Draft decision

CitiPower electricity distribution determination

1 July 2026 – 30 June 2031

Attachment 1 – Building block approach: Annual revenue requirement, Regulatory asset base, Regulatory depreciation and Corporate income tax

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AUSTRALIAN ENERGY REGULATOR

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1 Building block approach

We determine the distributor's annual revenue requirement (ARR) using a building block approach. The efficient costs to be recovered by a distributor can be thought of as being made up of various building block costs. Our draft decision assesses each of the building block costs and the elements that drive these costs. The building block costs are approved reflecting trade-offs and interactions between the cost elements, service quality and across years.

Table 1.1 shows the building block costs that form the ARR for each year and where discussion on the elements that drive these costs can be found within this draft decision.

Table 1.1 Building block costs

Building block costs	Attachments where elements are discussed
Return on capital	Building block approach – Regulatory asset base (Attachment 1) Rate of return (Overview) Capital expenditure (Attachment 2)
Regulatory depreciation (return of capital)	Building block approach – Regulatory asset base (Attachment 1) Building block approach – Regulatory depreciation (Attachment 1) Capital expenditure (Attachment 2)
Operating expenditure	Operating expenditure (Attachment 3)
Estimated cost of corporate income tax	Building block approach – Corporate income tax (Attachment 1)
Other revenue adjustments	
Adjustments for shared assets	Building block approach – Annual revenue requirement (Attachment 1)
Operating efficiency benefits/penalties	Efficiency benefit sharing scheme (Attachment 5)
Capital efficiency benefits/penalties	Capital expenditure sharing scheme (Attachment 6)
Demand management innovation allowance	Demand management incentive scheme and Demand management innovation allowance mechanism (Attachment 8)

1.1 Annual revenue requirement

This section sets out our draft decision on CitiPower's ARR and expected revenues for the provision of standard control services (SCS) over the 2026–31 regulatory control period. Specifically, it sets out our draft decision on:[1]

- the ARRs (unsmoothed), which are the sum of annual building block costs
- the total revenue requirement, which is the sum of the ARRs
- the annual expected revenues (smoothed)
- the X factors.

We determine the X factors by smoothing the ARR over the 2026–31 period. The X factor is used in the CPI–X methodology to determine the annual expected revenue (smoothed).[2]

1.1.1 Draft decision

We determine a total ARR of $1,969.0 million ($ nominal, unsmoothed) for CitiPower over the 2026–31 period for SCS. This amount reflects our draft decision on the various building block costs and represents a reduction of $118.6 million (5.7%) to CitiPower's proposed total ARR of $2,087.7 million. This reduction is largely driven by a lower return on capital, operating expenditure (opex), and revenue adjustment building blocks in this draft decision, which have been partially offset by higher regulatory depreciation and cost of corporate income tax building blocks.

We determine the annual expected revenue (smoothed) and X factor for each regulatory year for the 2026–31 period by smoothing the ARRs. For the 2026–31 period, our draft decision is to approve total expected revenues of $1,964.9 million ($ nominal, smoothed) for CitiPower.

At the time of making this draft decision, we have used placeholder values for certain components such as the rate of return, expected inflation and some expenditure forecasts. We will make further updates for these values as part of our final decision. It is for this reason that we expect the total expected revenues approved in our final decision to be different to this draft decision.

Table 1.2 sets our draft decision on the building block costs, the ARR, annual expected revenue and X factors for CitiPower over the 2026–31 period.

1 NER, cll. 6.3.2(a)(1), 6.5.9(a) and 6.5.9(b)(1)–(2).

2 NER, cll. 6.2.6(a) and 6.5.9.

Table 1.2 AER's draft decision on CitiPower's ARR, annual expected revenue and X factors for the 2026–31 period ($ million, nominal)

	2026–27	2027–28	2028–29	2029–30	2030–31	Total
Return on capital	137.9	146.6	155.7	164.1	170.7	775.1
Regulatory depreciation[a]	97.9	102.9	111.1	122.7	131.0	565.6
Operating expenditure[b]	102.9	109.1	113.2	118.4	122.8	566.4
Revenue adjustments[c]	–2.5	–5.5	–0.1	–0.6	–0.9	–9.7
Cost of corporate income tax	13.6	13.2	14.2	14.8	15.9	71.6
Annual revenue requirement (unsmoothed)	349.8	366.2	394.2	419.3	439.6	1,969.0
Annual expected revenue (smoothed)	**361.0**	**376.3**	**392.3**	**408.9**	**426.3**	**1,964.9**
X factor[d]	n/a[e]	–1.65%	–1.65%	–1.65%	–1.65%	n/a

Source: AER analysis.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening regulatory asset base (RAB).

(b) Includes debt raising costs.

(c) Includes revenue adjustments, where applicable, from the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), shared asset adjustment and the demand management innovation allowance mechanism (DMIAM).

(d) The X factors will be revised annually to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.

(e) CitiPower is not required to apply an X factor for 2026–27 because we set the 2026–27 expected revenue in this decision. The expected revenue for 2026–27 is around 5.5% lower than the approved total annual revenue for 2025–26 in real terms, or 3.0% lower in nominal terms.

1.1.2 Overview of proposal

CitiPower proposed a total expected revenue (smoothed) of $2,077.6 million ($ nominal) for the 2026–31 period. CitiPower's proposal sets out the details of its building block costs, the ARR, annual expected revenue and X factors over the 2026–31 period.[3]

1.1.3 Assessment approach

In appendix A.1, we discuss the building block approach used to determine the ARR and expected revenue for CitiPower for each year of the 2026–31 period.[4]

[3] CitiPower, *Attachment 1.01- SCS Revenue and control mechanism – 2026–31 Regulatory Proposal*, January 2025, p.2; CitiPower, *Regulatory proposal - CP MOD 1.02 – SCS RFM*, January 2025.

[4] NER, cll. 6.3.2(a)(1), 6.5.9(b)(2).

1.1.4 Reasons for draft decision

We determine a total ARR of $1,969.0 million ($ nominal, unsmoothed) for CitiPower over the 2026–31 period. This is a reduction of $118.6 million (5.7%) to CitiPower's proposed total ARR of $2,087.7 million for this period. This reflects the impact of our draft decision on the various building block costs.

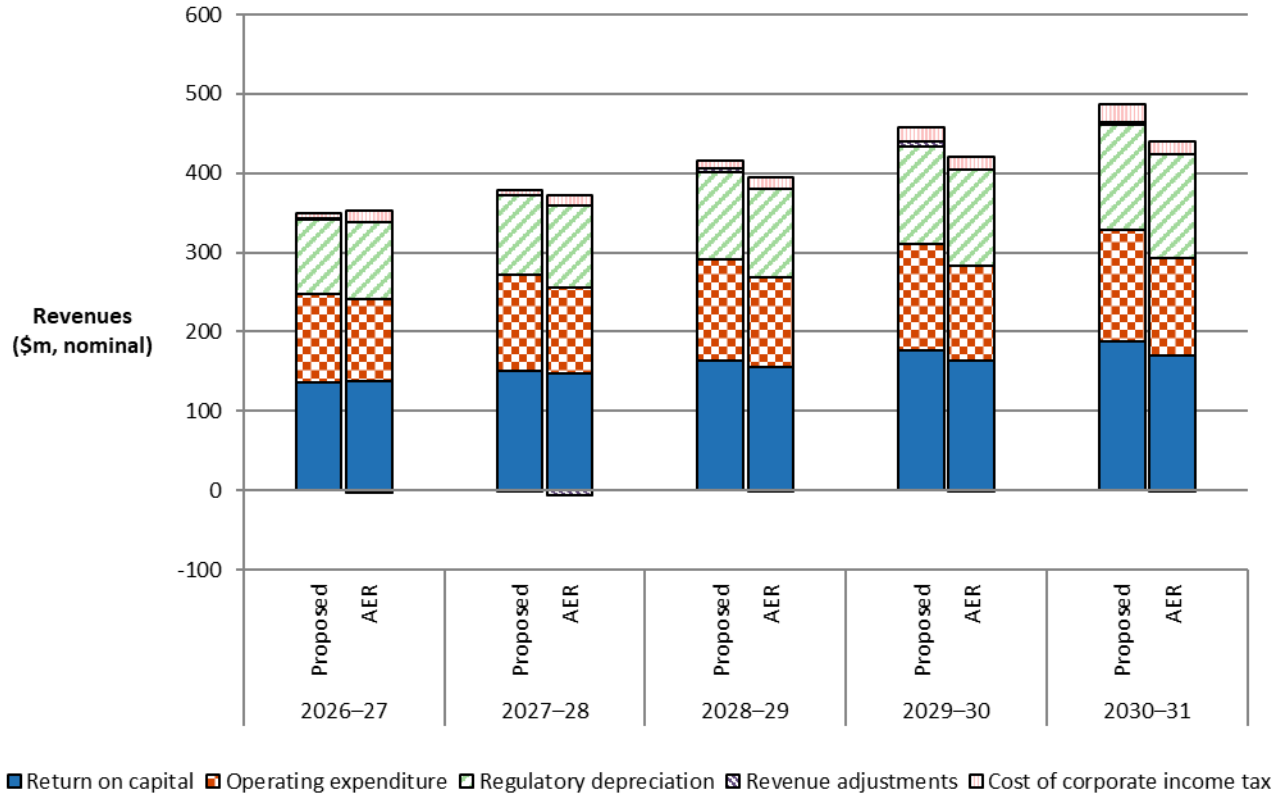
The changes we made to CitiPower's proposed building blocks include (in nominal terms):

- A reduction in the return on capital of $39.4 million (4.8%) (section 1.2, Overview section 2.2 and Attachment 2). This is driven primarily by a lower opening RAB and forecast capital expenditure (capex) in our draft decision compared to CitiPower's proposal.
- An increase in the regulatory depreciation of $5.6 million (1.0%) (section 1.3). This is driven primarily by a lower expected inflation rate in our draft decision compared to CitiPower's proposal, which reduces the indexation of the RAB.[5] It is partially offset by our draft decision to reduce forecast capex and a lower opening RAB.
- A reduction in the opex forecast of $70.9 million (11.1%) (Attachment 3). This is driven by lower forecast output growth and lower estimates of proposed step changes in this draft decision compared to CitiPower's proposal.
- An increase in the cost of corporate income tax of $7.3 million (11.3%) (section 1.4). This is driven primarily by a lower tax depreciation amount due to our reduction to forecast capex in this draft decision compared to CitiPower's proposal.
- A reduction in the revenue adjustments of $21.2 million (Attachments 5 and 6). This is driven primarily by our draft decision to determine a CESS penalty and a higher EBSS penalty compared to CitiPower's proposal. Our draft decision also applies a lower DMIAM (Attachment 8).

Figure 1.1 shows the building block components from our draft decision that make up the ARRs for CitiPower, and the corresponding components from its proposal.

[5] Since RAB indexation is deducted from straight-line depreciation, the lower RAB indexation results in higher regulatory depreciation all else being equal.

Figure 1.1 AER's draft decision and CitiPower's proposed ARRs ($ million, nominal)



Source: AER analysis; CitiPower, *Regulatory proposal - CP MOD 1.01 – SCS PTRM*, January 2025.
Note: Revenue adjustments include EBSS, CESS, shared asset adjustment and DMIAM amounts. Opex includes debt raising costs.

1.1.4.1 X factor and annual expected revenue

To determine the profile of expected revenue for CitiPower over the 2026–31 period, we have set the expected revenue for the first regulatory year at $361.0 million ($ nominal). This is $11.2 million higher than the ARR for that first year. We then apply an expected inflation rate of 2.55% per annum and a profile of X factors to determine the expected revenue in subsequent years.[6]

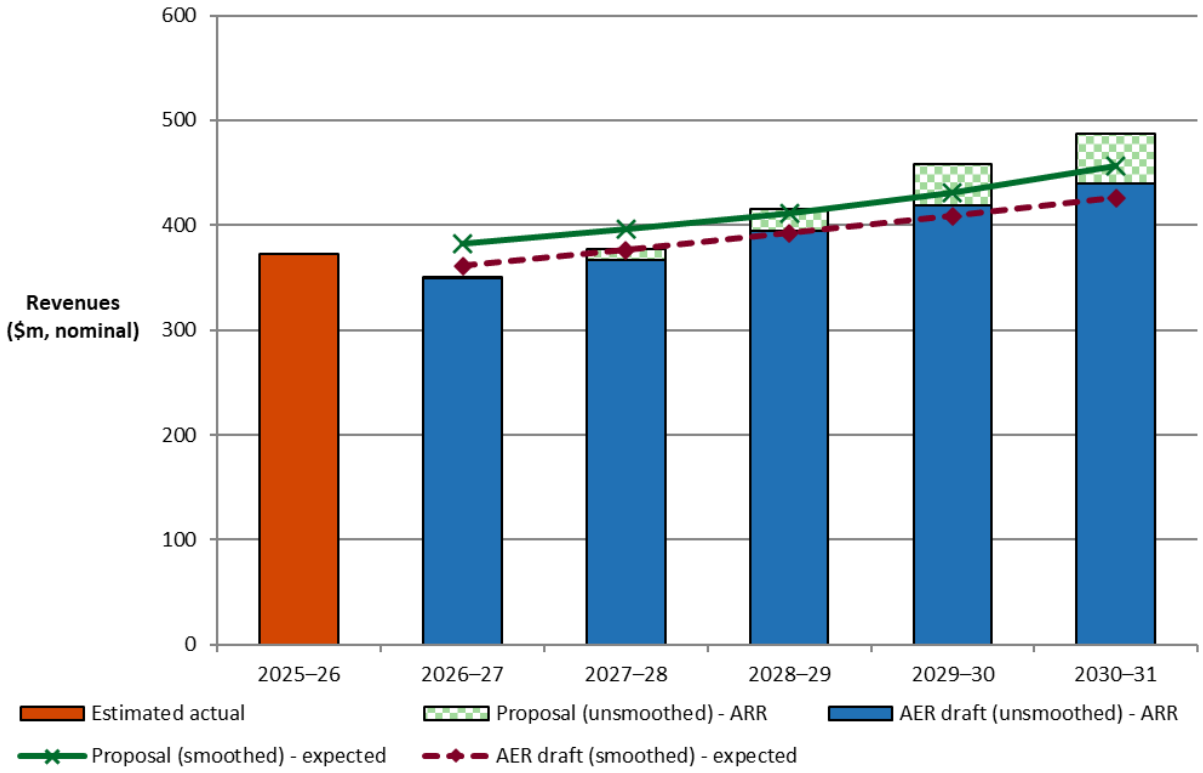
For this draft decision, we determine an X factor for CitiPower of –1.65% per annum for the period from 2027–28 to 2030–31.[7] The net present value (NPV) of the ARRs is $1,645.9 million ($ nominal) as at 1 July 2026. Based on this NPV and applying the CPI–X framework, we determine that the expected revenue (smoothed) for CitiPower is $361.0 million in 2026–27 increasing to $426.3 million in 2030–31 ($ nominal). The resulting total expected revenue is $1,964.9 million for the 2026–31 period.

6 NER, cl. 6.5.9(a).

7 CitiPower is not required to apply an X factor for 2026–27 because we set the 2026–27 expected revenue in this decision.

Figure 1.2 shows our draft decision on CitiPower's annual expected revenue (smoothed revenue) and the ARRs (unsmoothed revenue) for the 2026–31 period.

Figure 1.2 AER's draft decision on CitiPower's revenue for the 2026–31 period ($ million, nominal)



Source: AER analysis; CitiPower, *Regulatory proposal - CP MOD 1.01 – SCS PTRM,* January 2025.

The X factors we set must minimise, as far as reasonably possible, the variance between the expected revenue (smoothed) and the ARR (unsmoothed) in the last year of the 2026–31 period.[8] This helps to minimise any potential large revenue variance (and thus price shocks) at the commencement of the 2031–36 period. Our standard approach has been to keep a divergence of up to ±3% between the smoothed and unsmoothed revenues for the last year of the regulatory period. This is with the objective to achieve smoother price changes across regulatory control periods.

We did not receive any stakeholder submissions on CitiPower's proposed revenue smoothing profile.

For this draft decision, we approve lower revenues than CitiPower's proposal. This is mainly driven by our reduction to CitiPower's forecast capex and opex. As such, CitiPower's unsmoothed revenue for the first year of the 2026–31 period (2026–27) is about 6.1% ($ nominal) lower than the approved revenue for the last year of the 2021–26 period

[8] NER, cl. 6.5.9(b)(2).

(2025–26). We consider it appropriate to apply most of this reduction in setting the expected revenue for 2026–27.

Our draft decision allows for higher overall revenues than those determined in the 2021–26 period (discussed further below). As a result, CitiPower's unsmoothed revenues for the remaining 4 years of the 2026–31 period increase by an average of 4.8% per annum. We are mindful that revenue increases would have a significant impact on network charges for CitiPower's customers. Consequently, we have smoothed the expected revenues by reducing the increases over the final 4 years of the 2026–31 period and passing on the appropriate reduction in 2026–27.

We consider that our profile of X factors results in an expected revenue in the last year of the 2026–31 period that is as close as reasonably possible to the ARR for that year.[9] We will review this smoothing profile for the final decision.

