Draft decision

CitiPower electricity distribution determination

1 July 2026 – 30 June 2031

Attachment 6 – Capital expenditure sharing scheme

September 2025

AUSTRALIAN ENERGY REGULATOR

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6 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers (NSPs) whose capital expenditures (capex) become more efficient, and financial penalties for NSPs whose capex become less efficient. Customers benefit from improved efficiency through lower regulated prices.

The CESS approximates efficiency gains or losses by calculating the difference between capex forecast in the distribution determination and actual capex. It shares these gains or losses between service providers and consumers.

The CESS works as follows:

- We calculate the cumulative efficiency gains or losses for the current regulatory control period in net present value terms.
- We apply the sharing ratio of 30% to all efficiency losses, and a tiered rate for efficiency gains, to work out what the service provider's share of the underspend or overspend should be.[1]
- We calculate the CESS payments taking into account the financing benefit or cost to the service provider of the underspend or overspend.[2] We can also make further adjustments to account for deferral of capex and ex post exclusions of capex from the regulatory asset base (RAB).[3]

The CESS payments will be added to or subtracted from the service provider's regulated revenue as a separate building block in the next regulatory control period.

The nature and details of the CESS that is applicable to the relevant regulatory control period is decided at the time of the making our distribution determination on a forecast basis.[4] So, for the current regulatory period, the CESS set out in the 2013 Capital Expenditure Incentive Guidelines will apply in the building block model.[5] For the upcoming 2026–31 regulatory control period, Capital Expenditure Incentive Guidelines (version 4) will be applied.

We consider in addition to greater incentives to improve capex efficiency, the CESS provides a consistent incentive to incur capex efficiently during a regulatory control period and encourages more efficient substitution between capex and operating expenditure (opex).

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1 The tiered rate calculation for efficiency gains will apply a 30% sharing ratio for any underspend amount up to and including 10% of the approved forecast capex allowance, while any amount greater will incur a 20% sharing ratio.

2 We calculate benefits as the benefits to the service provider of financing the underspend since the amount of the under-spend can be put to some other income generating use during the period. Losses are similarly calculated as the financing cost to the service provider of the overspend.

3 The capex incentive guidelines outline how we may exclude capex from the RAB and adjust the CESS payment for deferrals. AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers,* August 2025, pp. 9–17.

4 NER, cl. 6.12.1(i).

5 AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013.

This attachment sets out our draft decision for the determination of the revenue impacts as a result of the CESS applying from the 2021–26 regulatory control period and the application of the CESS for CitiPower in the 2026–31 regulatory control period.

6.1 Draft decision

6.1.1 Revenue impact from the 2021–26 regulatory control period

Our draft decision is to apply a CESS revenue decrement amount of $3.9 million ($2025–26) across the 2026–31 regulatory control period. This CESS revenue decrement is calculated using the CESS from the 2021-26 regulatory control period and the corresponding CESS carryover true-up for 2020. This is $17.2 million lower than CitiPower's forecast CESS revenue increment of $13.3 million ($2025–26).

The difference between our calculations and CitiPower's proposal is due to our adoption of:

- an adjustment to account for the deferral of capex
- more recent inflation figures
- an update to weighted average cost of capital (WACC) input information.

The CESS decrement arises as a result of an overspend in total capex compared to the forecast for the 2021–26 period, to which the CESS applies. Our draft decision on the revenue impact of the application of the CESS in the 2021–26 period and the corresponding CESS carryover true-up 2020 is summarised in Table 6.1.

Table 6.1 CESS revenue increments in 2026–31 ($ million, 2025–26)

CESS item	2026-27	2027-28	2028-29	2029-30	2030-31
CESS revenue increment as per NER 6.4.3(a)(5)	-1.30	-1.30	-1.30	-1.30	-1.30
CESS carryover true-up for 2020	0.53	0.53	0.53	0.53	0.53
AER draft decision CESS	**-0.78**	**-0.78**	**-0.78**	**-0.78**	**-0.78**

Note: Numbers may not sum due to rounding.
Source: AER analysis. CitiPower, *CP RIN.04 – Workbook 4 Capital Expenditure Sharing Scheme – Jan2025 - Public*, 31 January 2025.

6.1.2 Application of scheme in 2026–31 regulatory control period

Our draft decision is to apply the CESS as set out in the Capital Expenditure Incentives Guidelines (version 4) to CitiPower in the 2026–31 regulatory control period.[6] Specifically, we will apply an ex ante volumetric adjustment for business-as-usual connection types. We also intend to allow adjustments to CESS penalties following an ex-post review for any additional large bespoke connections and data centres that have not been included in CitiPower's proposal. However, given that the amended Capital Expenditure Incentives Guidelines

[6] NER, cl 6.12.1(i); AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers,* August 2025.

