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30 October 2024

Dr Kris Funston
Executive General Manager, Network Regulation
Australian Energy Regulator
GPO Box 3131
Canberra ACT 601

cc: Steven Spencer, Director Reset Coordination and Strategy

Dear Kris

Powerlink's 2027/28 to 2031/32 Revenue Determination Process
Framework and Approach Initiation

Powerlink's current five-year regulatory period ends on 30 June 2027. Consistent with the National Electricity Rules[1], Powerlink requests that the Australian Energy Regulator (AER) amend or replace its Framework and Approach (F&A) paper for Powerlink's 2027-32 Revenue Proposal in relation to the following matters in particular:

- the Service Target Performance Incentive Scheme (STPIS); and
- the incentive sharing schemes for capital and operating expenditure.

Powerlink will give further consideration to the other matters identified in the National Electricity Rules (the Rules) that can be considered as part of the F&A process and will engage with the AER and customers on these matters in the coming months. These include application of the Expenditure Forecast Assessment Guidelines, any small-scale incentive scheme (where applicable), Demand Management Innovation Allowance and whether depreciation for establishing the regulatory asset base should be based on forecast or actual capital expenditure.

In addition, Powerlink takes this opportunity to advise the AER of its intention to develop and apply a hybrid approach to forecast its capital expenditure for the upcoming regulatory period.

<u>Service Target Performance Incentive Scheme</u>

We recognise that the AER is currently in the process of undertaking a review of the STPIS for electricity transmission. In April 2023, the AER completed its review of all the incentive schemes. As part of that review, the AER found that the service component of the STPIS remained fit-for-purpose, but the market impact and network capability components of the scheme were not working as intended.

[1] NER, 6A.10.1A(c)(1)

In early December 2023, the AER published an Issues Paper on the STPIS for transmission network service providers (TNSPs). Among other things, the paper discussed the effectiveness of the scheme and possible options to address identified shortcomings.

As the AER is aware, Powerlink lodged a submission in response to the AER's Issues Paper, which made a number of recommendations[2] as follows:

- *Introduce greater flexibility into the STPIS* - we consider a more customer-focussed outcome could be achieved by allowing key STPIS parameters to be determined as part of a revenue determination process. A particular benefit of such an approach is the additional engagement with customers and other stakeholders that is undertaken on various aspects of a Revenue Proposal, including the STPIS. This engagement also incorporates the broader business context, future outlook and expenditure requirements to deliver prescribed transmission services in the upcoming regulatory period.

- *Service Component should form part of the STPIS Review* – to ensure interactions with the other components of the scheme are appropriately considered together. Under the current National Electricity Rules, changes to the STPIS parameters can only be considered as part of a scheme review, such as the AER's STPIS Review currently underway.

- *Market Impact Component should be paused or converted to report only* – this will ensure that TNSPs do not continue to be systematically penalised for factors outside their control. At the very least, we strongly recommend the MIC be paused to enable the AER and other stakeholders to observe the behaviours of TNSPs in the absence of the incentive.

- *Simplify reporting and revise penalty arrangements for the Network Capability Component (NCC)* - given the current metric involves a high administrative burden and ongoing reporting requirements.

While Powerlink does not intend to repeat the details of its submission here, we are strongly of the view that TNSPs should not be penalised for factors outside their control. Doing so would undermine the incentive properties upon which the scheme is based.

<u>STPIS Review</u>

In terms of Powerlink's 2027-32 Revenue Proposal, we understand that the outcome of the AER's current STPIS Review will apply to Powerlink's next regulatory period. We also understand the AER is expected to release its Draft STPIS Guideline in late October/early November 2024 for consultation.

The outcomes of the AER's STPIS review will have a direct impact on the level of preparation required for Powerlink's Revenue Proposal, including in relation to engagement with our customers and other stakeholders. To ensure our preparatory works are conducted in a timely and efficient manner, Powerlink seeks the AER's cooperation to engage directly on this matter over the next few months in particular to achieve an outcome that is practical, provides transparency and avoids any unnecessary use of resources.

[2] Powerlink Submission on Issues Paper for Transmission Service Target Performance Incentive Scheme (STPIS) Review, 5 April 2024.

Capex and Opex Incentive Schemes

The Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS) are intended to provide a continuous incentive for TNSPs to pursue efficiency improvements in operating expenditure and efficient capital investments, respectively.

Powerlink has been subject to the AER's Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS) since their establishment for electricity transmission businesses in 2013.

Powerlink also notes that the AER undertook a review of its incentive schemes for networks over the late 2021 to early 2023 period. This culminated in the AER's publication of Final Decisions on its *Review of Incentives* and the *Capital Expenditure Incentive Guideline for Electricity Network Service Providers* in April 2023. Having reviewed this information and engaged with AER staff, we understand that the AER retains some flexibility under the Incentive Guidelines and/or the Rules as to how it may apply the schemes to a TNSP (or DNSP).

At this time, we anticipate that Powerlink will overspend both its capital and operating and maintenance expenditure allowances for the current regulatory period due to factors such as supply chain challenges and inflationary pressures. The extent to which this may occur is yet to be determined, particularly in light of the transformational works being undertaken to meet our requirements under the Queensland Energy and Jobs Plan and other associated instruments to transition to net zero.

For the purposes of the F&A process and, ultimately, the AER's Final Decision on Powerlink's 2027-32 Revenue Proposal, we encourage the AER to have regard to the circumstances for any material overspends in capex and/or opex and exercise its discretion on whether to apply a net negative carryover from one regulatory period to the next.

Capital Expenditure Forecasting Methodology

Powerlink adopted a hybrid approach to forecasting its five-year capital expenditure requirements in its Revenue Proposals for the previous and current regulatory periods. Our approach involved a combination of top-down and bottom-up methods to derive a forecast, which largely depended upon the nature (eg. load-driven), significance (eg. major, one-off needs) and approval status of capital projects.

For our 2027-32 Revenue Proposal, we intend to apply a hybrid approach that is fit-for-purpose, reflects our asset management practices and enables us to develop a reasonable forecast in a more efficient manner. While the details of this approach have yet to be worked through, Powerlink's approach will be set out in further detail within the Expenditure Forecasting Methodology, which must be lodged with the AER in June 2025.

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Engagement

Powerlink has flagged these items with both its Customer Panel and the AER in the last 12-18 months in particular. We will continue to engage with our customers, the AER and other stakeholders on these matters prior to the preparation and lodgement of our 2027-32 Revenue Proposal with the AER by end January 2026.

If you have any questions in relation to this letter, please contact Jennifer Harris.

Yours sincerely,

Paul Simshauser
CHIEF EXECUTIVE

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