

Consumer

Challenge

Panel

**Powerlink Framework and Approach for Regulatory
Control Period commencing 1 July 2022**

CCP23 response to Preliminary Framework and Approach

Consumer Challenge Panel (CCP) Sub-Panel CCP23

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About the CCP

The objective of the CCP is to:

- advise the AER on whether the network businesses' proposals are in the long term interests of consumers; and
- advise the AER on the effectiveness of network businesses' engagement activities with their customers and how this is reflected in the development of their proposals.¹

The subpanel appointed to advise the AER regarding the Powerlink regulatory proposal for 2022-27 is CCP23, comprising Bev Hughson, David Prins and Mark Henley.

Role of the Framework and Approach

The AER summarises the role of the Framework and Approach (F&A) with the following from the preliminary Framework and Approach for Powerlink regulatory process 2022-27.

"The final F&A paper will set out, amongst other things, the application of any incentive schemes. The F&A also facilitates early consultation with consumers and other stakeholders and will assist Powerlink to prepare expenditure proposals. ...

This preliminary F&A paper sets out our proposed approach for the 2022–27 regulatory control period concerning the application of the following:

- *service target performance incentive scheme (STPIS)*
- *efficiency benefit sharing scheme (EBSS)*
- *capital expenditure sharing scheme (CESS)*
- *expenditure forecast assessment guidelines*
- *demand management innovation allowance mechanism (DMIAM)*
- *whether depreciation will be based on forecast or actual capital expenditure (capex) in updating the regulatory asset base (RAB)."*²

Consumer Engagement

The AER states that *"The F&A also facilitates early consultation with consumers and other stakeholders and will assist Powerlink to prepare expenditure proposals."* We agree that while setting the "ground rules" for development of a regulatory proposal, the F&A also acts as a focus point for developing consumer engagement in the lead up to lodgement of the regulatory proposal.

¹ <https://www.aer.gov.au/about-us/consumer-challenge-panel>

² AER Preliminary Framework and Approach Powerlink, February 2020, page 2

Powerlink's 2022-27 regulatory proposal is being developed in a period of significant change and uncertainty. Current processes being undertaken by the market bodies and the Energy Security Board include development of the next version of the integrated System Plan (ISP), Coordination Of Generation And Transmission Investment (COGATI), expectations of significant increases in renewable energy being connected to the transmission network with associated changes to transmission requirement as set out in the AEMO's ongoing renewable Integration study, a review of market frameworks beyond 2025, and the risk of more extreme weather events, as highlighted by the summer of 2019-20, particularly the extreme impacts of bushfires.

Since the AER released the preliminary F&A document, the impact of COVID-19 increased dramatically, with widespread implications including in this instance, the need to re-assess consumer engagement methodology with likely extended periods of very limited face-to-face forums and meetings possible. Issues around affordability of energy will become even more prominent in the minds of all consumers, including direct connection transmission customers, given the impacts of COVID-19.

It is not the role of the F&A to specify consumer engagement requirements or recommended approaches. However, it is worth noting the significant contextual changes in how Powerlink (and other energy network businesses) will engage with consumers and handle increased uncertainty, in developing and lodging their next regulatory proposal. We also take this opportunity to make some brief observations about consumer engagement in the development of the Powerlink regulatory proposal.

Over recent months, CCP23 has observed several Powerlink engagement activities including:

- Revenue Proposal Reference Group (RPRG) meetings (approximately monthly over recent months);
- Customer Panel meetings; and
- Powerlink's 3rd Annual Transmission Network Forum.

We are satisfied that Powerlink is actively seeking the views of the diversity of its end-user customer base (residential, SMEs and commercial and industrial customers), and is planning relevant consumer engagement, COVID-19 notwithstanding.

In its October 2019 letter to the AER on the F&A, Powerlink discussed applying "regulatory sandbox" approaches to engagement. In our initial submission regarding the Powerlink F&A, we indicated support in principle for the potential application of regulatory sandbox methodologies. A regulatory sandbox in energy regulation applies to a trial that would (or may) require suspension of aspects of the National Electricity Rules (NER) for a project, in order to test the project hypothesis. The hypothesis must have an intent, and high likelihood of being in the best interests of consumers.

