Ref. A2128143

6 February, 2015

Ms Paula Conboy
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Dear Paula

POWERLINK REVENUE RESET – CAPEX FORECASTING METHODOLOGY

Powerlink has started preparing its Revenue Proposal for the Regulatory Control Period covering the five years 2018-2022.

Powerlink wrote to Mr Chris Pattas, General Manager Networks (Investment and Pricing), on 31 October 2014 expressing Powerlink's desire to work with the AER on the development of a Framework and Approach Paper for its next regulatory determination process.

A particular matter raised in that letter was Powerlink's interest in applying a top down approach to forecasting capital expenditure requirements for its next Regulatory Control Period. Powerlink expects that a top down forecasting approach can deliver a sound basis for the making of a regulatory determination. This approach will significantly reduce the cost to Powerlink of preparing its Revenue Proposal, and might similarly assist the AER and stakeholders in terms of the time, effort and cost to review and assess Powerlink's Proposal.

Powerlink also contacted Mr Sebastian Roberts in January 2015 to express its preparedness to engage with the AER early in regard to its proposed top down forecasting approach for capital expenditure. An initial discussion was had subsequently with Ms Lynley Jorgensen, Mr Blair Burkitt and Mr Paul Dunn. Powerlink has since developed its approach further and would like to provide the AER with more specific information about it. The key elements are set out below.

Load driven capital expenditure

Load driven capital expenditure relates to the capital expenditure categories of network augmentations and connections. Powerlink proposes that capital expenditure necessary to meet growth in electricity demand continue to be forecast using a bottom up methodology. Given current demand forecasts, Powerlink anticipates that its next Revenue Proposal will include a relatively small number of projects in the categories of network augmentations and connections compared to its previous Revenue Proposal. As a result, Powerlink considers the likely number of investment triggers to be so few as to

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not warrant the development of new top-down forecasting techniques for load driven capital expenditure.

In previous Revenue Proposals Powerlink developed load driven capital expenditure forecasts across a wide range of future scenarios. The scenarios were generated by combinations of variations in forecast growth in demand and other key drivers of investment trigger variability, such as new generator locations or retirements of existing generators. In the current environment of low demand growth, Powerlink considers such variability to be much less likely, but still possible. Powerlink anticipates that the bottom up load driven capital expenditure forecast will be best developed using a single scenario, with possible variations to that forecast being managed through the contingent projects regime. However, this will also require further exploration to ensure the Rules requirements for contingent projects can be met.

Other capital expenditure

For other categories of capital expenditure, which include replacement and non-network expenditure, Powerlink's preference remains to use top-down forecasting methodologies as the primary means of determining its required revenue. These methodologies are likely to include one or more of the techniques already employed by the AER for assessing capital expenditure forecasts, including replacement expenditure modelling and base-step-trend analysis. Powerlink is looking to further develop these methodologies for both non-load driven and non-network capital expenditure so that more of Powerlink's asset management practices and decision-making framework can be incorporated into the existing models (in particular, the AER's replacement expenditure model).

Supporting information

Top down forecasts by definition do not include the identification of individual investment triggers, options analysis and detailed project scopes and estimates. Under such an approach, the supporting information for Powerlink's next Revenue Proposal would depart significantly from its previous Proposals in which practically all forecast capital expenditure was supported by such documentation, albeit at different stages of solution or individual project development.

Powerlink recognises that its preferred primary technique of forecasting its capital expenditure will need support from complementary information. Powerlink consequently proposes that its Revenue Proposal will include a limited range of bottom up forecasting, notably information for projects:

- that are already approved and committed;
- for which specific investment triggers have been identified and which are progressing towards approval; and
- forecasts for investment triggers that are still some way into the future.

It is important to note that there will be a progression in the level of supporting information that Powerlink will be able to provide, driven by the timing of the need and the stage of development of the solution or project. The AER and other stakeholders can expect there to be more detailed supporting information for the first type of expenditure forecast noted above, than for the third. Powerlink considers this to be reasonable given that forecasts are required up to eight years into the future.

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This information is provided to assist the AER's understanding of Powerlink's proposed approach to top down forecasting for capital expenditure and the likely implications for supporting information. Powerlink representatives will be happy to discuss this information further with the AER as required. Given the resources and costs required to undertake a more traditional bottom up approach Powerlink is keen to receive early advice from the AER.

If you have any queries in relation to this matter, please contact Don Woodrow.

Yours sincerely,

Garry Mulherin
EXECUTIVE MANAGER INVESTMENT AND PLANNING

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