(version 4) was published on 26 August 2025, CitiPower may opt out of the volumetric adjustment and/or identify large bespoke connections in its revised proposal.

We will not allow innovation expenditure to be excluded from the CESS. However, CitiPower may voluntarily forgo any CESS revenue increment associated with innovation expenditure.

The reasons for adopting this approach to CESS are set out in our final decision for the Capital Expenditure Incentive Guidelines Review 2025.[7]

6.2 CitiPower's proposal

6.2.1 CESS revenue increments from the 2021–26 regulatory control period

CitiPower proposed a CESS revenue increment of $10.6 million ($2025–26) for the 2021–26 regulatory control period. This reflects an expected underspend of 9% compared to the AER's regulatory allowance.

In response to our information request, CitiPower has noted two project deferrals for Brunswick modernisation project and S/4 HANA (non-recurrent) ICT project. CitiPower considers that COVID-19 caused a 20% to 30% reduction in energy consumption in Melbourne, including Brunswick. Compounded by cost increases on construction/delivery of the projects relative to pre-pandemic conditions, CitiPower maintains it faced delayed timeframes and higher costs during the period.

CitiPower also considers that these projects do not give rise to a deferral adjustment to the CESS as it has not materially underspent its regulatory allowance for the 2021-26 regulatory period.[8]

6.2.2 Final year actual capex true-up for 2020

CitiPower submitted a true-up calculation method that proposed a true-up increment of $2.6 million ($2025–26) be added to its CESS revenue increments in the 2026–31 period.

6.2.3 Application of CESS in the 2026–31 regulatory control period

CitiPower proposed to apply the CESS in the 2026–31 regulatory period, except to the connections and innovation cost categories.[9]

6.3 Assessment approach

Under the National Electricity Rules (NER), we must decide:

- whether or not to apply the CESS to CitiPower in the 2026–31 regulatory control period and how any applicable scheme will apply[10]

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7 AER, *Capital Expenditure Incentive Guidelines Review 2025 explanatory statement, August 2025*, pp. 21-25.

8 CitiPower, *Response to AER information request - IR 019*, 6 June 2025

9 CitiPower, *Regulatory Proposal 2026–31 – Part B: Revenue & Expenditure Forecast*, 31 January 2025, pp. 84; CitiPower, *CP BUS 9.01 - Innovation allowance – Jan2025 - Public,* 31 January 2025

10 NER, cl. 6.4.3(a)(5).

- the revenue effects on CitiPower arising from applying the CESS in the 2021–26 regulatory control period.[11]

Our assessment approach is set out below.

We must determine the appropriate revenue increments or decrements (if any) for each year of the 2026–31 regulatory control period arising from the application of the CESS during the 2021–26 regulatory control period.[12] Next, we assess whether any adjustments should be made to the CESS for deferred capex in accordance with the Capital Expenditure Incentive Guidelines. Finally, we make adjustments based on updated modelling inputs.

In deciding whether to apply a CESS to CitiPower for the 2026–31 regulatory control period, and the nature of the details of the scheme, we must:[13]

- make that decision in a manner that contributes to the capex incentive objective[14]
- take into account the CESS principles,[15] the capex objectives and if relevant the opex objectives,[16] the interaction with other incentive schemes[17] as they apply to the particular service provider, and the circumstances of the service provider.[18]

The capex incentive objective is to ensure that only capex that meets the capex criteria is included in the RAB used to set prices. This ensures consumers only pay for capex that is efficient and prudent.

6.3.1 Interrelationships

The approval of the CESS revenue increment determines the associated CESS building block as part of CitiPower's overall forecast revenue requirement for the 2026–31 regulatory control period.

The CESS relates to other incentives CitiPower faces to incur efficient opex, conduct demand management, and maintain or improve service levels. Related schemes include the efficiency benefit sharing scheme (EBSS) for opex, the service target performance incentive scheme (STPIS) for service levels, and the demand management incentive allowance mechanism (DMIAM). We aim to incentivise network service providers to make efficient decisions on when and what type of expenditure to incur and to balance expenditure efficiencies with service quality.

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11 NER, cl. 6.12.1(9).

12 Increments or decrements arising from the application incentive mechanisms, including the CESS, form one of the building blocks that is used to determine the annual revenue requirement for distribution network service providers for each regulatory year of a regulatory control period: NER, cl. 6.4.3(a)(5).

