

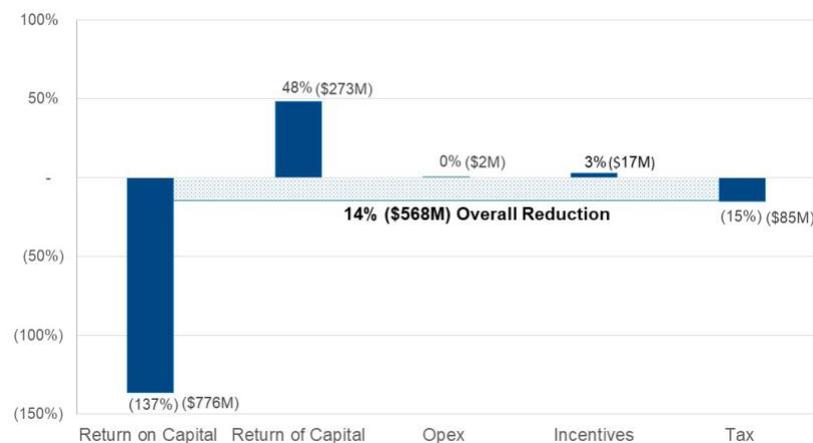
Powerlink Customer Panel – Comments on Draft Regulatory Proposal 2023-27

This document provides a record of discussions at a (virtual) meeting of the Powerlink Customer Panel held on 28th October 2020, without Powerlink representatives in attendance. Some details were updated following comments/explanations by Powerlink at the RPRG meeting on 29th October.

Summary

- The Customer Panel welcomes the publication of the Draft Regulatory Proposal as a vehicle to facilitate further engagement on Powerlink’s plans for 2023-27. Overall, it’s a very comprehensive and transparent document.
- Members consider that Powerlink’s engagement to date has been genuine and open. We have been afforded regular opportunities to provide feedback on the plans as they have progressed through several iterations, and our views have been recorded and taken into account.
- The proposal to keep opex at the same real level as the current period is welcome, with most comment around whether the proposed 0.8% productivity target is achievable
- There are concerns about the impact of the 12% increase in capex on long term affordability and we look forward to Powerlink closely reviewing whether this increase is prudent and efficient in a falling demand outlook prior to making its reset submission.
- While the proposed 12% price reduction is welcome, we are concerned that it is all due to falling WACC – with the same WACC as the current period, prices would increase 7% driven by higher depreciation. Given capex is predominately non-load driven replacement which has long asset lives, the increase in capex will lock in affordability issues for many decades and expose consumers to price rises when the interest rate cycle turns and WACC increases.

Figure 11.2: Drivers of revenue change



- The question of whether the Draft Proposal is ‘Capable of Acceptance’ by Customer Panel members was discussed, with reference to the criteria proposed by Consumer Challenge Panel 24 in relation to the current gas regulatory reset for AGN (South Australia) and the AER’s ‘Framework for considering consumer engagement’ published as part of the recent Draft Decisions for the Victorian electricity distribution businesses.
- Members are of the opinion that it is too early to respond to the question at this stage, and that it should be considered more fully once the Revenue Proposal has been lodged.
- Overall issue – is Powerlink proposing to do enough to lift itself from the bottom of the latest TNSP benchmarking results?
- We would like to understand how the regulatory proposal is consistent with Powerlink’s commitments under the Energy Charter.
- Need to make it clearer that all \$ are 2021/22 (if that is the case).

Productivity and efficiency

Draft Plan

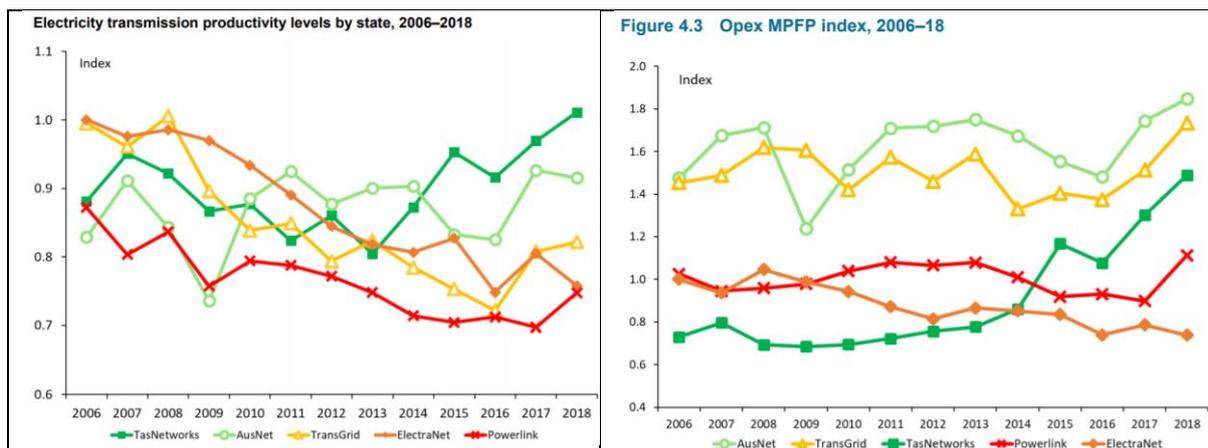
Chapter 4 talks about Powerlink's efficiency focus with improvements in the current period vs previous period eg pp34-35. Refers to HoustonKemp report at Appendix 4.01 but this is not available given confidential 2018/19 data.

