

# Regulatory Proposal 2022-27 Powerlink – Transmission, Queensland

Presentation to Public Forum  
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CCP23  
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Consumer  
Challenge  
Panel

# Recognition of Country



*We acknowledge the Traditional Owners of Country throughout Australia, in this situation the owners of the land hosting the Queensland electricity transmission network and the lands on which participants are located.*

*We recognise the continuing connection to land, waters and culture.*

*We pay our respects to their Elders past, present and emerging.*

# Context: For the Draft Determination

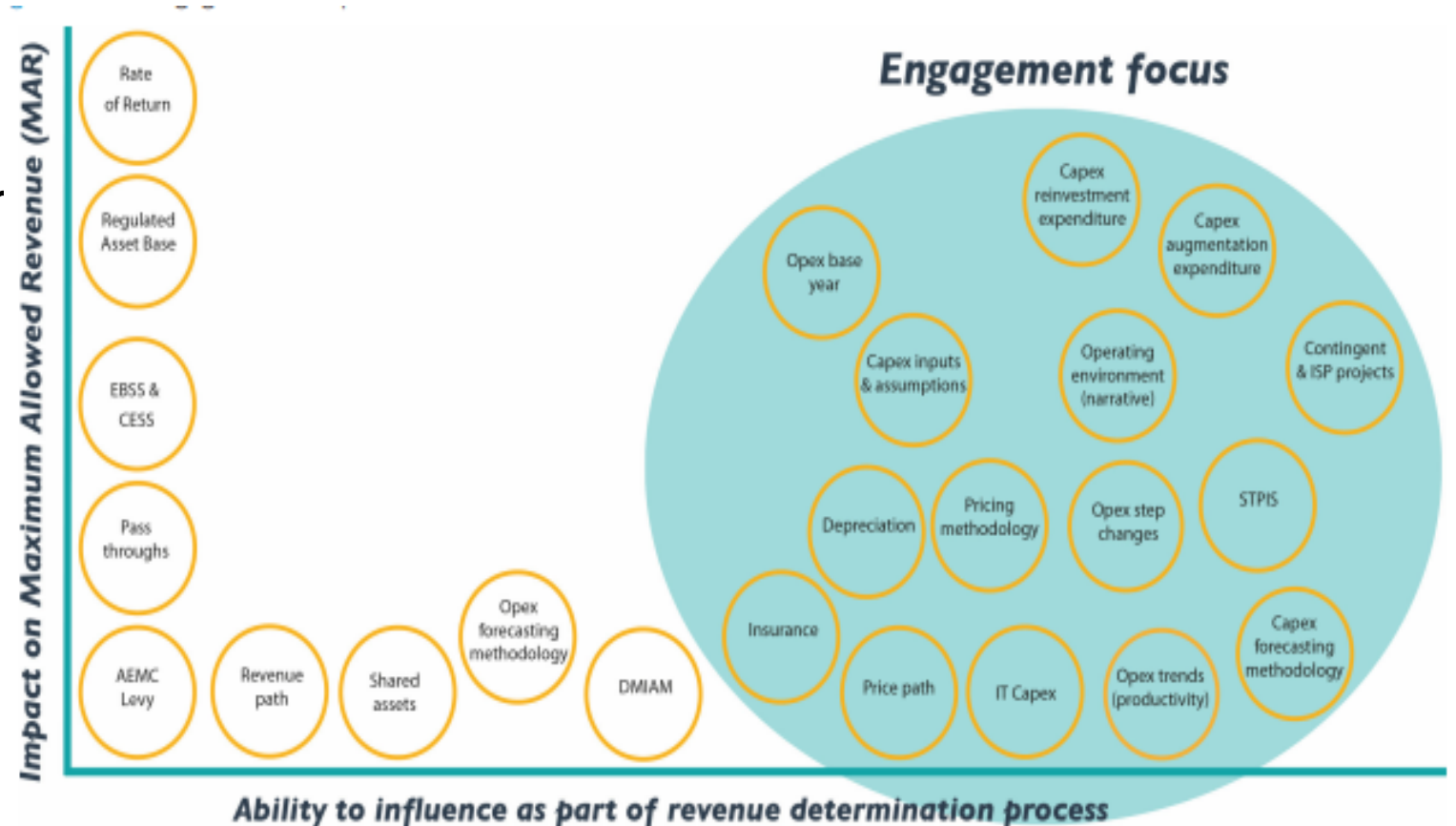
- Powerlink and consumers reps, particularly through the Revenue Proposal Reference Group (RPRG) have interacted well with each other, and Powerlink has been open in saying it wanted to lodge a “proposal capable of acceptance”.
- What then are the rewards for Powerlink owners and consumers from good process?
- Meanwhile, AER is in the early stages of developing a “Better Resets Handbook”, to identify good processes between NSPs and their customers, as a means for improving the efficiency and effectiveness of the regulatory process.
- This Draft Determination is, we suggest, playing to more audiences than usual (NSPs and consumer groups) and reflects tensions between what, for simplicity, we can call ‘standard’ and ‘light handed’ regulation.

