



Ref: A1134366

30 August 2011

Mr Warwick Anderson
General Manager
Network Regulation North Branch
Australian Energy Regulator
PO Box 3131
CANBERRA ACT 2601

Dear Mr Anderson

RESPONSE TO SUBMISSIONS ON POWERLINK'S 2013-17 REVENUE PROPOSAL

Powerlink submitted its Revenue Proposal for the 2012/13 – 2016/17 regulatory period to the AER on 31 May 2011. Powerlink's Revenue Proposal was prepared in accordance with the requirements of the National Electricity Rules and the AER's Submission Guidelines. The AER conducted a preliminary examination of Powerlink's proposal required under clause 6A.11.1 of the Rules and found that Powerlink included sufficient information in its proposal to satisfy the requirements of the AER's Submission Guidelines and the Rules.

Powerlink has reviewed the submissions made in response to the AER's consultation on its Revenue Proposal. Powerlink appreciates the time and effort that respondents have invested in contributing to the revenue setting process and is interested to further understand the views of stakeholders.

Having reviewed the submissions, Powerlink has identified several material errors which should be corrected. These include errors in the following key areas:

- Mixing of dollar bases when comparing historical and future expenditures;
- Revenue and price path;
- Demand and energy forecasting during the Global Financial Crisis and subsequent economic recovery;
- Network developments in South-West Queensland / Surat Basin;
- Opex Benchmarking; and
- Assessment of replacement capex drivers.

Basis for Comparisons

In preparing the Revenue Proposal, Powerlink and the AER agreed a consistent basis for presenting expenditure, both in relation to historical expenditure for the current regulatory period and future expenditure in the next (2013-17) regulatory period. Such an approach is consistent with accepted regulatory practice and occurs for all TNSPs regulated by the AER.

The agreed standard was that all historical expenditure be expressed in nominal terms in the year that the expenditure was incurred, while all future expenditure forecasts be presented in 2011/12 real dollars. Powerlink has adhered to this standard in its Revenue Proposal, pro-forma templates for capex and opex, as well as the Post Tax Revenue Model (PTRM) and the Roll Forward Model (RFM).

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To ensure that all trends were presented on a consistent basis, it was necessary for Powerlink to escalate all historical expenditure to 2011/12 real dollars.

Powerlink notes that a number of submissions provided trending analysis, often stating that Powerlink's proposed expenditure in the 2013-17 regulatory period is a certain multiple of that category of expenditure in an earlier period¹. From Powerlink's analysis, these submissions generally appear to compare historical nominal expenditure with forecast real expenditure, or in some cases forecast nominal expenditure.

Consistent with its Revenue Proposal and regulatory and economic practice, Powerlink maintains that any meaningful comparison between historical and future expenditure must be made on a common dollar basis.

Revenue and Price Paths

As required by the AER Submission Guidelines, Powerlink's Revenue Proposal details its maximum allowable revenue requirements² in the next regulatory period.

Consistent with AER regulatory practice to help inform stakeholders, Powerlink has provided an estimate of the impact upon average transmission charges by dividing the maximum allowable revenue by forecast energy from its 2010 Annual Planning Report³. Powerlink has also provided information on the approximate impact upon typical residential electricity charges in Queensland.

Demand and Energy Forecasts

As required by the Rules, Powerlink lodged its Revenue Proposal with the AER by 31 May 2011. To meet this legislative timeframe, Powerlink developed its capital expenditure forecasts using demand forecasts consistent with the demand and energy forecasts published in its 2010 Annual Planning Report. Powerlink's 2011 Annual Planning Report was published on 30 June 2011, one month after the Revenue Proposal was submitted to the AER.

Several submissions⁴ cited a chart of historic and forecast native energy taken from the 2011 Annual Planning Report (Figure 2.7). This chart shows that native energy in 2010/11 was projected to be around the same as in 2007/08, and a significant decrease from 2009/10. Powerlink's 2011 Annual Planning Report also noted that there had been significant impacts on electricity consumption due to floods and cyclones across Queensland over the 2010/11 summer period, namely:

"(I)t has been assessed that this resulted in a reduction of around 270 MW for 2010/11 summer peak demand. This impact of natural disasters on maximum demand and energy has not been factored into the following tables."⁵ (emphasis added)

The decrease in native energy in 2010/11 comes straight after the effect of the Global Financial Crisis, which is acknowledged to have resulted in below trend demand and energy growth during 2009/10. Powerlink, as would other industry participants, considers that it would be erroneous to treat this combination of two consecutive and highly unusual circumstances as evidence of a paradigm shift in electricity consumption growth patterns in Queensland.

In addition, energy use in Queensland is forecast to increase significantly in the next regulatory period with the development of the liquefied natural gas and mining industries. For example, APLNG has a new connection agreement for 289 MVA⁶. These loads will have high

¹ TEC p.2, p.5, p.10, p.12; EUAA p.2, p.10, p.12; Wesfarmers p.2, p.4, p.5.

