

2023-27 Revenue Proposal

Response to public submissions

August 2021



Introduction

Powerlink lodged its Revenue Proposal for the 2023-27 regulatory period with the Australian Energy Regulator (AER) in January 2021. The AER called for submissions on our Revenue Proposal between 24 March and 24 May 2021 and received four submissions from:

- Powerlink's Customer Panel;
- Energy Users Association of Australia (EUAA);
- Aurizon Network; and
- AER Consumer Challenge Panel 23 (AER CCP23).

We have considered each submission and thank those who made submissions for their input and insights. The purpose of this document is to summarise feedback received and provide Powerlink's response.

We have divided feedback into seven key themes:

- capable of acceptance;
- customer engagement;
- capital expenditure;
- operating expenditure;
- financial elements;
- Proposed Pricing Methodology; and
- incentive schemes and allowances.

Key themes from submissions

Capable of acceptance

In our experience to date, Powerlink has been the most forthright of any network business, in claiming from early in its engagement that it was intending to lodge a proposal that was capable of acceptance.

- AER CCP23 submission, page 10

Our overarching goal has been to deliver a Revenue Proposal that is capable of acceptance by our customers, the AER and Powerlink, at the time of lodgement in January 2021. This has been the guiding objective for our engagement and built on the strong foundations we undertake in the normal course of business.

Submissions from our Customer Panel, the EUAA and AER CCP23 were broadly positive in relation to our overall Revenue Proposal, with statements that it is reasonable¹, capable of support² and capable of acceptance³. However, we recognise that customers also stated that the support provided is contingent upon the AER's analysis and confirmation of the prudence and efficiency of our forecasts. AER CCP23 outlined specific topics for AER confirmation, for example testing models, further review of capital expenditure and resolution of our contingent project trigger⁴.

The AER's review of our Revenue Proposal is ongoing and we will revisit the question of capable of acceptance with our customers after publication of the AER's Draft Decision in September 2021 and in the development of our Revised Revenue Proposal, which is due to be lodged in early December 2021.

Customer engagement

There was strong endorsement in all submissions on Powerlink's engagement approach, in particular our co-design process and customers' ability to significantly influence the Revenue Proposal.

Customer Panel members have been deeply engaged in the development of the Revenue Proposal, and we believe that we have been able to influence the contents of the Proposal to better reflect the interests and concerns of customers.

- Customer Panel submission, page 1

Powerlink's comprehensive engagement should provide comfort to the AER that consumer representatives are very supportive of the progress made and this should lead to a lighter touch as the AER fulfils its role in assessing the prudent and efficient level of allowable expenditure.

- EUAA submission, page 3

Our Revenue Proposal included a self-assessment against a set of capable of acceptance criteria, which were developed from a set of criteria published by the AER in previous determinations. A significant portion of this criteria related to customer engagement⁵.

¹ Customer Panel submission, page 3.

² EUAA submission, page 3.

³ AER CCP23 submission, page 1.

⁴ *Ibid.*

⁵ 2023-27 Revenue Proposal, Powerlink, pages 18 and 19.

Our Customer Panel agreed with our overall self-assessment and suggested additional assessment information related to the nature of engagement and use of multiple channels⁶. We accept the Customer Panel's views in relation to these matters, in particular the need for us to undertake greater breadth of engagement outside the Customer Panel and to further demonstrate this breadth of engagement.

AER CCP23 provided their own assessment against the same set of criteria⁷ and stated their assessment was a "strong endorsement" of the effectiveness of our engagement design and implementation.

We have also encouraged the AER to provide its assessment against the same set of criteria as part of its Draft Decision, in order to provide a full assessment from all three parties (Powerlink, AER and our customers). We will continue the use of this criteria in our Revised Revenue Proposal and consider its use and application for future business-as-usual engagement activities.

Capital expenditure

Our engagement with customers and the AER over the 15-month period in the lead up to submitting our Revenue Proposal included presenting five iterations of our capital expenditure to customers, with successive forecasts reflecting the feedback we received.

