



31 January 2023

Attachment 4.1: 2024-29 proposed revenue

Ausgrid's 2024-29 Regulatory Proposal

Empowering communities for a resilient, affordable and net-zero future.



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1. Executive summary

1.1 Building block revenue

Our proposed total revenue for the 2024-29 period is \$9,714 million (nominal). This is 28% higher than our forecast revenue for the current 2019-24 period, and 2% higher than the revenue we included in our Draft Plan. We calculated this revenue using the AER's post-tax revenue model (PTRM) in **Attachments 4.1.b – PTRM for distribution** and **4.1.d – PTRM for transmission** and the AER's 2018 rate of return instrument.¹

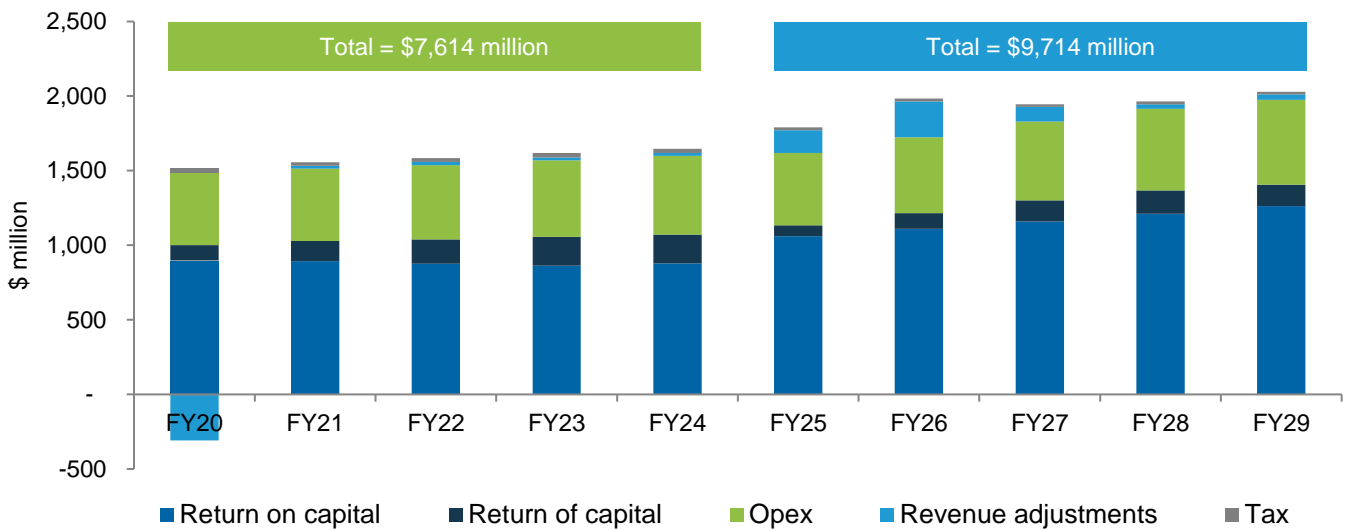
Figure 1.1 sets out our proposed revenue by building block component. For context, **Figure 1.2** compares this proposed revenue to our approved building block revenue for the current regulatory period.

Figure 1.1 Proposed revenue and building block components for the 2024-29 period (\$ million, nominal)

| | FY25 | FY26 | FY27 | FY28 | FY29 | Total |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Return on capital | 1,060.9 | 1,109.1 | 1,159.8 | 1,210.3 | 1,263.0 | 5,803.2 |
| Return of capital | 72.0 | 105.8 | 141.1 | 157.5 | 143.3 | 619.7 |
| Opex | 486.2 | 509.2 | 527.9 | 547.7 | 567.8 | 2,638.9 |
| Efficiency benefit sharing scheme | 153.5 | 206.9 | 63.7 | (5.5) | 0.0 | 418.6 |
| Capital efficiency sharing scheme | (0.2) | 35.6 | 36.6 | 37.6 | 38.7 | 148.4 |
| Demand management incentive allowance | 1.6 | 1.8 | 1.7 | 1.8 | 1.8 | 8.6 |
| Shared assets | (2.9) | (3.1) | (3.5) | (3.5) | (3.6) | (16.6) |
| Tax allowance | 19.2 | 18.9 | 18.4 | 18.9 | 18.0 | 93.4 |
| Revenue requirement | 1,790.4 | 1,984.1 | 1,945.8 | 1,964.8 | 2,029.1 | 9,714.2 |