² Powerlink Queensland Revenue Proposal - 2013-2017, p.14, p.110.

³ Powerlink Queensland Revenue Proposal - 2013-2017, p.113.

⁴ PAGE, TEC, Wesfarmers.

⁵ Powerlink 2011 Annual Planning Report, p.22.

⁶ Australia Pacific LNG Pty Limited, 2011.

utilisation (>90%) and will contribute to a significant increase in Queensland's energy consumption.

Given that demand forecasts are a key input which underpins Powerlink's proposed expenditure forecasts (augmentations are driven by maximum demand not energy consumption), it is imperative that they are appropriately assessed and that due regard be given to the factors which impact upon them in the context of the Queensland operating environment.

South-West Queensland / Surat Basin Developments

Powerlink's Revenue Proposal identifies a number of new requirements which have not been incurred in its 2009/10 base year operating expenditure (opex). One of these new requirements is attributable to expansion of the transmission network further into South West Queensland. Such an expansion will impose additional costs to maintain that part of the network which are over and above the inherent network growth factors⁷ incorporated into Powerlink's operating expenditure model. For clarity, the AER is currently undertaking a detailed review of Powerlink's models.

Some submissions⁸ contend that these developments are predominantly non-regulated and are irrelevant to Powerlink's Revenue Proposal, and that the developments are in areas where Powerlink's network is already well established.

Powerlink confirms that the additional costs associated with these new requirements are attributable only to expansion of the transmission network that is providing *prescribed* transmission services. This is the new 275kV backbone from Western Downs to Columboola to Wandoan South that will support existing Ergon Energy load in the area as well additional loads from multiple coal seam gas to liquefied natural gas developments, mining developments and supporting ancillary loads. The proposed works associated with these developments were subject to a public Regulatory Test consultation process.

Consistent with the Rules and the nature of the services requested, individual large loads that connect to the Powerlink network will connect (and in some cases have connected) under negotiated / non-regulated transmission services arrangements. The costs of these non-prescribed services are not included in Powerlink's Revenue Proposal.

Opex Benchmarking

Several submissions⁹ have commented on benchmarking generally and the use of opex benchmarking in particular. Any robust comparison of opex performance between TNSPs, or through time for a single TNSP, must be made on a like-for-like basis.

International Transmission Operations and Maintenance Study (ITOMS) is a widely accepted (both nationally and internationally) measure for transmission network cost and performance which benchmarks of the order of 30 businesses across the Asia Pacific, Europe, North America and Scandinavian regions. Inputs to the study are normalised to ensure relative performance and cost comparisons are benchmarked appropriately between different network service providers. Over a number of years, Powerlink has consistently benchmarked as providing high levels of network performance at low cost.

In addition, the AER has consistently used opex/RAB as a benchmark measure for regulatory purposes. Consistent with the AER's approach, this measure relates to controllable opex only, hence excludes volatile and circumstance specific items such as network support costs. This particular indicator is robust in that it inherently incorporates the effects of geography and distance. Powerlink considers that benchmark ratios that do not reflect the distance electricity is transported are inappropriate and can be misleading¹⁰.

⁷ Powerlink Queensland Revenue Proposal - 2013-2017, p.90.

⁸ PAGE p.4; TEC p.5.

⁹ PAGE, TEC, Wesfarmers.

¹⁰ Powerlink Queensland Revenue Proposal- 2013-2017, p.100.

Several submissions¹¹ made the observation that Powerlink's opex/RAB measure will increase over the period. Powerlink forecasts the opex/RAB measure to reduce from 3% in 2008/09 to approximately 2.5% by 2016/17.

Replacement Capex Drivers

Powerlink's Revenue Proposal also identifies a number of specific assets that are forecast to require replacement during the next regulatory period. Replacement of these assets has been justified on the basis of prudent condition and risk assessments of their capacity, capability and compliance.¹²

A number of submissions¹³ have suggested that, on average, only a benchmark proportion of assets should be replaced within any given regulatory period. These submissions appear to have erred in equating expenditure on replacement capex with the value of the RAB to suggest that Powerlink is proposing asset replacements at twice the rate necessary. This analysis overlooks the fact that the forecast replacement capex reflects the cost of modern engineering equivalent equipment, while the assets being replaced are in the RAB at their depreciated values.

As noted above, Powerlink adopts a prudent and efficient approach to each replacement need. This approach adopts a robust methodology that recognises the ongoing needs, actual condition and associated issues across all types of transmission assets.

If the AER requires further information or clarification on any of the points raised in the submissions please contact Stewart Bell on (07) 3860 2374.

Yours sincerely



Stewart Bell
MANAGER REVENUE RESET

¹¹ TEC p.12, Wesfarmers p.5.

¹² Powerlink Asset Management Strategy, p.24.

¹³ TEC p.11, Wesfarmers p.4