Our ref: A3231355

OFFICE OF THE CHIEF EXECUTIVE

31 October 2019

Mr Sebastian Roberts
General Manager – Transmission and Gas
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

cc: Slavko Jovanoski, Director

Dear Sebastian,

Powerlink 2023-27 Revenue Determination Process
Framework and Approach Initiation

Powerlink's current regulatory period ends on 30 June 2022. Powerlink requests the Australian Energy Regulator (AER)[1] to amend or replace its Framework and Approach (F&A) paper for Powerlink's forthcoming 2023-27 Revenue Proposal in respect to the following matters:

- application of the Service Target Performance Incentive Scheme (STPIS); and
- the application of the Demand Management Incentive Scheme (DMIS) and/or Demand Management Innovation Allowance (DMIA), consistent with the outcome of the current National Electricity Rule (NER) change for which a Final Determination is anticipated in December 2019.

Powerlink is also writing to:

- formally advise the AER of its intention to apply a 'Hybrid+' approach to forecast its capital expenditure. As you are aware, Powerlink has had initial discussions with its customers and the AER in relation to this methodology;
- seek further discussion on the expected treatment of the outcomes of other key reforms and/or consultations that are either underway or proposed to impact electricity transmission network service providers (TNSPs) during Powerlink's next regulatory period; and
- explore the potential application of regulatory sandbox arrangements proposed by the Australian Energy Market Commission (AEMC)[2] to Powerlink's forthcoming regulatory period.

STPIS

The STPIS is designed to provide performance incentives for TNSPs to improve or maintain a high level of service for the benefit of customers and National Electricity Market (NEM) participants. Version 5 of the STPIS, finalised in 2015, currently applies to Powerlink. Powerlink seeks to explore changes to two elements of the scheme:

1. **Market Impact Component (MIC)**: significant changes have occurred in generation diversity and location with subsequent impacts on system utilisation in Queensland since 2015. The current scheme utilises historic performance for target setting purposes. Given the changing environment for the operation of the network, this may no longer provide a meaningful future performance benchmark.

[1] *Pursuant to clause 6A.10.1A(c)(1) of the National Electricity Rules (NER).*
[2] *Final Report – Regulatory Sandbox Arrangements to Support Proof-of-Concept Trials*, AEMC, 26 September 2019

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2. **Service Component (SC)**: as a consequence of improvements in customer loss of supply events, there is potential for Powerlink's existing "large" threshold target for the loss of supply event frequency measure to be set at zero for the upcoming regulatory period. This would appear to be contrary to the intent of the scheme, which aims to provide service-level improvement and benefit to customers. Given this, there may be an opportunity for the target setting arrangements for the SC to be reviewed to avoid a potential zero target outcome.

Similar issues to those above may also be experienced in other NEM jurisdictions. Powerlink's view is that it is important to explore these issues with customers, the AER and other TNSPs to ensure the STPIS, and its target setting mechanisms, remain fit-for-purpose within the current and expected future operating environment.

DMIS and DMIA

The AEMC is currently considering a Rule change proposal to apply a DMIS/DMIA to TNSPs, recognising that the AEMC's draft position is to apply the DMIS only. DMIS and DMIA were both introduced and applied to Distribution Network Service Providers (DNSPs) in 2015, to encourage innovation in non-network solutions for the benefit of customers.

Powerlink's view is that extending a DMIS/DMIA to TNSPs will encourage innovation in non-network solutions at a transmission level, for instance demand management contracting with end-use customers and coordination of Distributed Energy Resources (DER). These types of innovations may lead to benefits for customers through lower transmission and total system costs over time.

The AEMC's Final Determination on DMIS/DMIA for TNSPs is planned to be released in December 2019. Powerlink would seek to have DMIS/DMIA apply in its next regulatory period if introduced by the AEMC.

Capital expenditure forecasting methodology

During the 2018-22 Revenue Determination process, Powerlink undertook a 'Hybrid' approach to capital expenditure forecasting. This approach utilised a mix of top-down and bottom-up methods to derive the five-year capital expenditure forecast included within Powerlink's Revenue Proposal.

Powerlink intends to build upon this approach with a 'Hybrid+' model, which will include an increased amount of bottom-up forecasting while still ensuring a balance between practicality, effort, cost and reasonableness.

Powerlink's initial view, which it is discussing with its customers and the AER, is that the 'Hybrid+' model will include a bottom-up forecast of:

- all internally approved projects;
- projects that are load-driven;
- power transformers;
- significant as well as major, one-off network needs; and
- ISP/contingent projects (noting these are not part of the ex-ante capital expenditure forecast).

A top-down approach will be applied to portfolio elements such as less significant network reinvestments, security and compliance. The top-down approach will include use of the AER's replacement expenditure model and trend analysis.

Powerlink's view is that the 'Hybrid+' model is fit-for-purpose, reflects our asset management practices and enables a more efficient, transparent and streamlined Revenue Proposal process.

Powerlink will continue to engage with its customers and the AER regarding its capital expenditure forecasting methodology. Powerlink will outline its approach further within its Expenditure Forecasting Methodology, which must be lodged with the AER in June 2020.

Reviews and Rule changes

Powerlink notes that a range of current and potential future key energy reforms may impact TNSPs during Powerlink's next regulatory period, for example:

- implementation of the Coordination of Generation and Transmission Investment (COGATI) reforms from 1 July 2022; and
- implementation of the Transmission Ring-Fencing Guideline Review in 2021.

While no final decisions have been made regarding the proposed reforms, should the reforms proceed there are likely to be consequential impacts on a number of matters pertaining to Powerlink during its next regulatory period (e.g. STPIS and Pricing Methodology).

Powerlink will continue to work cooperatively with the AER, AEMC and other market bodies to put in place suitable transitional arrangements, including as part of its 2023-27 Revenue Proposal.

Regulatory sandbox

The adoption of regulatory sandbox arrangements, as proposed by the AEMC, have the potential to provide additional value to customers at a time of rapid change in the power system. The regulatory sandbox process is a framework within which participants can trial innovative business models, products and services in the market under relaxed regulatory requirements on a time-limited basis and with appropriate safeguards in place.

Powerlink would like to explore the potential for such arrangements to apply in its next regulatory period.

Powerlink has been, and will continue to, engage with its customers in respect to these matters over the coming months.

If you would like to discuss any matters raised in this letter, please contact Matthew Myers.

Yours sincerely,

Kevin Kehl
Interim Chief Executive

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