Our draft decision results in an average increase of 2.7% per annum ($ nominal) in the expected revenue over the 2026–31 period.[10] This consists of an initial reduction of 3.0% in 2026–27, followed by average annual increases of 4.2% during the remainder of the 2026–31 period.[11]

Our draft decision results in an increase of $441.8 million (29.0%) in nominal dollar terms to CitiPower's total ARR for the 2026–31 period relative to that in the 2021–26 period. This is because:

- Approximately 53% of the increase is due to factors potentially outside the control of CitiPower. This includes higher actual inflation rates for the 2021–26 period, which increase the indexation component of the RAB. It is also driven by a higher rate of return on equity and interest rates for the 2026–31 period, which lead to a higher forecast rate of return (Overview section 2.2). Together, these changes in market variables result in a much higher return on capital building block compared to the current period.
- The remaining 47% of the increase is driven by other factors. This includes higher regulatory depreciation, which is due to forecast capex in the 2026–31 period driving further moderate growth in the forecast RAB in real terms. It is also driven by higher opex and cost of corporate income tax determined in this draft decision for the 2026–31 period compared to the 2021–26 period. The increase in estimated cost of corporate income tax is mainly due to higher return on equity and customer contributions.

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9 NER, cl. 6.5.9(b)(2). We consider a divergence of up to 3% between the expected revenue and ARR for the last year of the 2026–31 period is appropriate if this can promote smoother price changes for users across the period. In the present circumstances, based on the X factors we have determined for CitiPower, this divergence is around 3.0%.

10 In real 2025–26 dollar terms, our approved expected revenue for CitiPower results in an average increase of 0.2% per annum over the 2026–31 period.

11 In real 2025–26 dollar terms, this consists of initial reduction of 5.47% in 2026–27, followed by annual average increases of 1.65% during the remainder of the 2026–31 period.

1.1.4.2 Shared assets

CitiPower submitted that its total revenue requirement is subject to a shared asset adjustment because its forecast annual unregulated revenue from shared assets exceeded the AER's materiality threshold.[12]

We consider CitiPower's forecast unregulated revenues from shared assets for the 2026–31 period are reasonable, noting that its forecasts have increased compared to the 2021–26 period due to an increase of the rental of distribution poles and ducts assets for telecommunication services as well as an increase in property rental.[13] CitiPower's forecast unregulated revenues must be compared to the regulated revenues we determine, rather than those proposed by CitiPower. Our draft decision sets lower expected revenues than CitiPower's proposal. Based on these lower expected revenues, we determine that CitiPower's unregulated revenues will be greater than 1% of its expected revenues in each year of the 2026–31 period. Hence, the materiality threshold is met in each year of the 2026–31 period and we apply a shared asset revenue adjustment over this period.[14]

Our draft decision is for a shared asset decrement of $2.9 million ($2025–26), which is a slightly higher decrement than that proposed by CitiPower after adjusting for the forecast cash flow timing assumption to reflect end of year values applied in the PTRM and update for expected inflation.[15]

1.1.4.3 Indicative average distribution price impact

Our draft decision on CitiPower's expected revenues ultimately affects the prices consumers pay for electricity. There are several steps required in translating our revenue decision into indicative distribution price impacts.

We regulate CitiPower's SCS under a revenue cap form of control. This means our draft decision on CitiPower's expected revenues does not directly translate to price impacts. This is because CitiPower's revenue is fixed under the revenue cap form of control, so changes in the consumption of electricity will affect the prices ultimately charged to consumers.

We are not required to establish the distribution prices for CitiPower as part of this determination. However, we will assess CitiPower's annual pricing proposals before the commencement of each regulatory year within the 2026–31 period. In each assessment we will administer the pricing requirements set in this distribution determination.

For this draft decision, we have estimated some indicative average distribution price impacts flowing from our determination on the expected revenues for CitiPower over the 2026–31

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12 CitiPower, *Attachment 1.01- SCS Revenue and control mechanism – 2026–31 Regulatory Proposal*, January 2025, pp. 7–8.

13 AER analysis; CitiPower, *Regulatory Proposal – CP RIN 01 – Workbook 1 – Forecast template,* January 2025.

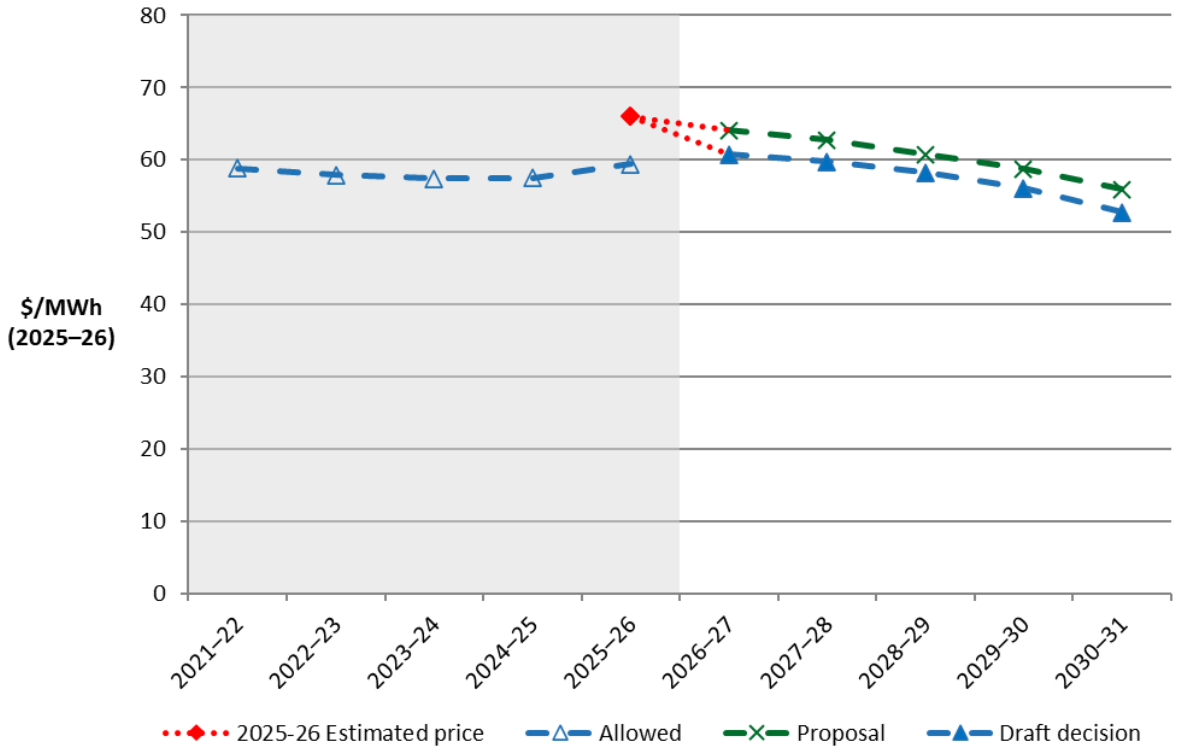
14 We will reassess the materiality of the forecast shared asset unregulated revenues for our final decision.

15 Our draft decision PTRM sets out the annual shared asset decrements in row 348 of the 'Input' sheet. CitiPower's proposed annual shared asset decrements are set out in the same row and sheet reference in its proposal PTRM.

period. In this section, our estimates only relate to SCS (that is, the core electricity distribution charges), not alternative control services (such as metering or public lighting). These indicative price impacts assume that actual energy consumption across the 2026–31 period matches CitiPower's forecast energy consumption, which we have adopted for calculating the indicative price path. We note that the Consumer Challenge Panel (sub-panel 32) submitted that customer prices are heavily dependent on uncertain demand forecasts.[16] Consequently, we have tested the sensitivity of the price impacts to changes in forecast energy delivered at section 1.1.4.5. We have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

Figure 1.3 shows CitiPower's indicative distribution price path over the period from 2021–22 to 2030–31 in real 2025–26 dollar terms based on the expected revenues established in our draft decision compared to CitiPower's proposed revenue requirement. The indicative price path is estimated using the approved expected revenue and dividing by forecast energy consumption for each year of the 2021–26 period.

Figure 1.3 Indicative distribution price path for CitiPower ($/MWh, 2025–26)



Source: AER analysis.

We estimate that our draft decision on CitiPower's annual expected revenue will result in a reduction to average distribution charges of about 4.4% per annum over the 2026–31 period

[16] CCP32, *Advice to the AER on the 2026–31 Regulatory proposal for CitiPower electricity distribution network,* May 2025, pp. 12–13.

in real 2025–26 dollar terms.[17] This compares to the real average reduction of approximately 3.3% per annum proposed by CitiPower over the 2026–31 period.[18] These high-level estimates reflect the aggregate change across the entire network and do not reflect the particular tariff components for specific end users.

Table 1.3 displays in nominal terms the comparison of the price impacts of CitiPower's proposal and our draft decision.

Table 1.3 Comparison of price impact of CitiPower's proposal and the AER's draft decision ($ nominal)

	2025–26	2026–27	2027–28	2028–29	2029–30	2030–31
AER draft decision						
Price path ($/MWh)[a]	66.0	62.3	62.8	62.8	62.1	59.8
Price path (change %)	–	–5.7%	0.9%	0.0%	–1.2%	–3.6%
CitiPower's proposal						
Price path ($/MWh)[a]	66.0[b]	65.9	66.2	65.9	65.4	64.1
Price path (change %)	–	–0.2%	0.5%	–0.5%	–0.7%	–2.1%

Source: AER analysis; CitiPower, *Regulatory proposal - CP MOD 1.01 – SCS PTRM.* January 2025.
(a) The price path is in nominal terms and is constructed by dividing nominal expected revenue for SCS by forecast energy consumption for each year of the period.
(b) We updated CitiPower's proposal for the approved total annual revenue from its annual pricing model for 2025–26. This was unavailable at the time CitiPower lodged its proposal.

1.1.4.4 Expected impact of draft decision on electricity bills

The annual electricity bill for customers in CitiPower's network reflects the combined cost of all the electricity supply chain components—wholesale energy generation, transmission, distribution, metering, and retail costs. This draft decision primarily relates to the distribution charges for CitiPower's SCS, which represent on average approximately 28% of residential customers' annual electricity bills and 31% of small business customers' annual electricity bills in CitiPower's network area.[19]

17 In nominal terms, we estimate average distribution charges to decrease by 2.0% per annum. This amount reflects an expected inflation rate of 2.55% per annum as determined in this draft decision.

18 In nominal terms CitiPower's proposal would decrease distribution charges by -0.6% per annum. This amount reflects an expected inflation rate of 2.75% per annum as proposed by CitiPower in its proposal.

19 AER analysis; CitiPower, *CitiPower 2025–26 - Final - SCS pricing model – 31 March 2025*, 9 May 2025; CitiPower, *Regulatory proposal - CP MOD 1.01 – SCS PTRM.* January 2025; Essential Services Commission, *Victorian Default Offer 2025–26: Decision Model*, 21 May 2025.

We estimate the expected bill impact by varying the distributions charges in accordance with our draft decision, while holding all other components constant.[20] This approach isolates the effect of our draft decision on the SCS distribution charges only for CitiPower. However, this does not imply that other components will remain unchanged across the period.[21]

Based on this approach, we expect that our draft decision on the distribution component will reduce the average annual residential electricity bill in 2030–31 by about $40 ($ nominal) or 2.6% from the 2025–26 total bill level. By comparison, had we accepted CitiPower's proposal, the expected change in the distribution component would reduce the average annual residential electricity bill in 2030–31 by about $13 ($ nominal) or 0.8% from the 2025–26 total bill level.

Our estimated bill impact is based on the typical annual electricity usage of 4,000 kWh and for residential customers in CitiPower's network.[22] Therefore, customers with different usage will experience different changes in their bills. We also note that there are other factors, such as metering, wholesale and retail costs, which affect electricity bills.

Similarly, for small business customers in CitiPower's network, we have estimated the average annual electricity bill for two customer categories:[23]

- consuming 10,000 kWh per annum, which the Essential Services Commission of Victoria (ESCV) noted as the 'representative' usage comparable to that adopted for default market offers in other jurisdictions
- consuming 20,000 kWh per annum, which the ESCV had historically adopted as the average annual usage for small business customers in Victoria.

We expect that our draft decision on the distribution component will reduce the average electricity bill in 2030–31 for a small business customer (10,000 kWh) by about $92 ($ nominal) or 2.9% from the 2025–26 total bill level. By comparison, had we accepted CitiPower's proposal, the expected change in the distribution component would reduce the average annual small business electricity bill in 2030–31 by about $29 ($ nominal) or less than 0.9% from the 2025–26 total bill level.

Likewise, the distribution component is expected to reduce the average annual electricity bill in 2030–31 for a small business customer (20,000 kWh) by about $166 ($ nominal) or 2.8% from the 2025–26 total bill level. By comparison, had we accepted CitiPower's proposal, the expected change in the distribution component would reduce the average annual small

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20 We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process. The other components that make up a typical electricity bill are held constant at the levels established in the 2025–26 Victorian default offer.

21 It also assumes that actual energy consumption will equal the forecast adopted in our draft decision. Since CitiPower operates under a revenue cap, changes in energy consumption will also affect annual electricity bills across the 2026–31 period.

22 Essential Services Commission, *Victorian Default Offer 2025–26: Decision Model*, 21 May 2025.

23 Essential Services Commission, *Victorian Default Offer 2025–26: Decision Model*, 21 May 2025.

business (20,000 kWh) electricity bill in 2030–31 by about $53 ($ nominal) or 0.9% from the 2025–26 total bill level.

Table 1.4 shows the estimated impact of our draft decision and CitiPower's proposal on the average annual electricity bills for residential and small business customers in its network over the 2026–31 period.

Table 1.4 Estimated impact of CitiPower's proposal and AER's draft decision on annual electricity bills for the 2026–31 period ($ nominal)

	2025–26[a]	2026–27	2027–28	2028–29	2029–30	2030–31
AER draft decision						
Residential (4,000 kWh consumption)	1,546	1,521	1,525	1,525	1,520	1,506
Annual change[b]	–	–25 (–1.6%)	4 (0.3%)	–0 (–0%)	–5 (–0.3%)	–15 (–1.0%)
Small business (10,000 kWh consumption)	3,186	3,130	3,139	3,139	3,127	3,094
Annual change[b]	–	–56 (–1.8%)	9 (0.3%)	–0 (0%)	–12 (–0.4%)	–33 (–1.1%)
Small business (20,000 kWh consumption)	5,843	5,742	5,758	5,757	5,737	5,677
Annual change[b]	–	–101 (–1.7%)	16 (0.3%)	–0 (–0%)	–22 (–0.4%)	–60 (–1.1%)
CitiPower's proposal						
Residential (4,000 kWh consumption)	1,546	1,545	1,547	1,545	1,542	1,533
Annual change[b]	–	–1 (–0.1%)	2 (0.1%)	–2 (–0.1%)	–3 (–0.2%)	–9 (–0.6%)
Small business (10,000 kWh consumption)	3,186	3,184	3,189	3,184	3,177	3,157
Annual change[b]	–	–2 (–0.1%)	5 (0.1%)	–5 (–0.1%)	–7 (–0.2%)	–21 (–0.6%)
Small business (20,000 kWh consumption)	5,843	5,839	5,848	5,840	5,827	5,790
Annual change[b]	–	–4 (–0.1%)	9 (0.1%)	–8 (–0.1%)	–12 (–0.2%)	–37 (–0.6%)

Source: AER analysis; CitiPower, *Regulatory proposal - CP RIN 05 – Workbook 5 – Bill impacts,* January 2025.
(a) Essential Services Commission, *Victorian Default Offer 2025–26,* 21 May 2025, pp. 12–14; Essential Services Commission, *Victorian Default Offer 2025–26: Decision Model*, 21 May 2025.
(b) Annual change amounts and percentages are indicative. They are derived by varying the distribution component of the 2025–26 bill amounts in proportion to yearly expected revenue divided by the forecast

energy proposed by CitiPower. Actual bill impacts will vary depending on electricity consumption and tariff class.

1.1.4.5 Sensitivity of forecast energy delivered on bills

The impact of our draft decision on customer bills is likely to change over the 2026–31 period. CitiPower forecast the amount of annual energy delivered through its network will increase from 5,639 GWh in 2025–26 to 7,125 GWh in 2030–31, a significant increase of 1,486 GWh, or 26% over the period. This is the forecast that has informed the illustrative estimates of tariff and bill impacts in this draft decision. A variance in actual energy consumption, compared to that forecast by CitiPower would lead to bill impacts that are higher or lower than what we have estimated.

Stakeholders welcomed the proposed moderate impact on customer bills. However, they raised concerns that the increase in revenues were tied to proposed material forecast increases in electricity demand resulting in low estimated impacts on electricity bills.[24] These stakeholders have highlighted there is a degree of uncertainty and risk around the demand forecasts proposed by CitiPower, noting that if actual energy delivered over the 2026–31 period is less than forecast, distribution network tariffs and customer bills would be higher, all else being equal.[25] This is because CitiPower operates under a revenue cap and is therefore entitled to recover the revenue we determine, regardless of the actual energy delivered.

For example, if energy delivered were to increase over the period at 40% of the rate forecast by CitiPower, the modelled impact on average annual bills would be:[26]

- a nominal increase of $15 (1.0%) by 2030–31 for a residential customer
- a nominal increase of $35 (1.1%) by 2030–31 for a small business customer (10,000 kWh).

Figure 1.4 and Figure 1.5 respectively show the average annual bill for a residential customer and small business customer for a range of alternative energy delivered forecasts. This analysis models the bill impacts of our draft decision revenue using increments in the rate of growth of energy delivered forecasts up to the proposed level.[27] Under this range of energy delivered forecasts:

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24 Hon Lily D'Ambrosio MP, *Issues Papers – Electricity Distribution Determination for 2026–31*, 3 June 2025, p. 1; CCP32, *Advice to the Australian Energy Regulator on the 2026-31 Regulatory Proposal for CitiPower Electricity Distribution Network*, 14 May 2025, p. 16.