¹ Publication of the 2022 rate of return instrument has been delayed until after this proposal is due, so we must include rate of return parameters aligned with the existing [2018 instrument](#).

Figure 1.2 Proposed annual building block revenue for 2024-29 compared to current period (\$ million, nominal)



Note: Negative amount in FY20 caused by the remittal where revenue was reduced due to over-recoveries in the 2014-19 period.

Our revenue proposal reflects our communities’ desire to progress towards a net zero and resilient future while balancing the need for affordability. We tested this balance in our Draft Plan and, pleasingly, the overwhelming response was that we had listened well, reflected customer priorities accurately and that the balance between investing for the future and affordability was right. Our customers expect us to continue to engage on our 2024-29 plans throughout 2023, given the potential for further significant changes in the economic environment.

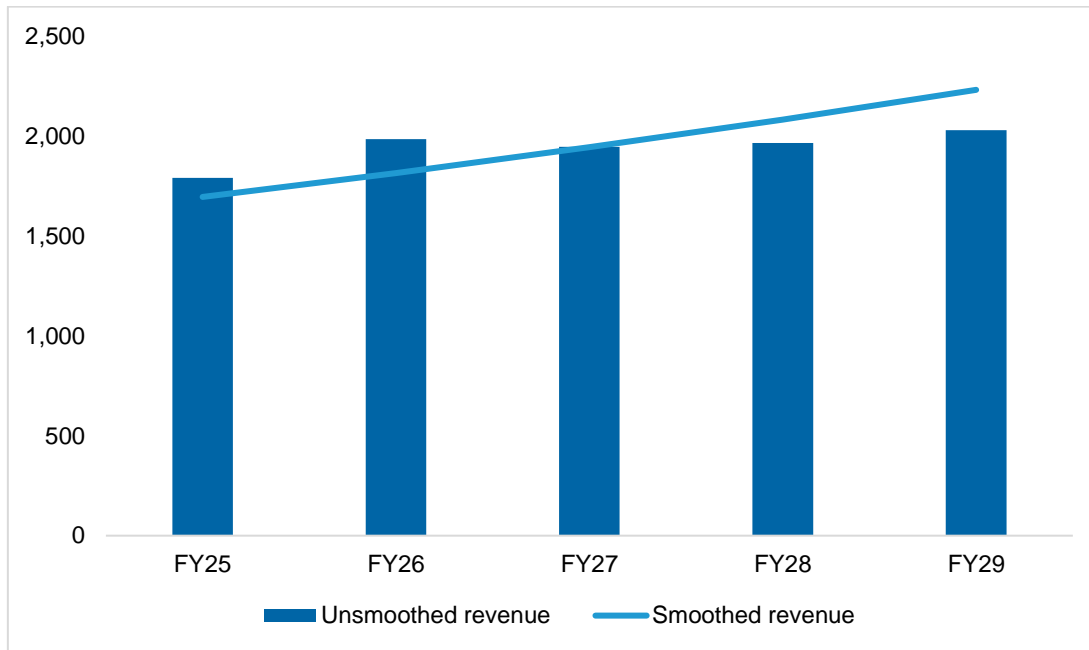
1.2 Smoothed revenue

Figure 1.3 shows the proposed X-factors used to smooth revenue. **Figure 1.4** shows building block and smoothed revenue. We have not used the AER’s preferred method for smoothing due to customer bill impacts that would result in the first year of the 2024-29 period. Instead, we have smoothed to keep price changes similar over each year of the period.

