# Draft decision

## Jemena 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 and efficiency 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 apply.

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 Jemena 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 $25.53 million ($2025–26) across the 2026–31 regulatory control period. This is from the application of the CESS in the 2021-26 regulatory control period. This is $28.66 million lower than Jemena's forecast CESS revenue increment of $3.13 million ($2025–26). This is a placeholder pending Jemena's updates to its capital contributions.

The difference between our calculations and Jemena's proposal is due to:

- Jemena withdrawing its proposal to reopen capex for the 2021-26 period[6]
- more recent inflation figures
- an updated weighted average cost of capital (WACC) input information

The CESS decrement arises as a result of an overspend in total capex to which the CESS applies against the forecast for the 2021–26 period. Our draft decision on the revenue impact of the application of the CESS in the 2021–26 period is summarised in Table 6.1. Unlike other Victorian DNSPs, a CESS carryover true-up for 2020 is not required for Jemena as it provided actual 2020 capex in its CESS calculations for our 2021-26 final decision, meaning no carryover true-up is required.[7] It is included here for comparative purposes only.

**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) | -5.11 | -5.11 | -5.11 | -5.11 | -5.11 |
| CESS carryover true-up for 2020 | 0 | 0 | 0 | 0 | 0 |
| **AER draft decision CESS** | **-5.11** | **-5.11** | **-5.11** | **-5.11** | **-5.11** |

Note: Numbers may not sum due to rounding.
Source: AER analysis. Jemena, *JEN – Att 08-10M CESS model – 20250131*, 31 January 2025; Jemena, *response to IR041*, August 2025

6 In October 2024, Jemena applied to reopen its capex forecast for 2021-26. If successful, this would have increased its capex forecast for 2021-26. However, in July 2025, Jemena withdrew its application, and so we use its most recent 2021-26 capex forecast.

7 Jemena was able to provide audited actual data for 2020 during the 6-month period when Victorian DNSP's transitioned from calendar to financial regulatory years

### 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 Jemena in the 2026–31 regulatory control period.[8] Specifically, we will apply ex ante volumetric adjustment for business-as-usual connection types. We also intend to allow adjustment to CESS penalties following an ex-post review for any additional large bespoke connections, data centres, that has not been included in its proposal. But given the amended Capital Expenditure Incentives Guidelines (version 4) was published on 26 August 2025, Jemena has the opportunity to propose to 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, Jemena may voluntarily forgo any CESS revenue increment associated with innovation expenditure.[9]

The reasons for adopting this approach to CESS are set out in our final decision for the Capital Expenditure Incentive Guidelines Review 2025.[10]

## 6.2 Jemena's proposal

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

Jemena proposed a CESS revenue increment of $3.13 million ($2025–26) for the 2021–26 regulatory control period. This reflects an expected underspend of 7.2% compared to the AER's regulatory allowance.[11] It also accounts for Jemena's identification of $33.6 million of projects deferred from the current period and reproposed in the 2026-31 period.[12]

However, Jemena's proposed CESS revenue increment was based on its application to reopen its 2021–26 period capex forecast.[13] Jemena's reopener application was based on accounting for unexpectedly high data centre investments late in the period and a resultant higher capex allowance for the 2021–26 period.

However, Jemena has since withdrawn its reopener application.[14] As a result, Jemena provided an updated version of its CESS model that accounts for this change which reverts to the lower capex allowance for the 2021–26 period.[15] The outcome of this change results in

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

9 AER, *AER Capital Expenditure Incentive Guidelines - August 2025*, August 2025.

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

11 Jemena, *JEN – Att 08-10M CESS model – 20250131*, 31 January 2025; AER analysis.

12 Jemena, *JEN - Att 07-01 Incentive mechanisms – 20250131*, January 2025, p. 4

13 Jemena, *Regulatory proposal reopener application*, 15 October 2024, p. v.

14 Jemena, *Notice to withdraw Jemena Electricity Networks' application to reopen 2021-26 electricity distribution - July 2025*, July 2025.

15 Jemena, *response to IR041*, August 2025; Jemena, *AER - Jemena electricity PTRM - 2024-25 Return on debt update (inc VEBM CPT) - September 2024*, September 2024. Note that Jemena's most recent PTRM update accounts for its accepted cost pass through for the Victorian Government mandated Victorian Emergency Backstop Mechanism.

Jemena incurring an expected overspend of 7.3% compared the AER's regulatory allowance. This resulted in a CESS revenue decrement of $25.51 million. [16]

Jemena also submitted that its actual capex figures for the 2021–26 period will be updated in its revised proposal, as it is recasting its capital contributions for the period. Jemena had previously reported capital contributions on an "as commissioned" basis. In November 2024, the AER issued a guidance note clarifying that material contributions for connection projects spanning more than 12 months should be individually reported on an "as incurred" basis under the regulatory reporting framework.[17] Changing the basis of capital contributions in this way leads to different capital contribution amounts in each year, and hence different net actual capex applicable to the CESS.