13 NER cl. 6.5.8A(e).

14 NER, cl. 6.5.8A(e)(3); the capex incentive objective is set out in cl. 6.4A(a).

15 NER, cl. 6.5.8A(e)(4)(i); the CESS principles are set out in cl.6.5.8A(c).

16 NER, cll. 6.5.8A(e)(4)(i) and 6.5.8A(d)(2); the capex objectives are set out in cl. 6.5.7(a); the opex objectives are set out in cl. 6.5.6(a).

17 NER, cl. 6.5.8A(d)(1).

18 NER, cl. 6.5.8A(e)(4)(ii).

6.4 Reasons for draft decision

6.4.1 CESS revenue increments from the 2020–25 regulatory control period

Our draft decision is to reduce CitiPower's CESS revenue increment by $17.2 million to a decrement of $3.89 million. This accounts for the $55.5 million ($2025–26) in reproposed capex that is included in our substitute capex forecast for the Brunswick modernisation project ($47.6 million) and S/4 HANA ($7.9 million). We have adjusted for modelling inputs such as internal and contract labour,[19] the consumer price index (CPI), reported capex and the WACC to reflect the most up-to-date information.

In accordance with the Capital Expenditure Incentive Guidelines, we adjust the CESS in situations where a distributor has capex deferrals in the current regulatory control and:[20]

- The amount of the estimated underspend in capex in the current regulatory control period is material.
- The amount of the deferred capex in the current regulatory control period is material.
- Total approved capex in the next regulatory control period is materially higher than it is likely to have been if a material amount of capex was not deferred in the current regulatory control period.

The next section sets out our analysis of each of these criteria, and reasons why in this case, these have been satisfied.

Assessment of deferral

We are satisfied that the underspend, deferral and reproposed of capex is material and sufficient to justify adjusting CitiPower's proposed CESS payment.

While we consider individual projects to inform our substitute estimate, we do not determine which programs or projects a distributor should or should not undertake. Once we set a forecast, it is up to CitiPower to prioritise its capex program within the total forecast capex allowance with regard to its circumstances, which are subject to change over the regulatory control period. However, in the event of a significant underspend compared to the final decision forecast, we have had regard to CitiPower's performance against its 2021–26 forecast as key indicators to determine whether there is a material deferral of capex.

CitiPower expects to underspend $66.5 million, or 9%, of its $711.7 million capex forecast for the 2021-26 period. We consider this is a material underspend relative to its total capex forecast.

In response to an information request, CitiPower identified 2 deferred capex projects for the Brunswick modernisation project and S/4 HANA (non-recurrent) ICT project. The total

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19 See AER *Attachment 2 – Capital expenditure | Draft decision – CitiPower distribution determination 2026–31*.

20 AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013*, p. 9.

amount deferred in the current period is $25.0 million. We consider this deferral is material as it contributes to the total underspend.

In relation to the Brunswick modernisation project, CitiPower expects a partial deferral of $11.4 million to the current regulatory period. CitiPower stated that it was originally intending to commence the Brunswick project in 2020. The total project cost was $33.2 million from 2020-2026. CitiPower has not commenced this project but expects to incur $17.6 million in capex relating to the project in the remaining 2 years of the current period and $47.6 million in the forecast period for a total project cost of $65.2 million. We compared to the $33.2 million CitiPower had forecast if it had undertaken the project as planned. For S/4 HANA, $13.6 million was included in the 2021-26 capex forecast. CitiPower has fully deferred this project to the 2026-31 period.

We have included $55.5 million, comprising the Brunswick modernisation project ($47.6 million) and S/4 HANA (non-recurrent) ICT project ($7.9 million), in the 2026-31 capex forecast. We consider a $55.5 million increase in forecast capex due to deferred capex to be a material amount.

Overall, we consider CitiPower has deferred a material proportion of capex, so we are not satisfied with CitiPower's proposal of the CESS revenue increments. Instead, we have subtracted the net present value of the $55.5 million CESS deferral from CitiPower's total efficiency gain, resulting in a CESS revenue decrement of $6.52 million. This is a reduction of $19.8 million, before the true-up adjustment. This ensures that consumers will share in the benefits where material amounts of capex are deferred from one regulatory control period to the next.

Updates for final decision

We note the adjustment reflects our draft decision capex substitute. Any changes to our final decision capex forecast for deferred and re-proposed capex would be reflected in our final decision CESS assessment.