Summary (p.43):

"The analysis in this chapter demonstrates that we have reduced our costs and responded to changes in our operating environment. This has contributed to improvements in benchmarking performance during the current regulatory period."

Comments/questions

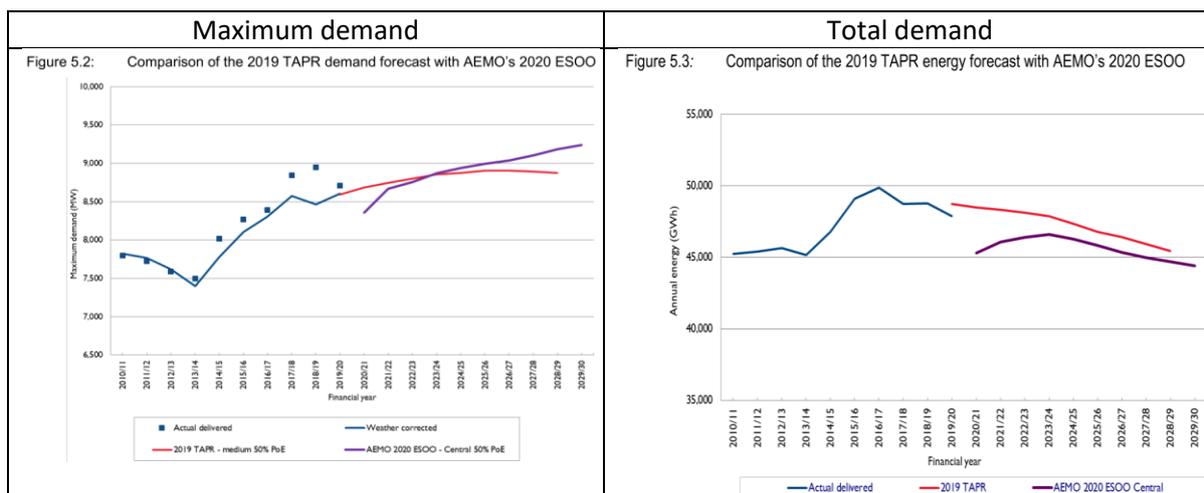
- Would encourage Powerlink to publish the HoustonKemp report – Appendix 4.01 – as soon as possible to enable CP feedback prior to finalisation of the Revenue Proposal
- Based on the latest published AER data, there was some improvement in 2017/18 but Powerlink is still 5 out of 5 in total productivity
- What is the forecast for the period to 2026-27 based on Draft Plan building blocks?



Demand Forecasts

Draft Plan

Based on AEMO P50 2020 ESOO forecasts which show rising maximum demand (strong from 2021-22) and falling total demand (energy consumption forecast to decline on average 0.7%/yr over the next 10 years)



Comments/questions

- AEMO forecast shows higher demand growth in maximum demand than 2019 TAPR ie after COVID
- How does this compare with 2020 TAPR? Reasons for differences?
- Up to the AER to assess demand forecasts – but seems optimistic eg assumptions on major loads in Queensland – coal/BSL?

System strength issues

Draft Plan

This is developing as a major issue for Powerlink. There is an increased incidence of constraints creating difficulties in meeting STPIS targets on network performance (p.119):

In May 2019, the Australian Energy Market Operator's (AEMO) National Electricity Market Dispatch Engine was updated to recognise system strength constraints in Queensland. AEMO formally declared a fault level shortfall in North Queensland in April 2020. The fault level shortfall occurred due to the significant number of Inverter-Based Resources (IBR) that connected to the North Queensland transmission network. These constraints only became apparent in Queensland in 2019 and are therefore not reflected in the historical constraint data before 2019.

The main driver of the increase in constraints is the rapid change in the mix and location of generation, which is not directly within our control. North Queensland now has the third highest proportion of solar and wind generation in the world, only slightly behind Denmark and South Australia. With limited base load synchronous generation in North Queensland and large distances between the synchronous generators in Central and Southern Queensland, this creates low system strength conditions in North Queensland.”

