

# 2023-27 Revenue Proposal

## Revenue Proposal Reference Group (RPRG)

25 June 2020



# Governance and progress update

Matthew Myers

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# Key actions from previous RPRG meetings



Action	Response
Powerlink to provide the RPRG with more information on its high-level cost estimate for QNI Medium.	<ul style="list-style-type: none"> <li>• Our high-level estimate for the Qld component of QNI Medium to AEMO broadly aligns with AEMO's estimated costings - ~\$580m (\$19/20, real).</li> <li>• This is not an investment-level estimate. QNI Medium will be subject to RIT-T process and a more detailed estimate will be developed at that time.</li> <li>• Still to determine if QNI Medium will be included as a contingent project in the Revenue Proposal.</li> </ul>
AER to provide information on the application of final actionable ISP rules, in particular treatment of preparatory costs expended for contingent projects which are delayed/no longer required.	<ul style="list-style-type: none"> <li>• The below response is from the AER: <p>Costs for general TNSP planning activities, as is currently the case, will continue to be recoverable as opex after the ISP rules commence. Opex will continue to be set by the AER on a top down basis, as set out in the Expenditure forecast assessment guideline. A TNSP may consider proposing a step change for the opex associated with the ISP rules.</p> <p>The Expenditure forecast assessment guideline states that 'Step changes should not double count the cost of increased regulatory burden over time, which forecast productivity growth may already account for. We will only approve step changes in costs if they demonstrably do not reflect the historic 'average' change in costs associated with regulatory obligations. We will consider what might constitute a compensable step change at resets, but our starting position is that only exceptional events are likely to require explicit compensation as step changes.'</p> <p>Preparatory activities are defined in the new ISP rules and are intended to be low cost. In addition, it should be rare that a project for which preparatory activities are undertaken does not proceed given that projects will only be included in the ISP following a joint planning process with TNSPs.</p> </li> </ul>

- Key developments since April RPRG:
  - **Opex** – we are unlikely to continue to pursue Nature Conservation Act, IT licences movement to cloud and Generator Technical Performance Standards step changes (~\$7.5m reduction to Cut 2 opex forecast).
  - **Capex** – productive first workshop held with the AER. We will continue to pursue the concept of contingent reinvestment projects. Our early capex numbers for Cut 3 are indicating a reduction from Cut 2.
  - **Inflation** – we propose to apply the AER's trimmed mean inflation approach for our Cut 3 forecasts.
  - **STPIS** – further data provided to the AER to support a review of STPIS.

A large, light gray circular graphic containing a map of Australia. A white line with circular nodes traces a path from the southern coast, through the center, and towards the northern coast, representing a power line route. The text "Insurance update" and "Marsh" is overlaid on this graphic.