Since this initial submission, the AEMC has developed Draft Rules for application of a regulatory sandbox, as well as developing a "toolkit". The AER will develop guidelines for application of this methodology over coming months.

The vast majority of the engagement options and any trials that Powerlink wishes to undertake, particularly in the context of developing its next regulatory proposal, can most likely be undertaken within existing rules. However, we remain open to Powerlink exploring the application of regulatory sandbox methodologies, where appropriate, once the rules and guidelines have been established. It is essential, however, that in initiating such proposals, Powerlink not only complies with the rules and guidelines, but also recognises that the intent and application of the ‘regulatory sandbox’ is strictly limited, and does not provide a ‘back door’ to change the NER more generally.

The best engagement methodologies are those that are appropriate at the relevant time and location, and which effectively engage the priority customer audiences. The network should continue to avail itself of a wide range of engagement methodologies, a vast majority of which can occur under the current rules, and many of which can still be applied even at a time of no face-to-face meetings with consumers.

The Incentive Schemes

Service Target Performance Incentive Scheme (STPIS)

As set out in the National Electricity Rules, the purpose of the STPIS is to offer incentives to a transmission network service provider, in this instance, to provide greater transmission network reliability when network users place greatest value on reliability, and improve and maintain the reliability of the elements of the transmission network most important to determining spot prices.³

Improving service performance is arguably the incentive scheme that is the subject of most current debate regarding incentive schemes. The AusNet Services (distribution) Customer Forum, a central part of the NewReg trial, was very clear that aspects of STPIS were no longer relevant to customers, and therefore recommended that AusNet Services (distribution) should propose a Customer Service Incentive Scheme (CSIS), which is now under active consideration by the AER. The AER summarised some of the arguments for a CSIS in its draft explanatory statement, December 2019:

“Information gathered from stakeholders supports adapting to the unique preferences of distributor customers, rather than pursuing the one-size fits all approach currently adopted under the STPIS. Additionally, customer preferences are likely to continue changing over time. We consider an approach that responds to this change is likely to deliver greater customer benefits.”⁴

While it is recognised that the proposed CSIS, if endorsed, might initially apply only to one distribution business, we raise it here because it is an example of aspects of the STPIS being currently reconsidered.

³ NER, cl. 6A.7.4(b)(1)

⁴ AER Draft CSIS explanatory statement, 17 December 2019, section 4.1, page 9

We are aware that there is encouragement from some network businesses, including Powerlink, for the current version of STPIS to be reviewed. Whether or not the AER chooses to review STPIS, we expect that there will be a current version of STPIS that will apply when Powerlink lodges its regulatory proposal. The relevant question for the F&A is whether it is appropriate that STPIS is applied to Powerlink for its 2022-27 regulatory control period.

In the preliminary F&A, the AER says:

“We propose to apply version 5 of the STPIS [to] Powerlink for the 2022–27 regulatory control period as follows:

- *the parameters for each service component and the maximum revenue increment or decrement that Powerlink can receive for a given level of performance will be those prescribed in version 5 of the scheme. The applicable parameter values will be set out in Powerlink’s transmission determination. Powerlink’s MAR will be adjusted according to its performance against these parameter values, as assessed by us, in accordance with the scheme*
- *the MIC annual performance target will be calculated in accordance with Appendix C and example 2 in Appendix F of the scheme*
- *the network capability component of version 5 of the scheme will apply to Powerlink.*
- *In its revenue proposal, Powerlink must:*
 - *submit proposed values for the service component parameters*
 - *submit data for its market impact component for the preceding seven regulatory years. Powerlink must submit a proposed value for a performance target, unplanned outage event limit and dollar per dispatch interval incentive.*
 - *submit a network capability incentive parameter action plan.*

We will accept Powerlink’s proposed parameter values for the service, market impact and network capability components if the proposed values comply with STPIS version 5 clauses 3.2, 4.2 and 5.2 respectively.”