Our draft Revenue Proposal, published in September 2020, reflected the fourth iteration of our forecast and included a 12% increase in capital expenditure. We had regard to customer feedback at that time that a 12% increase in capital expenditure was a serious concern for customers and undertook a significant amount of work to challenge ourselves on the need for proposed capital investments. Ultimately, our Revenue Proposal included a 3% reduction in capital expenditure compared to the current regulatory period. This is primarily a result of a management induced push to drive efficiency, deliver value for customers and build a culture of constructive discomfort within our organisation.

Submissions from the AER CCP23 and the EUAA directly discussed capital expenditure and supported Powerlink's proposed 3% reduction in capital expenditure, while noting that the prudence and efficiency of the forecast is a matter for the AER to review.

Powerlink has conducted an open and transparent process in preparing its capex proposal, including acting on the request of its consumers to significantly reduce the proposed capex between the draft and final proposal.
- AER CCP23 submission, page 45

The AER CCP23 submission analysed specific elements of our capital expenditure in further depth and:

- noted we took important steps to enhance our approach to IT investments, and accepted our IT and non-network capital expenditure⁸;
- observed improvements in our overall asset management approach since 2014/15⁹; and
- recognised our Hybrid+ capital expenditure forecasting approach as being reasonable for a Transmission Network Service Provider (TNSP)¹⁰. This approach was also supported by the EUAA in its submission¹¹.

⁶ Powerlink Customer Panel submission, pages 2 and 3.

⁷ AER CCP23 submission, pages 9 and 10.

⁸ AER CCP23 submission, page 39.

⁹ AER CCP23 submission, page 26.

¹⁰ AER CCP23 submission, page 2.

¹¹ EUAA submission, page 8.

The EUAA and AER CCP23 also raised two issues for further consideration – our proposed Central to North Queensland Reinforcement contingent project and capital productivity.

In relation to our single proposed contingent project, the concern from the AER CCP23 related to how specific the contingent project trigger event was¹², while the EUAA had broader concerns about the likelihood of one of the trigger events occurring and who should pay for the regulated investment¹³. We understand these concerns and have considered them. Our view remains that it is reasonable to include the Central to North Queensland Reinforcement as a contingent project based on the information we have provided in our Revenue Proposal. We have also provided additional information to the AER about our proposed contingent project triggers and understand the AER will have regard to this in forming its September 2021 Draft Decision.

On the topic of capital productivity, the EUAA and AER CCP23 both highlighted a need for further emphasis on capital productivity improvement targets, given potential changes in our operating environment e.g. declining utilisation¹⁴. At its 17 June 2021 meeting, our Customer Panel also expressed an interest in this topic. We discussed capital productivity with our Customer Panel, AER CCP23 and the AER at a Revenue Proposal Reference Group (RPRG) meeting on 10 August 2021 and will include detailed minutes of this discussion on our [website](#).

Operating expenditure

We proposed a target of no real growth in our operating expenditure, achieved through a combination of no step changes and productivity of 0.5%, which is higher than the industry average of 0.31%. Customer input on productivity and affordability were central to this decision and this will not be an easy target for our business to meet. Customers recognised the ambition and effort behind this target and all submissions were broadly supportive of our proposed operating expenditure forecast.

We welcome the approach of no step changes and the decision to commit to top-down productivity improvements to achieve the opex target.

- EUAA submission, page 6

We recognise that while our proposed productivity target of 0.5% per annum was supported in the submissions, customers were interested in how we would meet this productivity target and expressed concern that there are risks to customers if the target is not met¹⁵. AER CCP23 suggested it is better for us to set an ambitious stretch target for productivity and fall short of meeting it, rather than setting an easy target and meeting it¹⁶.

We provided further details in our Revenue Proposal¹⁷ and at a Customer Panel session in May 2021 about several initiatives we are pursuing to drive productivity. We have also committed to provide updates to our Customer Panel during the 2023-27 regulatory period on material progress against our productivity initiatives. Ultimately, we decided to take up this challenge in the interests of customer affordability and to drive the business harder while continuing to meet our customer and regulatory obligations, with a view to becoming a world-class service provider.