# Key issues / themes

- Well delivered and responsive Consumer Engagement. Does good CE give scope for slightly less than ‘optimal’ MAR?
- Proposal “capable of acceptance” says the AER, with some conditionality – note language shift to “capable of support”
- Modest average price reductions, enhanced by reduction in rate of return – which is exogenously determined.
- Repex: Does it pass the ‘prudent and efficient’ test?
  - Repex forecasting methodology - Powerlink commits to a review in 2022-23, AER accepts
- Innovation mechanism: DMIAM serves an interesting debate. Powerlink says it can save customers money by not applying it. Some think that innovation and sharing is important. Powerlink commits to further consideration.

# Consumer Engagement, Engagement Scope

- RPRG central to process and highly engaged. We estimate over 30 hours per person.
- Co-design
- Clear engagement focus
- Iterative approach. Customer Panel and RPRG travelled with Powerlink: “involve and collaborate” more than “inform and consult”
- Draft plan was well on the path to final proposal, and timely
- Strong documentation of consumer influence in Revenue Proposal



# Powerlink Consumer Engagement

AER said

“We commend Powerlink on its consumer engagement approach to date, and note that it is further engaging on issues raised by stakeholders, such as the operationalisation of opex and capex productivity opportunities in the 2022–27 period and application of the DMIAM to Powerlink.”

There are challenges in ‘rewarding’ this engagement, and sticking with the Rules (NEL), including AER accepting a potentially not quite optimal capex budget, due to consumer support and a promise of future action, including engagement by Powerlink.

# Consumer Engagement, Assessment.

‘Table 3’ applied, CCP23 perspective.

Element	Possible Assessment	CCP Powerlink Assessment
<b>Nature of Engagement</b>	Consumers partner in informing the proposal	Yes
	Relevant skill and experience of stakeholders and customers	Yes
	Impartial support provided	Option available, not requested
	Sincerity of Engagement	Yes
	Independence of consumers	Yes
	Multiple channels used for engagement	to an extent
<b>Breadth and Depth</b>	Clear identification of topics and reset relevance	Yes
	Consumers consulted on broad range of topics	Yes
	Consumers able to influence topics	Yes
	Consumers encouraged to test assumptions	Yes
	Consumers able to access & resource independent research & engagement	Option available, not requested
<b>Clearly Evidenced Impact</b>	Proposal clearly tied to expressed views of consumers	Yes
	High level of business engagement, eg access to CEO / Board	Yes
	Responded to consumer views	Yes
	Impacts of engagement clearly identified	Yes
	Submissions from consumers show impact consistent with expectations	Yes
<b>Proof Point</b>	Reasonable opex and capex proposed	Yes
	In line with or lower than historical costs	Yes
	In line with or lower than top down analysis	TBA – AER role NB Capex hybrid model
	If not, explained by bottom up category analysis	TBA – AER role

# Capable of Acceptance?

- Powerlink Customer Panel said: “Proposal [is] not ... an ‘ambit claim’. Contingent upon the AER’s analysis confirming that the proposal overall is prudent and efficient, we believe that Powerlink’s Regulatory Proposal is reasonable, and it has our support.”
- Aurizon Network: “... commends Powerlink on the significant improvements in its stakeholder engagement and recommends that the AER have regard to the quality of the stakeholder engagement in assessing Powerlink’s Revenue Proposal.”
- AER: “ ...subject to being satisfied with Powerlink’s revised proposal, we are confident that our draft decision on Powerlink’s 2022–27 proposal is likely to be in the long-term interests of consumers.”
- Language development: Capable of “Acceptance” vs “Support.”