# Insurance update

## Marsh



# Revenue Proposal Reference Group Global Market Update

John Donnelly  
Jane Smith  
Gerard O'Kelly

25 June 2020

# The Insurance Market Cycle



## Combined Ratios - Major Global Insurers





## Global Market Sentiment = less-competitive dynamics

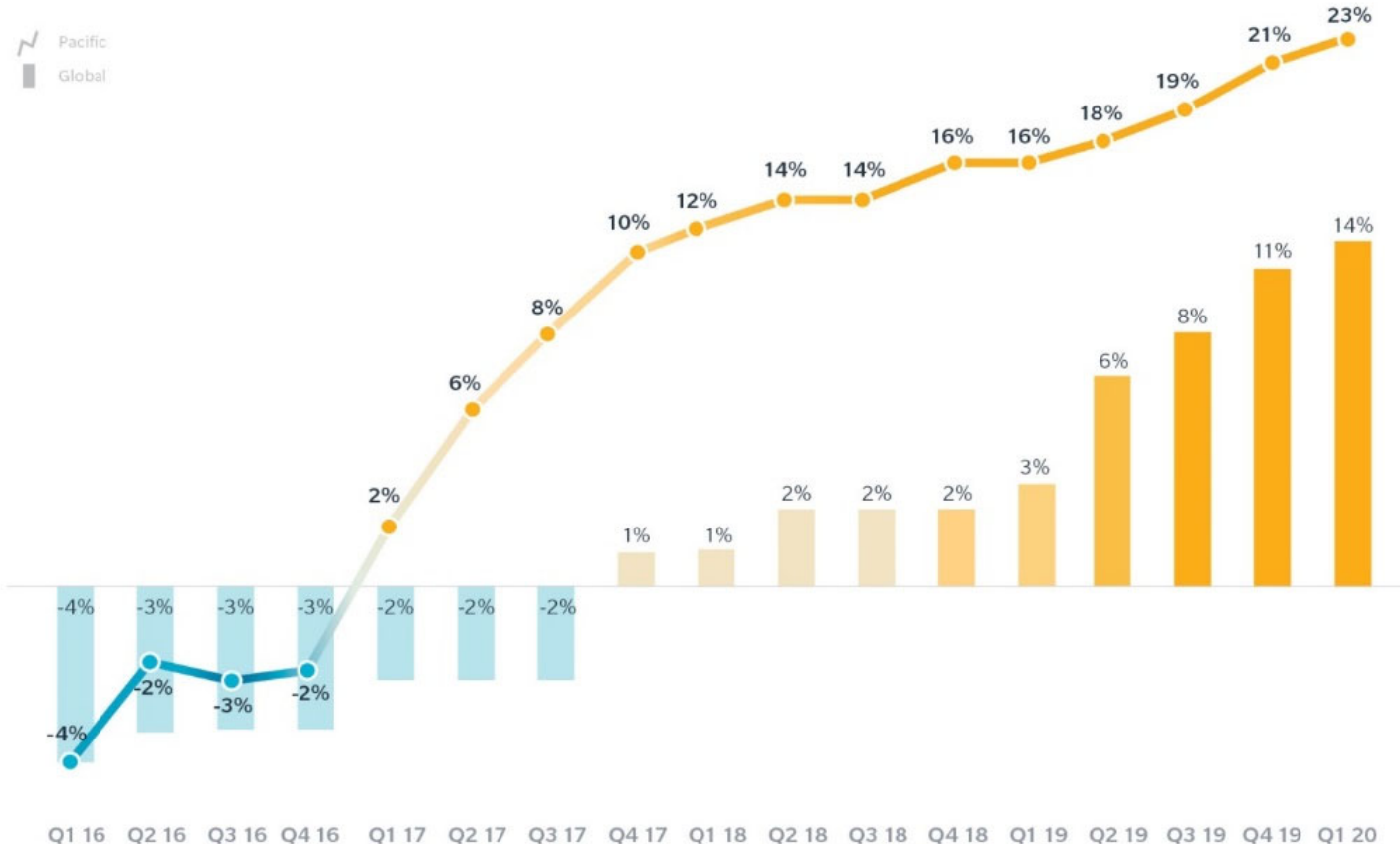


# Global Insurance Market Index – Q1 2020

FIGURE  
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Pacific Composite Insurance Pricing Change

SOURCE: MARSH GLOBAL ANALYTICS



- Global commercial insurance prices rose 14% in Q1 2020.
- 10<sup>th</sup> consecutive quarter of price increases.
- The reported increase was the largest year-over-year increase in the Marsh Global Market Index since its inception in 2012.
- COVID-19 will likely have an impact on pricing for the balance of 2020.
- In the Pacific region, overall insurance pricing in Q1 2020 increased 23%, continuing an upward trend that began in 2015.

# COVID-19 – Insurance Implications

Marsh has established technical teams in Australia and around the world to enhance monitoring of claims trends, insurer security, as well as coverage impacts.

## **Claims:**

- Increasing volumes of claims for COVID-19 related losses globally predominantly relating to Business Interruption and against Directors, Event Cancellations and Travel policies.
- Insurers potentially facing catastrophic losses - obligation for insurers to pay will depend on policy form which can vary significantly.

## **Premiums:**

- Significant losses hitting insurers at a time of focus on return to profitability - could result in further increases.
- Contraction in capacity will continue to reduce competition in the market, driving premiums.
- Economic contraction could see insurers losing premium volume which they may need to replace elsewhere.

## **Capital Concerns:**

- Standard and Poor's (S&P) downgrading of certain insurers.
- Slump in the value of certain insurers' shares.
- Some insurers are raising capital to weather the economic impact of the pandemic.
- If this trend continues, the rest of 2020 could be increasingly challenging market as capital constraints would restrict insurers capacity, thus reducing competition and options in the insurance market.