Figure 1.3 Proposed X-factors for the 2024-29 period

| | FY25 | FY26 | FY27 | FY28 | FY29 |
|-------------------------|---------|--------|--------|--------|--------|
| Distribution | -3.00% | -3.56% | -3.56% | -3.56% | -3.56% |
| Dual function | -30.00% | -9.20% | -9.20% | -9.20% | -9.20% |
| Weighted average | -5.00% | -4.08% | -4.10% | -4.13% | -4.16% |

Figure 1.4 Smoothed and unsmoothed revenue (\$ million, nominal)



2. Regulatory asset base

2.1 Opening value of the regulatory asset base (RAB)

The estimated value of our RAB as at 1 July 2024 is \$18.5 billion (nominal) (see **Figure 2.1**). This comprises \$16.0 billion attributable to distribution assets and \$2.5 billion attributable to dual function assets. Calculations and assumptions can be found in **Attachments 4.1.a – RFM for distribution** and **4.1.c – RFM for transmission**.

Figure 2.1 RAB value at 1 July 2024 (\$ million, nominal)

| | Distribution | Dual function | Total |
|--------------------------------|-----------------|----------------|-----------------|
| Opening RAB as at 1 July 2019 | 13,779.4 | 1,901.7 | 15,681.0 |
| Net capex | 2,140.2 | 302.2 | 2,442.4 |
| Straight line depreciation | (2,468.1) | (325.4) | (2,793.5) |
| Inflation on opening RAB | 2,736.5 | 381.2 | 3,117.7 |
| Final year adjustment | 76.8 | 21.4 | 98.3 |
| Assets changing classification | (219.9) | 219.9 | 0.0 |
| Opening RAB as at 1 July 2024 | 16,044.9 | 2,501.0 | 18,545.9 |

2.1.1 Final year adjustment

The final year adjustment of \$98.3 million accounts for the difference between actual capex in the final year of the previous regulatory period, 2014-19, and the amount that was forecast in our 2019-24 decision. The amount includes \$27.2 million to account for return on asset that would have accrued on that expenditure.

Capex in FY19 was higher than forecast in our 2019-24 regulatory proposal mainly due to storm events, the accelerated fit-out of Roden Cutler House, unbudgeted rectifications (for example asbestos or site remediation not budgeted) and higher support costs.

2.1.2 Assets changing classification

Some adjustments have been made between the distribution and dual function RABs to reflect definitions under clause 6.24.2 of the National Electricity Rules (NER). Where assets no longer meet the definition of a dual function asset under this clause, they have been moved from the dual function asset RAB to the distribution RAB. Assets that now meet the definition of the clause have been moved from the distribution RAB to dual function asset RAB.

While undertaking the review for this regulatory proposal it became apparent that at the last determination, a data error resulted in a higher value of assets being moved from dual function assets to distribution assets. We have corrected this error in our proposal by moving \$219.9 million of assets from distribution back to dual function assets.

Attachment 4.1.g – Assets changing classification shows the calculations and asset classes affected by these updates. We note that there is no impact to Ausgrid's overall RAB from assets changing classification.

2.1.3 Property sales strategy to help with affordability

Net capex includes \$564 million of property sales – \$151 million² of which we forecast to accelerate from 2024-29 in response to affordability concerns. Customers benefit from property sales because the full disposal value is netted off the RAB. This means any uplift in value compared to the original value recognised in the RAB is fully passed through to customers through lower return on asset. We had identified some properties for disposal in our accommodation strategy that would typically be sold over time. However, we determined that it would be most prudent to achieve the sales as soon as possible, rather than offering the properties for sale over a number of years. This is because:

² \$158 million of total sales is forecast, however after CAM allocation \$151 million is attributable to standard control services (SCS).

- Property values are forecast to fall over coming years, therefore we can maximise the value returned to customers by selling over the coming year; and
- The benefit to customers comes sooner if a large portfolio of properties is removed from the RAB in the current regulatory period, rather than phased over the 2024-29 regulatory period.