**Capable of Support?** YES. With application implications.

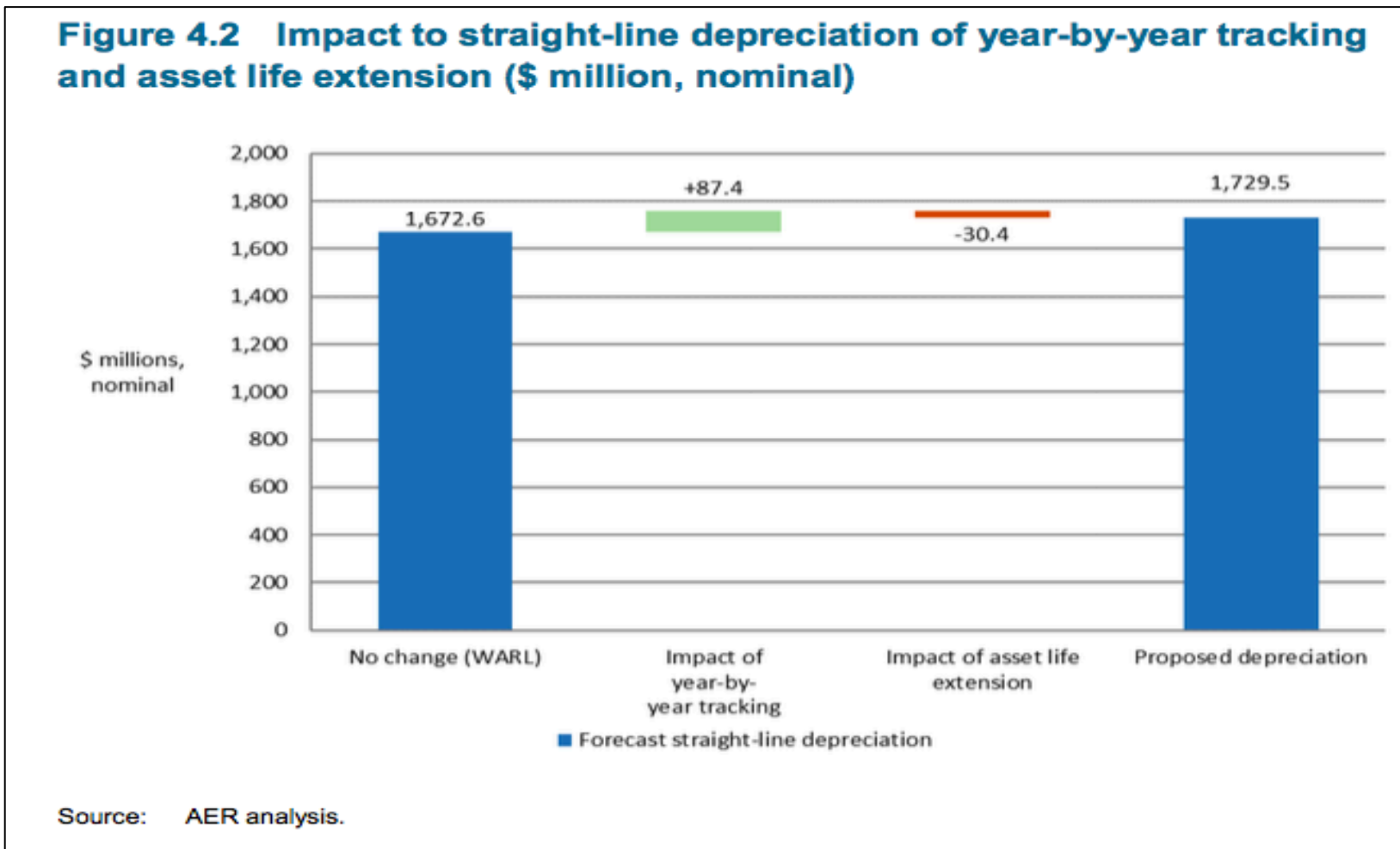


# AER's DD on RAB, RoR, Inflation and depreciation largely align with Powerlink's proposals

	<b>Powerlink's Proposal</b>	<b>AER's Draft Decision</b>	<b>CCP23 initial response to DD</b>	<b>Comment</b>
Regulatory Asset Base (\$nominal)	\$6,958m(opening) \$6,939m (closing)	\$6,983m (opening) \$6,962m (closing)	Accept	Minor updates & corrections. Significant reduction in \$real terms
Return on capital – nominal vanilla WACC (% & \$nominal)	RoR = 4.44% (2022/23) \$1,470m	RoR = 4.65% (2022/23) \$1,536m)	Accept	Increase due to updated market data (increase in risk free rate). Updated annually through the RCP
Inflation	2.25%	2.25%	Accept	Updated methodology, but same outcomes for inflation
Regulatory Tax allowance	\$26m	\$38m	Accept	Flows from higher return on capital. Adjusted for value of imputation credits (0.585)
Regulatory Depreciation	\$944m	\$947m	Accept	Change in methodology, offset in part by adjustment to some standard asset lives

Notes: All figures in nominal terms. Regulatory depreciation is depreciation after adjustment down for inflation.

# New depreciation methodology increases allowance, but partly offset by extension of some asset lives



# Powerlink's capex proposal accepted by AER, but...

	Powerlink's Proposal (\$2021-22)	AER's Draft Decision (\$2021-22)	CCP23's initial response to DD	Comment
Load driven	\$30m	Accepted	Accept	
Reinvestment	\$675m	Accepted, on the basis of Powerlink's commitment to review in 2022-23	?	AER is concerned with aspects of replacement expenditure but accepted following agreement to review after Final Decision
System Services/ security/ compliance/other	\$51m	Accepted	Accept	
Non-network	\$108m	Accepted	Accept	
<b>Total</b>	<b>\$864m</b>	<b>\$864m</b>	<b>?</b>	

## Some additional context:

*Between 2005-14 Powerlink's RAB grew by 91%. The AER states that this is "significantly faster than other transmission network service providers at the time". (Attachment 5, p 6)*

*"Powerlink's weighted average asset age remains significantly younger [than other TNSPs], particularly the transmission lines median age, which averages around 34 years compared to over 50 years for most TNSPs".*