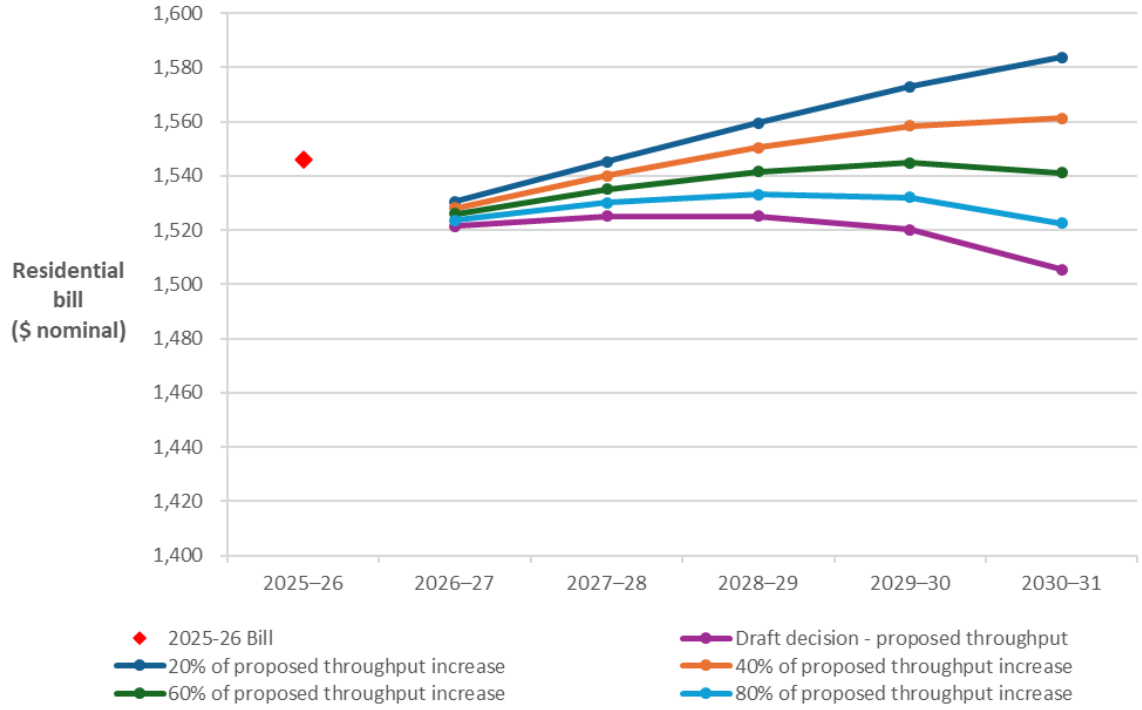
25 Hon Lily D'Ambrosio MP, *Issues Papers – Electricity Distribution Determination for 2026–31*, 3 June 2025, p. 1; CCP32, *Advice to the Australian Energy Regulator on the 2026-31 Regulatory Proposal for CitiPower Electricity Distribution Network*, 14 May 2025, p. 16.

26 This would therefore reflect energy throughput of 6,233 GWh in 2030–31, or an increase in energy throughput over the period of 10.5% compared to the 26.3% increase proposed by CitiPower.

27 The forecast rate of growth of energy delivered proposed by CitiPower has been reduced by increment of 20%. Starting with the proposed forecast energy delivered, we model 80%, 60%, 40% and 20% of the proposed forecast rate of growth in each year of the 2026–31 period.

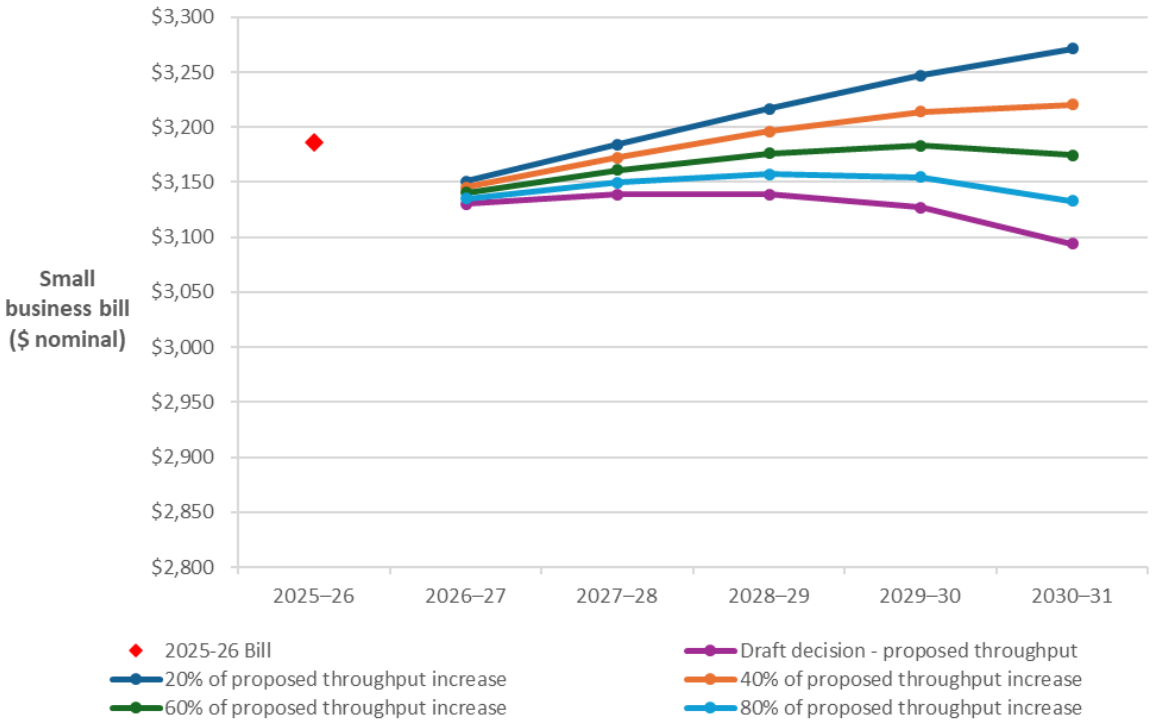
- a residential customer bill in 2030–31 ranges from $1,506 based on CitiPower's proposed forecast energy delivered, to $1,584 based on forecast energy delivered at 20% of the proposed growth rate
- a small business customer (10,000 kWh) bill in 2030–31 ranges from $3,094 based on CitiPower's proposed forecast energy delivered, to $3,271, based on forecast energy delivered at 20% of the proposed growth rate.

Figure 1.4 Sensitivity of energy delivered on annual residential bills ($ nominal)



Source: AER analysis.

Figure 1.5 Sensitivity of energy delivered on annual small business (10,000 kWh) bills ($ nominal)



Source: AER analysis.

1.2 Regulatory asset base

The RAB is the value of the assets used by CitiPower to provide SCS.[28] Our distribution determination specifies the RAB as at the commencement of the regulatory control period and the appropriate method for the indexation of the RAB.[29] The indexation of the RAB is one of the building blocks that form the ARR for each year of the 2026–31 period.[30] We set the RAB as the foundation for determining a distributor's revenue requirements and use the opening RAB for each regulatory year to determine the return on capital and return of capital (regulatory depreciation) building blocks.[31]

This section presents our draft decision on the opening RAB value as at 1 July 2026 for CitiPower and our forecast of its RAB values over the 2026–31 period. It also presents our draft decision for establishing the RAB as at the commencement of the 2031–36 period using depreciation that is based on forecast capital expenditure (capex).[32]

1.2.1 Draft decision

We determine an opening RAB value of $2,324.3 million ($ nominal) as at 1 July 2026 for CitiPower. This value is $12.6 million (0.5%) lower than CitiPower's proposed opening RAB of $2,336.9 million ($ nominal) as at 1 July 2026.[33] This reduction is mainly due to our update to the roll forward model (RFM) for a lower actual consumer price index (CPI) input for 2025–26.

As the RAB must be maintained in real dollar terms by indexing for inflation,[34] the 2025–26 CPI update results in a reduction to the opening RAB value as at 1 July 2026 by $12.6 million (0.5%) compared to CitiPower's proposal, all else being equal.

We accept CitiPower's proposed method for calculating the opening RAB. However, we have made some input amendments in the RFM (in addition to the CPI update), which offset the reduction from the CPI update and therefore affected the opening RAB value as at 1 July 2026.

To determine the opening RAB as at 1 July 2026, we have rolled forward the RAB over the 2021–26 period to determine a closing RAB value at 30 June 2026 in accordance with our RFM.[35] This roll forward process includes an adjustment at the end of the 2021–26 period to

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28 NER, cl. 6.5.1(a).

29 NER, cl. 6.3.2(a) (2).

30 NER, cll. 6.4.3(a)(1) and (b)(1).

31 NER, cll. 6.4.3(a)(2) and (3).

32 NER, cl. 6.12.1(r).

33 CitiPower, *Attachment 1.01 – SCS Revenue and Control Mechanism – Regulatory proposal 2026–31,* January 2025, p.3.

34 NER, cll. 6.4.3(b)(1) and 6.5.1(e)(3).

35 We amended our standard RAB roll forward model (RFM) to reflect the half-year extension period of 1 January 2021 to 30 June 2021.

account for the difference between actual 2020 and half-year 2021 capex and the estimates approved in the 2021–26 determination.[36]

Table 1.5 sets out our draft decision on the roll forward of CitiPower's RAB over the 2021–26 period.

Table 1.5 AER's draft decision on CitiPower's RAB for the 2021–26 period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25[a]	2025–26[b]
Opening RAB	1,968.9	1,968.2	2,017.1	2,137.3	2,249.7
Net capex[c]	91.1	98.1	96.0	170.5	166.8
Inflation on opening RAB	16.9	68.9	158.0	86.6	54.5
Less: straight-line depreciation[d]	108.7	118.1	133.7	144.6	152.5
Interim closing RAB	1,968.2	2,017.1	2,137.3	2,249.7	2,318.6
Difference between estimated and actual capex in 2020 and half-year 2021[e]	-	-	-	-	4.2
Return on difference for 2020 and half-year 2021 capex[e]	-	-	-	-	1.5
Closing RAB as at 30 June 2026	**-**	**-**	**-**	**-**	**2,324.3**

Source: AER analysis.
(a) Based on estimated capex provided by CitiPower. We will update the RAB roll forward with actual capex in the final decision.
(b) Based on estimated capex provided by CitiPower. We expect to update the RAB roll forward with a revised capex estimate in the final decision, and true-up the RAB for actual capex at the next distribution determination.
(c) Net of disposals and capital contributions and adjusted for actual CPI and half-year WACC.
(d) Adjusted for actual CPI. Based on forecast capex.
(e) Includes the calendar year 2020 and the half-year period from 1 January 2021 to 30 June 2021.

We determine a forecast closing RAB value as at 30 June 2031 of $2,724.1 million ($ nominal) for CitiPower. This is $392.7 million lower than CitiPower's proposed closing RAB value of $3,116.8 million ($ nominal).[37] This reduction is mainly due to our draft decision on forecast capex (Attachment 2). Our draft decisions on the opening RAB as at 1 July 2026

[36] The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2021–26 determination.

[37] CitiPower, *Attachment 1.01 – SCS Revenue and Control Mechanism – Regulatory proposal 2026–31,* January 2025, p.5.

(section 1.2.4.1), the expected inflation rate (Overview section 2.2) and forecast depreciation (section 1.3) also affect the forecast closing RAB value as at 30 June 2031.[38]

Table 1.6 sets out our draft decision on the forecast RAB values for CitiPower over the 2026–31 period.

Table 1.6 AER's draft decision on CitiPower's RAB for the 2026–31 period ($ million, nominal)

	2026–27	2027–28	2028–29	2029–30	2030–31
Opening RAB	2,324.3	2,445.2	2,571.3	2,660.2	2,961.8
Net capex[a]	218.8	228.9	200.1	154.3	163.3
Inflation on opening RAB	59.3	62.4	65.6	67.8	68.6
Less: straight-line depreciation	157.2	165.2	176.7	190.5	199.7
Closing RAB	**2,445.2**	**2,571.3**	**2,660.2**	**2,691.8**	**2,724.1**

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling.

We accept CitiPower's proposal that the forecast depreciation approach is to be used to establish the opening RAB at the commencement of the 2031–36 period.[39] We consider this approach is consistent with the capex incentive objective in that it will provide sufficient incentives for CitiPower to achieve capex efficiency gains over the 2026–31 period. This approach is also consistent with our *Framework and approach* (F&A) paper.[40]

1.2.2 Overview of proposal

CitiPower used our RFM to establish an opening RAB as at 1 July 2026 and our post-tax revenue model (PTRM) to roll forward the RAB over the 2026–31 period. It proposed an opening RAB value as at 1 July 2021 of $1,968.9 million ($ nominal). Rolling forward this RAB with actual/estimated capex and using depreciation based on forecast capex approved for the 2021–26 period, CitiPower proposed a closing RAB value of $2,336.9 million ($ nominal) as at 30 June 2026. CitiPower's proposal sets out the details of its RAB roll forward over the 2021–26 period.[41]

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38 Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Therefore, our draft decision on the forecast RAB also reflects our amendments to the rate of return for the 2026–31 period (Overview section 2.2).

39 NER, cl. 6.12.1(r).

40 AER, *Framework and approach – AusNet Services, CitiPower, Jemena, Powercor and United Energy 2026–31,* July 2024, p. 22.

41 CitiPower, *Attachment 1.01 - SCS Revenue and control mechanism – Regulatory Proposal 2026–31,* January 2025, p. 3; CitiPower, *Regulatory Proposal – CP MOD 1.02 – SCS RFM*, January 2025.

CitiPower proposed a forecast closing RAB as at 30 June 2031 of $3,116.8 million ($ nominal). This value reflects its proposed opening RAB, forecast capex, expected inflation, and depreciation (based on forecast capex) over the 2026–31 period. CitiPower's proposal sets out the details of its RAB roll forward over the 2026–31 period.[42]

CitiPower proposed to apply a forecast depreciation approach to establish the RAB at the commencement of the 2031–36 period,[43] consistent with the approach set out in our F&A.[44]

1.2.3 Assessment approach

In appendix A.2, we set out our assessment approach for the RAB.

1.2.4 Reasons for draft decision

We determine an opening RAB value of $2,324.3 million ($ nominal) as at 1 July 2026 for CitiPower, a reduction of $12.6 million (0.5%) from the proposed value. We forecast a closing RAB value of $2,724.1 million by 30 June 2031. This represents a reduction of $392.7 million (12.6%) compared with CitiPower's proposal. The reasons for our decision are discussed below.

1.2.4.1 Opening RAB as at 1 July 2026

We determine an opening RAB value of $2,324.3 million as at 1 July 2026 for CitiPower. This value is $12.6 million (0.5%) lower than CitiPower's proposed opening RAB of $2,336.9 million ($ nominal) as at 1 July 2026.[45] This reduction is mainly driven by the updates in market variables such as actual CPI for 2025–26 and nominal vanilla WACC for 2025–26 being lower than CitiPower's estimates in its proposed RFM.

Figure 1.6 shows the key drivers of the change in CitiPower's RAB over the 2021–26 period for this draft decision. Overall, the closing RAB value at the end of the 2021–26 period is forecast to be 18.0% higher than the opening RAB at the start of that period, in nominal terms. The new net capex increases the RAB by 31.6%, while inflation indexation increases it by 19.6%. Depreciation, on the other hand, reduces the RAB by 33.4%. End of period adjustments increase the RAB by 0.3%.

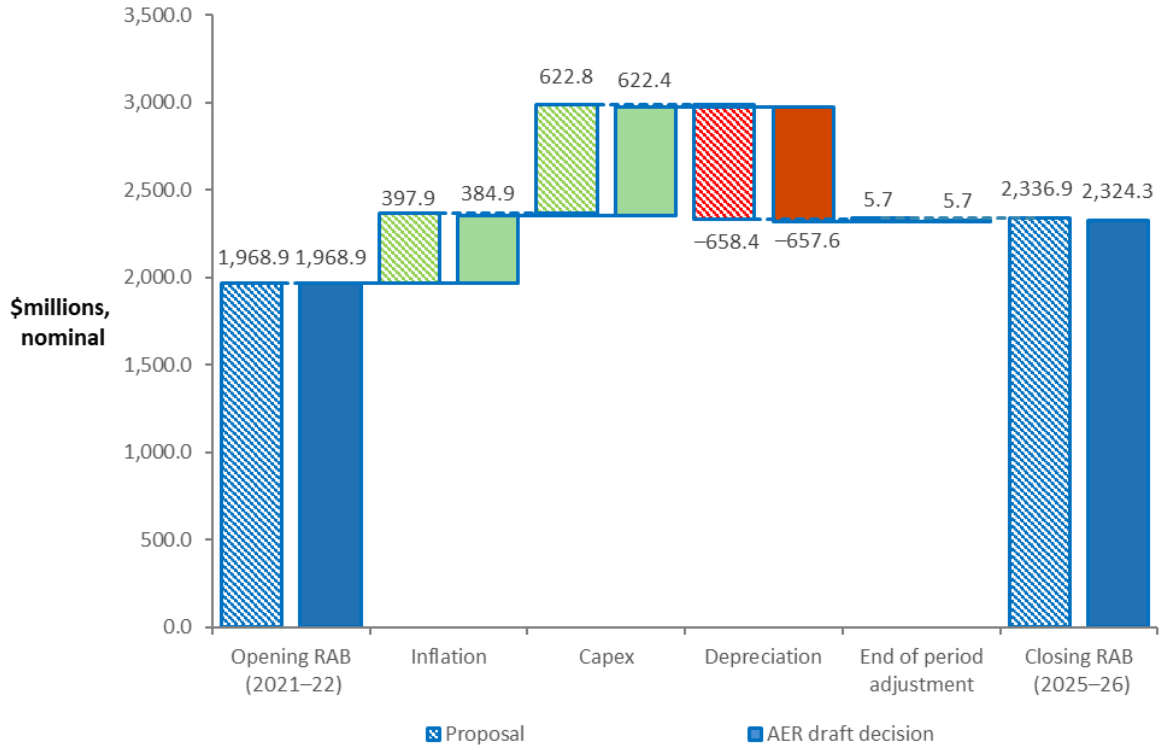
42 CitiPower, *Attachment 1.01 - SCS Revenue and control mechanism – Regulatory Proposal 2026–31,* January 2025, p. 5; CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM*, January 2025.

