POWERLINK QUEENSLAND

DRAFT REVENUE PROPOSAL OVERVIEW

2022/23 – 2026/27
REGULATORY PERIOD

SEPTEMBER 2020

Overview of Powerlink's draft 2023-27 Revenue Proposal

This document provides an overview of Powerlink's draft 2023-27 Revenue Proposal.

We will lodge our Revenue Proposal with the Australian Energy Regulator (AER) in January 2021. This happens every five years as part of our Revenue Determination process.

This process is important, for us and for our customers, as it sets about 80% of our revenue. This revenue funds the capital and operating expenditure we need to build, operate and maintain the prescribed (regulated) transmission network and is paid for by electricity customers across Queensland.

For the first time, we have developed and published a draft Revenue Proposal. We did this to provide customers, stakeholders and the AER with an early version of our Revenue Proposal for input and feedback.

This is a key step in reaching our overarching goal to deliver a Revenue Proposal that is capable of acceptance by our customers, the AER and Powerlink.

This overview document has been prepared to provide a summary of the key elements of our draft Revenue Proposal, including:

- forecast revenue and price impacts;
- forecast capital expenditure;
- forecast operating expenditure;
- network performance;
- our engagement approach; and
- key risks and benefits

We will consider all feedback as part of the development of our Revenue Proposal, which will be lodged with the AER in January 2021. To enable sufficient time to consider feedback, submissions must be received by **30 October 2020**.

All customers and stakeholders will have the opportunity to provide a submission to the AER on our Revenue Proposal after it is lodged in January 2021. We also encourage customers and other stakeholders to provide their input and feedback to us directly.

How to provide feedback

A feedback submission form has been prepared and is available on our website.

Feedback can also be provided by emailing resetteam@powerlink.com.au.

To view the complete draft Revenue Proposal, please visit our website at www.powerlink.com.au/2023-27-regulatory-period.

All figures in the draft Revenue Proposal are preliminary. They do not represent our final Revenue Proposal position.

About Powerlink

Powerlink Queensland is a Government Owned Corporation that owns, develops, operates and maintains the electricity transmission network in Queensland. Our transmission network runs approximately 1,700km from north of Cairns to New South Wales (NSW).

We have an important responsibility to deliver safe, secure, reliable and cost-effective electricity to our direct-connect customers and almost five million Queenslanders.

Our role in the energy system is to transport high voltage electricity, generated at power stations, through our transmission grid to the distribution networks owned by Energex and Ergon Energy (part of the Energy Queensland Group) and Essential Energy (in northern New South Wales) to supply customers.

We also transport electricity to high-usage industrial customers such as rail companies, mines and mineral processing facilities, and to NSW via the Queensland/NSW Interconnector (QNI) transmission line.

For a typical Queensland residential electricity consumer, the cost of Powerlink's high voltage electricity grid represents around 8% of the total delivered cost of electricity.

8%

The cost of Powerlink's high voltage electricity grid represents around 8%* of the total delivered cost of electricity for the typical Queensland residential electricity consumer.

Electricity supply chain components	Proportion of electricity bill
Generation	41%
Transmission	8%
Distribution	36%
Retail and other^	10%
Environmental policies	5%

*2020 Residential Electricity Price Trends Report

^Includes costs associated with retail, losses and errors in the estimated value of all other supply chain cost components, the AEMC 2020 Residential Price Trends Report refers to this overall component as residual.

Draft Revenue Proposal Snapshot

Our draft Revenue Proposal demonstrates our commitment to being customer-focused, and to provide safe, secure, reliable and cost-effective transmission services to our direct-connect customers and almost five million Queenslanders.

Key components of our draft Revenue Proposal include:

Maximum Allowed Revenue

2018-22 - **$3950.0m**
2023-27 - **$3382.2m**

$567.8m (14%)

Rate of return

2018-22 - **~6%**
2023-27 - **~4.47%**

1.5%

Capital expenditure

2018-22 - **$883.2m**
2023-27 - **$988.9m**

$105.7m (12%)

Operating expenditure

2018-22 - **$1038.9m**
2023-27 - **$1038.9m**

$0 difference - no real growth

Notes:

- All figures are in $m real, 2021/22 and are for the full five-year regulatory period.
- MAR is compared to the AER allowance for the 2018-22 regulatory period.
- Rate of return / Weighted Average Cost of Capital (WACC) is nominal vanilla.
- Capital and operating expenditure are compared to the actuals/forecast for the 2018-22 regulatory period.
- Capital expenditure figures are net of disposals.
- Operating expenditure figures are exclusive of debt raising costs.