6.4.2 Final year actual capex true-up for 2020

Our draft decision includes a true-up adjustment of $2.63 million ($2025–26) to account for CitiPower's updated actual capex for 2020. This is $0.01 million more than CitiPower's forecast true-up adjustment of $2.62 million. This increases the CESS revenue decrement to $3.89 million, resulting in a reduction of $17.2 million from CitiPower's proposal.

6.4.3 Application of CESS in the 2026–31 regulatory control period

We consider that the CESS is needed to provide CitiPower with a continuous incentive to pursue efficiency gains. The ex ante measures are the primary means of revealing efficient costs over time. The CESS provides a strong incentive to reveal this expenditure and serves as a good indicator of future costs. We updated the capital expenditure sharing scheme in August 2025 which includes our consideration of category-specific exclusions from the CESS for large bespoke connections.

We had regard to the Victorian Department of Energy, Environment and Climate Action's (DEECA) submission to the issues paper on the draft proposals for each of the Victorian electricity Distribution Network Service Providers (DNSP) for the 2026–31 regulatory control

period.[21] DEECA stated that it finds no reason as to why NSP cannot accurately forecast connections.[22] DEECA considered that exclusions may lead to NSPs not carrying out connections more efficiently and the AER should ensure overinvestment is disincentivised and the overall benefit is to consumers.[23]

We consider CitiPower has discretion over how they undertake their capex and which projects they prioritise within regulatory control periods. However, we note that the volume of connections is an area where forecasting error is likely to drive the differences in capex outcomes, rather than efficiency and this can have a material effect on capex outcomes. This is because DNSPs must respond to connection requests and have little control over the volume of such requests.

For this reason, we introduced a mechanism in Section 2.6.1 of the 2025 Capital Expenditure Incentive Guidelines (version 4) to reduce the impact of connections volume forecasting error. We consider a volumetric adjustment to the CESS which takes into account the change in volumes of connections, so that a DNSP is not rewarded or penalised for changes in the volume of work it needs to undertake, is appropriate. Applying volumetric adjustment is a symmetrical mechanism that reduces any windfall gains and losses associated with forecasting error in a time of significant connection uncertainty. By applying this mechanism as a default, we will ensure DNSPs are provided with a consistent incentive framework to business-as-usual connections. This approach effectively removes forecast uncertainties caused by volatility in connection volumes.

We note that an ex ante volumetric adjustment to the CESS would not address the issue of forecasting error for individual large connections. These types of connections do not have standardised unit rates. In Section 2.8.1 of the 2025 Capital Expenditure Incentive Guidelines (version 4), we have included the ability for us to reduce CESS penalties associated with large bespoke connections following an ex-post review. For example, a data centre, including associated augmentation costs, may have bespoke costs that could vary significantly based on a customer's requirements. So, we may adjust the CESS penalties after an ex post review for large bespoke connections that were not in a DNSP's original forecast.

For innovation exclusions, CitiPower noted that it would return unspent funds on innovation to customers. To facilitate this, it requires a CESS exclusion for this category.[24]

We maintain our position to deny category-specific exclusions beyond the volumetric adjustment for the CESS. However, we have made it clear in section 2.3.4 of the updated guidelines that a DNSP may voluntarily reduce its CESS award, or increase its CESS penalty, as it may directly benefit consumers. This provides CitiPower with the same outcome as it proposed for innovation without us specifically excluding innovation from the CESS.

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21 Hon. Lily D'Ambrosio MP, *Submission – Victorian electricity distribution proposals 2026-31*, May 2025, pp. 8–9.

22 Hon. Lily D'Ambrosio MP, *Submission – Victorian electricity distribution proposals 2026-31*, May 2025, pp. 8–9.

23 Hon. Lily D'Ambrosio MP, *Submission – Victorian electricity distribution proposals 2026-31*, May 2025, pp. 8–9.

24 CitiPower, *CP BUS 9.01 - Innovation allowance – Jan2025 - Public,* 31 January 2025, p 18.

Please see our final explanatory statement accompanying the Capital Expenditure Incentive Guidelines (version 4).

Therefore, we will apply the updated CESS to CitiPower in the 2026–31 regulatory control period.

Shortened forms

Term	Definition
AER	Australian Energy Regulatory
augex	augmentation expenditure
capex	capital expenditure
CESS	capital expenditure sharing scheme
DNSP	distribution network service provider
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficient benefit sharing scheme
NER or the rules	national electricity rules
NSP	network service provider
RAB	regulatory asset base
STIPIS	service target performance incentive scheme
WACC	weighted average cost of capital