# COVID-19 – Insurance Implications

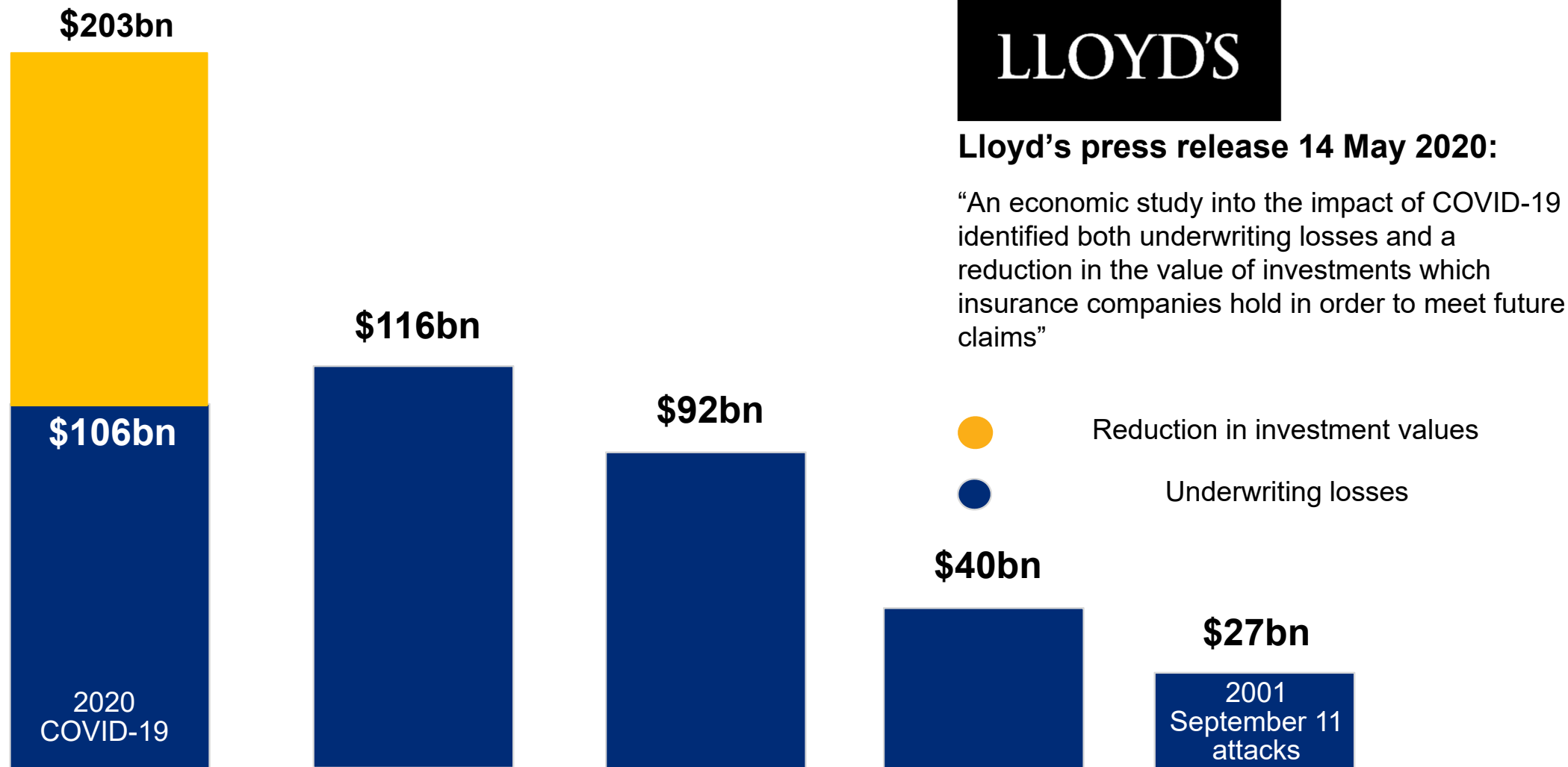
## **Imposition of Exclusions**

- Insurers moving quickly in applying COVID-19 and infectious disease exclusions to many renewals.
- Marsh designing preferred exclusions with improved language to drive a market consistent approach and minimise the negative effect of these endorsements on our clients.

## **Underwriting**

- Additional underwriting information around Insureds' ability to trade through social distancing restrictions, and to continue to manage the risks.
- Property insurers focus on staffing levels, supply chain management, delays to maintenance and capex programs, and the challenge of engineering surveys delayed which are so critical in this technical underwriting market we are in
- Liability insurers seeking additional information around health and safety management systems to prevent the spread of COVID-19 on Insured's sites.
- Directors' and Officers' Liability insurers are concerned with impacts on revenues and solvency as well ability of management systems to respond to the crisis.

# COVID-19 – Global insurance market impacts



# 2020 Market Experience and key implications

First half experience	Second half expectations
<ul style="list-style-type: none"><li>▪ Pricing increases of between 20% to 40%, average +/- 25%, with some extreme increases of up to 70% to 100% if that capacity was needed.</li><li>▪ Significant retention increases traded to mitigate rate increases.</li><li>▪ Specific renewal pricing impacts driven by a combination of risk exposure / claims / risk engineering / historical under pricing / loss of markets / relationships.</li><li>▪ Insurers / reinsurers becoming slow in providing terms.</li><li>▪ Reduced line sizes / limits for natural catastrophe, including bushfire.</li><li>▪ Coverage scrutiny.</li></ul>	<ul style="list-style-type: none"><li>▪ Hard market cycle to continue average rate increases of 30% plus expected.</li><li>▪ Continuing pressure / scrutiny on retentions, limits / sub-limits, general policy coverage, contingent business interruption, cyber and infectious diseases cover.</li><li>▪ Some underwriters will package deals on other lines to justify capacity release / pricing.</li></ul>

## Key implications

- Can't assume expiring capacity will be there at renewal. Overall terms and conditions can't be confirmed until 100% placed.
- Replacement capacity may come at more onerous terms and conditions.