To achieve the sales quickly, we intend to sell the properties to another company in the Ausgrid group. Being a related party transaction, the highest levels of probity will be adhered to, including procuring independent valuations for the properties to ensure maximum benefit is derived for our customers. We discussed this strategy with the Reset Customer Panel (**RCP**) and their view is that disposing of property that we are not using productively, or likely to use productively in the foreseeable future, is in the best interests of customers. The RCP will be kept informed of progress.

Sale of the properties also results in a negative step change to opex as discussed in **Attachment 6.1 – Proposed operating expenditure**.

2.2 Value of the RAB over the 2024-29 period

The estimated annual value of our RAB increases to \$21.6 billion (nominal) by the close of the 2024-29 period (**Figure 2.2**). This represents an average annual increase of 3% over this period.

Figure 2.2 Annual RAB values over 2024-29 (\$ million, nominal (except where specified))

| | FY25 | FY26 | FY27 | FY28 | FY29 | 2024-29 period |
|-----------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Opening RAB | 18,545.9 | 19,222.3 | 19,840.0 | 20,429.5 | 20,994.1 | 18,545.9 |
| Net capex | 748.4 | 723.4 | 730.6 | 722.1 | 711.0 | 3,635.6 |
| Straight line depreciation | (605.2) | (658.3) | (711.4) | (744.8) | (746.8) | (3,466.5) |
| Inflation on opening RAB | 533.1 | 552.6 | 570.3 | 587.3 | 603.5 | 2,846.8 |
| Closing RAB | 19,222.3 | 19,840.0 | 20,429.5 | 20,994.1 | 21,561.8 | 21,561.8 |
| Closing RAB – real \$ FY24 | 18,685.2 | 18,746.7 | 18,764.3 | 18,744.1 | 18,713.0 | 18,713.0 |

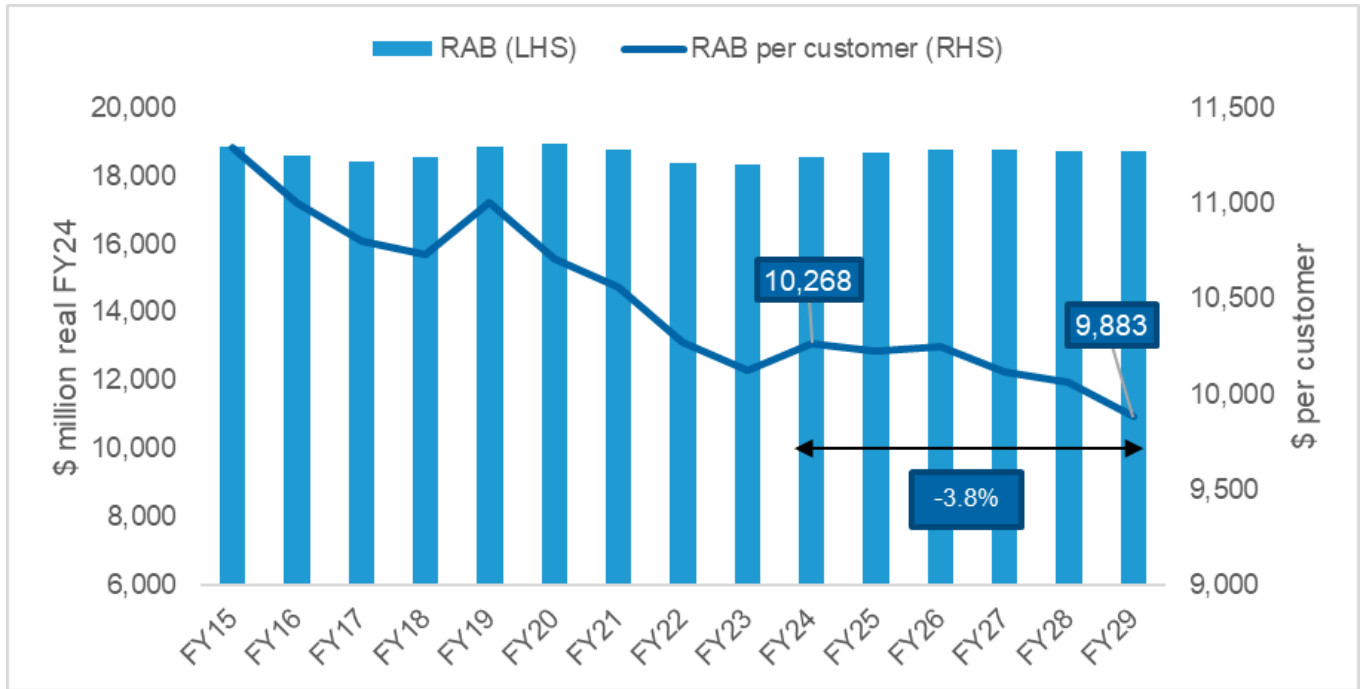
Net capex is based on capex and disposals and discussed in **Attachment 5.1 - Proposed capital expenditure**. Depreciation is discussed **Section 3.3**. Inflation on the RAB has been calculated using placeholder regulatory inflation of 2.87%.³ Other assumptions and calculations can be found in **Attachments 4.1.b - PTRM for distribution and 4.1.d - PTRM for transmission**.

