proposal and our final decision.

2.4 Capital expenditure

Capital expenditure (capex)—the capital costs and expenditure incurred in the provision of prescribed transmission services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. Forecast capex directly affects the size of the RAB and the revenue generated from the return on capital and depreciation building blocks.

Our draft decision is to accept Murraylink's total forecast capex of $12.6 million ($2022) for the 2023-28 period. We undertook an assessment to arrive at an alternative estimate for capex of $12.4 million because we did not accept Murraylink's proposed $0.2 million in regulatory reset costs. Our alternative capex forecast is not materially different to

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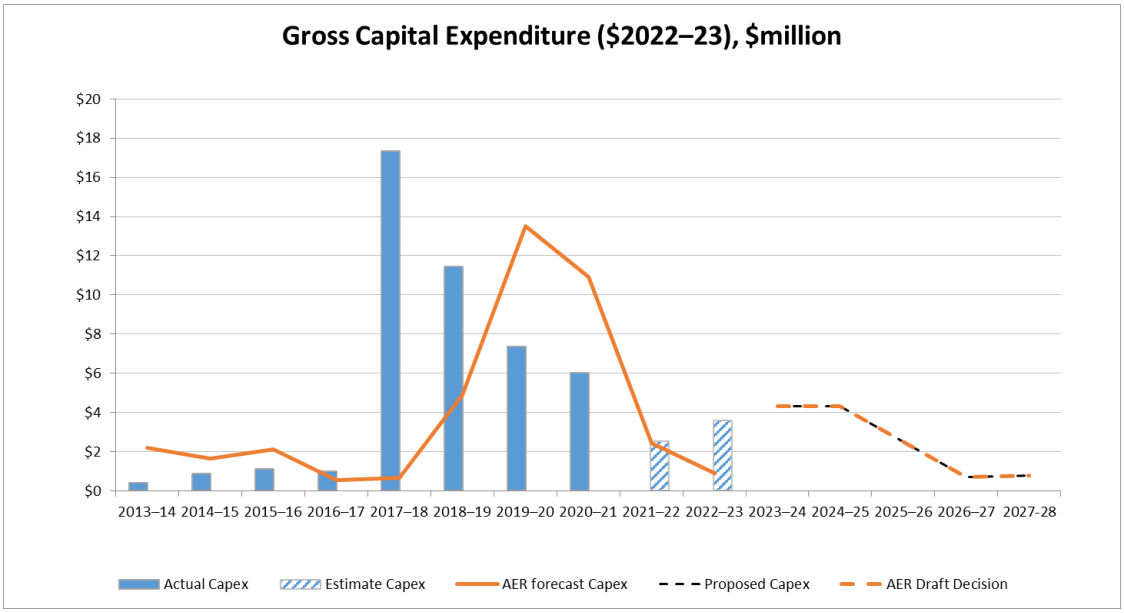
3 AER, *Final position – Regulatory treatment of inflation*, December 2020.

4 AER, *Rate of return Instrument, Explanatory Statement*, December 2018, pp. 307–382.

Murraylink's capex forecast and we are satisfied that Murraylink's estimate reasonably reflects the capex criteria.

Figure 6 compares this forecast to Murraylink's forecast and actual capex in the current and previous periods. Our approved forecast is $17.5 million (57.8%) lower than Murraylink's expected, actual expenditure for the 2018–23 period, and a reduction on prior periods.

Figure 6 Historical and forecast capex ($million, 2022)



Source: AER, *Murraylink 2018–23 - Post-tax revenue model,* April 2018; AER, *Murraylink 2018–23 - Roll forward model*,

A key driver of capex in the current period was the replacement of the control and protection system (estimated actual capex of $28.6 million). Its January proposal did not include any projects of that scale. The forecast capex we have approved in this draft decision will allow Murraylink to continue the safe, reliable and secure operation of its network.

However, our acceptance of the total capex forecast in Murraylink's proposal is made based on information that is before us now. Should Murraylink seek, in its revised proposal, to materially change the total capex forecast it has submitted as part of its proposed IGBT solution, we anticipate the need to re-examine existing elements of that forecast and whether they remain appropriate as part of a holistic capex program.