CCP23 supports this approach and agrees that it provides incentive for Powerlink to monitor, develop and improve services to its various customer cohorts.

Should the AER decide to review STPIS, this will be a separate AER process, and changes to the STPIS scheme would require an extended consultation process.

However, we recognise that there are new issues that will face most of the TNSPs in ensuring a secure and reliable network as a result of the rapid expansion of large scale solar and wind developments. For example, the current study being conducted by AEMO linked into the ISP process (the “Renewable Integration Study”), recognises the issue of potential constraints on the TNSP networks. The Study has three main objectives, all of which are relevant to and may well impact on Powerlink’s performance over the 2022-27 regulatory control period (RCP). The objectives are:

- Modelling the expected renewable and non-renewable energy in the grid and its subregions in 2025
- Quantifying the technical limits of the power system for this projected generation mix in 2025
- Investigating when the technical limits may become an issue and what we recommend to address them.

[See: <https://aemo.com.au/energy-systems/electricity/national-electricity-market-nem/system-operations/future-grid/renewable-integration-study>]

We do not see this as a sufficient reason, in principle, to propose an alternative to the application of STPIS version 5 as set out in the preliminary F&A. However, we ask the AER to consider carefully any options proposed by Powerlink that are within the overall framework of version 5. For example, version 5 gives the AER options to:

- Vary the requirement for the Service Component of the STPIS using an average performance history over 5 years. Clause 3.2(g), for instance, allows the AER to use: *“a different period if it is satisfied that the use of a different period is consistent with the objectives in clause 1.4 of this scheme.”* (See p 6 of STPIS version 5). Alternatively, clauses 3.2(i) and 3.2(j) provide conditions under which a performance target could be altered.⁵
- Vary the weightings of the parameters in the Service Component (see pp7-8, and Table 3-1)
- Vary the amount of MAR at risk as a result of deviation from the standards for each of the three components (service, market impact and network capability)

CCP23 is not recommending a particular solution to the issues raised by Powerlink and the ENA. We are simply recognising that there are challenges in the 2022-27 RCP that are not part of the current regulatory period environment, and which may have direct and indirect impacts on Powerlink’s performance – at least in the first few years.

As mentioned above, the AER is currently considering whether a CSIS should be developed and applied to a distribution network business(es). However, we agree with the AER that the relationship between a TNSP and its customers may be quite different from that between a DNSP and its customers.⁶ As such, a CSIS for transmission could not simply ‘piggy-back’ off the work undertaken by the distribution businesses, and would need to be examined freshly and comprehensively across TNSPs.

In any case, there is no proposal from Powerlink to seek to apply a CSIS for the 2022-27 RCP, and so there is no need to consider such a scheme in this F&A.

⁵ Currently, Powerlink is performing above the current STPIS standards and has done so for some years. Therefore, averaging actual performance over these years to derive the future standard *may* not reflect future challenges on the network.

⁶ AER Preliminary Framework and Approach Powerlink, February 2020, section 5, page 17

Efficiency Benefit Sharing Scheme (EBSS)

The purpose of the Efficiency Benefit Sharing Scheme is to provide incentives to energy network businesses to apply a continuous improvement approach to their operating costs, seeking to improve efficiency of their day-to-day operations, and to share the benefits between the network business and its customers.

The AER's preliminary position is

*"We intend to apply the EBSS to Powerlink in the 2022–27 regulatory control period if we are satisfied the scheme will fairly share efficiency gains and losses between the business and consumers. This will occur only if the opex forecast for the following period is based on Powerlink's revealed costs. Our transmission determination for Powerlink for the 2022–27 regulatory control period will specify if, and how, we will apply the EBSS."*⁷

This approach is consistent with the AER's treatment of other network businesses, and supports the objective of greater efficiency in operating costs, to the benefit of consumers. Consequently, CCP23 supports this approach to EBSS.