¹² AER CCP23 submission, page 2.

¹³ EUAA submission, page 9.

¹⁴ AER CCP23 submission, page 2 and EUAA submission, page 9.

¹⁵ EUAA submission, page 7 and AER CCP23 submission, pages 65 and 66.

¹⁶ AER CCP23 submission, page 66.

¹⁷ Powerlink 2023-27 Revenue Proposal, Section 6.6.2, pages 95-97.

Financial elements

Financial elements cover a range of topics in the Revenue Proposal, such as our Rate of Return, Regulatory Asset Base (RAB) and RAB transfers, depreciation, taxation and shared assets.

One area of customer interest was our proposed change in depreciation tracking from the Weighted Average Remaining Life (WARL) approach to the more accurate year-by-year tracking approach, which we engaged on with our Customer Panel¹⁸. AER CCP23's submission noted the engagement undertaken, as well as our proposed smoothing approach to reduce the impact of the change on customers, and found the proposed depreciation tracking change, on balance, to be acceptable¹⁹.

AER CCP23 also expressed support for the reduction in our RAB, both in the current and forecast period²⁰. The reduction in our RAB demonstrates our prudent and efficient asset management approach and is a key part of driving customer value and affordability.

Aurizon Network raised two financial matters for further consideration. The first related to our approved Cost Allocation Methodology (CAM), which we have not proposed to amend for the 2023-27 regulatory period. Aurizon Network suggested we engage further on and consider reviewing our CAM for the 2028-32 regulatory period²¹. Separately, our Customer Panel has also raised interest in the CAM and we have committed to engage further on this topic outside the current revenue determination process.

The second matter raised by Aurizon Network was in relation to the RAB transfer process and the function of specific Powerlink assets associated with its connections²². We have engaged directly with Aurizon in relation to the specific asset issues raised.

EUA raised the issue of potential increases in the Rate of Return in future regulatory periods and the impact this may have on network revenues and customer prices. This is not related directly to Powerlink's current Revenue Proposal. However, we do acknowledge EUA's concerns and agree that we must continue to focus on making prudent and efficient decisions, particularly with respect to network capital investment, that are in the long-term interests of consumers.

¹⁸ Powerlink's 2023-27 Revenue Proposal, Section 10.4.1, page 121.

¹⁹ AER CCP23 submission, page 28.

²⁰ AER CCP23 submission, page 29

²¹ Aurizon Network submission, pages 8 and 9.

²² *Ibid*, pages 7 and 8.

Proposed Pricing Methodology

To help respond to customer expectations on affordability and service at the lowest long run cost, we undertook a review of our transmission pricing arrangements and proposed one key change and several minor changes as part of our Proposed Pricing Methodology. This followed extensive consultation with our customers between April 2018 and November 2020²³.

Submissions from the EUAA, Aurizon Network and AER CCP23 all supported our Proposed Pricing Methodology and the proposed amendments, recognising the significant engagement undertaken.

Aurizon Network has welcomed the deeper engagement Powerlink has undertaken with directly connected load customers in respect of the Pricing Methodology and that engagement has benefited Aurizon Network in terms of obtaining a deeper understanding of the proposed changes to the Pricing Methodology.

- Aurizon Network submission, page 3

Incentive schemes and allowances

Incentive schemes and allowances cover the Efficiency Benefit Sharing Scheme (EBSS), Capital Expenditure Sharing Scheme (CESS), Service Target Performance Incentive Scheme (STPIS) and Demand Management Innovation Allowance Mechanism (DMIAM). At the time of public submissions, there were no specific issues raised in submissions in relation to the EBSS, CESS or DMIAM.