Electricity prices

12% nominal reduction in the transmission component of electricity prices in the first year of the 2023-27 regulatory period.

- $14 reduction for residential customers.
- $24 reduction for small business customers.

Pricing and Revenue

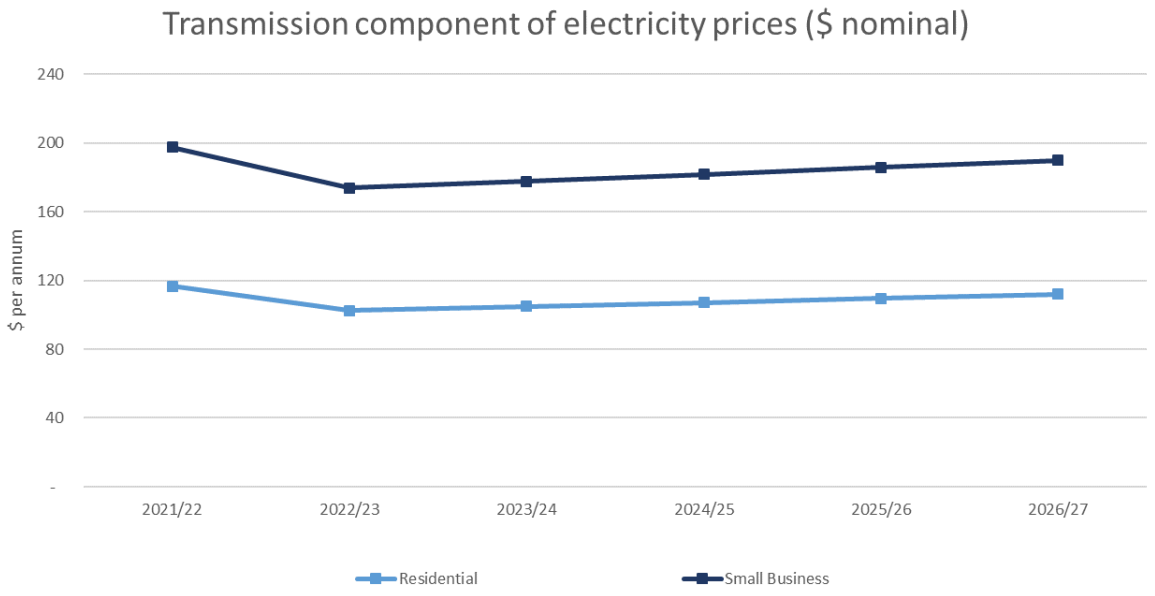
Pricing

Based on our draft Revenue Proposal forecast, the indicative impact to the transmission component of electricity prices in the first year of the next regulatory period (2022/23) would be:

- Residential: a nominal reduction of $14 (12%).
- Small business: a nominal reduction of $24 (12%).

On average, transmission price increases for average residential households and small businesses will remain in line with CPI (assumed forecast of 2.25%) for the remainder of the regulatory period. This is demonstrated by the graph below.