43 CitiPower, *Attachment 1.01 - SCS Revenue and control mechanism – Regulatory Proposal 2026–31,* January 2025, p. 4.

44 AER, *Framework and approach – AusNet Services, CitiPower, Jemena, Powercor and United Energy 2026–31,* July 2024, p. 22.

45 CitiPower, *Regulatory Proposal – CP MOD 1.02 – SCS RFM*, January 2025.

Figure 1.6 Key drivers of changes in the RAB over the 2021–26 period – CitiPower's proposal compared with the AER's draft decision ($ million, nominal)



Source: AER analysis.
Note: Capex is net of disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the RFM.

In the following sections we discuss our assessment of CitiPower's proposed inputs in the RFM and the ex-post review of capex between calendar year 2020 and financial year 2023–24 for RAB roll forward purposes.

Key inputs in the RFM

To determine the opening RAB for CitiPower as at 1 July 2026, we have rolled forward the RAB over the 2021–26 period to determine a closing RAB value as at 30 June 2026. In doing so, we reviewed the key inputs of CitiPower's proposed RFM, such as actual inflation, rate of return, gross capex values, asset disposal values, capital contribution values, forecast depreciation and asset lives. We found these inputs were generally correct and reconcile with relevant data sources such as ABS data, annual reporting regulatory information notices (RINs) and the 2021–26 decision models.[46] However, we consider that some of CitiPower's proposed RFM inputs require updating with newly available data.

[46] At the time of this draft decision, the roll forward of CitiPower's RAB includes estimated capex values for 2024–25 and 2025–26. We expect to update the 2024–25 estimated capex with actuals in the final decision. We may also update the 2025–26 estimated capex with a revised estimate in the final decision.

Therefore, we have made the following amendments to CitiPower's proposed RFM inputs, which impact the opening RAB value as at 1 July 2026:[47]

- We updated CitiPower's estimate of 2025–26 inflation of 3.00% with actual CPI of 2.42% published by the ABS, which became available after CitiPower submitted its proposal. This value reflects the lagged CPI series and is calculated using the actual CPI between December 2023 to December 2024.
- We updated the nominal vanilla WACC for 2025–26 and forecast straight-line depreciation amounts. These updates are required to reflect the 2025–26 return on debt update in the PTRM for the 2021–26 period, which became available after CitiPower submitted its proposal.

Ex post review of 2020 to 2023–24 capex

We also consider the extent to which our roll forward of the RAB to 1 July 2026 contributes to the achievement of the capital expenditure incentive objective.[48] In the 2021–26 distribution determination, we noted that the 2020 and half-year 2021 capex would form part of the review period for whether past capex should be excluded for inefficiency reasons in this distribution determination.[49] The capex for 2021–22 to 2023–24 also forms part of the review period.

Consistent with the requirements of the National Electricity Rules (NER) we have excluded the last two years of the 2021–26 period from the review of past capex for this distribution determination.[50] This approach ensures that actual capex (instead of estimated capex) is available when the review of past capex commences.

CitiPower's total actual capex incurred from 2020 to 2023–24 is below the forecast allowance set at the previous relevant distribution determinations. Therefore, the overspending requirement for an efficiency review of past capex is not satisfied.[51]

Further, for the purposes of this draft decision, we have included estimated capex for 2024–25 and 2025–26 in the RAB roll forward to 1 July 2026. At the next distribution determination, the 2024–25 and 2025–26 capex will form part of the review period for whether past capex should be excluded for inefficiency reasons.[52] Our RAB roll forward applies the incentive framework approved in the previous distribution determination, which included the use of a forecast depreciation approach in combination with the application of the capital expenditure

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47 We issued CitiPower an information request to confirm the updated inputs. In CitiPower's response it agreed with these updates. CitiPower, *Response to AER information request #039*, 13 June 2025, pp. 1–3.

48 NER, cl. 6.12.2(b).

49 AER, *Final decision, CitiPower distribution determination 2021–26, Attachment 2–Regulatory asset base*, April 2021, pp. 5–6.

50 NER, cl. S6.2.2A(a1).

51 NER, cl. S6.2.2A(c).

52 Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NER, cl. S6.2.2A. The details of our ex-post assessment approach for capex are set out in AER, *Capital expenditure incentive guideline for electricity network service providers*, July 2024, pp. 12–19.

sharing scheme (CESS).[53] As such, we consider that the 2021–26 RAB roll forward contributes to an opening RAB (as at 1 July 2026) that includes capex that reflects prudent and efficient costs, in accordance with the capex criteria.[54]

1.2.4.2 Forecast closing RAB as at 30 June 2031

We forecast a closing RAB value of $2,724.1 million ($ nominal) by 30 June 2031 for CitiPower, which represents a reduction of $392.7 million (12.6%) compared to CitiPower's proposed amount of $3,116.8 million ($ nominal).[55] The reduction reflects our draft decision on the inputs for determining the forecast RAB in the PTRM.

The change in the size of the RAB over the 2026–31 period depends on our assessment of its various components including forecast depreciation (section 1.3), expected inflation (Overview section 2.2) and forecast capex (Attachment 2). Inflation and capex increase the RAB, while depreciation and disposals reduce it.

To determine the forecast RAB value for CitiPower, we amended the following PTRM inputs:

- We reduced CitiPower's proposed opening RAB value as at 1 July 2026 by $12.6 million ($ nominal) or 0.5% (section 1.2).
- We updated CitiPower's proposed expected inflation rate of 2.75% per annum to 2.55% per annum over the 2026–31 period (Overview section 2.2). Compared to CitiPower's proposal, our draft decision results in a reduction to the indexation of the RAB component for the 2026–31period by $48.6 million ($ nominal) or 13.1%.[56]
- We reduced CitiPower's proposed forecast straight-line depreciation for the 2026–31 period by $43.0 million ($ nominal) or 4.6% (section 1.3).
- We reduced CitiPower's proposed forecast capex for the 2026–31 period by $374.5 million ($ nominal) or 27.9%.[57] Forecast net capex is a significant driver of the proposed increase in the RAB over the 2026–31 period. We received a submission from the Victorian state government which highlighted how the significant RAB uplift proposed by the Victorian distributors is a key driver of revenue and prices.[58] Our review of CitiPower's forecast capex is set out in Attachment 2 of this draft decision.

Figure 1.7 shows the key drivers of the change in CitiPower's RAB over the 2026–31 period for this draft decision. Overall, the closing RAB value at the end of the 2026–31 period is forecast to be 17.2% higher than the opening RAB at the start of that period, in nominal terms. The approved forecast net capex increases the RAB by 41.5%, while expected

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53 AER, *Final decision, CitiPower distribution determination 2021–26, Attachment 2–Regulatory asset base,* April 2021, pp. 9-10.

54 NER, cll. 6.4A(a), 6.5.7(a), 6.5.7(c) and 6.12.2(b).

55 CitiPower, *Regulatory Proposal – CP MOD 1.02 – SCS RFM*, January 2025.

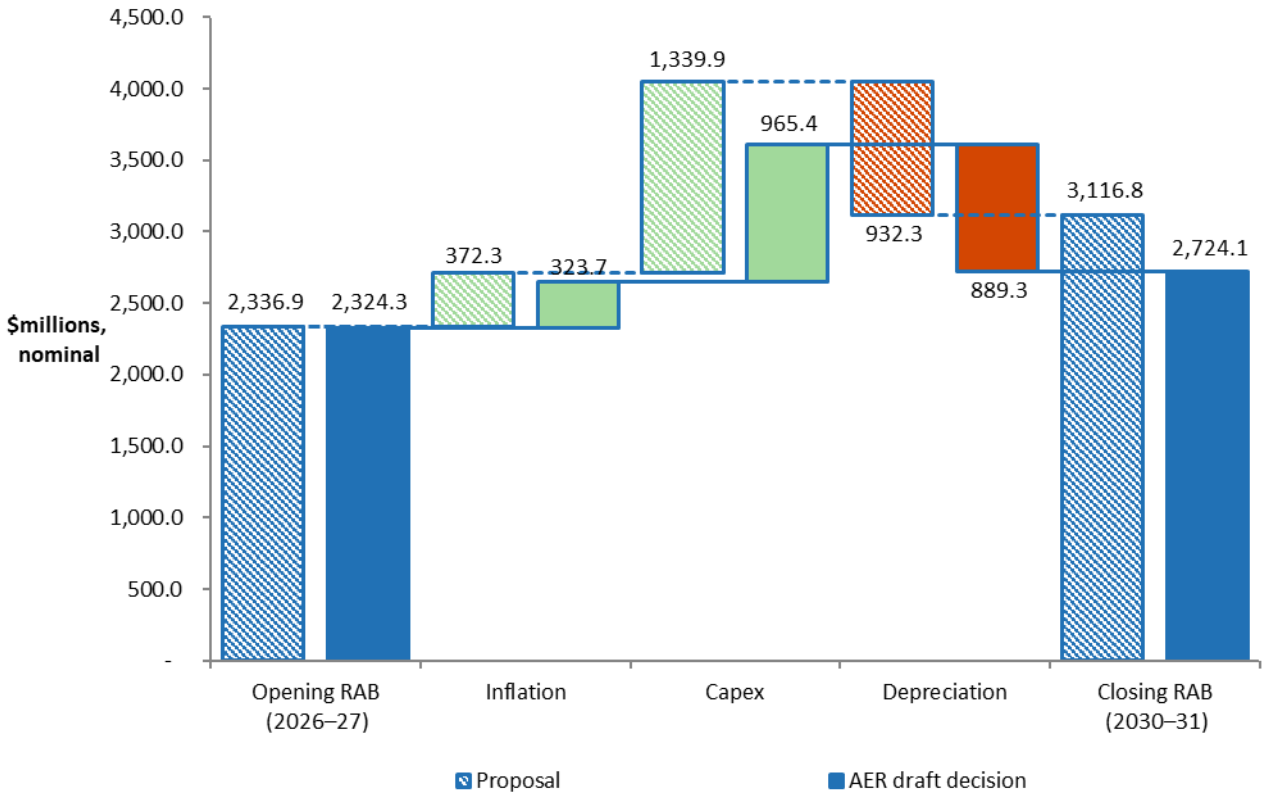
56 The reduction in the indexation of the RAB is largely due to our draft decision to reduce forecast capex and the lower expected inflation rate used in our draft decision.

57 Capex is net of forecast disposals and customer contributions, and inclusive of half-year WACC adjustment.

58 Hon Lily D'Ambrosio MP, Minister for Climate Action, Energy and Resources, and the State Electricity Commission, *Submission - Victorian electricity distribution proposals 2026-31*, June 2025, p. 1.

inflation increases it by 13.9%. Forecast depreciation, on the other hand, reduces the RAB by 38.3%.

Figure 1.7 Key drivers of changes in the RAB over the 2026–31 period – CitiPower's proposal compared with the AER's draft decision ($ million, nominal)



Source: AER analysis.
Note: Capex is net of forecast disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

1.2.4.3 Application of depreciation approach in RAB roll forward for the next distribution determination

We determine that the depreciation approach to be applied to establish CitiPower's opening RAB at the commencement of the 2031–36 period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2026–31 period. We consider this approach will provide sufficient incentives for CitiPower to achieve capex efficiency gains over the 2026–31 period.[59]

[59] NER, cll. 6.12.1(r) and S6.2.2B.

CitiPower proposed to use the forecast depreciation approach to roll forward its RAB for the commencement of the 2031–36 period.[60] We note that this approach is consistent with our F&A.[61]

We have used forecast depreciation for this draft decision when rolling forward the opening RAB at the commencement of the 2026–31 period (section 1.2.4.1). The use of forecast depreciation to establish the opening RAB for the commencement of the 2031–36 period at the next distribution determination therefore maintains the current approach.

As discussed in Attachment 6, CitiPower is currently subject to the CESS for the 2021–26 period. We will continue to apply the CESS to CitiPower over the 2026–31 period. We consider that the CESS will provide sufficient incentives for CitiPower to achieve capex efficiency gains over that period. We are satisfied that the use of a forecast depreciation approach in combination with the application of the CESS and our other ex-post capex measures are sufficient to achieve the capex incentive objective.[62]

60 CitiPower, *Attachment 1.01 - SCS Revenue and control mechanism – 2026–31 Regulatory Proposal,* January 2025, p. 4.

61 AER, *Framework and approach – AusNet Services, CitiPower, Jemena, Powercor and United Energy 2026–31,* July 2024, p. 22.

62 Our ex-post capex measures are set out in the capex incentives guideline, AER, *Capital expenditure incentive guideline for electricity network service providers*, July 2024, pp. 12–19. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.

1.3 Regulatory depreciation

Regulatory depreciation is the amount provided so capital investors recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by CitiPower, we make determinations on the indexation of the RAB and depreciation building blocks for CitiPower's 2026–31 period.[63] The regulatory depreciation amount is the net total of the straight-line depreciation less the indexation of the RAB.

This section sets out our draft decision on CitiPower's regulatory depreciation amount. It also presents our draft decision on the proposed depreciation schedules, including an assessment of the proposed standard asset lives used for calculating straight-line depreciation.

1.3.1 Draft decision

We determine a regulatory depreciation amount of $565.6 million ($ nominal) for CitiPower for the 2026–31 period. CitiPower proposed a regulatory depreciation amount of $560.0 million ($ nominal).[64] Our draft decision represents an increase of $5.6 million (1.0%) from the proposed amount.

This increase is primarily the result of a lower expected inflation rate for the 2026–31 period (Overview section 2.2), which affects the projected RAB over this period. Indexation of the RAB is $48.6 million (13.1%) lower than the proposal, largely due to applying a lower expected inflation rate of 2.55% per annum in this draft decision compared to CitiPower's proposal of 2.75% per annum. Consequently, the lower RAB indexation increases regulatory depreciation (since indexation is deducted from straight-line depreciation). This is partially offset by straight-line depreciation, which is $43.0 million (4.6%) lower than the proposal due our reductions to forecast capex (Attachment 2) and the opening RAB at 1 July 2026 (section 1.2), and the introduction of new longer lived asset classes (section 1.3.4.2).

For our draft decision on CitiPower's regulatory depreciation:

- We accept CitiPower's proposed straight-line depreciation method used to calculate the regulatory depreciation amount.
- We accept CitiPower's proposal to continue using the 'year-by-year tracking' approach for implementing straight-line depreciation of its existing assets and its forecast capex (section 1.3.4.1).
- We accept the majority of CitiPower's proposed existing asset classes and standard asset lives, with the exception of the standard asset life for the 'Equity raising costs'

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63 Clause 6.12.1 of the National Electricity Rules (NER) sets out the 'constituent decisions' we must make as part of a distribution determination. We must decide whether or not to approve the depreciation schedules submitted by a Distribution Network Service Provider (cl. 6.12.1(h)). This is one of the building blocks we must use to determine the annual revenue requirement: cl. 6.4.3 of the NER.

64 CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM*, January 2025.

asset class and the standard asset life for the 'Non-network general assets – IT' asset class (section 1.3.4.2).

- We introduce a new asset class for 'Concrete poles' with a standard asset life of 80 years applying to CitiPower's forecast capex associated with this asset type (section 1.3.4.2).
- We also introduce a new asset class for 'ERP and billing systems' with a standard asset life of 10 years applying to CitiPower's forecast capex associated with this asset type after our review of its information and communications technology (ICT) capex business proposal. Consequently, we adjust down slightly the standard asset life for the existing 'Non-network general assets – IT' asset class due to the removal of the enterprise resource platform (ERP) and billing systems expenditure from this existing asset class and being reallocated to a new longer lived asset class (section 1.3.4.2).

We made determinations on other components of CitiPower's proposal which affect the forecast regulatory depreciation—for example, the opening RAB at 1 July 2026 (section 1.2), expected inflation (Overview section 2.2), and forecast capex (Attachment 2) including its effect on the projected RAB over the 2026–31 period.[65]

Table 1.7 sets out our draft decision on the annual regulatory depreciation amount for CitiPower's 2026–31 period.

Table 1.7 AER's draft decision on CitiPower's forecast depreciation for the 2026–31 period ($ million, nominal)

	2026–27	2027–28	2028–29	2029–30	2030–31	Total
Straight-line depreciation	157.2	165.2	176.7	190.5	199.7	889.3
Less: inflation indexation on opening RAB	59.3	62.4	65.6	67.8	68.6	323.7
Regulatory depreciation	**97.9**	**102.9**	**111.1**	**122.7**	**131.0**	**565.6**

Source: AER analysis.

1.3.2 Overview of proposal

CitiPower proposed a total forecast regulatory depreciation amount of $560.0 million ($ nominal) for the 2026–31 period. To calculate the depreciation amount, CitiPower proposed to use:[66]

- the straight-line depreciation method employed in the AER's PTRM

[65] Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year weighted average cost of capital (WACC) to account for the timing assumptions in the PTRM. Our draft decision on the RAB (section 1.2) also reflects our updates to the WACC for the 2026–31 period.