- Powerlink is exploring options to manage insurance costs in this challenging insurance market, while still ensuring a prudent and efficient level of coverage.
- The current insurance market volatility will necessitate updates to the insurance forecast on a regular basis between now and the Revenue Proposal lodgement, and potentially for the Revised Revenue Proposal.
- We will engage further with the RPRG on insurance in the coming months.

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# Business IT capex

Mark Pozdena and Greg Hesse

# Context – what is OT and IT?



- Powerlink distinguishes between Business IT that delivers support to the business and Operational Technology (OT) that directly supports the operation of the network.
- OT = the core Energy Management System (EMS) and other facilities that interact with operational devices in the field. This is part of Network capex.
- Business IT = corporate and asset management systems, records management, user devices and software. This is part of Non-network capex.
- This presentation is focused on Non-network (Business) IT capex.

# Comparison of TNSP ICT capex allowances



Network Service Provider (NSP)	Categorisation of ICT capex	Most recent allowance (\$m)	ICT capex as % of total capex
<b>ElectraNet</b>	All ICT is Non-Network	63.2	14%
<b>AusNet (Tx)</b>	All ICT is Non-Network	83.6	12%
<b>TransGrid</b>	All ICT is Non-Network	84.3	7%
<b>TasNetworks (Tx)</b>	ICT is both Network (OT) and Non-network	10 + 14.5	4% (OT) + 5% (IT) = 9%
<b>Powerlink</b>	ICT is both Network (OT) and Non-network	35 + 61	4% (OT) + 7% (IT) = 11%

## Notes:

- Tx = transmission
- All \$'s are in their respective Final Decision base year

- **Capex:**

- IT capex for 2023-27 is currently forecast to be similar to the current period allowance.
- \$7m has been brought forward into current period for investments in SAP and Geographical Information System (GIS) programs.

- **Opex:**

- Not likely to pursue an opex step change for Business IT. Expect that any increased operating costs associated with as-a-service subscription licensing will be offset and absorbed through the broader efficiency in IT service delivery.
- Our approach has regard to AER ICT expenditure guidelines for DNSPs, as well as Customer Panel consultation into our IT Benefits Framework, which is used to guide and regularly assess investments.

- Powerlink forecasts the costs of its forward IT investment program through a combination of methodologies appropriate to each type of investment:
  - IT infrastructure investment costs will be estimated based on a forecast of the IT fleet assets due for renewal each financial year.
  - Significant IT application investments planned for the coming period will be supported by draft investment cases.
    - Normal Business Case analysis will still need to be done to support actual investment approval.
  - Other recurrent investments, such as minor updates, upgrades or compliance changes, will be estimated consistent with historic trend.

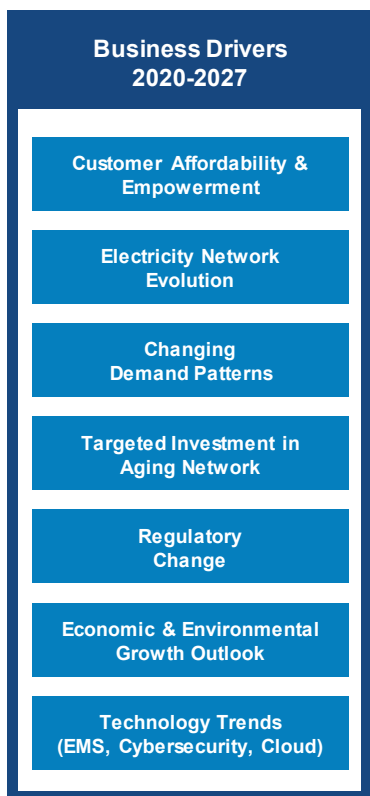


# IT strategic themes for 2023-27



**Our Mission** *To enrich lifestyles and power economic growth through electricity transmission and associated solutions*

**Our Vision** *To be innovative and customer focused with a stronger business and reputation*



## 1. Reduce IT operating costs

*“Reduce total cost of IT operations through efficient work practices, systems and use of commercial services”*

## 2. Focus IT delivery for better customer outcomes

*“Leverage the opportunities for IT enabled improvement while also reducing cost”*