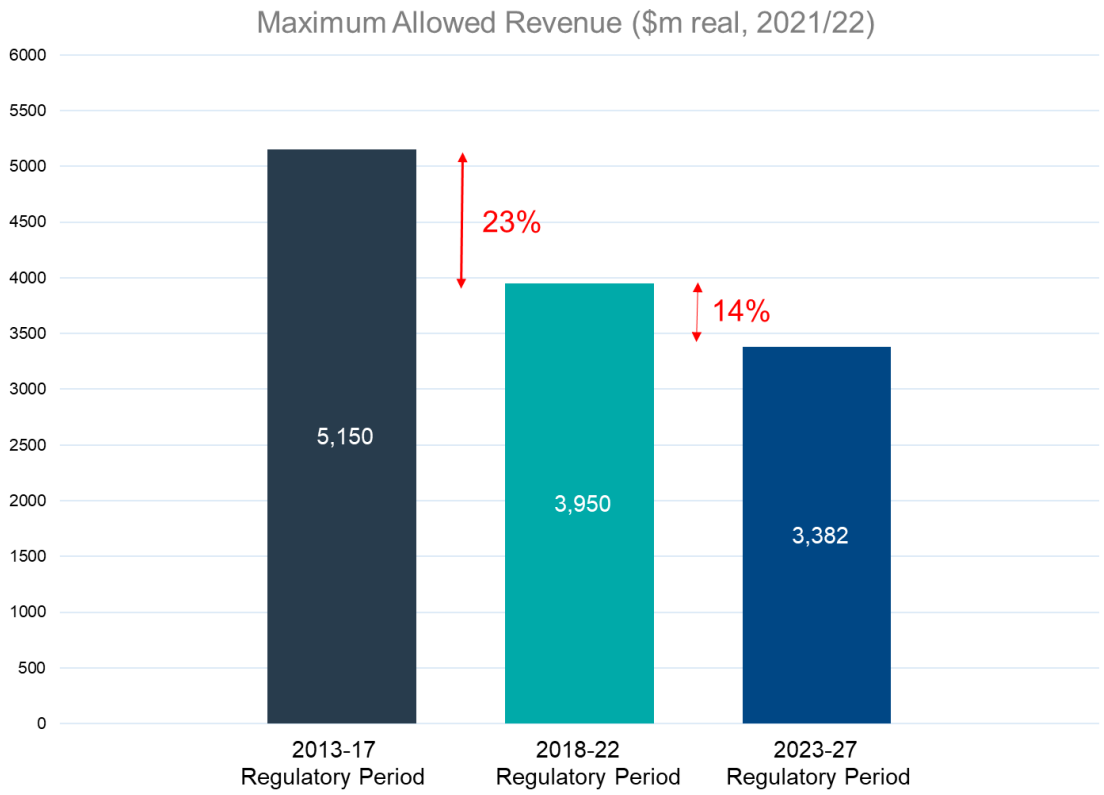
We recognise a significant driver of this reduction is the current low rate of return environment, which is largely driven by financial markets.



Revenue

Our draft Revenue Proposal forecasts Maximum Allowable Revenue (MAR) of $3.382 billion for the 2023-27 regulatory period.

This is $567.8 million or 14% lower than the AER's allowance for the current regulatory period. The key driver for this reduction in MAR is a lower rate of return.



Rate of return

The rate of return is a key building-block element in determining our MAR.

We have adopted and applied the AER's binding 2018 Rate of Return Instrument to calculate our rate of return. This results in an indicative nominal rate of return of 4.47% for the first year of the 2023-27 regulatory period. This is a substantial reduction from our current regulatory period rate of return of approximately 6%.

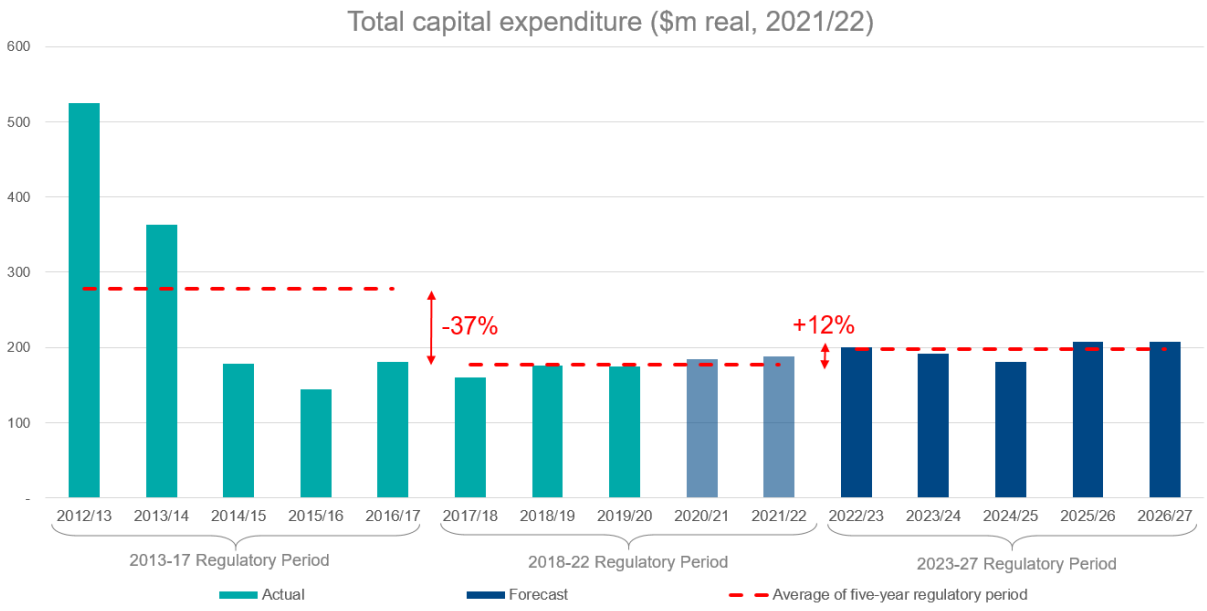
The main driver of our lower rate of return is a historically low risk free (Government bond) rate.