# Why has the AER some concern with Powerlink's replacement capex proposal?

**AER's DD conclusion:** "...we are satisfied that Powerlink's proposed total forecast capex of \$864m (\$2021-22) reasonably reflects prudent and efficient costs to maintain the safety, reliability and security of the networks." (Att 5, p 5)

## **AER's qualifications:**

- "...we have had regard, among other things, to Powerlink's commitment to undertake a review of its approach to network asset reinvestment in 2022-23 and to implement the results of this review over the remainder of the 2022-27 regulatory control period." (Att 5, p 5)
- "...In particular, we are concerned that the **scope of works for some replacement projects may be overstated**. We consider that Powerlink's asset management approach, particularly in relation to the transmission lines replacement expenditure, should encompass a more targeted economic risk based practice." (Att 5, p7)
- "We also have concerns with Powerlink's use of the Repex Model for top-down forecasting]. We consider that the **Repex Model is not well suited to use in forecasting transmission capex.**" (Att 5, p 7)
- "While we have identified opportunities for improvement in Powerlink's forecasting approach that **could potentially result in lower repex forecast**, it is difficult to construct a robust alternative forecast of transmission line expenditure that would result in significantly lower forecast of total capex." (Att 5, p 7)

# Why does the CCP23 seek further explanation of this component of the capex decision?

- The AER's DD on reinforcement capex leads us to ask the following questions:
  - Is this approach consistent with the requirements in the Rules for the AER to determine a prudent and efficient capex allowance?
  - Is this approach consistent with previous practice, and if changed, why?
    - Previously, the DD has been the place where capex allowance is cut back subject to the network providing additional information etc.
    - The agreement between the AER & Powerlink specifies that the review will be undertaken after the Final Determination (FD), with no certainty on the outcome of the proposed review
  - Have consumers been consulted by the AER, or Powerlink, over the review commitment that has been made between the two parties?
    - The commitment refers to Powerlink working with the AER and consumers, but only after the FD has been determined (i.e. some time in 2022-23)
  - What process will be put in place to ensure the commitment is undertaken as written and in good faith?
  - Will this approach of 'agreeing' on a post Final Determination review establish a precedence for other networks to pursue? What are the implications of this?
- **Importantly, is this agreement consistent with consumers' expectations about the role of the AER as the 'expert' decision maker?**

