Draft decision

Powercor 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) becomes more efficient, and financial penalties for NSPs whose capital expenditure becomes 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 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 guideline outlines 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 of the CESS applying from the 2021–26 regulatory control period and the application of the CESS for Powercor 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 $90.5 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 $0.7 million lower than Powercor's forecast CESS revenue decrement of $89.8 million ($2025–26).

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

- more recent inflation figures
- an update to weighted average cost of capital (WACC) input information.

The CESS decrement arises from 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)	-18.22	-18.22	-18.22	-18.22	-18.22
CESS carryover true-up for 2020	0.12	0.12	0.12	0.12	0.12
AER draft decision CESS	**-18.10**	**-18.10**	**-18.10**	**-18.10**	**-18.10**

Note: Numbers may not sum due to rounding.
Source: AER analysis. Powercor, *RIN.04 Workbook 4 – Capital Expenditure Sharing Scheme – January 2025 - 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 Powercor 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, data centres and grid connected batteries that have not been included in Powercor's proposal. However, given that the amended Capital Expenditure Incentives Guidelines (version 4) was published on 26 August 2025, Powercor may propose

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

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, Powercor 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 Powercor's proposal

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

Powercor proposed a CESS revenue decrement of $90.4 million ($2025–26) for the 2021–26 regulatory control period. This reflects an expected overspend of 10% compared to the AER's regulatory allowance.

6.2.2 Final year actual capex true-up for 2020

Powercor submitted a true-up calculation method that proposed a true-up increment of $0.6 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

Powercor proposed to apply the CESS in the 2026–31 regulatory period, except to the connections and innovation cost categories.[8]

6.3 Assessment approach

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

- whether or not to apply the CESS to Powercor in the 2026–31 regulatory control period and how any applicable scheme will apply[9]
- the revenue effect on Powercor arising from applying the CESS in the 2021–26 regulatory control period.[10]

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

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

8 Powercor, *Regulatory Proposal 2026–31 – Part B: Revenue & Expenditure Forecast*, 31 January 2025, p. 101; Powercor, *PAL BUS 10.01 - Innovation allowance - Jan2025 – Public,* 31 January 2025.

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

10 NER, cl. 6.12.1(9).

2021–26 regulatory control period.[11] 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 Powercor for the 2026–31 regulatory control period, and the nature of the details of the scheme, we must:[12]

- make that decision in a manner that contributes to the capex incentive objective[13]
- take into account the CESS principles,[14] the capex objectives and if relevant the opex objectives,[15] the interaction with other incentive schemes[16] as they apply to the particular service provider, and the circumstances of the service provider.[17]

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 Powercor's overall forecast revenue requirement for the 2026–31 regulatory control period.

The CESS relates to other incentives Powercor 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 2020–25 regulatory control period

Our draft decision is to increase Powercor's CESS revenue decrement by $0.7 million. We have adjusted for modelling inputs such as the consumer price index (CPI), reported capex and the WACC, to reflect the most up-to-date information.

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11 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).

12 NER cl. 6.5.8A(e).

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

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

15 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).

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

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

6.4.2 Final year actual capex true-up for 2020

Our draft decision includes a true-up adjustment of $0.6 million ($2025–26) to account for the updated actual capex for 2020.

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

We consider that the CESS is needed to provide Powercor with an ongoing incentive to pursue efficiency gains. The ex ante measures are the primary means of revealing efficient costs over time. The CESS is a strong incentive to reveal this expenditure and a good indicator of future costs.

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.[18] DEECA stated that it finds no reason as to why NSP cannot accurately forecast connections.[19] 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.[20]

We consider Powercor 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

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

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

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

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, Powercor noted that it would return unspent funds on innovation to customers. To facilitate this, it requires a CESS exclusion for this category.[21]

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 Powercor with the same CESS outcome it proposed for innovation without us specifically excluding innovation from the CESS.

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

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

21 Powercor, *PAL BUS 10.01 - Innovation allowance - Jan2025 – Public,* 31 January 2025, p 20.

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