Forecast Capital Expenditure

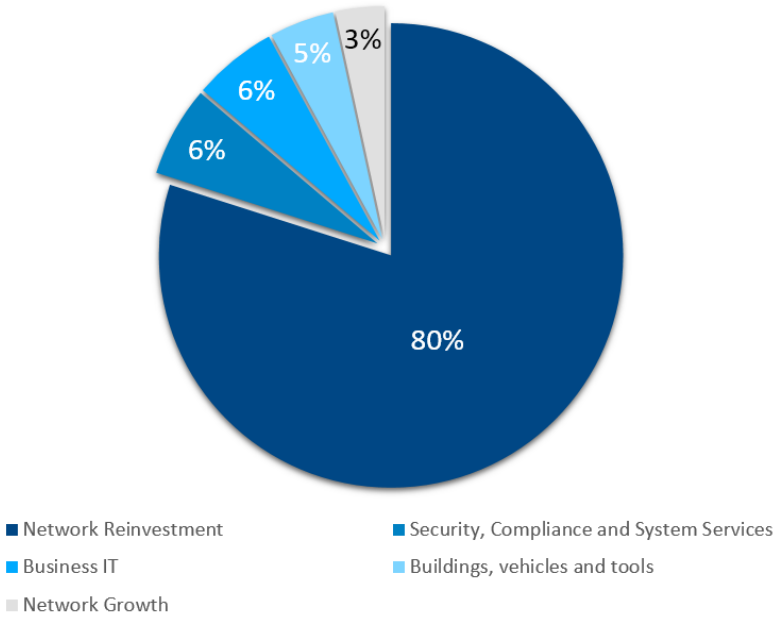
Our total forecast capital expenditure for the 2023-27 regulatory period is $988.9 million. The majority of this forecast ($851.9 million or 86%) is non load-driven network expenditure.

This represents a 12% increase on actual/forecast spend in the 2018-22 regulatory period, driven primarily by our reinvestment program in the transmission network to maintain a safe, secure, reliable and cost-effective transmission network as our assets continue to age.

Due to our uncertain operating environment, Powerlink is also pursuing contingent network reinvestment projects. This is intended to balance investment risks for both consumers and for Powerlink. These projects are not in the proposed capital expenditure forecast and, as a result, revenue is not included in our MAR.



A breakdown of our forecast capital expenditure for the 2023-27 regulatory period is shown below. The majority (80%) of our forecast capital expenditure is reinvestment in the existing network.



Forecast Operating Expenditure

We recognise the need to deliver further efficiency and productivity improvements to minimise operating costs and respond to customer concerns on affordability.

We have set a target of no real growth in total operating expenditure over the 2023-27 regulatory period, when compared to actual/forecast operating expenditure in the current 2018-22 regulatory period.