[66] CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM*, January 2025; CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM*, January 2025; CitiPower, *Regulatory proposal – Depreciation Tracking Module*, January 2025.

- the closing RAB value at 30 June 2026 derived from the AER's RFM
- its forecast capex for the 2026–31 period
- an expected inflation rate of 2.75% per annum for the 2026–31 period
- the AER's year-by-year tracking depreciation module in the RFM, which implements the straight-line method to calculate the forecast depreciation (over the 2026–31 period) of the opening RAB at 1 July 2026
- with the exception of the 'Equity raising costs' asset class, the same asset classes and standard asset lives for depreciating its forecast capex for the 2026–31 period, which are consistent with those approved in the 2021–26 distribution determination. CitiPower proposed a standard asset life of 38.6 years for the 'Equity raising costs' asset class based on the weighted average of the standard asset lives of the proposed forecast capex for each depreciable asset class over the 2026–31 period.

CitiPower's proposal sets out the details of its regulatory depreciation over the 2026–31 period.[67]

1.3.3 Assessment approach

In appendix A.3, we set out our assessment approach for regulatory depreciation.

1.3.4 Reasons for draft decision

We accept CitiPower's proposed straight-line depreciation method for calculating the regulatory depreciation amount as set out in the PTRM. However, we have increased CitiPower's proposed forecast regulatory depreciation amount for the 2026–31 period by $5.6 million (1.0%) to $565.6 million ($ nominal).

This increase is the result of a lower expected inflation rate (Overview section 2.2), which affects the projected RAB over the 2026–31 period. Our draft decision applies a lower expected inflation rate of 2.55% per annum compared to CitiPower's proposal of 2.75% per annum. However, this is partially offset by our reduction to forecast capex (Attachment 2), a lower opening RAB as at 1 July 2026 (section 1.2), and the introduction of new longer lived asset classes for 'Concrete poles' and 'ERP and billing systems' (section 1.3.4.2).

In the following sections, we discuss our assessment of CitiPower's proposal to continue using the year-by-year tracking depreciation approach, its proposed standard asset lives, and our draft decision to introduce two new asset classes for 'Concrete poles' and 'ERP and billing systems'.

[67] CitiPower, *Regulatory Proposal – Attachment 1.01 - SCS Revenue and control mechanism,* January 2025, pp. 4–5; CitiPower, *Regulatory proposal - CP MOD 1.01 – SCS PTRM*, January 2025.

1.3.4.1 Year-by-year tracking approach

CitiPower proposed to continue using the year-by-year tracking approach for calculating the straight-line depreciation of its existing assets, consistent with that approved for its previous regulatory control periods.[68]

For our draft decision, we accept CitiPower's proposed year-by-year tracking approach meets the requirements of the NER in that it will result in depreciation schedules that:[69]

- reflect the nature of the assets and their economic life
- ensure that total depreciation (in real terms) equals the initial value of the assets, and
- allow the economic lives of existing assets to be consistent with those determined on a prospective basis in our 2021–26 distribution determination.

CitiPower used our depreciation module in the RFM to implement year-by-year tracking. We have reviewed CitiPower's application of this module and updated the inputs to be consistent with the RFM, as discussed in section 1.2.4.1.

1.3.4.2 Standard asset lives

We accept the majority of CitiPower's proposed standard asset lives for its existing asset classes used to depreciate the forecast capex to be incurred in the 2026–31 period, with the exception of the 'Equity raising costs' and 'Non-network general assets – IT' asset classes. This is because the proposed standard asset lives are consistent with those approved for the 2021–26 period and are largely comparable with the standard asset lives used by other network businesses for similar asset classes.

For the 'Equity raising costs' asset class, we have updated the calculation of the standard asset life by taking the weighted average of the standard asset lives of the draft decision forecast capex for each depreciable asset class over the 2026–31 period. We also introduce two new asset classes of:

- 'Concrete poles' and assign a standard asset life of 80 years.
- 'ERP and billing systems' and assign a standard asset life of 10 years. In adding this new asset class, we adjust down slightly the standard asset life for the existing 'Non-network general assets – IT' asset class.

Equity raising costs

The standard asset life for the 'Equity raising costs' asset class needs to be reviewed each regulatory control period. We consider the standard asset life for this asset class should

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[68] AER, *Final decision: CitiPower Distribution Determination 2021 to 2026 – Attachment 4 – Regulatory depreciation,* April 2021, p. 5*;* AER*, Final decision: CitiPower Distribution Determination 2016 to 2020 – Attachment 5 – Regulatory depreciation,* May 2016, p. 12.

[69] NER, cl. 6.5.5(b).

reflect the lives of the mix of assets making up the approved forecast net capex, because the equity raising cost benchmark is associated with that forecast.[70]

CitiPower's proposal adopted our standard approach to calculate a standard asset life of 38.6 years for equity raising costs. However, we have updated this calculation to be consistent with the weights derived from our draft decision on CitiPower's forecast capex for the 2026–31 period. Therefore, we have calculated a standard asset life of 36.7 years for amortising $2.8 million ($2025–26) in equity raising costs determined in this draft decision.

New asset class for concrete poles

We consider a new asset class for 'Concrete poles' should be introduced based on our review of CitiPower's proposed poles capex (discussed in Attachment 2). Our draft decision is to assign a standard asset life of 80 years for this new asset class in the PTRM for the 2026–31 period based on our assessment of the expected economic life of concrete poles.

CitiPower proposed to allocate its forecast capex for concrete poles across the existing asset classes of 'Subtransmission' and 'Distribution system assets' with standard asset lives of 50 years and 49 years respectively. We consider this forecast capex should be reallocated to a new asset class of 'Concrete poles' to provide for a depreciation schedule that better reflects the nature and economic life of this type of asset.[71] Based on our review of the material for the Victorian distributors, which suggests that the technical life for concrete poles can range from 60 to 100 years,[72] we consider that adopting the mid-point of this range of 80 years would reasonably reflect the expected life of concrete poles.

In its response to our information request, CitiPower did not support the introduction of a new 'Concrete poles' asset class. CitiPower submitted that the introduction of an asset class for concrete poles would have an immaterial impact on the regulatory depreciation schedule because the volume of concrete poles installed on its network is relatively low. CitiPower also stated that it would incur costs from the introduction of a new asset class to update its record keeping and reporting processes. The imposition of these costs would limit the value from the introduction of the new asset class to consumers.[73]

We acknowledge CitiPower's concerns over the imposition of costs arising from introducing a new asset class for concrete poles in the PTRM for regulatory depreciation purposes. However, we consider such costs are unlikely to be material because the change is being applied to forecast capex for the 2026–31 period and beyond. We have not sought to disaggregate existing concrete pole assets from the current asset class allocations. We note our current suite of annual reporting requirements for distributors comprise detailed

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70 For this reason, we used forecast net capex as the weights to establish the weighted average standard asset life for amortising equity raising costs.

71 NER, cl. 6.5.5(b)(1).

72 CitiPower, *CP BUS 4.01 – Poles*, January 2025, p. 5. Powercor, *PAL BUS 4.01 – Poles*, January 2025, p. 5; United Energy, *UE BUS 4.01 – Poles*, January 2025, p. 5; AusNet Services, *Poles – Asset Strategy*, January 2025, p. 9; Jemena, *Att 05-01 Capital expenditure*, January 2025, p. 74.

73 CitiPower, *Response to AER information request #041*, 14 July 2025, pp. 29–30.

information on assets installed on the network, which includes concrete poles.[74] In addition, distributors are also required to report asset failure rates and replacement costs at a more granular asset classification than the aggregated level of approved assets classes CitiPower used to calculate its regulatory depreciation building block.

We consider that reallocating concrete poles forecast capex from the existing asset classes to a new asset class improves the transparency of expenditure on different types of assets installed on a distributor's network and provides for a depreciation profile that better reflects the nature and economic life of concrete poles. We are satisfied that the benefit of increased transparency is unlikely to be outweighed by any additional costs from introducing a new asset class to CitiPower's annual reporting of actual capex.

New asset class for ERP and billing systems

We also consider a new asset class for 'ERP and billing systems' should be introduced based on our review of CitiPower's ICT capex business proposal associated with its ERP and billing systems upgrade.[75] Our draft decision is to assign a standard asset life of 10 years for this new asset class in the PTRM for the 2026–31 period.

CitiPower's proposed forecast capex for ERP and billing systems upgrade is allocated to the existing IT asset classes of 'Non-network general assets – IT' and 'In-house software'.[76] These asset classes are assigned standard asset lives of 6 years and 5 years, respectively. Our review of CitiPower's proposed business case indicates that the core systems identified only receive a major upgrade every 10 to 20 years.[77]

In its response to our information request, CitiPower agreed with the introduction of a new asset class of 'ERP and billing systems' and reallocating this type of IT expenditure into this new asset class. CitiPower submitted that assigning a standard asset life of 10 years would be suitable for this type of capex due to the pace of change for these types of systems. As such, future upgrade cycles are likely to be at the lower end of the 10 to 20 years window.[78]

Our draft decision is to assign a standard asset life of 10 years for the new 'ERP and billing systems' asset class. We accept CitiPower's view that adopting the lower end of the 10 to 20 years upgrade cycle for these longer life IT assets is appropriate. We note that the pace of innovations, such as cloud-based systems and software as a service (SaaS), continues to evolve with the potential to impact the effective service life of these IT assets. In its revised

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74 AER, *Expenditure forecast assessment guideline – Regulatory information notices for category analysis 2014*, 7 March 2014; available at https://www.aer.gov.au/industry/registers/resources/guidelines/expenditure-forecast-assessment-guideline-regulatory-information-notices-category-analysis-2014.

75 CitiPower, *Regulatory Proposal 2026–31 – CP BUS 6.01 – ERP and billing system upgrade – Jan2025 – Public*. January 2025.

76 CitiPower, *Regulatory Proposal 2026–31 – Attachment CP MOD 1.04 – Standardised capex model – Jan2025 – Public*. January 2025.

77 CitiPower, *Regulatory Proposal 2026–31 – CP BUS 6.01 – ERP and billing system upgrade – Jan2025 – Public*. January 2025, pp. 11, 17.

78 CitiPower, *Response to AER information request #045*, 27 June 2025, p. 4.

proposal, we encourage CitiPower to consider if there are any other proposed IT investments that would be suitable for allocating to the new longer life IT asset class.

In reallocating the forecast longer life IT assets from the existing 'Non-network general assets – IT' asset class, we also accept CitiPower's proposal to revise down slightly the standard asset life to 5 years from 6 years for this asset class. We are satisfied that this revision provides for a depreciation schedule that still reflects the nature and economic life of the general IT type assets.

Our draft decision PTRM sets out CitiPower's standard asset lives for each of its asset classes over the 2026–31 period.[79] We note the asset classes we have assigned with a standard asset life of 'n/a' (not applicable) is because the capex allocated to them is either not subject to depreciation, or they have zero forecast capex allocated to them. We are satisfied that our draft decision on depreciation conforms to the following:[80]

- the standard asset lives and depreciation approach more broadly would lead to a depreciation schedule that reflects the nature of the assets over the economic lives of the asset classes,
- the sum of the real value of the depreciation attributable to the assets is equivalent to the value at which the assets were first included in the RAB for CitiPower, and
- the asset lives, and the depreciation methods and rates underpinning the calculation of depreciation for a regulatory control period are consistent with those determined for the same assets on a prospective basis.

79 AER, *Draft decision – CitiPower distribution determination 2026–31 – SCS PTRM*, September 2025.

80 NER, cll. 6.5.5(b)(1)–(3).

1.4 Corporate income tax

Our determination of the ARR includes the estimated cost of corporate income tax for CitiPower's 2026–31 period.[81] Under the post-tax framework, the cost of corporate income tax is calculated as part of the building block assessment using our PTRM. This amount allows CitiPower to recover the costs associated with the estimated corporate income tax payable during the 2026–31 period.

This section presents our assessment of CitiPower's proposed corporate income tax amount for the 2026–31 period. It also presents our assessment of its proposed opening tax asset base (TAB), and the proposed standard tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

1.4.1 Draft decision

We determine an estimated cost of corporate income tax amount of $71.6 million ($ nominal) for CitiPower over the 2026–31 period. This amount is $7.3 million (11.3%) higher than CitiPower's proposed cost of corporate income tax amount of $64.3 million. This increase is mainly due to our draft decision on a higher regulatory depreciation amount (section 1.3), and lower tax depreciation amount which is calculated in our PTRM.[82]

This increase is partially offset by our draft decision to reduce the return on equity and lower capital contributions, which is driven by our reduction to the forecast capex (Attachment 2).[83]

Table 1.8 sets out our draft decision on the estimated cost of corporate income tax for CitiPower over the 2026–31 period.

Table 1.8 AER's draft decision on CitiPower's cost of corporate income tax for the 2026–31 period ($million, nominal)

	2026–27	2027–28	2028–29	2029–30	2030–31	Total
Tax payable	31.6	30.7	32.9	34.3	37.0	166.5
Less: value of imputation credits	18.0	17.5	18.8	19.6	21.1	94.9
Net cost of corporate income tax	**13.6**	**13.2**	**14.2**	**14.8**	**15.9**	**71.6**

Source: AER analysis.

For our draft decision on CitiPower's estimated cost of corporate income tax:

81 NER, cl. 6.4.3(a)(4).

82 The lower tax depreciation is driven by the changes we made to CitiPower's opening tax asset base and forecast capex in this draft decision. All else being equal, a lower tax depreciation increases the cost of corporate income tax as it is a component of tax expense.

83 The lower return on equity and capital contributions is driven by a lower forecast of capital expenditure in our draft decision compared to CitiPower's proposal. All else being equal, a lower return on equity and capital contributions are components of revenue for tax purposes thereby decreasing the cost of corporate income tax.

- We determine an opening TAB value of $2,060.3 million ($ nominal) as at 1 July 2026 for CitiPower. Our draft decision is to accept CitiPower's proposed opening TAB value as at 1 July 2026 (section 1.2.4.1).[84]
- We accept CitiPower's proposed approach for its forecast of immediately expensed capex, as it is generally consistent with its 2021–26 distribution determination and the actual immediately expensed capex reported in the annual RINs for the period 2021–22 to 2023–24. However, we updated CitiPower's proposed forecast immediately expensed capex for the 2026–31 period to reflect our draft decision on the total forecast capex (section 1.4.4.2).
- We accept CitiPower's proposed forecast capex associated with in-house software for the 2026–31 period will be exempted from the diminishing value tax depreciation method. This maintains the approach approved in the 2021–26 determination of applying the straight-line tax depreciation method for this type of assets (section 1.4.4.3).
- We accept CitiPower's proposed change to using the year-by-year depreciation tracking method as set out in our depreciation module in the RFM to calculate the forecast tax depreciation of its existing assets (section 1.4.4.4).
- We accept CitiPower's proposed standard tax asset lives for its existing asset classes for the 2026–31 period. The proposed standard tax asset lives are broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in Australian Taxation Office (ATO) Taxation Ruling 2022/1 and/or are the same as the approved standard tax asset lives for the 2021–26 period (section 1.4.4.5).[85]
- We introduce a separate 'Concrete poles' asset class and assign a standard tax asset life of 45 years, which is consistent with the ATO Taxation Ruling 2022/1 (section 1.4.4.5).
- We also introduce a separate 'ERP and billing systems' asset class and assign a standard tax asset life of 5 years, which is consistent with section 40-95(7) of the *Income Tax Assessment Act 1997* (ITAA) (section 1.4.4.5). Given the capex allocated to this asset class generally reflects the nature of an intangible depreciating asset, we will exempt the capex from the diminishing value tax depreciation method (section 1.4.4.3).
- We discuss a potential change to the tax treatment of forecast capital contributions from large customer connections by directly charging for the tax cost associated with their connections (section 1.4.4.6).

Our adjustments to the return on capital (section 1.2, Overview section 2.2 and Attachment 2) and the regulatory depreciation (section 1.3) building blocks affect revenues, which in turn impact the calculation of the cost of corporate income tax for this draft decision.

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84 CitiPower, *Regulatory proposal – CP MOD 1.02 – SCS RFM*, January 2025.

85 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022.

1.4.2 Overview of proposal

CitiPower proposed an estimated cost of corporate income tax of $64.3 million ($ nominal) for the 2026–31 period using our PTRM,[86] and with the following inputs:[87]

- an opening TAB value as at 1 July 2026 of $2,060.3 million ($ nominal)
- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.57
- forecast immediately expensed capex amount of $504.0 million ($2025–26)
- tax depreciation of the opening TAB as at 1 July 2026 for each asset class applying the year-by-year tracking approach calculated in the depreciation module of the RFM
- the same standard tax asset lives for tax depreciation of new capex for its existing asset classes in the 2026–31 period as approved for the 2021–26 distribution determination.[88]

CitiPower's proposal sets out the details of its cost of corporate income tax over the 2026–31 period.[89]

1.4.3 Assessment approach

In appendix A.4, we set out our assessment approach for the estimated cost of corporate income tax.

1.4.4 Reasons for draft decision

We determine the estimated cost of corporate income tax amount is $71.6 million ($ nominal) for CitiPower over the 2026–31 period. This represents an increase of $7.3 million from CitiPower's proposal of $64.3 million. In the following sections, we discuss the reasons for our draft decision on:

- the opening TAB value as at 1 July 2026
- the forecast immediately expensed capex
- assets to be exempted from the diminishing value method for tax depreciation
- the year-by-year tracking approach for tax depreciation
- the standard tax asset lives for depreciating forecast capex over the 2026–31 period

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86 Our published electricity PTRM uses the diminishing value tax depreciation approach for all new assets with the exception of in-house software, buildings (capital works) and equity raising costs. All assets acquired prior to 1 July 2021 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated. The PTRM also allows for the immediate expensing of certain capex for tax purposes.