## 3. Rationalise systems

*“Rationalise systems for supportability, sustainability and productivity improvement”*

## 4. Keep ahead of cybersecurity threats

*“Mitigate cybersecurity threats through proactive management and controls”*

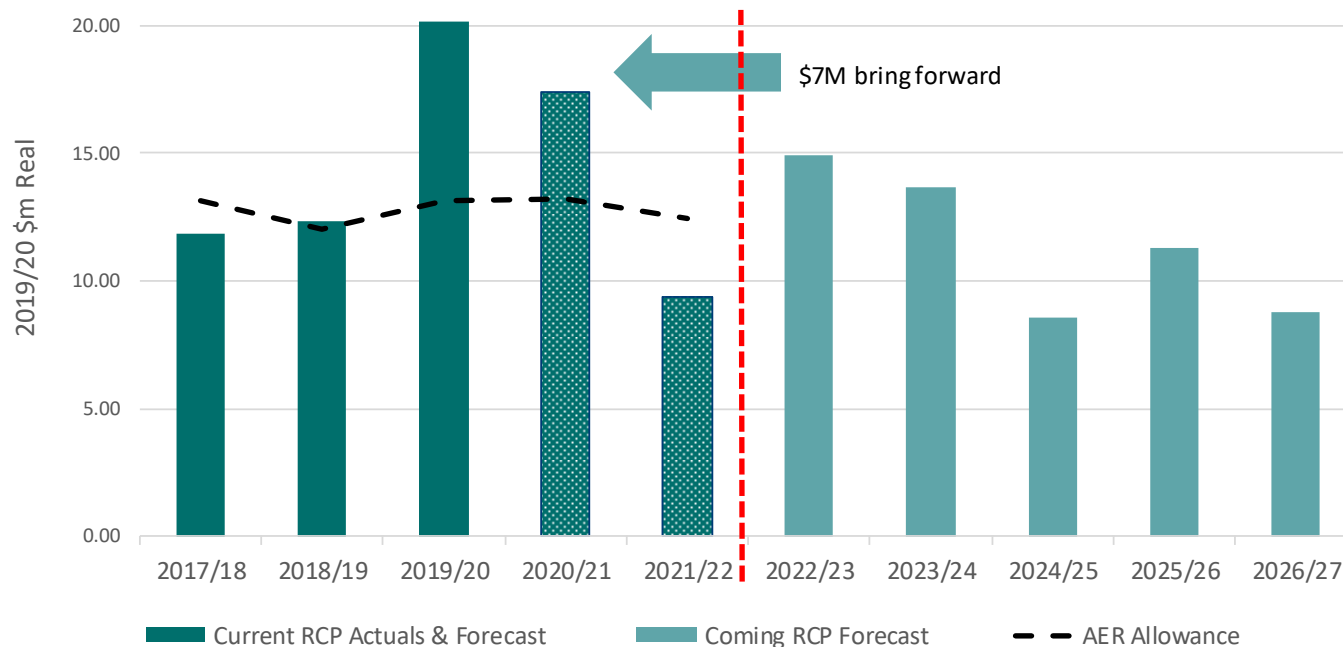
## 5. Make efficient use of cloud and emerging technologies

*“Progressively transition to commodity cloud hosted services and other new emerging technologies where efficient and secure”*

## 6. From data to analytics and insights

*“Leverage data for business efficiency risk mitigation and improved capital utilisation”*

# IT capex – 2018-22 and 2023-27 regulatory periods



## 5-year figures (\$19/20 real)

Current allowance

\$63.98m

Current actuals/forecast

\$71.1m (\$64.1m + \$7m brought forward)

Next period forecast

\$57.2m (\$64.21m - \$7m brought forward)

# Key investment drivers



Driver	2023-27 forecast (\$19/20 real)	Brief definitions
<b>Non-recurrent</b>		
Compliance & Risk	\$2.6m	<ul style="list-style-type: none"><li>• Compliance or risk driven</li></ul>
Maintain capability	\$26.6m	<ul style="list-style-type: none"><li>• Periodic expenditure longer than a 5 year cycle</li></ul>
New capability	0	<ul style="list-style-type: none"><li>• New or expanded capability</li></ul>
<b>Recurrent</b>	\$28m	<ul style="list-style-type: none"><li>• Periodic expenditure less than a 5 year cycle</li></ul>
<b>Total</b>	<b>\$57.2m</b>	