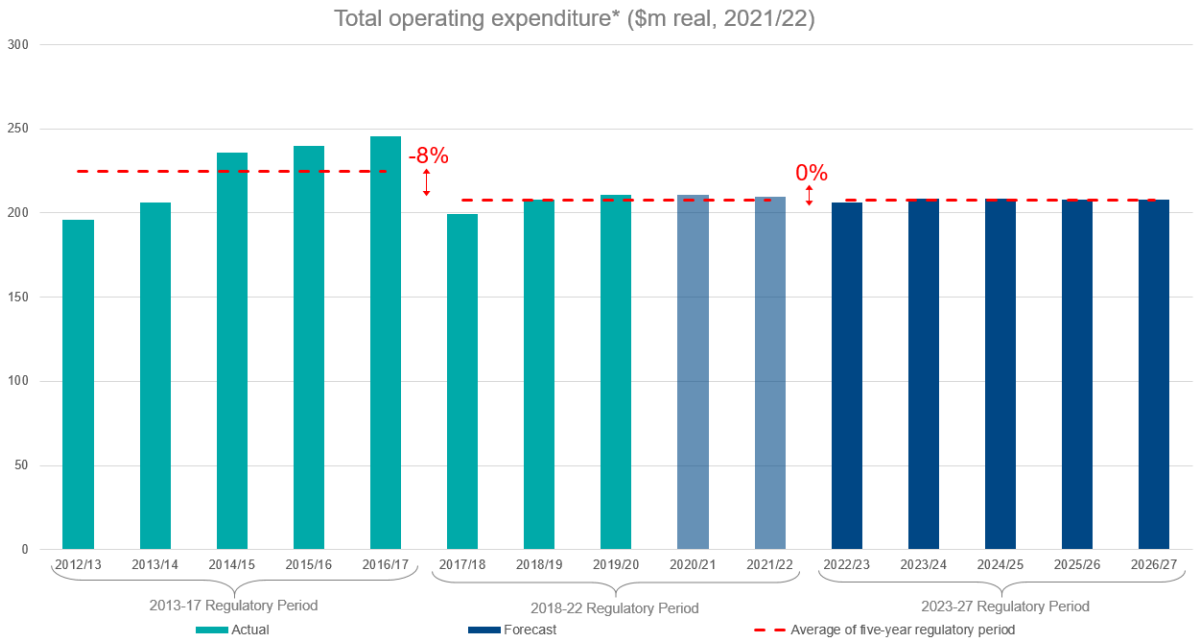
Based on this target, our total operating expenditure forecast for the 2023-27 regulatory period is $1,038.9 million[1].

To achieve this target, we have set a challenging productivity target of 0.8% per annum. This is above the AER's benchmark industry average.

We have also not proposed any operating expenditure step changes.

We have taken this approach in response to customer feedback on productivity, affordability and the impacts of the current and expected mid-term economic climate.

We will balance our target against our overarching requirement to continue to operate the network in a prudent and efficient manner, within an increasingly complex operating environment, while meeting all our regulatory obligations.



* excludes debt raising costs.

[1] Target and total figures exclude debt raising costs. Debt raising costs are set using a benchmark methodology and should not be considered when targeting no real growth based on underlying operating expenditure performance.

Network performance

Part of our revenue allowance for the 2023-27 regulatory period will be linked to how well we perform under the AER's Service Target Performance Incentive Scheme (STPIS).

The STPIS is designed to provide performance incentives for electricity transmission network service providers to improve or maintain a high level of service for the benefit of National Electricity Market (NEM) participants and end users of electricity.

We commenced our participation in the scheme in 2007. Since then, we have performed strongly under the STPIS by closely managing performance of our network in terms of reliability and availability, while minimising the impact of transmission congestion. This ultimately benefits customers by way of improved, or maintained, high levels of network reliability, availability and capability.

There have been significant changes in our operating environment, as Australia's energy market transitions to a low carbon future. This presents challenges in the management of our network performance, such as changes in power flows and the emergence of system strength constraints, and may impact our ability to meet STPIS targets during the 2023-27 regulatory period.

We will continue to respond to these challenges to ensure that the needs of our customers are met, while also ensuring that we meet our network security and reliability obligations. We are also firmly of the view that the STPIS should be reviewed in light of the significant and rapid changes in the energy market, to ensure it remains fit-for-purpose and continues to promote the long-term interests of customers.

Our engagement approach

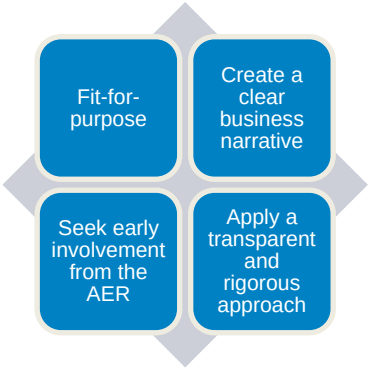
We are committed to genuine and timely engagement that leads to improved decision-making and better outcomes for our customers and stakeholders through an open and transparent approach.

Powerlink is the first network business to co-design our Revenue Proposal engagement approach with customers and stakeholders. This has enabled customers to directly shape the scope, sequencing, techniques and evaluation of our engagement.