87 CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM,* January 2025.

88 The asset class of 'Accelerated depreciation assets' has been removed because its residual TAB value has been fully depreciated for tax purposes.

89 CitiPower, *Regulatory Proposal – Attachment 1.01 – SCS revenue and control mechanism*, January 2025, pp. 8–9; CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM*, January 2025.

- a potential change to the tax treatment of forecast capital contributions from large customer connections.

1.4.4.1 Opening tax asset base as at 1 July 2026

We determine CitiPower's opening TAB value as at 1 July 2026 to be $2,060.3 million ($ nominal), consistent with its proposal. We accept CitiPower's proposed method to establish the opening TAB value as at 1 July 2026. This is because CitiPower's proposed approach is based on our RFM and consistent with that previously approved for the 2021–26 period.

We have reviewed the inputs to the TAB roll forward and found they were correct and reconciled with relevant data sources such as annual reporting RINs and the 2021–26 decision models. Our updates to the RFM and depreciation tracking module inputs have no bearing on the value of CitiPower's proposed opening TAB as at 1 July 2026 and so we accept the value for our draft decision.

We note that the opening TAB value as at 1 July 2026 may be updated as part of the final decision to reflect actual 2024–25 capex and any revised 2025–26 capex estimates.

Table 1.9 sets out our draft decision on the roll forward of CitiPower's TAB over the 2021–26 period.

Table 1.9 AER's draft decision on CitiPower's TAB roll forward for the 2021–26 period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25[a]	2025–26[a]
Opening TAB	1,761.1	1,791.8	1,846.5	1,875.8	1,970.5
Capital expenditure[b]	141.0	175.0	172.2	239.3	256.7
Less: tax depreciation	110.3	120.2	143.0	144.5	166.9
Closing TAB	**1,791.8**	**1,846.5**	**1,875.8**	**1,970.5**	**2,060.3**

Source: AER analysis.
(a) Based on estimated capex. We expect to update the TAB roll forward with actual capex for 2024–25 and a revised capex estimate for 2025–26 in the final decision.
(b) Net of disposals.

1.4.4.2 Forecast immediately expensed capex

CitiPower proposed $504.0 million ($2025–26) of forecast capex to be immediately expensed over the 2026–31 period.[90]

We consider CitiPower's approach to forecast its immediately expensed capex to be reasonable. CitiPower's proposed amount is informed by its total forecast replacement capex less zone substation transformer capex and adding total capitalised overheads.[91] Our review

90 CitiPower, *Regulatory Proposal – CP MOD 1.01 – SCS PTRM*, January 2025.

91 CitiPower, *Attachment 1.01 – SCS Revenue and control mechanism*, January 2025, pp. 8–9.

of CitiPower's approach to forecast immediately expensed capex identified an inconsistency between the amount of forecast immediately expensed capex and the proposed approach.[92] In its response to our information request, CitiPower amended its approach to forecast immediately expensed capex by including repair deductions for zone substations and embedded overhead deductions.[93] CitiPower's response amended the level of forecast immediately expensed capex and proportion allocations to the PTRM asset classes.

Our review of CitiPower's actual reporting confirms that its amended forecasts reflect the type of actual capex immediately expensed historically by CitiPower.[94] This is largely consistent with CitiPower's approved approach where the level of immediately expensed capex is informed by its replacement capex program during the 2021–26 determination.[95] We note that CitiPower's amended calculation of its proposed forecast immediately expensed amount is about 27% of its total proposed forecast capex for the 2026–31 period. This is broadly consistent with the average proportion of capex being immediately expensed over the period 2021–22 to 2023–24 as reported in the annual RINs, which was on average about 29%.

As discussed in Attachment 2, however, we have made reductions to CitiPower's proposed forecast capex. Our draft decision is to therefore reduce the proposed amount of immediately expensed capex to reflect our draft decision on the overall forecast capex. This results in a lower forecast immediately expensed capex of $342.1 million ($2025–26) for the 2026–31 period, a reduction of $161.9 million from the proposal.[96]

We will continue to collect actual data relating to this expenditure in our annual reporting RINs to inform our decision on the amount of forecast immediately expensed capex in the next determination for CitiPower.

1.4.4.3 Assets exempt from the diminishing value method

The PTRM applies the diminishing value method as the regulatory benchmark for tax depreciation to all new capex. However, as discussed in appendix A.4.2, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings (capital works) and equity raising costs.[97] In the PTRM, the benchmark equity

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92 AER, *CitiPower – Information request #045*, 19 June 2025, pp. 1–3.

93 We issued CitiPower an information request to address an inconsistency in its proposed amount of forecast immediately expensed capex compared to its proposed approach. CitiPower responded by supplying revised calculations of its immediately expensed forecast capex to be consistent with the proposed approach. CitiPower, *Response to AER information request #045*, 27 June 2025, pp. 1–3.

94 The type of actual capex is informed by the historical allocation of immediately expensed capex to CitiPower's approved asset classes of 'Distribution system assets', 'Subtransmission' and 'SCADA/Network Control'.

95 AER, *Draft Decision – CitiPower Distribution Determination 2021 to 2026 – Attachment 7 – Corporate income tax*, September 2020, pp. 15-16.

96 We will conduct a further review of CitiPower's calculation of immediately expensed capex and update to reflect our assessment of its forecast capex as part of our final decision.

97 Asset classes 47, 48, 49 and 50 in the PTRM provide for this.

raising costs is determined within the model and depreciated using the straight-line tax depreciation method as default.

In addition to equity raising costs, CitiPower proposed forecast capex associated with in-house software for the 2026–31 period to be exempted from the diminishing value tax depreciation method. For the reasons discussed in Appendix A.4.2, we accept CitiPower's proposal because the forecast capex satisfies the relevant definitions under the tax law.[98] Therefore, these assets will continue to be depreciated using the straight-line method for tax purposes, consistent with the approach applied in the 2021–26 determination.

Our draft decision is to exempt the new 'ERP and billing systems' asset class from the diminishing value tax depreciation method. CitiPower's proposed forecast capex related to ERP and billing systems was allocated to the asset classes of 'Non-network general assets – IT' and 'In-house software', with the majority being portioned in the latter class. As discussed below (section 1.4.4.5) we have assigned a standard tax asset life of 5 years to the 'ERP and billing systems' asset class, consistent with the requirement of section 40-95(7) of the ITAA.[99] Therefore, as the capex for this new asset class generally reflects the nature of an intangible depreciating asset, we will depreciate the ERP and billing systems capex using the straight-line method for tax purposes.[100]

1.4.4.4 Year-by-year tracking approach

We accept CitiPower's proposed change to using the 'year-by-year' tracking method as set out in our depreciation module in the RFM for calculating the tax depreciation of its existing assets as at 1 July 2026.[101]

The proposed method represents a change from the 'weighted average remaining life' approach previously adopted in the 2021–26 determination.[102] This change is required as a result of implementing the diminishing value tax depreciation method under the 2018 tax review at the 2021–26 determination.[103]

Under the diminishing value method, the tax depreciation of the capex for each year of a regulatory control period must be calculated individually. This could not be achieved under the weighted average remaining life approach previously applied by CitiPower. Therefore, CitiPower is required to switch to using the year-by-year tracking method to correctly calculate its tax depreciation of existing assets in the TAB as at 1 July 2026. Because of this

98 ATO, *Taxation Ruling 2016/3*, October 2018; ITAA, section 995-1.

99 ITAA, *s. 40.95(7) – Effective life of certain intangible depreciating assets*, viewed on 5 August 2025.

100 ITAA, ss. 40-72 & 40-95(7).

101 Under this approach, the capex for each year of a regulatory control period is depreciated individually for tax purposes. It will result in each tax asset class having an expanding list of sub-assets to reflect the regulatory year in which capital expenditures on those assets occurred.

102 The weighted average remaining life method calculates the remaining tax asset life at the end of the regulatory control period by weighting together the remaining tax asset life at the start of that period with the capex incurred over that period.

103 AER, *Explanatory statement, Electricity transmission and distribution network service providers, Proposed amendments to the roll forward models (Distribution – version 3) (Transmission – version 4)*, December 2019, pp. 17–20.

change there will be no single set of remaining tax asset lives for each asset class at the start of the 2026–31 period.

For this draft decision, we are satisfied that the application of the year-by-year tracking method provides an appropriate estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.[104]

1.4.4.5 Standard tax asset lives

We accept CitiPower's proposed standard tax asset lives assigned to its existing asset classes because they are:

- broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1[105]
- the same as the approved standard tax asset lives for the 2021–26 period.

As discussed in section 1.3.4.2, our draft decision is to introduce 2 new asset classes for 'Concrete poles' and 'ERP and billing systems' to provide a depreciation schedule that better reflects the nature and economic lives of these types of assets.

We consider the forecast capex associated with concrete poles should be allocated to a separate asset class for depreciation instead of the existing asset classes of 'Subtransmission' and 'Distribution system assets' proposed by CitiPower. For tax depreciation purposes, we have assigned a standard tax asset life of 45 years for this new asset class, which is consistent with that prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1 for this asset type.[106]

We also consider the forecast capex associated with ERP and billing systems should be allocated to a separate asset class for depreciation instead of the existing asset classes of 'Non-network assets general – IT' and 'In-house software'. Given the majority of this capex was allocated to the 'In-house software' asset class, we are satisfied that the expenditure generally reflects the nature of an intangible depreciating asset. We note that the tax law specifies that depreciating intangible assets such as in-house software should employ an effective life of 5 years. Therefore, our draft decision is to assign a standard tax asset life of 5 years for the new 'ERP and billing systems' asset class as it is consistent with section 40-95(7) of the ITAA.[107]

Our draft decision PTRM sets out CitiPower's standard tax asset lives for each of its asset classes.[108] We note the asset classes we have assigned with a standard tax asset life of 'n/a' (not applicable) is because the capex allocated to them is either not subject to depreciation,

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104 Clause 6.5.3 of the NER sets out the formula we must use to estimate corporate income tax. It requires an estimate of the taxable income of a benchmark efficient entity.

105 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022.

106 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022, Table A, p. 175.

107 ITAA, s. 40-95(7).

108 AER, *Draft decision – CitiPower distribution determination 2026–31 – SCS PTRM*, September 2025.

or they have zero forecast capex allocated to them. We are satisfied that the standard tax asset lives are appropriate for application over the 2026–31 period. We are also satisfied that the standard tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.[109]

1.4.4.6 Tax treatment of forecast capital contributions from large customer connections

Our draft decision is to adopt the same tax treatment for type 1 capital contributions (cash) from large customer connections for the 2026–31 period as that employed for the 2021–26 period. For regulatory tax purposes and consistent with tax law, type 1 capital contributions paid by customers (including large load connections) to the distributor, are recognised as income. This results in a tax liability for the distributor and is recovered from the broader SCS customer base. The depreciation of the capital contributions may be claimed as tax deductions over time to offset future income and therefore lower the tax liability in future regulatory control periods. This net tax liability is ultimately paid for by the broader SCS customer base.

As discussed in Attachment 16, we anticipate that CitiPower will amend its proposed connection policy in the revised proposal to remove what is an effective cross subsidy of tax costs associated with capital contributions from connecting data centres and other large load customers. This change would mean that the net tax liability from these connections would be added to the capital contribution amount paid by the connecting customer for the 2026–31 period. The net tax liability would, therefore, be borne by the connecting customer rather than the broader SCS customer base. All else being equal, this change would reduce the forecast capital contributions and gross capex in the PTRM for the 2026–31 period and therefore reduce the cost of corporate income tax for SCS customers.[110] Our assessment of this matter remains ongoing and CitiPower has indicated it will engage further on this issue with its stakeholders ahead of lodging its revised proposal in December 2025.

[109] NER, cl. 6.5.3.

[110] In the event of zero cost of corporate income tax, this change would, all else being equal, increase the size of the forecast tax loss over the 2026–31 period, allowing for a reduced cost of corporate income tax in a future distribution determination.

A Appendix

A.1 Annual revenue requirement – assessment approach

The ARR must be determined using a building block approach.[111] Therefore, we adopt a building block approach when making our decision on the distributor's total ARR and expected revenue for each regulatory year of the regulatory control period. Under this approach, we determine the value of the building block costs that make up the ARR for each regulatory year. The ARR for each year is the sum of the building block costs. These building block costs are set out in section 1.

A.1.1 Calculating the ARR and expected revenue in the PTRM

The ARR is calculated using the PTRM.[112] For the applicable control mechanism (Attachment 12) applying to SCS, the revenue to be earned by the distributor (expected revenues) for the regulatory control period must be equal to the NPV of the total revenue requirement.[113] The total revenue requirement is the sum of the ARRs for the regulatory control period.

We developed the PTRM, which brings together the various building block costs and calculates the ARR for each year of the regulatory control period.[114] The PTRM also calculates the X factors required under the CPI–X methodology[115] which is used to escalate the expected revenue for each year (other than the first year) of the regulatory control period.[116] Using the X factors and ARR, the annual expected revenue (smoothed) is forecast for each year of the regulatory control period. The distributor's proposal must be prepared using our PTRM.[117]

The ARR can be lumpy over the regulatory control period. To minimise price shocks, revenues are smoothed within a regulatory control period while maintaining the principle of cost recovery under the building block approach. Smoothing requires diverting some of the cost recovery to adjacent years within the regulatory control period so that the NPV of the annual expected revenue (smoothed revenues) is equal to the NPV of the ARR (unsmoothed revenues). That is, a smoothed profile of the expected revenue is determined for the regulatory control period under the CPI–X methodology.

The expected revenue for the first year is generally set equal to the ARR for the first year of the regulatory control period. At times, it may be more appropriate to set the expected

111 NER, cl. 6.4.3.
112 NER, cl. 6.4.2.
113 NER, cl. 6.5.9(b)(3)(i).
114 NER, cl. 6.4.2.
115 NER, cl. 6.2.6(a).
116 NER, cl. 6.5.9.
117 NER, cl. 6.3.1(c).

revenue for the first year to align with the revenue from the last year of the previous regulatory control period to avoid any large revenue variation between periods (or P_0).[118]

For a determination, we first calculate the ARR for each year of the regulatory control period. To do this we consider the various costs facing the distributor and the trade-offs and interactions between these costs, service quality and across years. This reflects our holistic assessment of the distributor's proposal.

We understand the trade-offs that occur between building block costs and test the sensitivity of these costs to their various driver elements. These trade-offs are discussed in the interrelationships section of the various attachments to this draft decision and are reflected in the calculations made in the PTRM.[119] Such understanding allows us to exercise judgement in determining the final inputs into the PTRM and the ARR that result from this modelling.

A.1.2 Revenue smoothing

In determining the total revenue requirement for the regulatory control period, we smooth the ARR for each regulatory year across that period. This step reduces revenue variations between years, and calculates the expected revenue and X factor for each year.[120] The X factors equalise (in NPV terms) the total expected revenues to be earned by the distributor with the total revenue requirement for the regulatory control period.[121] The X factor profile must also minimise, as far as reasonably possible, the variance between the expected revenue and ARR for the last regulatory year of the period.[122] By minimising this divergence, it helps to manage the prospect of a significant revenue change (and consequently prices) between the last year of the regulatory control period, and first year of the following regulatory control period. We consider a divergence of up to 3% between the expected revenue and ARR for the last year of the regulatory control period is reasonable, if this can promote smoother price changes across the regulatory control periods.

A.1.3 Shared assets

Distributors may use assets to provide both the SCS we regulate and unregulated services, for example by the stringing of telecommunications cables on the electricity network poles for the provision of telecommunication services. These assets are called 'shared assets'.[123] If

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118 The expected revenue for year 1 of the next regulatory control period may include adjustments for the performance incentive that applied during the previous regulatory control period, and under or over recovery adjustments from previous regulatory years.

119 There are trade-offs that are not modelled in the PTRM but are reflected in the inputs to the PTRM. For example, service quality is not explicitly modelled in the PTRM, but the trade-offs between service quality and price are reflected in the forecast capital expenditure and operating expenditure inputs to the model. Other trade-offs are obvious from the calculations in the PTRM. For example, while it may be expected that a lower RAB would also lower revenues, the PTRM shows that this will not occur if the reduction in the RAB is due solely to an increase in the depreciation rate. In such circumstances, revenues increase as the increased depreciation more than offsets the reduction in the return on capital caused by the lower RAB.

120 NER, cl. 6.5.9(a).

121 NER, cl. 6.5.9(b)(3)(i). The X factors represent the real revenue path over the regulatory control period under the CPI–X framework.

122 NER, cl. 6.5.9(b)(2).

123 NER, cl. 6.4.4.

the revenue from shared assets is material, 10% of the unregulated revenues that a distributor earns from shared assets will be used to reduce the distributor's revenue for SCS.[124]

The shared asset principles establish that use of shared assets should be material before cost reductions are applied.[125] The NER does not define materiality in this context. Our approach to what constitutes a material use of shared assets is that unregulated use of shared assets in a specific regulatory year is material when a distributor's annual average unregulated revenue from shared assets is expected to be greater than 1% of its expected revenue for that regulatory year.[126]

A.2 Regulatory asset base – assessment approach

We roll forward the distributor's RAB over the regulatory control period to arrive at an opening RAB value at the start of the next regulatory control period. This value must be adjusted for any differences in estimated and actual capex.[127] It may also be adjusted to reflect any changes in the use of the assets, with only assets used to provide SCS to be included in the RAB.[128]

A.2.1 Rolling forward the RAB in the RFM

To determine the opening RAB at the start of the next regulatory control period, we developed an asset base RFM that a distributor must use in preparing its regulatory proposal.[129] We use the RFM to roll forward the distributor's RAB from the beginning of the final year of the previous regulatory control period, through the current regulatory control period, to the beginning of the next regulatory control period.