# What do consumers expect from the AER?

## Powerlink's Customer Panel:

*"The customer Panel considers that Powerlink's Regulatory Proposal does not represent an 'ambit claim'. Contingent upon the AER's analysis confirming the Proposal overall is prudent and efficient we believe that Powerlink's Regulatory Proposal is reasonable, and it has our support"*

## Energy Users Association (EUAA):

*"... While there is no real growth in opex, a 3% reduction in capex and falling nominal/real RAB, the AER has to undertake its role under the rules to assess whether those proposed expenditures are prudent and efficient".*

## CCP23:

*"... before the AER has had the chance to assess that a proposal is within the rules and is within the bounds determined by various, established AER assessment models and tools, consumers or other stakeholders are not well placed to deem whether a proposal is capable of acceptance ... Commentary on capability of acceptance, at least before the AER's Draft determination, must consequently be conditional."*

CCP23 will keep thinking and talking about these questions and provide further comment in our submission.

# Contingent Project: Should Powerlink's proposed contingent project be included and is the proposed trigger appropriate?

- Contingent projects are major new capex projects but the timing and costs are uncertain. The proposed project must include a clearly defined 'trigger event' as set out in the NER
- Powerlink proposed 1 contingent project - the "Central to North Queensland Reinforcement Project"
- CCP23 advised the AER that it supported the project *in principle* but was concerned the proposed 'trigger event' was not sufficiently specific.
- The AER's DD states:
  - Powerlink's proposed contingent project should be classified as a contingent project for the 2022-27 regulatory control period as it meets the Rule requirements
  - The load related trigger was amended in consultation with Powerlink, to be more specific in its location and cause
- CCP23 is satisfied that the revised trigger event meets the Rule requirements

# Revised contingent project trigger event

Figure 2.1: Bouldercombe and Broadsound / Lilyvale network



Amended trigger:

*Customer commitment for additional load in excess of 250MW to be connected to the Central West and/or North Queensland zones that results in higher power flows on the 275kV feeders Stanwell to Broadsound, Bouldercombe to Broadsound, and Bouldercombe to Nebo northwards from Stanwell and Bouldercombe substations and requires the dispatch of higher cost liquid fuel or gas generation in northern Queensland to maintain power transfers within limits (that is, “out-of-merit” generation either through network support arrangements or constrained/directed on by AEMO).*



# Opex: \$AER > \$PL!

- This is another important aspect of the “capable of acceptance / support” story.
- AER now has more regulatory ‘tools’ than in the past, so many opex items are subject to separate, fair and reasonable processes. Eg base year adjustment, which ‘tweaks’ opex up, post lodgment.

Opex category	Powerlink's proposal	AER's alternative estimate	Difference (AER less Powerlink) (\$)
Base (reported opex in 2018–19)	1,030.1	1,044.3	14.2
Base year adjustments	-31.7	-2.7	29.0
Final year increment	-8.7	-9.6	-0.9
Trend: Output growth	11.6	12.3	0.7
Trend: Real price growth	13.1	17.3	4.2
Trend: Productivity growth	-14.7	-9.6	5.1
Step changes	-	-	-
Category specific forecasts	29.7	-	-29.7
<b>Total opex (excluding debt raising costs)</b>	<b>1,029.4</b>	<b>1,052.1</b>	<b>22.7</b>
Debt raising costs	17.0	15.9	-1.1
<b>Total opex (including debt raising costs)</b>	<b>1,046.4</b>	<b>1,068.0</b>	<b>21.6</b>
Percentage difference to proposal			2.1%

Source: Powerlink, *Revenue Proposal 2023–27, Operating Expenditure Model*, January 2021; AER analysis.

Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '-0.0' represent small variances and '-' represents no variance.

# Base Year, Step Changes and Trend

- Powerlink proposed a base year of 2018–19, and base year opex of \$206.0 million (\$2021–22)
- The AER’s higher estimate is due to using updated consumer price index (CPI) index values, released after Powerlink submitted its proposal.
- CPI partially offset by Powerlink including a notional self-insurance premium (\$1.59 million (\$2021–22)) in its base year opex, whereas the AER’s alternative estimate includes the actual self-insured losses (\$0.9 million) incurred.
- No step changes
- Powerlink commitment to “constructive discomfort” for itself