Despite the RAB increasing in nominal terms, our real asset value per customer is expected to decline by 3.8% over the 2024-29 period, continuing the downward trend since 2014-15 (see **Figure 2.3**). This is because the amount of net capex we forecast adding to the RAB is similar, in real terms, to the amount scheduled to be subtracted through depreciation, while our customer numbers are increasing. RAB growth per customer is a key metric that we have reported on throughout our consultation for this proposal when discussing our capex forecast. This meets the requirement in the Better Resets Handbook to genuinely consult on the impact of proposed capex on the RAB⁴. Further, the RCP considered a stable or declining RAB per customer as an important outcome for the 2024-29 period.

³ 2.87% is calculated using the RBA forecast for December 2024 of 3.25% for FY25 with a glidepath calculation to 2.5% in FY29. A geometric average over 5 years is then calculated, in line with the AER's final position on regulatory treatment of inflation.

⁴ AER (2021) [Better Resets Handbook](#), p 22.

Figure 2.3 Asset value and asset value per customer (\$ real, FY24)



3. Revenue

3.1 Rate of return

Delay of the 2022 rate of return instrument (**RORI**) final decision to February 2023 means we need to include rate of return parameters aligned with the 2018 RORI. We have estimated placeholder values for the risk free rate and return on debt in accordance with the 2018 RORI. **Figure 3.1** shows the parameters used to build up the rate of return.

Figure 3.1 Rate of return

| Component (<i>placeholder averaging period</i>) | Value |
|--|-------|
| Risk free rate (<i>1 September 2022 – 29 September 2022</i>) | 3.77% |
| Market risk premium | 6.10% |
| Equity beta | 0.6 |
| Return on equity | 7.43% |
| Return on debt* (<i>28 July 2022 – 29 September 2022</i>) | 4.58% |
| Gearing | 60% |
| Nominal vanilla rate of return* | 5.72% |

* First year estimates. Debt is updated each year during the regulatory period. The average return on debt over 5 years is 4.80% and average rate of return 5.86%.

The relevant calculations are included in **Attachment 4.1.j – Rate of return**. Our proposed averaging periods, which comply with both the 2018 and draft 2022 RORIs, are included in **Attachment 4.2 – Averaging period for cost of equity and debt**.

3.2 Return on asset

The return on asset building block is an allowance to fund the efficient costs of debt and provide a reasonable return on equity. This allowance is calculated by multiplying the opening value of the RAB by the rate of return set by the AER in each year of the regulatory period.

In calculating our proposed return on asset, we used the RAB values shown in **Figure 2.2**, and the rate of return as calculated in **Figure 3.1**.⁵ The average rate of return of 5.86% is higher than the average WACC of 5.31% for the 2019-24 period.