# IT Program Roadmap - DRAFT



2019/20 \$m Real	Current Regulatory Period		Coming Regulatory Control Period					FY23-27	
	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	5yr Total	
<b>ERP, EAM &amp; Works Management</b> - Asset Management, Work Program & Project Management - Field Delivery Management, Inspections & Field Data Capture - Finance & Accounting, Human Resource (HR) & Payroll - Environment, Health & Safety (EHS) - Procurement, Contract Management, Logistics & Warehouse Management - Laboratory	5 Min Settlements	Investment Planning	3.10	3.80	2.10	2.10	0.60	11.70	
	S/4 Upgrade		IT01: Supply Chain & Works Management		\$5.7M capex Supply Chain, Warehouse Management, Logistics, PPM/PS		\$3M capex Payroll Management system renewal		
	SAP Contract Procurement, Incident & HSE (CLMS, Ctrl Rm Incidents & Cintellate)				IT02: Payroll Management				
			ERP EAM & Works Mgt - Minor Updates & Upgrades						
	HCM Perf. Mgt	HCM Phase 3		\$0.6M p.a. capex SAP Core & Config Releases, LIMS, PQSwitch, Asbestos Register (etc)					
<b>Network &amp; Market Management</b> - Portfolio Development - Grid Analysis & Planning - Design, Engineering Tools & Drawing Management - Metering & Network Billing Calculation - Pricing & Market Data Management			2.49	3.24	0.20	0.20	0.20	6.33	
			IT03: Network Design Management		\$5.3M capex CAD, Engineering and Drawing Management renewal				
			Network & Market Mgt - Minor Updates & Upgrades						
				\$0.2M p.a. capex Bravo, Portfolio Risk System (PRS), PSSE & ODMS, PowerFactory, Prophet & TARS					
<b>Information, Analytics &amp; Insights</b> - Data Warehousing - Business Intelligence - Reporting - Analytics			0.15	1.11	2.06	1.19	0.15	4.66	
				IT04: Information, Analytics & Insights		\$3.9M capex BI & related tooling			
			Information, Analytics & Insights - Minor Updates & Upgrades						
					\$0.15M p.a. capex				
<b>Corporate Systems</b> - Corporate Emergency Coordination - Geographic Information System (GIS) & Mapping - Travel Management - Facilities & Site Access Management - Fleet Management, Legal Support, Risk & Governance Management	GIS Update		0.20	0.20	0.20	3.55	3.75	7.90	
					\$5.4M capex Stakeholder & Document Management system renewal		IT05: Stakeholder & Document Management		
			Corporate Systems - Minor Updates & Upgrades						
				\$200k p.a. capex incl Internet, Intranet, Legal, Property, Fleet Management Tools + \$1.5M capex for GIS upgrade in FY25/26-FY26/27					
<b>Technology Applications</b> - Service Management - Office Applications - Technology Architecture & Design, Delivery & Maintenance Tools - Technology Operations & Performance Management Tools	Office 365 Mobility		0.25	0.25	1.75	2.05	0.25	4.55	
					IT06: Technology Applications Sustainability		\$3.3M capex Exchange, AD, Windows, Sharepoint, Svc Mgt		
			Technology Systems - Minor Updates & Upgrades						
	AESCSF maturity and risk management				\$250k p.a. capex Citrix, ServiceNow, iServer and various others				
<b>Cybersecurity</b> - Security Management Tools & Appliances - Identity & Access Management	ISMP		2.15	2.55	0.53	0.20	0.20	5.63	
			IT07: Cybersecurity Maturity		\$2.6M capex AESCSF cybersecurity practices and tooling				
			Cybersecurity - Cyclic Renewals and Ad Hoc Minor Threat Responses						
				\$2M capex over the years FY22/23-FY23/24 for cyclic appliance renewals + \$200k p.a. capex for ad hoc minor threat responses					
<b>Endpoint Devices</b> - Laptops, Desktops & Mobile Devices - Meeting Room & Collaboration Devices			1.97	0.85	0.81	1.57	1.97	7.18	
			Endpoint Devices - Cyclic Renewals						
<b>IT Infrastructure</b> - Servers, Storage and Corporate Networking Infrastructure - Virtualisation, Databases and Operating Systems			4.37	1.39	0.61	0.14	1.39	7.91	
			IT Infrastructure - Cyclic Renewals						
<b>Minor works</b> - Compliance, risk and safety focused minor IT change			0.27	0.27	0.27	0.27	0.27	1.35	
			Minor Works, Updates & Upgrades						
Totals	17.39	9.35	14.95	13.66	8.54	11.27	8.78	57.21	

Compliance & Risk

Maintain Capability

New Capability/Extensions

Recurrent

Pre 2022/23 Investment

Note – a separate attachment of this document has been provided to the RPRG for readability.