In particular, we agree with the AER that if the TNSP's revealed costs for the 2017-22 RCP are "materially higher" than the opex incurred by a benchmark efficient transmission business, then the AER would not necessarily apply the EBSS based on revealed costs (preliminary F&A, p 14). Powerlink is currently suggesting a significant number of 'step changes' for the 2022-27 RCP, and potentially undertaking several contingent projects in the same period. This raises some questions around how the revealed costs from 2017-22 RCP relate to the opex forecast, and therefore to the basis of the EBSS.

Capital Expenditure Sharing Scheme (CESS)

The purpose of the Capital Expenditure Sharing Scheme is to offer incentives to energy network businesses to apply a continuous improvement approach to their capital costs, by providing financial benefit to network businesses whose capex spending becomes more efficient, with countervailing penalties for inefficient expenditure.

The AER's preliminary position is:

We propose to apply the CESS as set out in our capex incentives guideline to Powerlink in its 2022–27 regulatory control period.

In deciding on whether to apply the CESS to a TNSP, including the nature and details of the applied CESS, we must:

- *make that decision in a manner that contributes to the capex incentive objective; and*

⁷ AER, Preliminary Framework and Approach, Powerlink, Regulatory control period commencing 1 July 2022, February 2020, section 3, page 12

- *consider the CESS principles, capex objectives, other incentive schemes, and (where relevant) the opex objectives, as they apply to the particular TNSP, and the circumstances of the TNSP*⁸

This approach is consistent with the AER’s treatment of the regulatory proposals by other network businesses and supports the objective of greater efficiency in capital expenditure costs, to the benefit of consumers. Consequently, CCP23 supports this approach to the CESS and application to the Powerlink 2022-27 regulatory proposal. Again, however, careful consideration must be given to the issue of contingent projects and capex employed in approved contingent projects, and how they feed into the CESS, given that these contingent project capex costs are not part of the regulatory determination.

Demand Management Innovation Allowance Mechanism (DMIAM)

The Demand Management Innovation Allowance Mechanism is another example of the changing regulatory decision-making environment, since it has been introduced more recently than other incentive schemes, as network businesses grapple with integration of large and small-scale renewable energy generation into their networks.

During 2019, the AEMC considered a rule change to apply both the Demand Management Incentive Scheme (DMIS) and the DMIAM to electricity transmission businesses as well as distribution businesses. In December 2019, a rule was made to apply DMIAM to network transmission businesses, but not the DMIS. The AEMC concluded that the DMIAM encouraged transmission businesses to enhance and share their understanding of innovative demand management practices. The advantages to customers of applying the DMIS were less obvious.

The AER says *“The AER must develop and publish, by 31 March 2021, the first DMIAM required under new clause 6A.7.6. The development of a DMIAM guideline will involve a process of consultation with our stakeholders. We expect to develop and apply a DMIAM to Powerlink for the 2022–27 regulatory control period in our final determination.”*⁹

The Consumer Challenge Panel, collectively and through subpanels, has been supportive of incentives to encourage network businesses to engage more proactively with demand management opportunities. CCP23 is no exception, believing that application of demand management opportunities provides significant benefits for consumers, their communities, and energy businesses. Consequently, we support the application of DMIAM to the Powerlink regulatory proposal for 2022-27.

⁸ AER, Preliminary Framework and Approach, Powerlink, Regulatory control period commencing 1 July 2022, February 2020, section 4, page 15

⁹ AER, Preliminary Framework and Approach, Powerlink, Regulatory control period commencing 1 July 2022, February 2020, section 6, page 17

Expenditure Forecast Assessment Guideline

Powerlink is required to advise the AER by 30 June 2020 of the methodology that it intends to use in preparing its forecasts for the 2022-27 RCP. The AER states that it is its intention to apply the guideline to Powerlink, noting that the guideline provides the AER with some flexibility in the use of its various 'assessment tools' (see preliminary F&A p 18).

CCP23 believes that such flexibility in approach will be important given the changes facing Powerlink and other TNSPs with the progressive implementation of the ISP, REZ, COGATI and other related changes. We therefore support the AER's approach and its acknowledgement that: *"some customisation of data requirements contained in the guideline might be required"*. (preliminary F&A, p 18).