Our proposed total return on asset is \$5,803 million, which represents 60% of our proposed total revenue for 2024-29. This is 32% higher than our allowance for the 2019-24 period, mainly due higher interest rates. It is 8% higher than we included in our Draft Plan, because of continued increases in the cost of funds.

3.3 Regulatory depreciation

The depreciation building block is an allowance to recover the cost of our efficient and prudent investments in assets over their useful lives. This allowance is calculated using the opening RAB value (as at 1 July 2024), new capex and the economic lives of assets. We then subtract the RAB inflation from this amount so that we are only compensated for actual inflation once (through the return on asset).

Our proposed total regulatory depreciation is \$620 million, which represents 6% of our proposed total revenue for 2024-29. This is 21% lower than our depreciation allowance for the 2019-24 period, primarily because RAB indexation, which is netted off straight line depreciation, is significantly higher in 2024-29 due to a higher inflation forecast. It is 44% lower than the depreciation we included in our Draft Plan, which was calculated using a different method to calculate depreciation than the method we have used for this Regulatory Proposal.

⁵ The rate of return is different in each year due to the trailing average debt methodology.

In the following sections, we discuss our decision to continue using the existing weighted average remaining life (WARL) depreciation method for the 2024-29 period and to create a new asset class for our Enterprise Resource Platform (ERP) implementation program expenditure.

3.3.1 We propose to continue using the existing ‘weighted average remaining life’ depreciation method

There are 2 main methods to calculate depreciation that have been accepted by the AER as meeting the NER requirements:⁶

1. **WARL** – calculated by weighting the remaining lives of assets existing at the start of the period and the remaining lives of new assets rolled into the RAB during the period; and
2. **Year-by-year tracking** – calculates individual straight line depreciation by asset class for each year of capex additions over the life of each asset class.

We currently use the WARL depreciation method and have decided to continue using this method for the forthcoming regulatory period.

We had intended to change from WARL to year-by-year tracking for this Regulatory Proposal and engaged with our customers on this matter. This is because:

- At this point in our investment cycle, WARL results in the dollar value of new assets being given more weight even though the older assets make up significantly more of the RAB in physical terms. This results in the WARL method over-estimating the remaining useful lives of all assets within a particular asset class; whereas
- Under year-by-year tracking, the assets added each year will be depreciated by their actual remaining life, rather than an average including older and younger assets. This better aligns the costs of assets with when they are used which is more equitable for customers over the life of the assets. While both methods recover the same value over the life of an asset, year-by-year tracking more accurately reflects the true straight line depreciation value in each year of the life of an asset class.

We began engaging with the RCP on this topic in late 2021. While it was recognised that moving to year-by-year tracking does not increase overall costs to consumers, there was discussion about different segments of customers having different views about whether this change should be implemented. Concerns were raised that it would increase prices at a time when other factors would also put upward pressure on prices. Ultimately, because year-by-year tracking is a valid and more accurate depreciation method, the RCP did not object to us proposing to change to this method.

We also discussed this in our Draft Plan, noting that changing methods to year-by-year tracking would result in an overall revenue increase in the 2024-29 period of \$42 million.⁷ While we did not receive any specific feedback from stakeholders on depreciation methods, we have re-considered our position in light of more recent affordability pressures being experienced by our customers. Our position remains that year-by-year tracking is a superior method to calculate depreciation, however we do not think it is appropriate to change to this method at this time. Based on updated data for our Regulatory Proposal, the decision to continue using the WARL method for the forthcoming 2024-29 period results in \$97 million lower revenue for this period than year-by-year tracking.

As required by NER clause S6.1.3(12), Ausgrid’s nominated depreciation schedules are provided in **Attachments 4.1.b – PTRM for distribution, 4.1.d – PTRM for transmission, 4.1.e – Depreciation calculation for distribution and 4.1.f Depreciation calculation for transmission**. These schedules are AER models that calculate depreciation to be compliant with clause NER 6.5.5(b).

3.3.2 A new asset class for our Enterprise Resource Platform implementation program expenditure

Our depreciation building block will be impacted by our decision to create a new asset class for our ERP implementation program expenditure.