Our engagement approach for the Revenue Proposal is driven by an overarching goal:

To deliver a Revenue Proposal that is capable of acceptance by our customers, the AER and Powerlink.

Our engagement approach is built on four foundational elements. These reflect feedback received from customers and stakeholders about what comprises successful engagement on a Revenue Proposal.

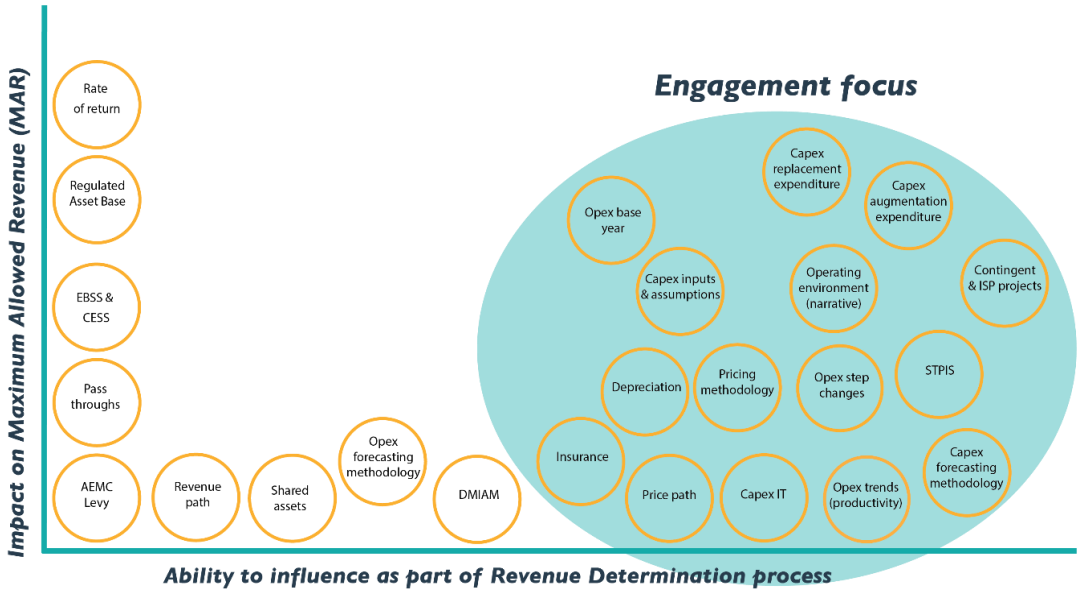


Engagement scope

As part of the co-design process, we worked with customer and stakeholder representatives to develop a clear scope for engagement.

The engagement scope was established by plotting elements that customers considered had the largest impact on revenue against the ability for each element to be influenced by engagement. This enabled efficient and focused engagement.

Our Engagement Plan also proposed the level of engagement on the IAP2 Spectrum, we intended to engage with our customers and stakeholders on by issue.