Murraylink's capex forecast did not include potential expenditure to replace obsolete IGBTs, which are an integral part of the operation of the Murraylink converter stations. At this stage, Murraylink is still working with its Consumer Engagement Group in investigating potential solutions and it is expected that the outcome of this process will be considered in Murraylink's revised proposal in December 2022. Potential options contemplated in its January proposal included the purchase of existing compatible transistors, or a contingent project should it become necessary to upgrade its control valve room within the 2023–28 control period to allow compatibility with the next generation transistors.

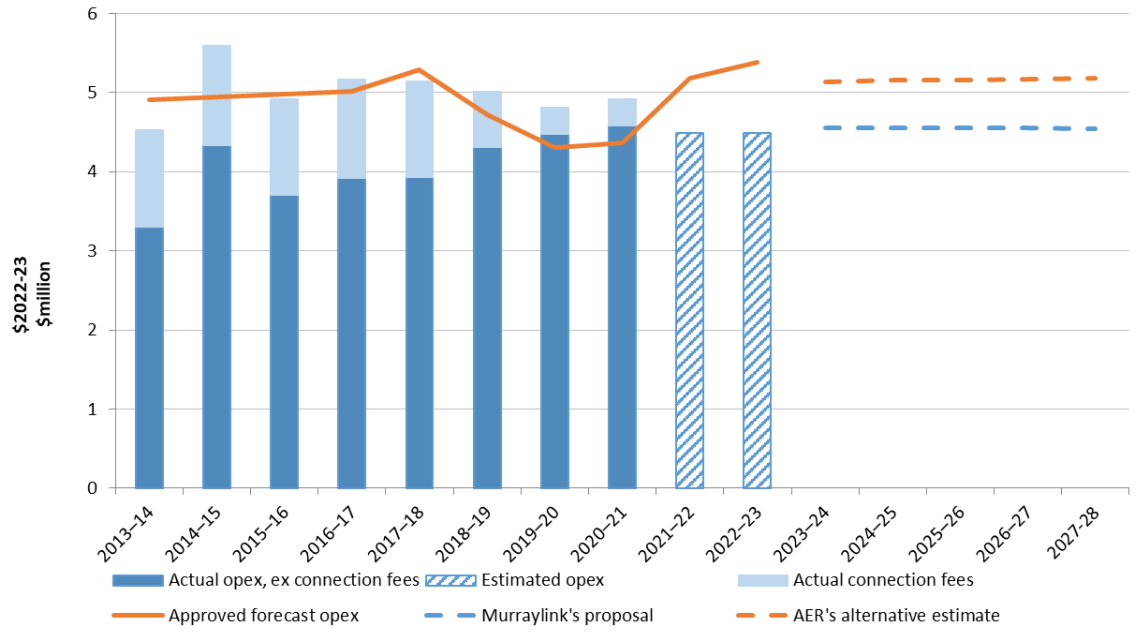
2.5 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses incurred in the provision of Murraylink's prescribed transmission services.

Our draft decision is to accept Murraylink's proposed opex forecast of $22.8 million ($2022–23). Figure 7 compares our draft decision to Murraylink's forecast and actual opex in the current and previous periods.

The total opex forecast approved in this draft decision is broadly consistent with the opex Murraylink has incurred over the last six years. It is $1 million (4%) lower than Murraylink's actual and expected opex in the current period, and $0.8 million (3%) lower than allowed in our last decision, including adjustments for negative cost pass throughs in 2018-19, 2019-20 and 2020-21 due to reduced connection charges. Further negative cost pass throughs are anticipated for 2021-22 and 2022-23.

Figure 7 Historical and forecast opex ($million, 2022)



Source: Murraylink, Economic benchmarking – Regulatory Information Notice response 2006–20; AER, Murraylink Final decision PTRM 2008–13; AER, Murraylink Final decision 2013–18 PTRM; AER, Murraylink Final decision 2018–23 PTRM and Opex model; Murraylink transmission determination 2023–28 - Overview - 31 January 2022; AER analysis.

Note: Includes debt raising costs and negative cost pass throughs for 2018-19, 2019-20 and 2020-21 due to reduced connection charges. Further negative cost pass throughs are anticipated for 2021-22 and 2022-23.

Murraylink used a simplified version of the base-step-trend approach outlined in our Expenditure forecast assessment guideline to prepare its opex forecast for 2023–28. It proposed 2020–21, the most recent year for which actual data was available, as its base year. Unlike our standard approach, Murraylink did not include any forecast output, price or productivity growth in its opex forecast. Murraylink did not propose any step changes and included only one category specific forecast for debt raising costs.