The roll forward for each year of the above periods occurs by:

- adding actual inflation (indexation) adjustment to the opening RAB for the relevant year. This adjustment is consistent with the inflation factor used in the control mechanism.[130]
- adding actual or estimated capex to the RAB for the relevant year.[131] We review a distributor's past capex and may exclude past capex from being rolled into the RAB where total capex exceeds the regulatory allowance.[132] The details of our assessment approach for capex overspending are set out in the *Capital expenditure incentive*

124 AER, *Shared asset guideline*, November 2013, Appendix A, p. 15.

125 NER, cl. 6.4.4(c)(3).

126 AER, *Shared asset guideline*, November 2013, pp. 8–9.

127 NER, cl. S6.2.1(e)(3).

128 NER, cl. S6.2.1(e)(7).

129 NER, cll. 6.5.1(b), 6.5.1(e), S6.1.3(7); AER, *Electricity distribution network service providers: Roll forward model version 3.1*, May 2022.

130 NER, cl. 6.5.1(e)(3).

131 NER, cl. S6.2.1(e)(4).

132 NER, cl. S6.2.2A. Under the NER, cl. S6.2.2A(b), the exclusion of inefficient capex could only come from three areas: overspend in capex, margin paid to third party and capitalisation of opex as defined in cll. S6.2.2A (c), (d) and (e) of the NER.

guideline.[133] We note that our review of past capex does not include the last 2 years of the current regulatory control period—these will instead be reviewed at the next distribution determination.[134] We check actual capex amounts against audited annual reporting regulatory information notice (RIN) data and generally accept the capex reported in those RINs in rolling forward the RAB.[135] However, there may be instances where adjustments are required to the annual reporting RIN data[136]

- subtracting depreciation from the RAB for the relevant year, calculated in accordance with the distribution determination for the distributor.[137] Depreciation based on forecast or actual capex can be used to roll forward the RAB.[138] Our default approach is to use depreciation based on forecast capex for rolling forward the distributor's RAB over the regulatory control period.[139]
- subtracting any gross proceeds for asset disposals for the relevant year from capex to be added to the RAB.[140] We check these amounts against audited annual reporting RIN data.

These annual adjustments give the closing RAB for any particular year, which then becomes the opening RAB for the following year. Through this process the RFM rolls forward the RAB to the end of the current regulatory control period. The PTRM, which is used to calculate the ARR for the next regulatory control period, generally adopts the same RAB roll forward approach as the RFM. However, in the PTRM, the annual adjustments to the RAB are based on forecasts, rather than actual amounts.[141]

A.2.2 Depreciation approach in the RAB roll forward

The opening RAB for the subsequent regulatory control period can be determined using depreciation based either on forecast or actual capex incurred during the next regulatory control period.[142] To roll forward the RAB using depreciation based on forecast capex, we would use the forecast depreciation contained in the PTRM for the next regulatory control period, adjusted for actual inflation. If the approach to roll forward the RAB using depreciation based on actual capex was adopted, we would recalculate the depreciation based on actual capex incurred during the next regulatory control period.

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133 AER, *Capital expenditure incentive guideline for electricity network service providers,* July 2024, pp. 12–19.

134 NER, cl. S6.2.2A(a1). The 2-year lag ensures that actual capex (instead of estimated capex) is available when the review of past capex commences.

135 We will update any estimated capex with actual capex at the time of the next distribution determination.

136 For example, we make adjustment for movements in capitalised provisions if the actual capex amounts reported in the RIN include capitalised provisions.

137 NER, cl. S6.2.1(e)(5).

138 NER, cl. 6.12.1(r).

139 The use of forecast depreciation must be consistent with the depreciation approach established in the distributor's distribution determination.

140 NER, cl. S6.2.1(e)(6).

141 NER, cl. S6.2.3.

142 NER, cl. S6.2.2B.

Our decision on whether to use actual or forecast depreciation must be consistent with the capex incentive objective.[143] This objective is to ensure that increases to the RAB through capex only occur where that capex reasonably reflects the capex criteria.[144] In deciding between actual and forecast depreciation, we have regard to:[145]

- the incentives the service provider has to undertake efficient capex
- substitution possibilities between assets with different lives and the relative benefits of each
- the extent of overspending and inefficient overspending relative to the allowed forecast
- the capex incentive guideline
- the capex factors.

A.2.3 Interrelationships

The RAB is an input into the determination of the return on capital and depreciation (return of capital) building block amounts.[146] Factors that influence the RAB will therefore flow through to these building block components and the annual revenue requirement. Other things being equal, a higher RAB increases both the return on capital and depreciation amounts.

The RAB is determined by various factors, including:

- the opening RAB (meaning the value of existing assets at the beginning of the regulatory control period)
- net capex[147]
- depreciation
- indexation adjustment – so the RAB is presented in nominal terms, consistent with the rate of return.

The opening RAB at the start of a regulatory control period depends on the value of existing assets and will depend on actual net capex, actual inflation outcomes and depreciation in the past.

The RAB when projected to the end of the period increases due to both forecast new capex and the indexation adjustment. The size of the indexation adjustment depends on expected

143 NER, cl. S6.2.2B(b).

144 NER, cl. 6.4A(a).

145 NER, cl. S6.2.2B(b) and (c).

146 The size of the RAB also impacts the benchmark debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

147 Net capex is gross capex less disposals and capital contributions. The rate of return or WACC also influences the size of the capex. This is because the capex is not depreciated in the year it is first incurred but added to the RAB at the end of the year. Instead, the capex amount is escalated by half-year WACC to arrive at an end of year value. It then begins depreciating the following year.

inflation (which also affects the nominal rate of return or WACC) and the size of the RAB at the start of each regulatory year.

Depreciation reduces the RAB. The depreciation amount depends on the size of the opening RAB, the forecast net capex and depreciation schedules applied to the assets. By convention, the indexation adjustment is also offset against depreciation to prevent double counting of inflation in the RAB and WACC, which are both presented in nominal terms. This reduces the regulatory depreciation building block that feeds into the annual revenue requirement.

We maintain the RAB in real terms by indexing for inflation.[148] A nominal rate of return (WACC) is multiplied by the opening RAB to produce the return on capital building block.[149] To prevent the double counting of inflation through the nominal WACC and indexed RAB,[150] the regulatory depreciation building block has an offsetting reduction for indexation of the RAB.[151] Indexation of the RAB and the offsetting adjustment made to depreciation results in smoother revenue recovery profile over the life of an asset than if the RAB was un-indexed. If the RAB was un-indexed, there would be no need for an offsetting adjustment to the depreciation calculation of total revenue. This alternative approach provides for overall revenues being higher early in the asset's life (as a result of more depreciation being returned to the distributor) and lower in the future—producing a steeper downward sloping profile of total revenue.[152] The implications of an un-indexed RAB are discussed further in appendix A.3.

A 10% increase in the opening RAB at the start of the regulatory control period generally causes unsmoothed revenues ($ nominal) to increase by about 4% to 8%. However, the impact on revenues of the annual change in RAB depends on the source of the RAB change, as some drivers affect more than one building block cost.[153]

A.3 Regulatory depreciation – assessment approach

We must determine the regulatory depreciation amount as part of determining a distributor's ARR.[154] The calculation of depreciation in each year is governed by the value of assets

148 NER, cll. 6.3.2(a)(2), 6.5.1(e)(3).

149 NER, cl. 6.5.2; AER, Rate of return instrument, cll. 1, 3, 36(c), February 2023.

150 NER, cl. 6.4.3(b)(1)(ii).

151 If the asset lives are extremely long, such that the RAB depreciation rate is lower than the inflation rate, then negative regulatory depreciation can emerge. The indexation adjustment is greater than the RAB depreciation in such circumstances. Please also refer to Appendix A.3.3 for further explanation of the offsetting adjustment to the depreciation.

152 A change of approach from an indexed RAB to an un-indexed RAB would result in an initial step change increase in revenues to preserve net present value (NPV) neutrality.

153 If capex causes the RAB increase, return on capital, depreciation, and debt raising costs all increase too. If a reduction in depreciation causes the RAB increase, revenue could increase or decrease. In this case, the higher return on capital is offset (perhaps more than offset) by the reduction in depreciation allowance. Inflation naturally increases the RAB in nominal terms.

154 NER, cll. 6.4.3(a)(3) and (b)(3).

included in the RAB at the beginning of the regulatory year, and by the depreciation schedules.[155]

A.3.1 Calculating depreciation in the PTRM

Our standard approach to calculating depreciation is to employ the straight-line method set out in the PTRM. Regulatory practice has been to assign a standard asset life to each category of assets that represents the economic or technical life of the asset or asset class.[156] We must consider whether the proposed depreciation schedules conform to the following key requirements:

- the schedules must depreciate using a profile that reflects the nature of the assets or category of assets over the economic life of that asset or category of assets[157]
- the sum of the real value of the depreciation that is attributable to any asset or category of assets must be equivalent to the value at which that asset or category of assets was first included in the RAB for the relevant distribution system[158]
- the economic life of the assets, and the depreciation methods and rates underpinning the calculation of depreciation for a regulatory control period must be consistent with those determined for the same assets on a prospective basis in the distribution determination for that period.[159]

To the extent that a distributor's regulatory proposal does not conform with the above requirements, we must determine the depreciation schedules for calculating the depreciation for each regulatory year.[160]

A.3.2 Assessing the depreciation inputs to the PTRM

The regulatory depreciation amount is an output of the PTRM. We therefore assess the distributor's proposed regulatory depreciation amount by analysing the proposed inputs to the PTRM for calculating that amount. The key inputs include:

- the opening RAB at the start of the regulatory control period

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155 NER, cl. 6.5.5(a).

156 This is the standard practice for the AER, as well as other jurisdictional regulators. See for example,
IPART, *Cost building block model template – RAB & tax inputs – Table 2*, February 2023.
ERAWA, *Final decision on proposed revisions to the access arrangement for the Western Power Network 2022/23 – 2026/27 – Target Revenue Model,* March 2023.
AER, *Final decision: Electricity distribution network service providers – Post-tax revenue model handbook*, April 2021, p. 15.
AER, *Draft decision: AusNet Services transmission determination 2017-18 to 2021-22, Attachment 5 – Regulatory depreciation*, July 2016, p. 37.

157 NER, cl. 6.5.5(b)(1).

158 NER, cl. 6.5.5(b)(2).

159 NER, cl. 6.5.5(b)(3).

160 NER, cl. 6.5.5(a)(2)(ii).

- the forecast net capex in the next regulatory control period[161]
- the expected inflation rate for the next regulatory control period
- the standard asset life for each asset class—used for calculating the depreciation of new assets associated with forecast net capex in the next regulatory control period
- the depreciation of existing assets in the opening RAB at the start of the regulatory control period—calculated in a separate year-by-year tracking depreciation module.

Our draft decision on the distributor's regulatory depreciation amount reflects our determinations on the opening RAB, forecast capex and expected inflation rate (the first three building block components in the above list).[162] Our determinations on these components of the distributor's proposal are discussed in section 1.2, Attachment 2 and Overview section 2.2, respectively.

In this attachment, we assess the distributor's proposed standard asset lives against:

- the approved standard asset lives in the distribution determination for the current regulatory control period
- the standard asset lives of comparable asset classes approved in our recent distribution determinations for other service providers
- the appropriate economic lives of the assets.

Our regulatory models (RFM and PTRM) provide for 2 approaches for calculating the straight-line depreciation of existing assets:

- The 'weighted average remaining lives' (WARL) approach: This approach calculates the remaining asset life for an asset class by weighting together its remaining asset life at the beginning of the regulatory control period with the new capex added to the asset class during that period. The residual asset values are used as weights to calculate the remaining asset life at the end of that period. The WARL for the asset classes are calculated in our RFM and are inputs to the PTRM. We consider this approach meets the requirements for determining depreciation under the NER.
- The 'year-by-year tracking' approach: Under this approach, the capex (in addition to grouping assets by type via asset classes) for each year of the regulatory control period is depreciated separately and tracked on a year-by-year basis over the assigned standard life for the asset class. This approach does not require the assessment of the remaining asset life at each five-yearly distribution determination. We consider this approach also meets the requirements for determining depreciation under the NER. Our depreciation tracking module in the RFM conducts the detailed calculations required under this approach. The output of this module is then recorded in the PTRM.

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161 Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and is adjusted for half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (section 1.2) also reflects our updates to the WACC for the 2026–31 period.

162 Our final decision will update the opening RAB for revised estimates of actual capex and inflation.

A.3.3 Interrelationships

The regulatory depreciation amount is a building block component of the annual revenue requirement.[163] Higher (or quicker) depreciation leads to higher revenues over the regulatory control period. It also causes the RAB to reduce more quickly (excluding the impact of further capex). This reduces the return on capital amount, although this impact is usually smaller than the increased depreciation amount in the short to medium term.[164]

Ultimately, however, a distributor can only recover the capex that it incurs on assets once. The depreciation amount reflects how quickly the RAB is being recovered, and it is based on the asset lives used in the depreciation calculation. It also depends on the level of the opening RAB and the forecast capex. Any increase in these factors also increases the depreciation amount.

The RAB has to be maintained in real terms, meaning the RAB must be indexed for expected inflation.[165] The return on capital building block has to be calculated using a nominal rate of return applied to the opening RAB.[166] As noted in section 1.1, the total ARR is calculated by adding up the return on capital, depreciation, operating expenditure (opex), tax and revenue adjustments building blocks. Because inflation on the RAB is accounted for in both the return on capital—based on a nominal rate—and the depreciation calculations—based on an indexed RAB—an adjustment must be made to the revenue requirement to prevent compensating twice for inflation.

To avoid this double compensation, we make an adjustment by subtracting the annual indexation gain on the RAB from the calculation of total revenue. Our standard approach is to subtract the indexation of the opening RAB—the opening RAB multiplied by the expected inflation for the year—from the RAB depreciation. The net result of this calculation is referred to as regulatory depreciation.[167] Regulatory depreciation is the amount used in the building block calculation of total revenue to ensure that the revenue equation is consistent with the use of a RAB, which is indexed for inflation annually. Figure 1.8 shows where the inflation components are included in the building block costs.

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163 The PTRM distinguishes between straight-line depreciation and regulatory depreciation, where regulatory depreciation is the straight-line depreciation less the indexation adjustment.

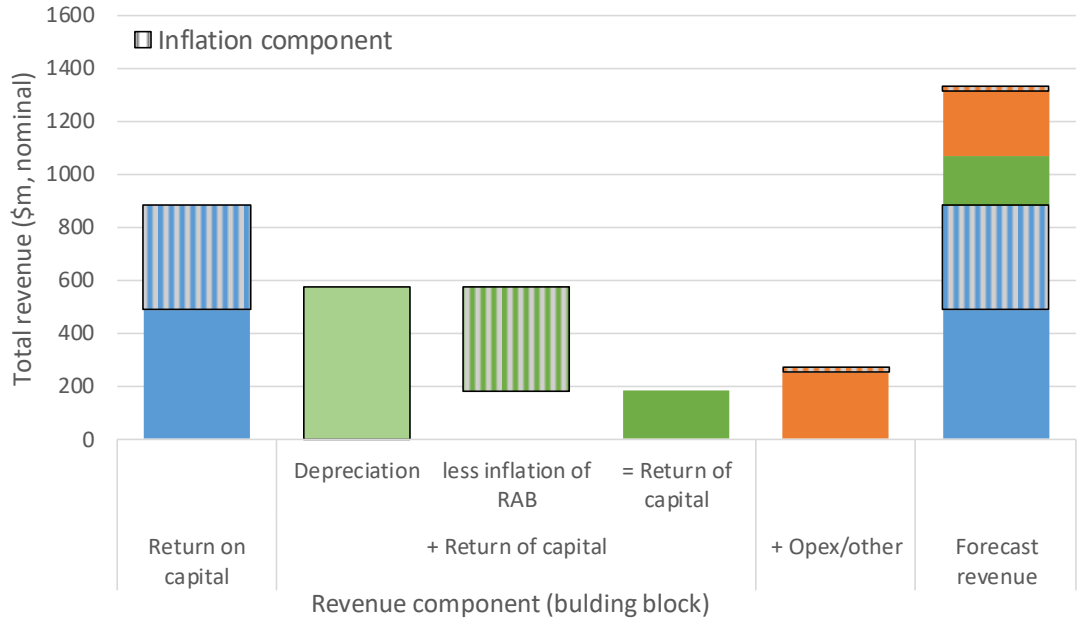
164 This is generally the case because the reduction in the RAB amount feeds into the higher depreciation building block, whereas the reduced return on capital building block is proportionate to the lower RAB multiplied by the WACC.

165 NER, cll. 6.3.2(a)(2), 6.4.3(b)(1) and S6.2.3(c)(4).

166 AER, Rate of return instrument, cll. 1, 3, 36(c), February 2023.

167 If the asset lives are extremely long, such that the RAB depreciation rate is lower than the inflation rate, then negative regulatory depreciation can emerge. The indexation adjustment is greater than the straight-line depreciation in such circumstances.

Figure 1.8 Inflation components in revenue building block – example



Source: AER analysis.