**Is this forecast likely to be capable of acceptance?**

**Do you feel this topic needs to be a focus for further engagement?**

A large, light gray circular graphic in the background. Inside the circle is a map of Australia. A white line, representing a power line, starts from the top right of the map and runs down the eastern coast, ending near the bottom right. Several small white circles are placed along this line, likely representing substations or connection points.

# Depreciation tracking

Dana Boxall



- Powerlink is considering changing its approach for calculating forecast depreciation on existing assets from using the 'weighted average remaining life' (WARL) approach to using year-by-year tracking.
- Our view is that year-by-year tracking is a more accurate method of depreciating our assets, better aligns depreciation with the capex spend profile and better reflects intergenerational equity in the future.
- We recognise there will be short-term customer impacts if we implement the year-by-year tracking approach and want RPRG feedback on this proposed change to help inform our decision-making.
- We will make a final decision after taking into account RPRG feedback, as well as feedback from our shareholders.

- Depreciation applies to assets that are consumed or depleted over multiple years in providing services. The regulatory depreciation building block allowance enables the recovery of investments over the economic lives of the assets.
- There are currently two approaches used for depreciating the opening Regulatory Asset Base (RAB) and Tax Asset Base (TAB), both of which have been previously accepted by the AER. They are explained below.

WARL	Year-by-year approach
<ul style="list-style-type: none"><li>• Involves weighting, within an asset class, the remaining life of each class.</li><li>• Approach is simple, but extends the life of old assets.</li></ul>	<ul style="list-style-type: none"><li>• More disaggregated than WARL and involves multiple depreciation calculations within each asset class, separately tracking capex by the regulatory year it was capitalised.</li><li>• Already used by TasNetworks (Tx), ElectraNet, AusNet (Tx), SA Power Networks (SAPN), Energex, Ergon Energy and a number of other DNSPs.</li></ul>

- Some customers have expressed concerns over possible price and cashflow fluctuations of year-by-year tracking. Others have also recognised year-by-year is a more accurate method and can reduce the rate of growth in the RAB.

# Comparison of approaches



Consideration	WARL	Year-by-year tracking
NER, cl. 6.5.5(b)(2) requires total depreciation (in real terms) to equal the initial value of the assets.	Meets requirement.	Meets requirement.
NER, cl. 6.5.5(b)(1) requires depreciation schedules that reflect the nature of the assets and their economic life	Meets requirement, however there will be some years where depreciation is received earlier or later than the underlying economic life of the assets.	Meets requirement.
Complexity	Less complex than year-by-year.	More complex than WARL.
Variability	Smooths recovery profile of assets.	Potential for increased variability as timing dependent on capex program.
Transparency	The WARL could artificially prolong the remaining life of old assets (as they are combined with newer assets to produce the average remaining life).	Increased granularity and transparency. Better aligns with capex spend profile.
Intergenerational equity	Inherent intergenerational equity issues, with customers periodically either underpaying or overpaying the capital related costs of each asset group.	Better reflects intergenerational equity in the future. Will only remain in relation to existing assets as they are likely to be depreciated before their technical life expires.