Engagement activities

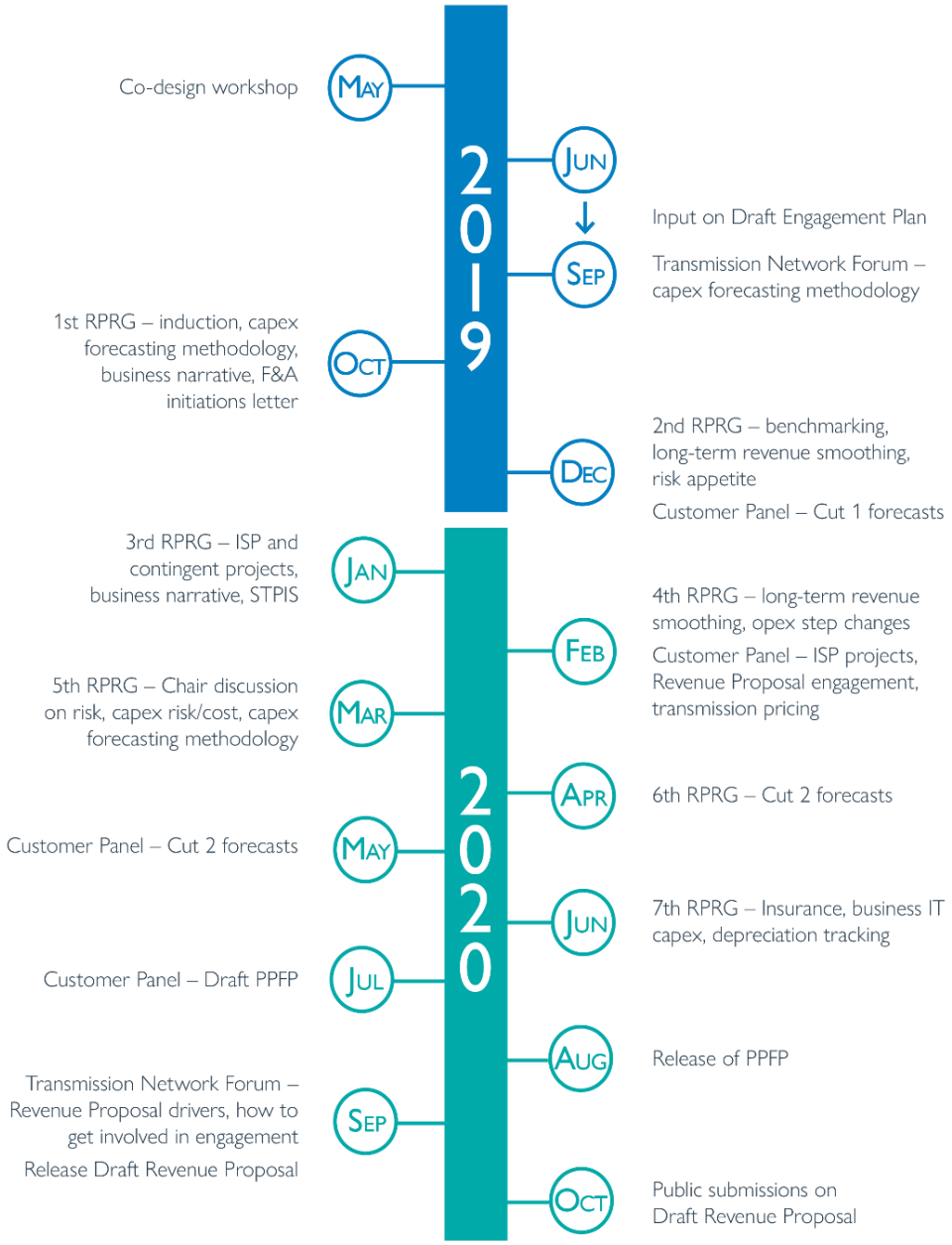
We leveraged our engagement off business-as-usual activities. In particular, we worked closely with our existing Customer Panel. Established in May 2015, our Customer Panel has played a primary role in influencing our decision-making since its inception.

To enable more regular and detailed engagement, a Revenue Proposal Reference Group (RPRG) involving five members of the existing Customer Panel was established.

Since its establishment in October 2019, the RPRG has considered and provided detailed input on key aspects of our Revenue Proposal on an almost monthly basis.

The AER and AER Consumer Challenge Panel (CCP23) also participated in engagement activities as appropriate, including Customer Panel and RPRG meetings. One-on-one briefings with our directly-connected customers were also undertaken on, for example, transmission pricing arrangements.

Our key engagement activities to date are shown on the following timeline.



Acronyms on the above diagram:

- F&A – Framework and Approach
- ISP – Integrated System Plan
- PPFP – Preliminary Positions and Forecasts Paper.

Our engagement activities also included:

- an adjustment to our engagement approach as a result of COVID-19 to be more focused on digital engagement (e.g. use of video conferencing);
- release of, and engagement on, four (including the draft Revenue Proposal) sets of forecasts of key building-block elements of the Revenue Proposal as it was being developed;
- publication of our Preliminary Positions and Forecasts Paper (PPFP) in August 2020. This was directly sent to more than 200 stakeholders and customers;
- our annual Transmission Network Forum, which had more than 200 attendees across Government, industry, customer groups, regulators and customer and industry advocates;
- an offer of one-on-one briefings to our direct-connect customers; and
- regular informal discussions with customers and stakeholders throughout the process.

How feedback has influenced our decision-making

We have committed to genuinely considering input and feedback received from customers and stakeholders consistent with the areas of focus identified in the engagement scope.

The following table shows a selection of key issues discussed, feedback received and how it influenced the development of the draft Revenue Proposal. A complete table is included in Chapter 3 of our draft Revenue Proposal.