This approach produces the same total revenue requirement and RAB as if a real rate of return had been used in combination with an indexed RAB. Under an alternative approach where a nominal rate of return was used in combination with an un-indexed (historical cost) RAB, no adjustment to the depreciation calculation of total revenue would be required. This alternative approach produces a different time path of total revenue compared to our standard approach. In particular, overall revenues would be higher early in the asset's life (as a result of more depreciation being returned to the distributor) and lower in the future—producing a steeper downward sloping profile of total revenue.[168] Under both approaches, the total revenues being recovered are in present value neutral terms—that is, returning the initial cost of the RAB.

Figure 1.9 shows the recovery of revenue under both approaches using a simplified example.[169] Indexation of the RAB and the offsetting adjustment made to depreciation results in a smoother revenue recovery profile over the life of an asset than if the RAB was un-indexed. The indexation of the RAB also reduces prices shocks when the asset is replaced at the end of its life.[170]

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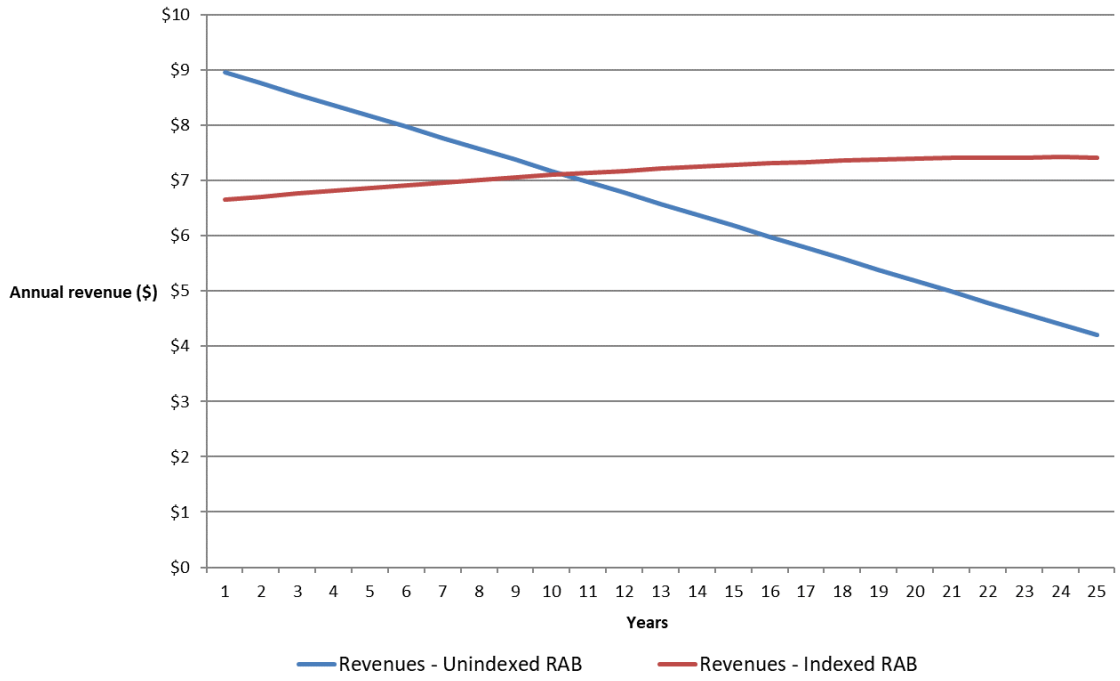
168 A change of approach from an indexed RAB to an un-indexed RAB would result in an initial step change increase in revenues to preserve net present value (NPV) neutrality.

169 The example is based on the initial cost of an asset of $100, a standard economic life of 25 years, a real WACC of 2.50%, expected inflation of 2.40% and nominal WACC of 4.96%. Other building block components such as opex, tax and capex are ignored for simplicity as they would affect both approaches equally.

170 In year 26, the revenues in the example for the un-indexed approach would jump from about $4 to $9, assuming the asset is replaced by an asset of roughly similar replacement cost as the initial asset. In contrast, in the same circumstances, the indexed approach would see revenues stay at roughly $7.

Figure 1.9 Revenue path example – indexed vs un-indexed RAB ($ nominal)



Source: AER analysis.

Figure 1.7 shows the relative size of the inflation and straight-line depreciation, and their impact on the RAB. A 10% increase in the straight-line depreciation generally causes unsmoothed revenues ($ nominal) to increase by about 3% to 5%.

A.4 Corporate income tax – assessment approach

We make an estimate of the taxable income for each regulatory year as part of our determination of the ARR for the distributor's regulatory control period.[171] Our estimate is the taxable income that a benchmark efficient entity would earn for providing SCS if it operated the distributor's network business, which is determined in accordance with the PTRM.

A.4.1 Calculating estimated cost of corporate income tax in the PTRM

Our standard approach for calculating a distributor's estimated cost of corporate income tax is set out in our PTRM[172] and involves the following steps:[173]

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the distributor's business. This is the approved

171 Clause 6.5.3 of the NER sets out the formula we must use to estimate corporate income tax.

172 AER, *Electricity distribution network service providers: Post-tax revenue model (version 5)*, April 2021.

173 The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NER, cl. 6.4.2(b)(4).

forecast revenues for the distributor that we determined using the building block approach.[174] It includes capital contributions where these are subject to taxation.

2. We then estimate the benchmark tax expenses such as opex, interest expense and tax depreciation in the following ways:
   - operating expense is set equal to the opex building block[175]
   - interest expense is a function of the size of the RAB, the benchmark gearing assumption (60%) and the regulated cost of debt
   - tax depreciation expense is calculated using a separate value for the TAB, and standard and/or remaining tax asset lives for taxation purposes. Previously, the PTRM applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the 2018 tax review,[176] the PTRM applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method[177] for all assets acquired after implementation of the tax review findings except for in-house software, buildings (capital works) and equity raising costs. The expenditure for these assets is to be depreciated using the straight-line method under the tax law. The PTRM also accounts for the value of certain forecast capex to be immediately expensed when estimating the benchmark tax expense. The value of immediately expensed capex is deducted from the net capex being depreciated for tax purposes for the year in which it is forecast to be incurred.[178] The immediately expensed amount is then included in the total tax depreciation amount for the relevant year.

   There may be other revenue adjustments, but the assessment of whether they should give rise to a tax payable occurs on a case-by-case basis.
3. We estimate the annual taxable income that would be earned by a benchmark efficient entity operating the distributor's business by subtracting the benchmark estimates of tax expenses (step 2) from the approved forecast revenues for the distributor (step 1).
4. We apply the statutory income tax rate to the estimated annual taxable income (after adjustment for any tax loss carried forward) to arrive at a notional amount of tax payable.
5. We deduct the expected value for the utilisation of imputation credits (gamma) by investors from the notional amount of tax payable. The tax payable net of the expected value of imputation credits represents the estimated cost of corporate income tax and is included as a separate building block in determining the distributor's ARR.

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174 The total revenue for tax purposes is the sum of the building blocks including return on capital, return of capital, operating expenditure and cost of corporate taxation, and any capital contributions. It may also include other revenue adjustments, but the assessment of whether they should give rise to a tax payable will occur on a case-by-case basis.

175 Our assessment approach for the opex building block is discussed in Attachment 3 of the draft decision.

176 AER, *Final report, Review of regulatory tax approach*, December 2018.

177 For more explanation of how we calculate depreciation using the diminishing value method, please see: AER, *Distribution PTRM handbook*, April 2021, pp. 22–23.

178 That is, the net capex to be added to the TAB for tax depreciation purposes is the amount of gross capex, less disposals, less the immediately deductible capex.

A.4.2 Assessing the tax inputs to the PTRM

The estimated cost of corporate income tax is an output of the PTRM. We therefore assess the distributor's proposed cost of corporate income tax by analysing the proposed inputs to the PTRM for calculating that cost. Our assessment approach for each of the tax inputs required in the PTRM are discussed in turn below:

- **The opening TAB value as at the commencement of the next regulatory control period**: We consider that the roll forward of the opening TAB should be based on the approved opening TAB at the start of the current regulatory control period and the distributor's actual/estimated capex incurred during the current regulatory period, and the actual capex incurred in the final year of the previous regulatory control period.[179] The roll forward of the opening TAB for the current regulatory period is calculated in our RFM, which relies on the depreciation module.

  The opening TAB value at the start of the next regulatory control period is used to estimate forecast tax depreciation for that period, including new assets to be added to the TAB over the next regulatory control period. We will continue to apply the straight-line method of tax depreciation for existing assets in the opening TAB prior to the implementation of the 2018 tax review findings. However, for all assets added to the TAB after this implementation (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **The form of customer contributions:** On 21 October 2020, the Full Federal Court of Australia published a judgment dealing with the tax treatment of capital contributions.[180] The determination:

  - Confirmed an earlier Court ruling that cash contributions were ordinary income and should be treated as assessable income for tax purposes.
  - Overturned an earlier Court ruling and determined that while a gifted asset was a 'non-cash business benefit' there was effectively nil income for tax purposes.

  We consider the Court's ruling on gifted assets requires us to exclude the cost of construction of these assets from the gross capex and capital contributions inputs to the PTRM. Consequently, this excludes gifted assets from the calculation of the estimated cost of corporate income tax building block. Capital contributions in the form of cash continue to be included in the calculation of the estimated cost of corporate income tax building block.

- **The standard tax asset life for each asset class:** Our assessment of a distributor's proposed standard tax asset life is generally guided by the effective life of depreciating assets determined by the Commissioner of Taxation. We consider that the standard tax asset lives for the majority of the distributor's asset classes should be consistent with the

[179] The tax depreciation is therefore recalculated based on actual capex. The same tax depreciation approach of using actual capex applies to the roll forward of the TAB at the next distribution determination.

[180] Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation* [2020] FCAFC 169, 21 October 2020.

ATO Taxation Ruling 2022/1 regarding the effective life of depreciating assets where possible.[181]

As discussed above, the PTRM applies the diminishing value tax depreciation method for all new assets except for in-house software, buildings (capital works) and equity raising costs. It provides designated asset classes for these assets to be depreciated using the straight-line method for tax purposes.[182] We note that the tax effective lives for in-house software, buildings (capital works) and equity raising costs are not covered under the ATO Taxation Ruling 2022/1. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment Act 1997* (ITAA). Specifically, we consider that the standard tax asset life should be:

- 40 years for buildings. This is consistent with the number of years required to completely depreciate capital works assets such as buildings for tax purposes when applying sections 43-15, 43-140 and 43-210 of the ITAA.
- 5 years for in-house software. This is consistent with subsection 40-95(7) of the ITAA.
- 5 years for equity raising costs. This is consistent with section 40-880 of the ITAA.

- **The income tax rate**: The statutory income tax rate is 30% per annum for businesses of the size we regulate.
- **The value of gamma**: The gamma input is set out in the 2022 *Rate of Return Instrument*, which requires us to use a gamma value of 0.57.[183] This is discussed further in Overview section 2.2.
- **The size and treatment of any tax losses as at the commencement of the next regulatory control period:** Where a business has tax losses under our benchmark approach, we require the provision of this value to determine the appropriate estimated taxable income for a regulatory control period. If there is an amount of tax losses accumulated, the forecast taxable income for the regulatory control period will be reduced by this amount.
- **Forecast immediately expensed capex:** The PTRM requires a forecast for immediately deductible capex to be provided for each regulatory year of the next regulatory control period. Our assessment of forecast immediately expensed capex will be guided by the distributor's actual immediately expensed capex from the previous regulatory control period.[184] We will collect actual data relating to this expenditure in our annual reporting RINs to further inform our decision on the amount of forecast immediately expensed

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181 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022.

182 Our assessment approach on new assets to be exempted from the diminishing value method is discussed in detail below.

183 AER, *Rate of Return Instrument*, February 2023, p. 9.

184 In the tax review final report, we labelled our approach to determining the amount of capex that is to be immediately expensed as an 'actuals informed approach'. AER, *Final report, Review of regulatory tax approach*, December 2018, p. 66.

capex in future regulatory determinations. Benchmarking may also be considered going forward.[185]

- **Diminishing value multiplier:** The PTRM applies the diminishing value method of tax depreciation and provides an input section for the 'diminishing value multiplier' to be recorded for each year of the regulatory control period. We note that currently the diminishing value multiplier is set at 200% by the ATO.
- **New assets to be exempted from the diminishing value method:** The PTRM applies the diminishing value method for tax depreciation purposes to all new depreciable assets except for certain assets. It provides for asset classes 47 to 50 to be depreciated using the straight-line method for tax purposes instead of the diminishing value method. These asset classes are to contain new assets associated with in-house software, buildings (capital works) and equity raising costs.

  We consider that the benchmark equity raising costs should not be depreciated using the diminishing value method. We note that section 40-880 of the ITAA and the ATO's taxation ruling 2011/6[186] require that businesses claim deductions on equity raising costs in equal proportions over a 5-year period. Therefore, in the PTRM, we apply the straight-line method for calculating the tax depreciation for equity raising costs, consistent with the ITAA and ATO's requirements.[187] Further, the distributor may propose capex associated with buildings and in-house software be exempted from the diminishing value method of tax depreciation in the PTRM if the proposal satisfies the following requirements:

  – Buildings: We consider that capex for buildings may be exempted from the diminishing value method in the PTRM, consistent with sections 43-15, 43-140 and 43-210 of the ITAA. However, such capex must be consistent with the definition of a capital work under section 43-20 of the ITAA and in ATO taxation ruling 97/25.[188] We note that this includes new buildings and structural improvements to existing buildings.[189] However, capex on separate assets within a building such as air-conditioning units, transformers and converters are not consistent with the definition of a capital work, and therefore are required to be depreciated using the diminishing value method in the PTRM.
  – In-house software: We consider that capex for in-house software may be exempted from the diminishing value method in the PTRM, consistent with section 40-72 of the ITAA. However, such capex must be consistent with the definition of in-house software under section 995-1 of the ITAA and in ATO taxation ruling 2016/3.[190] We note that this includes computer software, or the right to use computer software that the distributor acquires, develops or has someone else develop for the distributor's

185 AER, *Final report, Review of regulatory tax approach*, December 2018, pp. 66–67.

186 ATO, *Taxation Ruling 2011/6*, July 2016.

187 The benchmark cost for equity raising costs is determined within the PTRM.

188 ATO, *Taxation Ruling 97/25*, July 2017.

189 ITAA, section 43-20.

190 ATO, *Taxation Ruling 2016/3*, October 2018.

business use.[191] However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and is therefore required to be depreciated using the diminishing value method in the PTRM.

A.4.3 Interrelationships

The cost of corporate tax income building block feeds directly into the annual revenue requirement. This amount is determined by 5 factors:

- pre-tax revenues
- tax expense (including tax depreciation)
- the corporate tax rate
- any tax losses carried forward
- gamma — the expected proportion of company tax that is returned to investors through the utilisation of imputation credits–which is offset against the corporate income tax payable.

Of these factors, the corporate tax rate is set by the Australian Government. The higher the tax rate, the higher the required tax payable.

The pre-tax revenues depend on all the building block components. Any factor that affects revenue will therefore affect pre-tax revenues. Higher pre-tax revenues can increase the tax payable.[192] Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.[193]

The tax expenses (or deductions) depend on various building block components and their size. Some components give rise to tax expenses, such as opex, interest payments and tax depreciation of assets. However, others do not, such as increases in return on equity. Higher tax expenses offset revenues as deductions in the tax calculation and therefore reduce the cost of corporate income tax (all things being equal). Tax expenses include:

- Interest on debt – because interest is a tax offset. The size of this offset depends on the ratio of debt to equity and therefore the proportion of the RAB funded through debt. It also depends on the allowed return on debt and the size of the RAB.
- General expenses – these expenses generally will match the opex forecast including any revenue adjustments, but the assessment of whether they should be treated as a tax expense occurs on a case-by-case basis.

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191 ITAA, section 995-1.

192 In fact, there is an iterative relationship between tax and revenues. That is, revenues lead to tax, being applied, which increases revenues and leads to slightly more tax and so on. The PTRM is therefore set up to run an iterative process until the revenue and the cost of corporate income tax become stable.

193 For example, although increased opex adds to revenue requirement, these expenses are also offset against the revenues as deductions in determining tax, so there is no net impact in this case. A higher return on equity, in contrast, gives rise to no offsetting tax expenses and therefore increases the tax payable in proportion to the company tax rate.

- Tax depreciation – a separate TAB is maintained for the distributor reflecting tax rules. This TAB is affected by many of the same factors as the RAB, such as capex, although unlike the RAB value it is maintained at its historical cost with no indexation. The TAB is also affected by the depreciation rate/method and asset lives assigned for tax depreciation purposes.

A business that has tax expenses which are greater than its taxable revenue in a period would not be subject to pay tax and instead will generate a tax loss. A tax loss can be carried forward to offset against tax payable in the future.

For a business that does not have tax losses, a 10% increase to the cost of corporate income tax amount generally causes unsmoothed revenues ($ nominal) to increase by up to 1%.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
ARR	annual revenue requirement
ATO	Australian Taxation Office
capex	capital expenditure
CCP32	Consumer Challenge Panel, sub-panel 32
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
ERP	enterprise and resource planning
ESCV	Essential Services Commission of Victoria
F&A	Framework and approach
gamma	imputation credits
IT	Information technology
ICT	Information and communication technology
ITAA	Income Tax Assessment Act 1997
NER	National Electricity Rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RIN	regulatory information notice
RFM	roll forward model
SCS	standard control services
TAB	tax asset base
WACC	weighted average cost of capital (rate of return)
WARL	weighted average remaining lives