# Implications and considerations for changing

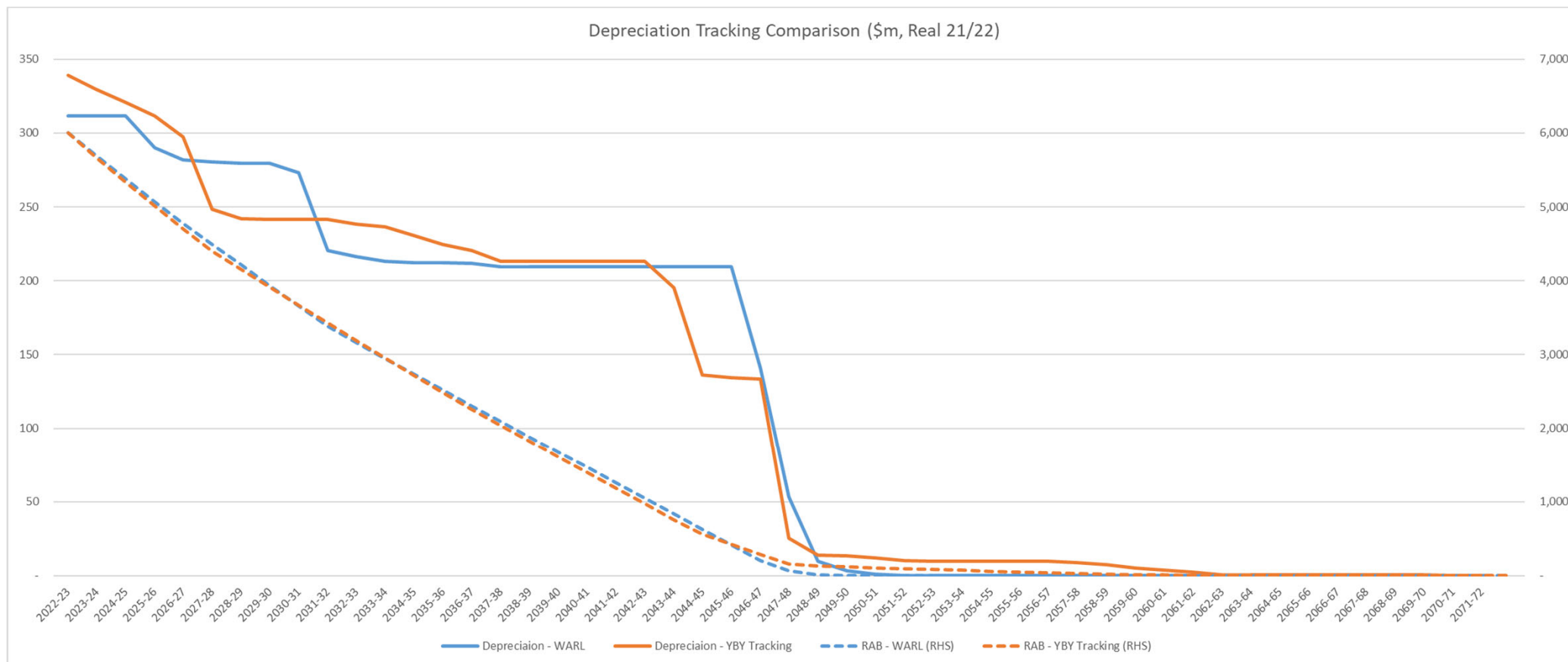


- Initial analysis for Powerlink's 2023-27 regulatory period has been undertaken to understand the impact of changing approach. This is based on the opening RAB only and no future capex has been taken into consideration.
- Year-by-year approach would increase Powerlink's revenue by ~\$20m p.a. (3%) over 2023-27. This is equivalent to a ~\$2 p.a. increase for the average residential customer.
- Impact to customers is reduced if a change in approach is implemented in a low Rate of Return (RoR) environment.
- We will be required to implement year-by-year tracking for TAB for the 2028-32 regulatory period due to the AER's tax review changes. This would align our RAB and TAB tracking approaches.

Regulatory period	Indicative MAR impact per year (\$21/22, real)
RR23-27	\$20m
RR28-32	(\$27m)
RR33-37	\$18m
RR38-42	\$3m
RR43-71 (6 reg periods)	(\$14m)
<b>Net</b>	<b>\$0m</b>

# Tracking comparison

- Both methods recover the asset value over time.



**Is year-by-year depreciation tracking a reasonable approach?**

**Would you support Powerlink adopting a year-by-year depreciation tracking approach (is this capable of acceptance)?**



A large, light gray circular graphic containing a map of Australia. Overlaid on the map is a network of white lines representing power lines, with several circular nodes indicating key connection points or substations.

# PPFP overview

## Matthew Myers

- The PPFP is another step in our ongoing journey of engagement.
- Indicate where key forecasts and positions are heading - for us, this builds on existing information we've shared.
- Explain the key drivers and assumptions behind our forecasts.
- Enable topics for deeper engagement between August-October to be identified.
- Provide broader range of customers and stakeholders opportunity to provide feedback, beyond the CP/RPRG.
- Important step toward 'capable of acceptance'.
- For Powerlink, it is not intended to be draft Revenue Proposal.

# What the PPFP will include



- The fundamentals: the organisation, its customers, customer engagement approach, operating environment.
- Forecasts and key drivers of MAR, RAB, electricity price, opex, capex and incentive schemes.
- Current regulatory period opex and capex performance.
- Brief explanation of inputs and assumptions for forecasting. Detailed explanation of our capex and opex forecasting approach is within the Expenditure Forecasting Methodology.
- A set of questions to guide engagement and feedback.
- Information about what key positions are still being considered or have not been included.

# Key learnings and suggestions we have adopted



- Do not have a long document – forums and direct contact are a better use of time.
- Need to have enough detail for customers to be able to sense check whether our approach and forecasts are reasonable.
- Make sure customers can ‘follow the bouncing ball’ – environment, drivers, inputs/assumptions, forecasts.
- Disaggregate information where possible.
- Don’t ignore current period data or focus only on the next regulatory period.
- Significant changes in forecasts / approach between the PPFP and Revenue Proposal, without clear reasons, damage reputation.
- Be clear about what is ‘out of scope’ or you have not got to yet.

**Is our approach to the PPFP reasonable?**

**Are there any particular items you think are critical to include within the PPFP?**