Topic	Feedback received	What we've done
Operating expenditure forecast	Customers were interested in how potential step changes were identified and which ones would and would not be pursued. Customers also wanted to understand whether we can drive a higher operating expenditure productivity target than the industry trend.	Based on customer feedback and recognition of the current economic environment, we have proposed no real growth in total operating expenditure. As part of this, 27 potential step changes were originally identified and we have decided not to proceed with any. We have also proposed a productivity target of 0.8%, which is higher than the industry trend.
Capital expenditure contingent reinvestment projects	Strong support was received from customers for the concept of contingent reinvestment projects for those investments that may have significant uncertainty around need, timing and cost.	We have proposed contingent reinvestment projects as part of our draft Revenue Proposal.
Proposed depreciation tracking approach change	Customers acknowledged the change to the year-by-year depreciation tracking approach is more accurate over time. We were asked to investigate whether the transitional impacts of this change in approach (i.e. higher revenue) could be mitigated/smoothed.	We investigated options to smooth the transitional impact and have proposed to manage this by a minor change to asset lives for existing secondary systems assets. This smooths the revenue impact on customers between the 2023-27 and 2028-32 regulatory periods.
Business Narrative	First draft did not reference impacts of climate change or clarify how factors will impact the draft Revenue Proposal and customers.	Multiple versions were circulated to the RPRG and Customer Panel with the majority of feedback incorporated into our Business Narrative.
Draft of Revenue Proposal	Customers strongly encouraged Powerlink to publish a draft Revenue Proposal by September 2020.	We agreed to publish a draft of our Revenue Proposal by September 2020. This was not in our original plans.

Key risks and benefits

We have identified several key risks and benefits associated with our draft Revenue Proposal forecasts. This is not intended to be a comprehensive list.

Risk	Description
COVID-19 impacts	To date, the cost impact of COVID-19 on our business has not been material. If COVID-19 persists or worsens, this may impact our ongoing capital and operating expenditure delivery.
Operating expenditure cost pressures	Potential operating expenditure cost increases (e.g. insurance, cyber security and others) may impact our ability to meet our no real growth in operating expenditure target.
External environment uncertainty	Significant change in energy markets, and the current and mid-term economic uncertainty, means it is more difficult to forecast capital and operating expenditure, demand and energy, and future requirements of the network to meet customer needs.
Service Target Performance Incentive Scheme (STPIS)	Changes in power flows and the emergence of system strength constraints may impact our ability to meet STPIS targets.
Treatment of contingent reinvestment projects	If the AER does not approve contingent reinvestment projects, we will need to consider inclusion of some of these projects in the ex-ante capital expenditure forecast in our Revised Revenue Proposal.

Benefits	Description
Reduction in electricity prices	Proposed revenue allowance will reduce Queensland electricity prices.
Engagement approach	Our engagement approach has allowed customers to influence decisions that directly impact on them, and has enabled us to build better relationships and trust with our customers and stakeholders.
Operating a safe, secure and reliable network	Proposed expenditure allowances will see Powerlink continue to operate its network in a safe, prudent and efficient manner.
Delivering business efficiency	Our no real growth in operating expenditure target, and an above benchmark industry productivity target, will mean we continue to drive our business hard to find further efficiencies and productivity improvements.
Contingent reinvestments	Our proposal for contingent network reinvestment projects is intended to balance investment risks for both consumers and for Powerlink. These projects are not in the proposed capital expenditure forecast and, as a result, revenue is not included in our MAR.

Next steps

The next steps in our Revenue Determination and Revenue Proposal engagement process are:

Date	Activity
30 September 2020	Release of draft Revenue Proposal.
30 October 2020	End of public submission period on draft Revenue Proposal.
October-December 2020	Engagement prior to Revenue Proposal lodgement.
31 January 2021	Powerlink lodges its Revenue Proposal with the AER.
February – May 2021*	AER reviews Powerlink's Revenue Proposal and invites public submissions. Public forum is held.
September 2021*	AER releases its Draft Decision.
November 2021*	Powerlink lodges its Revised Revenue Proposal with the AER.
30 April 2022	AER releases its Final Decision.
1 July 2022	Start of new regulatory period.

** indicative dates*

Further Information

A full copy of the draft Revenue Proposal is available on our website.

Contact Us

You can contact us in the following ways:

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Website www.powerlink.com.au