This issue is also discussed in a number of other sections - opex (cost of third-party procurement of system support services), capex (Powerlink investment in system support) and pass through events (future costs of system support).

Comments/questions

- Given that Powerlink has obligations to meet system security standards, we would like to understand the impact of the recently published [AEMC System Strength Report](#)
 - in particular, how much of that cost is born by all consumers in the regulated opex/capex, and how much is borne by generators, and how the AEMC's 'do no harm' principle will influence that.
- We look forward to more analysis in the regulatory proposal

Opex

Draft Plan

Current period forecast expenditure of \$1,038.9m (\$21/22) - \$5.3m (0.5%) higher than the AER's allowance; excludes debt raising costs.

Proposed same \$1,038.9m (excluding debt raising costs) in 2023-27 ie no real increase which requires:

- productivity factor of 0.8% per annum vs industry benchmark average of 0.14% and AER requirement for DNSPs of 0.5%; and
- no step changes.

HoustonKemp review says proposed base year of 2018/19 had 'efficient' level of opex.

Comments/questions

- Welcome approach to opex – required given Powerlink's poor relative performance over last decade
- It is difficult to comment on the efficiency of the proposed base year (18/19) in the absence of the HoustonKemp report but there is confusing terminology (p. 72):

"Key findings were:

- A detailed category analysis of Powerlink's operating expenditure suggests that its 2018/19 revealed operating expenditure is efficient.
- Powerlink's 2018/19 revealed operating expenditure does not appear to be materially inefficient. This conclusion held under several adjusted scenarios and after consideration of key network differences and capitalisation practices....

Based on HoustonKemp's independent advice, we consider that our benchmark performance is comparable to our TNSP peers."

- So what is the meaning of different terms - 'efficient' and 'not materially inefficient' and 'benchmark performance comparable to our peers'.
- Customer Panel members were puzzled by the following statement (p. 72):
"Our Revenue Proposal Reference Group (RPRG) and Customer Panel has also recognised that changes to certain inputs in the analysis can have a material impact on benchmarking results without improvements to outcomes for customers."

What does this mean and when did the Customer Panel say this?

- Recognise the risks in Powerlink committing to a stretch target of 0.8% annual productivity improvement as a ‘top down’ commitment vs industry productivity average of 0.14%
 - This is at a time of falling demand and real level of RAB so how much of the proposed productivity should have occurred anyway?
 - what is the Powerlink average 2007-19?
 - we need to have some confidence around Powerlink’s ability to achieve this stretch target, given under EBSS, consumers effectively pay for 30% of any opex overrun
 - the Draft has a high-level discussion of the four key areas of focus to achieve this productivity and it would be good to see a lot more detail in the regulatory proposal to give better confidence around the pathway.
- The Customer Panel would appreciate a short presentation on the cost allocation methodology (CAM) – we understand that the current CAM will carryover to 2023-27.
 - We would like to understand what it covers and in particular how it adapts to the increasing importance of Powerlink’s non-regulatory activities.
- While no step changes are proposed, potential step changes have been re-categorised as pass through events that may potentially add to opex – though recognise the first approach will be to re-prioritise:
 - cyber security (\$1.1-2.5m/yr) because of uncertainty about Federal Government legislation;
 - system strength (does this meet the step change conditions?)
 - insurance, and
 - costs as a result of the AER ring-fencing review.

We look forward to more detail on these issues in the Regulatory Proposal.

As a result, consumers may still face increased opex if these pass-through events occur. The statement (p.61)

“As a result of our no real growth approach, no step changes and forecast insurance cost pressures, there is potentially up to \$35.2m of cost increases over the 2023-27 regulatory period that we may absorb.”

....may be slightly misleading given:

- it assumes all those \$35.2m costs would have been accepted as step changes
- the normal expectation of a business in a workably competitive market is to absorb some costs to remain competitive.
- We look forward to the deep dive on insurance to better understand the risks – what should Powerlink bear, and what should consumers bear? Does its public ownership make a difference – as seems to have been the case in the past when Powerlink/EQ were directed not to exercise their rights for pass through on cyclone damage?
- There were 27 step changes identified – did all of these increase costs? Were there any step changes that decreased costs? What were they and how much was the decrease?
- Where does the ‘alternative Queensland WPI forecast’ come from? (p.75)
- Does the \$1,038.9m exclude Transmission System Planner (ISP) costs that will be borne by TNSPs and passed through to consumers?