Post public submissions, on 9 July 2021, we wrote to the AER to request the DMIAM is not applied in the 2023-27 regulatory period. Our reasons for this are explained in our letter to the AER, published on their [website](#). We recognise that this recent development on the DMIAM occurred after public submissions and wanted to ensure it was captured here for completeness. We discussed our approach to DMIAM at our 10 August 2021 RPRG meeting and noted interest from customers, CCP23 and the AER on this topic. We intend to provide further information on our approach to inform customer and AER views prior to the Draft Decision and engage further prior to our Revised Revenue Proposal.

With regard to the STPIS, AER CCP23 did not support Powerlink's proposed alternative Service Component (SC) target of one (vs. a target of zero)²⁴ and referred to compliance with the STPIS Guidelines in relation to our proposed target setting years for the Market Impact Component (MIC) of the STPIS²⁵. We acknowledge these perspectives, but remain of the view that our proposals for the SC and MIC are reasonable and consistent with the intent of the STPIS scheme, as outlined in our Revenue Proposal²⁶. We will continue to engage on these matters with the AER prior to its September 2021 Draft Decision.

²³ Powerlink 2023-27 Revenue Proposal, Chapter 16 Pricing Methodology, pages 158-165.

²⁴ AER CCP23 submission, page 72.

²⁵ *Ibid*, page 73.

²⁶ Powerlink 2023-27 Revenue Proposal, Chapter 15 STPIS, pages 142-157.

Summary and next steps

The following table summarises those elements of our Revenue Proposal that, from our perspective, either gained support, were not supported, or are for further consideration/where improvements have been suggested.

The table is not intended to imply agreement across relevant parties on individual elements, but rather to provide a summary from our perspective which we will use to focus engagement activities in the future. We have also included material specific issues raised in an individual submission and highlighted which customers raised these issues. We recognise that the majority of the elements, other than customer engagement, are supported subject to the AER's review of our Revenue Proposal.

We have published a [Post Revenue Proposal Lodgement Engagement Plan](#) to cover engagement over the period January 2021 to December 2021. This engagement plan was shaped by feedback received and our Customer Panel had input to this engagement plan in August 2021 prior to publication.

Revenue Proposal element	Supported / supported subject to AER review	For further consideration / improvements suggested	Not supported
Capable of acceptance	<ul style="list-style-type: none"> Capable of acceptance criteria, goal and our self-assessment. Submissions indicated our Revenue Proposal was reasonable (Customer Panel), capable of support (EUAA) and capable of acceptance subject to AER review (AER CCP23)¹. 	<ul style="list-style-type: none"> Additional capable of acceptance criteria suggested (Customer Panel). 	
Customer engagement	<ul style="list-style-type: none"> Engagement approach (e.g. co-design). Engagement scope. Customer influence. 	<ul style="list-style-type: none"> Engagement breadth. 	
Capital expenditure	<ul style="list-style-type: none"> Proposed capital expenditure. Hybrid+ forecasting methodology. Asset management approach. Non-network capital expenditure. 	<ul style="list-style-type: none"> Capital productivity. Contingent project triggers (AER CCP23). 	<ul style="list-style-type: none"> Contingent project (EUAA).
Operating expenditure	<ul style="list-style-type: none"> Proposed operating expenditure and no real growth target. Productivity target. Base year, no step changes, trend factors. 	<ul style="list-style-type: none"> Delivery of proposed operating expenditure productivity initiatives. 	
Financial elements	<ul style="list-style-type: none"> RAB. Change in depreciation tracking. Cost pass through events. 	<ul style="list-style-type: none"> CAM. RAB transfers (Aurizon Network). 	
Proposed Pricing Methodology	<ul style="list-style-type: none"> Proposed Pricing Methodology Engagement approach 		
Incentive schemes and allowances	<ul style="list-style-type: none"> EBSS, CESS, STPIS. 	<ul style="list-style-type: none"> Application of the DMIAM². 	<ul style="list-style-type: none"> STPIS – MIC target setting years and SC alternative target (AER CCP23).

¹ Refer to the Capable of Acceptance section of this document for further detail.

² Note: application of the DMIAM has arisen as a topic of interest post public submissions. See section on Incentive Schemes and Allowances for further information.