Depreciation (re RAB)

This aspect of the F&A relates specifically to the approach to depreciating the allowed capex for the current RCP, as input into the value of the RAB for the start of the next RCP. Specifically, a decision must be made a priori in the current F&A, as to whether the AER will apply the forecast depreciation (based on the forecast capex for 2022-27), or the actual depreciation (based on actual capex for 2022-27), when calculating the RAB for the start of the following RCP (2027-32).

The AER can apply either approach for any particular TNSP, and its decision reflects the different incentive characteristics of the 'forecast' versus the 'actual' depreciation approach.

The AER states:

"Our approach is to apply forecast depreciation, except where:

- *there is no CESS in place and therefore the power of the capex incentive may need to be strengthened, or*
- *a TNSP's past capex performance demonstrates evidence of persistent overspending or inefficiency, thus requiring a higher-powered incentive.*

We propose to use the forecast depreciation approach to establish the RAB at the commencement of the 2027-32 regulatory control period for Powerlink.

The opening RAB at the commencement of the 2022–27 regulatory control period will be established using forecast depreciation, as stated in our previous determination that applies to Powerlink for the 2017–22 regulatory control period. The use of forecast depreciation to establish the opening RAB for the commencement of the 2027–32 regulatory control period therefore maintains the current approach. Powerlink is currently subject to version 1 of the CESS. We propose to continue to apply version 1 of the CESS in the 2022–27 regulatory control period."

This approach (i.e. using forecast depreciation) was applied to Powerlink’s 2017-22 RCP. The opening RAB for 2022-27 will, therefore, reflect the use of forecast depreciation. It is also consistent with the AER’s approach across the network businesses.

In addition, we do not see evidence that Powerlink has persistently exceeded its current capex allowance or demonstrated a material level of inefficiency. Consequently, CCP23 accepts the AER’s proposed approach.

Finally, given the changing mix of capital expenditure (e.g. the increase in non-system costs), it is useful to adopt an approach to depreciation that provides the same incentive for capex regardless of the asset lives. As the AER states:

*“The incentive from using actual depreciation to roll forward the RAB also varies with the life of the asset. Using actual depreciation will provide a stronger incentive for the TNSP to underspend capex on shorter lived assets compared to longer lived assets as this will lead to a relatively larger increase in the RAB. **Use of forecast depreciation, on the other hand, leads to the same incentive for capex regardless of asset lives. This is because using forecast depreciation does not affect the TNSP’s incentive on capex as the TNSP does not lose the full cost of any overspend and is not able to keep all the benefits of any underspend. To this end, using forecast depreciation means the capex incentive is focussed on the return on capital.**”* [emphasis added] (see preliminary F&A, p 19)

Given the many challenges that we have noted above, CCP23 supports the more ‘conservative’ approach of adopting forecast depreciation (based on forecast capex), where the incentive power is independent of the asset age.

Summary of Response to Preliminary F&A

CCP23 accepts the various methodologies proposed in the Preliminary F&A for the Powerlink regulatory determination 2022-27. However, we note the following matters:

- While we support the adoption of STPIS to the Powerlink regulatory proposal and note that the current version is version 5, we encourage the AER to consider where version 5 provides some flexibility in the light of the real challenges that are facing the TNSPs in the 2022-27 period recognising that this is a period of rapid expansion of large scale renewable energy. These challenges for transmission have been well documented in the ISP and COGATI processes and should form part of the AER’s consideration when it determines the detailed implementation of STPIS for 2022-27.
- The ISP has identified several significant projects (Type 1 and Type 2) that will be progressively rolled out during the 2022-27 RCP, and these may have significant impacts on Powerlink’s expenditure and performance requirements for 2022-27 RCP. Powerlink currently regards most of these as ‘contingent’ projects and not part of its ex-ante forecasts. Moreover, the overall cost-benefit analysis for each of these projects is being assessed via the ISP process rather than through the standard regulatory cost benefit / efficiency test processes. It is possible that this will provide

a challenge to assessing the efficiency of some of the forecast expenditures and the operation of the incentive schemes. We ask the AER to consider specifically, or at least acknowledge, the potential impact of these developments in the final F&A.