# Incentives (section 3 and Appendices 8, 9, 10)

- Efficiency Benefit Sharing Scheme (EBSS)
- Capital Expenditure Sharing Scheme (CESS)
- Service Target Performance Incentive Scheme (STPIS)
- The AER's draft decision is to apply the EBSS, CESS and STPIS to Powerlink for the 2022–27 period
- Key issue is STPIS
- The AER's draft decision
  - Did not accept Powerlink's proposal to change the selection of reference years for setting the market impact component performance targets – because this would be inconsistent with the scheme instrument's specification
  - Nor its proposal to adjust the loss of supply event from the historical average – as this would result in an outcome that is inconsistent with the NEO and the scheme's objectives

# Demand Management Innovation Allowance Mechanism (DMIAM) (1)

- The DMIAM is intended to fund Powerlink for research and development in demand management projects that have the potential to reduce long-term network costs
- Most recently discussed at the Powerlink Revenue Proposal Reference Group (RPRG) on 17 September 2021
- On 9 July 2021, Powerlink requested the AER not to apply the DMIAM to Powerlink in the 2023-27 regulatory period
- The AER's Draft Decision (Section 3; Attachment 13) is to apply the DMIAM
- Powerlink proposes to engage at the **Empower** level of the IAP2 spectrum on whether to seek to apply the DMIAM in its revised regulatory proposal
- Powerlink proposes that its Customer Panel should consider this matter and **provide its decision** at the Customer Panel meeting on 22 October 2021
- If the Customer Panel decides to apply the DMIAM, Powerlink will take relevant steps to identify and pursue appropriate projects in the next regulatory period. It will engage with and update the Customer Panel on this, and any relevant advisory panel formed as part of implementation of the DMIAM, during the next regulatory period

# Demand Management Innovation Allowance Mechanism (DMIAM) (2)

## AER Draft Decision:

- Powerlink has not provided details of its innovation framework on how demand management innovation initiatives will be integrated into its business as usual plans
- Powerlink's revised revenue proposal should outline its consultation process with stakeholders on how demand management innovation initiatives will be integrated into its business as usual plans
- How would Powerlink's research and development accommodate future efficiency gains by implementing the outcomes of previous trials
- How would Powerlink propose to share its learnings from demand management initiatives with the power industry including to develop improved ways to manage the power system

# Opex Productivity (section 2.5 / Attachment 6)

- “Powerlink applied a higher productivity growth forecast (0.5 per cent per annum), compared to the industry average growth rate (0.3 per cent per annum) we applied in our alternative estimate”
- CCP23 “lauded Powerlink’s decision to set a target of zero real opex growth for the next regulatory period and to deliver a 0.5 per cent opex productivity growth dividend to customers”
- EUAA “welcomed the 0.5 per cent opex stretch productivity growth target, but highlighted the risk to consumers under the Efficiency Benefit Sharing Scheme (EBSS) if the stretch target of 0.5 per cent productivity improvement is not achieved. EUAA members did not want to see a situation where consumers are paying 70.0 per cent of the increased costs from a failure to meet the stretch target”

# Opex Productivity (section 2.5 / Attachment 6)

- “Our productivity growth forecast reflects our expectation of the opex productivity growth an efficient service provider in the transmission industry can achieve. It reflects historic industry opex productivity growth to the extent we consider past performance to be a good indicator of future performance under a business-as-usual situation”
- “We have forecast 0.3 per cent productivity growth based on opex partial factor productivity index analysis over the 2006–19 period. We consider this reflects a reasonable expectation of the benchmark productivity that an efficient and prudent transmission network can achieve for the forecast period”

**Further consideration is needed in regard to the implications of the AER substituting a network’s higher proposed productivity with its own lower productivity value.**

# Pricing Methodology (Attachment 11)

- The AER's draft decision is to accept Powerlink's pricing methodology for the 2022-27 regulatory control period
- This is because it gives effect to, and is consistent with, the pricing principles in the NER, and complies with the information requirements set out in the pricing methodology guidelines



# Next Steps

- Powerlink engagement on DMIAM
- Repex forecasting methodology
  - Powerlink to undertake further stakeholder engagement
  - AER to lead further consideration about transparency and reporting arrangements / guidance for 'promise' from Powerlink
- Reflections on this Powerlink process to be considered as part of “the Handbook” process. NB consider the extent to which 'good' consumer input provides a little leeway in assessing optimal MAR (assuming that there is a single, optimal MAR)