For its initial CESS proposal, Jemena used a placeholder method to account for the difference between as commissioned and as incurred capital contributions. Jemena has incorporated the whole difference into 2024-25, as outlined in Table 6.2.[18]

**Table 6.2 Jemena's proposed placeholder approach to reporting capital contributions ($2025-26, millions)**

| Capital contributions | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 |
|---|---|---|---|---|---|
| As commissioned | 48.2 | 74.1 | 96.2 | | |
| Adjustment for FY22 to FY24 | | | | 49.1 | |
| As incurred | | | | 113.7 | 180.6 |
| **Total capcons applicable to CESS** | **48.2** | **74.1** | **96.2** | **162.8** | **180.6** |

Source: Jemena, *JEN - Att 07-01 Incentive mechanisms – 20250131*, January 2025, p. 5.

### 6.2.2 Final year actual capex true-up for 2020

Jemena submitted a true-up calculation method, which proposed a true-up increment of $0 million to be added to its CESS revenue increments in the 2026–31 period.[19] As noted, Jemena was able to include audited actual 2020 capex in its CESS calculations for our 2021-26 final decision and as such no true-up is required.

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

Jemena proposed to apply the CESS in the 2026–31 regulatory period but proposed to exclude certain categories of capex from the CESS. In its proposal, it proposed to exclude

16 Jemena's initial proposal estimated an underspend of 7.2% and a CESS increment of $3.1 million, while its update estimated an overspend of 7.3% and a CESS decrement of $25.5. The reason why underspends and overspends of similar magnitudes can lead to CESS revenue adjustments of such different magnitudes is because underspends also account for deferrals. Accounting for deferrals lowers the CESS increment for an underspend.

17 AER, *Reporting capital contributions AER Guidance Note for electricity distributors*, November 2024, p. 2.

18 Jemena, *JEN - Att 07-01 Incentive mechanisms – 20250131*, January 2025, pp. 4-5; Jemena, *Response to IR041*, August 2025

19 Jemena, *JEN - Att 08-11M CESS true-up model – 20250131*, January 2025. The outputs of this true-up model are equal to those of its CESS model for 2021-26. As such, the true-up is $0.

connections capex.[20] After submission of its proposal, Jemena also proposed to exclude the innovation cost category.[21]

## 6.3 Assessment approach

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

- whether or not to apply the CESS to Jemena in the 2026–31 regulatory control period and how any applicable scheme will apply;[22] and
- the revenue effects on Jemena arising from applying the CESS in the 2021–26 regulatory control period.[23]

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.[24] 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 Jemena for the 2026–31 regulatory control period, and the nature of the details of the scheme, we must:[25]

- make that decision in a manner that contributes to the capex incentive objective[26]
- take into account the CESS principles,[27] the capex objectives and if relevant the operating expenditure (opex) objectives,[28] the interaction with other incentive schemes[29] as they apply to the particular service provider, and the circumstances of the service provider.[30]

The capex incentive objective is to ensure that only capex that meets the capex criteria enters the RAB used to set prices. Therefore, consumers only fund capex that is efficient and prudent.

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20 Jemena, *JEN 2026-31 Proposal*, 31 January 2024, p. 92; Jemena, *JEN - Att 07-01 Incentive mechanisms - 20250131*, 31 January 2025, pp. 5-6,

21 Jemena, *Response to IR012*, 2 May 2025.

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

23 NER, cl. 6.12.1(i).

24 Increments or decrements arising from the application of applicable incentive mechanisms, including any capital expenditure sharing scheme, form one of the building blocks that must be 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).

25 NER cl. 6.5.8A(e).

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

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

28 NER, cl. 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).

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

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

### 6.3.1 Interrelationships

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

The CESS relates to other incentives Jemena 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.

## 6.4 Reasons for draft decision

### 6.4.1 CESS revenue increments from the 2021–26 regulatory control period

Our draft decision is to reduce Jemena's CESS revenue increment by $28.66 million to a decrement of $25.53 million. This is a placeholder pending Jemena's updates to its capital contributions.

Our draft decision primarily owes to Jemena's withdrawal of its application to reopen its capex forecast for the 2021-26 period in July 2025. In October 2024, Jemena applied to reopen its 2021–26 period capex forecast in response to unexpectedly high data centre investments late in the period.[31] Jemena's CESS proposal for the 2026–31 period included its reopener application and so it used a higher capex allowance for 2021–26.

In July 2025, Jemena withdrew its reopener application.[32] As such, we requested that Jemena provide an updated version of its CESS model that accounts for this change.

Jemena's updated CESS model used its capex allowance as reported in its most recent post-tax revenue model update.[33] This capex allowance is lower resulting in Jemena incurring an overspend.