We tested Murraylink's forecast against our own, alternative estimate of forecast opex—which included an annual 0.6% adjustment for price growth for the 2023–28 period to reflect

expected growth in labour costs, and an annual productivity adjustment of 0.5% consistent with our projections for other electricity transmission networks—and found its forecast opex was lower than our own, primarily due to increased inflation. On that basis we are satisfied that in the context of its overall proposal the total forecast opex in Murraylink's proposal is likely to be prudent and efficient.

2.6 Revenue adjustments

Our calculation of Murraylink's total revenue includes adjustments under the EBSS and CESS that applied in its determination for the current period. These mechanisms provide a continuous incentive for Murraylink to pursue efficiency improvements in opex and capex, and a fair sharing of these between Murraylink and its users.

Our draft decision includes a higher revenue increment (reward) of $0.47 million under the CESS than Murraylink proposed ($0.35 million) as a result of updated modelling inputs, including inflation and the rate of return.

This is offset by our revenue reduction (penalty) of –$1.9 million under the EBSS in place of the revenue increment (reward) of $0.2 million in Murraylink's proposal, after updates to modelling inputs for expected inflation and for actual opex in the current period, and removal of the impact of negative opex cost pass throughs during the current period from the EBSS calculation.

2.7 Corporate income tax

Our determination of the total revenue requirement includes the estimated cost of corporate income tax for 2023–28 period. Under the post-tax framework, this amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM).

Our draft decision determines an estimated cost of corporate income tax amount of $1.7 million ($ nominal) for Murraylink over the 2023–28 period. This decision represents an increase of $1.1 million from Murraylink's proposal of $0.6 million. The key reason for the increase is our draft decision on the rate of return on equity, which in turn increased Murraylink's taxable revenue and therefore the cost of corporate income tax.[5]

[5] All else being equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on equity, a component of taxable revenue.

3 Incentive schemes and allowances

Incentive schemes are a component of incentive-based regulation and complement our approach to assessing efficient costs. They provide important balancing incentives under network determinations, encouraging businesses to pursue expenditure efficiencies while maintaining the reliability and overall performance of its network. Our draft decision is that the following incentive schemes will apply to Murraylink in the 2023–28 period:

- Efficiency benefit sharing scheme (EBSS). This provides a continuous incentive to pursue efficiency improvements in opex and provide for a fair sharing of these between Murraylink and network users. Consumers benefit from improved efficiencies through lower opex in regulated revenues for future periods.
- Capital expenditure sharing scheme (CESS). This incentivises efficient capex throughout the period by rewarding efficiency gains and penalising efficiency losses, each measured by reference to the difference between forecast and actual capex. Consumers benefit from improved efficiencies through a lower RAB, which is reflected in regulated revenues for future periods.
- Service target performance incentive scheme (STPIS). This balances incentives to reduce expenditure with the need to maintain or improve service quality, by providing financial incentives to maintain and improve service performance where consumers are willing to pay for these improvements. Once improvements are made, consumers benefit as the benchmark performance targets will be tightened in future years.

Our draft decision on the application of these schemes and allowances is consistent with the position taken in our Framework and Approach paper and is set out in Attachments 8-10 of this draft decision.

Our Framework and Approach Paper also suggested that the Demand Management Innovation Allowance Mechanism (DMIAM) could apply to Murraylink as it does to other transmission network service providers. Murraylink has not proposed this, and our draft decision is that the DMIAM will not apply. Under the current operational framework, we consider that there will be very limited utility to energy users were Murraylink to invest in researching demand management opportunities through the DMIAM.[6]

Demand management is typically achieved through load shifting, increasing the level of embedded generation sources, and to a lesser extent minimising energy losses. Murraylink is a point-to-point interconnector between South Australia and Victoria. The power flowing through this link is determined by the price differential between the two regions and other network constraint factors at the time of generation dispatch by AEMO. There is no scope for Murraylink to manage the power flow volume by load shifting or to connect new embedded generators. Nor can it reduce losses within the link without some sort of capital investment. Given the DMIAM does not allow capex expenditure under the mechanism,[7] the scope for loss reduction under the DMIAM is limited.

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6 AER, Framework and Approach Murraylink Regulatory control period commencing 1 July 2023, July 2021, p. 1; Murraylink, Response to AER email re: DMIAM for Murraylink for 2023-28, 7 June 2022.