Capex

Draft Plan

Current period forecast capex of \$883.2m - \$16.5m (1.8%) lower than the AER's allowance; proposed \$989m, 12% increase on current period forecast

Dominated by non-load driven capex (\$851m) including system services/security (\$32m); augmentation is mainly easement purchases for QNI medium upgrade (\$25m of \$34m)

Comments/questions

- Support the hybrid+ approach in concept – it will be up to the AER to assess individual projects and repex
- But the large increase on current period is a major concern and we look forward to seeing a comprehensive evaluation to justify the increase; this would include alternate options, impacts of deferral, programme scale relative to network life cycle and any associated opex reductions associated with reduced fault response.
- The emphasis on affordability that drove the opex decision does not seem to be present in the capex proposal – given the long asset lives of much of the capex – non-load driven replacement is \$798m out of \$989m – so it will affect affordability for decades and at time when the interest rate cycle would have turned and WACC is much higher than today.
- Would like some more detail on \$ amounts of bottom up vs top down in total capex.
- Leave AER to undertake detailed assessment of categories.
- Load driven capex – what happens with easement acquisition if QNI does not pass the RiT-T?
- Need more information on contingent re-investment projects; in particular, what is the level of AER scrutiny vs putting them in the ex-ante approval bucket?
 - Has the AER accepted the asset intervention criteria of degree of corrosion?
 - Are any other measures being proposed?
 - What engagement on the trigger point for those measures – noting role of AER to get independent engineering advice to help decide maintenance vs replacement
- Contingent projects – Table 5.7 – should provide some confidence intervals around those costs ie greater explanation around the range of \$ given in the final column.
- Galilee Basin contingent project – this will cover the need to augment existing network to cope with expansion of coal mining in the Galilee Basin
 - Given recent announcements of net zero emission targets by China (2060) and Japan (2050), how does Powerlink propose to assess the stranded asset risk consumers might bear from building 50 year assets to meet new coal mine electricity demand?
- Network support – why should consumers pay through regulated revenue (opex or capex) for the failure to set the appropriate generator connection standards in the past – that now require purchase of service to overcome fault level shortfalls?
- Capex programme deliverability – it would be good to see some PIRs and capex reports to give confidence that Powerlink can execute/deliver on their proposed capex?
- Impact of SAP announcement of faster move to the cloud on IT costs – allow more competition for SAP

RAB

The opening RAB as at 1 July 2022 is forecast to be ~\$7b; increase by \$107m (nominal) and decline by \$640.7m (\$21/22) by end of 2023-27. The main driver of this decrease in real terms is an

increased depreciation profile with lower capital expenditure reflecting the low load growth environment.

Comments/questions

- What is the trend on RAB/customer and RAB/MWh delivered, both using AER draft expected inflation methodology?

Depreciation

The Customer Panel has previously expressed support for the proposed move from a Weighted Average Remaining Life (WARL) approach to a year-by-year depreciation tracking approach conditional on a transitional arrangement that Powerlink has agreed to.

Comments/questions

- Would like more information on the proposed transitional arrangements – what is the impact on depreciation and prices from the adjustment in WARL of secondary system that will be used to achieve the transition over two regulatory periods
- The webinar estimated that the application of the AER's draft expected inflation decision (5 years with glidepath) is to increase MAR by ~\$110m; what impact does this draft decision have on proposed move to year by year depreciation tracking combined with the transition measures?

Pass Through Events

Draft Plan

Three events nominated – Insurance Coverage, Insurer Credit Risk and Natural Disaster; and three events potentially a pass through - network support event, transmission ring fencing and cyber security.

Comments/questions

- Were any of these proposed pass through events, pass through events in the current period?
- What pass through events have been triggered in current/previous periods?
- There is another network currently in reset process that has decided to accept a larger deductible on bush fire insurance to limit insurance pass through costs
- What are the risks around the transmission ring fencing guideline due in September 2021?
- It would be good to understand the pass through for inertia or fault level shortfall given our system security discussion above – why should consumers pay for this in the RAB?

Incentive Schemes

Draft Plan

Propose EBSS/CESS carry over to 2023-27 and that 2023-27 opex and capex be subject to EBSS/CESS.

Concern about having to operate under the 2015 version of STPIS as AER does not see the necessity of a review.

Comments/questions

- Up to AER to assess EBSS/CESS carryover and STPIS target and values.

Pricing methodology

Powerlink has undertaken an extensive engagement process on various options to increase the level of cost reflective pricing.

Comments/questions

- We understand discussions have been held with a range of direct connected customers and Ergon ICC customers

DMIAM

Draft Plan

The AER is in the midst of a consultation process on introduction of a DMIAM scheme for TNSPs. This process will not be complete prior to Powerlink submitting its proposal in January 2021. The AER has agreed to Powerlink having a DMIAM for 2023-27.

Comments/questions

- We leave the AER to assess any proposed projects for compliance.

Customer Panel

3 November 2020