Although Jemena has capex deferrals in the 2021-26 period the CESS has not been adjusted for these. In accordance with the Capital Expenditure Incentive Guidelines, we will adjust the CESS in situations where a distributor has capex deferrals in the current regulatory control and:[34]

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31 Jemena, *Regulatory proposal reopener application*, 15 October 2024, p. v.

32 Jemena, *Notice to withdraw Jemena Electricity Networks' application to reopen 2021-26 electricity distribution - July 2025*, July 2025.

33 Jemena, response to IR041, August 2025; Jemena, *AER - Jemena electricity PTRM - 2024-25 Return on debt update (inc VEBM CPT) - September 2024*, September 2024. Note that Jemena's most recent PTRM update accounts for its accepted cost pass through for the Victorian Government mandated Victorian Emergency Backstop Mechanism.

34 AER, *AER - Capital expenditure incentive guideline - July 2024*, July 2024.

i) The amount of the estimated underspend in capex in the current regulatory control period is material; and

ii) The amount of the deferred capex in the current regulatory control period is material, and

iii) 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.

As Jemena has incurred an overspend the deferrals are not accounted for.

Table 6.3 outlines the difference between Jemena's CESS proposal and its response to our information request to adjust for its withdrawal of its reopener application.

**Table 6.3 Comparison between Jemena's initial CESS proposal and Update (IR041)**

| CESS item | Proposal | Updated | Difference |
|---|---|---|---|
| 2021-26 capex allowance ($2021-22) | 744.6 | 644.0 | -100.6 |
| 2021-26 deferrals ($2021-22) | 27.9 | 0 | -27.9 |
| CESS revenue increment ($2025-26) | 3.1 | -25.5 | -28.6 |

Source: Jemena, *JEN – Att 08-10M CESS model – 20250131*, 31 January 2025. Updated values were provided in Jemena's, response to IR041, August 2025.

Note: The 2021-26 allowance and deferral figures are input figures from the 2021-26 period, and so are presented in $2021-22 terms. The CESS revenue increment output figures will be applied in the 2026-31 period, and so are presented in $2025-26 terms.

Jemena's updated CESS calculations are reasonable. For our draft decision, we have updated CPI and WACC figures compared to Jemena's updated CESS model.

### Updates for final decision

Our draft decision on the CESS calculations are a placeholder.

The transition from reporting capital contributions on an as commissioned basis to an as incurred basis will affect the capex allowance applicable to the CESS. Jemena's placeholder method for accounting for the difference between as commissioned and as incurred capital contributions is acceptable for the draft decision, provided Jemena fully recasts its capital contributions for the 2021–26 period for its revised proposal.

## 6.4.2 Final year actual capex true-up for 2020

Our draft decision includes a true-up adjustment of $0 ($2025–26). Jemena did not need to true-up for actual capex in 2020 because at the time of our final decision for 2021-26, Jemena had already reported its actual 2020 capex.

Between the 2015-20 and 2021-26 periods, the regulatory years for the Victorian DNSPs transitioned from calendar to financial years. There was a transition period of 6-months from January to June 2021. In that time, the Victorian DNSPs had the opportunity to report their 2020 actuals before our 2021-26 final decision on CESS. Jemena was one of the few to have fully audited its figures before the final decision.

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

We consider that the CESS is needed to provide Jemena with a continuous incentive to pursue efficiency gains. The ex-ante measures are the primary means to reveal efficient costs over time. The CESS provides a relatively strong incentive to reveal this expenditure and provides 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 will apply the updated CESS to Jemena in the 2026–31 regulatory control period.

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.[35] DEECA stated that it finds no reason as to why NSP cannot accurately forecast connections.[36] 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.[37]

We consider Jemena has discretion over how they undertake their capex and which projects they prioritise over 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.[38]

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

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

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

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

38 AER, *AER Capital Expenditure Incentive Guidelines - August 2025*, August 2025, pp. 7-8.

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 DNSPs original forecast.[39]

For innovation exclusions, Jemena submitted that applying the CESS to its innovation fund would create a perverse incentive against innovation. Its innovation fund is intended to finance novel projects which may not be justified using standard cost-benefit analysis. A reward for not spending this money would disincentivise this investment in innovation.[40]

We maintain our position to not have 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 Jemena with the same outcome as its proposed treatment for innovation cost category without it being specifically excluded from the CESS.

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

39 AER, *AER Capital Expenditure Incentive Guidelines - August 2025*, August 2025, pp. 10-11.

40 Jemena, *Response to IR012,* May 2025.

# Shortened forms

| Term | Definition |
|---|---|
| AER | Australian Energy Regulatory |
| capex | capital expenditure |
| CESS | capital expenditure sharing scheme |
| DEECA | Victorian Department of Energy, Environment and Climate Action |
| DNSP | distribution network service provider |
| CPI | consumer price index |
| NER or the rules | national electricity rules |
| NSP | network service provider |
| opex | operating expenditure |
| RAB | regulatory asset base |
| WACC | weighted average cost of capital |