7 AER, *Explanatory statement Draft demand management innovation allowance mechanism for electricity transmission network service providers*, December 2020, p.13

A Constituent decisions

Our draft decision on Murraylink's transmission revenue determination for the 2023–28 regulatory control period includes the following constituent components:[8]

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 Murraylink's building block proposal. Our decision on Murraylink's total revenue cap is $87.4 million ($ nominal, smoothed) for the 2023–28 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 Murraylink's building block proposal. Our decision on Murraylink's MAR for each year of the 2023–28 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 Murraylink for the 2023–28 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 Murraylink in respect of the 2023–28 regulatory control period is 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 Murraylink proposed in its revenue proposal. The regulatory control period will commence on 1 July 2023 and the length of this period is five years, expiring on 30 June 2028.
In accordance with clause 6A.14.1(2)(i) of the NER and acting in accordance with clause 6A.6.7(c), the AER's draft decision is to accept Murraylink's proposed total forecast capital expenditure of $12.6 million ($2022). The reasons for our draft decision are set out in Attachment 5 of this draft decision.
In accordance with clause 6A.14.1(3)(i) of the NER and acting in accordance with clause 6A.6.6(c), the AER's draft decision is to accept Murraylink's proposed total forecast operating expenditure inclusive of debt raising costs of $22.8 million ($2022). The reasons for our draft decision are set out in Attachment 6 of this draft decision.
In accordance with clause 6A.14.1(4) of the NER, the AER's draft decision is that the control valve room upgrade to support new generation Insulated Gate Bi-Polar Transistors is not a contingent project for the purpose of this revenue determination for Murraylink. This is set out in Attachment 5 of this draft decision.
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 in the Capital Expenditure Incentives Guideline will apply to Murraylink in the 2023–28 regulatory control period. This is set out in Attachment 9 of this draft decision.
In accordance with clause 6A.14.1(5A) of the NER, the AER's draft decision is that the demand management innovation allowance mechanism (DMIAM) for electricity transmission networks will not apply to Murraylink in the 2023–28 regulatory control period.

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

Constituent component
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 2022–23 regulatory year is 5.56 per cent (nominal vanilla), as set out in Attachment 3 of this draft decision. The rate of return for the remaining regulatory years 2024–28 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(5D) 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 2023–28 regulatory control period, being 1 July 2023, is $130.7 million ($ nominal). This is set out in Attachment 2 of this draft decision.
In accordance with clause 6A.14.1(5E) 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 Murraylink's regulatory control period as at 1 July 2028. This is set out in Attachment 2 of this draft decision. We also note that the regulatory depreciation amount that is approved in this decision is $25.1 million ($ nominal) for the 2023–28 regulatory control period.
In accordance with clause 6A.14.1(8) of the NER, the AER's draft decision is to approve Murraylink's proposed pricing methodology. 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 that no additional pass through events will apply to Murraylink for the 2023–28 regulatory control period.
By virtue of clause 11.98.8 of the NER, the provisions for negotiated transmission services in version 109 of the NER continue to apply in Victoria. Under clauses 6A.2.2(3) and 6A.14.1(6) of version 109 of the NER, the AER's draft decision is to approve Murraylink's proposed negotiating framework. This is set out in Attachment 12 of this draft decision.
By virtue of clause 11.98.8 of the NER, the provisions for negotiated transmission services in version 109 of the NER continue to apply in Victoria. In accordance with clause 6A.14.1(7) of version 109 of the NER the AER has specified the negotiated transmission services criteria for Murraylink in Attachment 12 to this draft decision.

B List of submissions

We received two submissions in response to the AER's issues paper and Murraylink's 2023–28 transmission revenue proposal. These are listed below.

Stakeholder	Date
Energy Users Association of Australia	11 May 2022
Department of Energy and Mining - SA	13 May 2022

Glossary

Term	Definition
2018 Instrument	2018 Rate of Return Instrument
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
CPI	Consumer price index
DMIAM	Demand management innovation allowance mechanism
EBSS	Efficiency benefit sharing scheme
Gamma	Value of imputation credits
MAR	Maximum allowed revenue
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
Opex	Operating expenditure
PTRM	Post-tax revenue model
RAB	Regulatory asset base
RBA	Reserve Bank of Australia
RIN	Regulatory information notice
RFM	Roll forward model
STPIS	Service target performance incentive scheme