⁶ NER, clause 6.5.5(b).

⁷ Ausgrid (September 2022), [Appendices: Regulatory Matters for our Draft Plan for consultation](#), p 27.

We are proposing to spend \$149 million to refresh and upgrade our business systems and unlock efficiencies through standardised business operations.⁸

This expenditure would normally be allocated to IT systems or in-house software, both of which have a 5 year life for depreciation. However, when discussing ERP with the RCP they noted that there could be an opportunity to lengthen the number of years ERP is depreciated if we replaced our ERP, given that it has not been replaced for over 20 years. This change would reduce the cost impact seen by customers in the 2024-29 period, and would be more reflective of the actual useful life of an ERP.

At our 'Town Hall' event on 15 October 2022, the RCP asked Voice of Community (VoC) Panel members whether we should depreciate ERP over a longer timeframe. Most VoC Panel members supported a depreciation period for ERP that was longer than 5 years.⁹

We assessed this opportunity to ease the bill increase faced by customers in the context of the NER requirements for economic life of assets.¹⁰ ERP systems are long-lived assets that are replaced infrequently because of their complexity and the integral role they play in an organisation's core functions. Implementing a modern ERP system will take several years and require significant process re-engineering and system configuration.

The majority of the cost associated with an ERP transformation is in the business process redesign and implementation, with a smaller component attributable to the cost of the underlying software. Whilst software is typically depreciated over 5 years, the business processes, system integrations and reporting will endure for a much longer period and will continue to be leveraged by Ausgrid throughout this time to deliver services to customers. Matching the useful asset life to the period over which Ausgrid will utilise the system will reduce the upfront cost to customers and ensure that the system is paid for over the period for which the ERP provides value to customers.

This approach is also supported by Australian accounting standards (specifically AASB 138¹¹ - intangible assets) which defines a useful asset life as "the period over which an asset is expected to be available for use by an entity" and provides guidance on how to determine the useful asset life with reference to "estimates of useful lives of similar assets that are used in a similar way". Historically, complex ERP systems such as Ausgrid's have been in place for over 20 years, however, due to shifts in technology we estimate that the upgrade cycle time may be somewhat shorter than we have seen previously and hence the recommendation for a 15 year asset life.

We are proposing a new asset class for ERP with an asset life of 15 years that:

- Reduces the bill impact of ERP in the 2024-29 period, and the subsequent regulatory period;
- Has customer and stakeholder support; and
- Reflects the estimated useful economic life of the implementation.

This proposal reduces depreciation in the 2024-29 period by \$29 million, and reduces revenue by \$32 million.

3.3.3 New asset classes for network and non-network leases

We are proposing new asset classes for network and non-network leases for our distribution assets. We are also proposing a new asset class for non-network leases for our dual function assets, which is distinct from our currently existing Transmission Leases (Network) asset class. The new asset classes relate to the lease of land and buildings where our network and non-network assets are located.

While we have an existing asset class for transmission network leases since the start of our current regulatory period, we have no similar asset class for leases relating to our distribution assets and non-network assets. We consider it is not appropriate to incorporate the leased assets in existing asset classes for land or buildings, as the depreciation lives of capitalised lease assets are based on the terms of the leases.

We have therefore created the new asset classes for these leased assets with remaining lives that reflect the weighted average of actual lease terms. We are also proposing a standard life of 7 years for all new network and non-network distribution assets and non-network dual function assets, based on the expected term on average for all new leases.

⁸ See **Attachment 5.01 – Proposed capital expenditure** for more detail.

⁹ Mosaiclab, Voice of Community Panel & Wider Customer Feedback "What was said" report, October 2022, p 40.

¹⁰ See NER, clause 6.5.5.

¹¹ [AASB 138](#).

3.4 Operating expenditure

The opex building block is an allowance to fund the efficient costs of operating and maintaining the network, including corporate support.

Our proposed opex is \$2,375 million (\$, real FY24), excluding debt raising costs. We used the AER’s preferred method for forecasting opex – the base-step-trend method to forecast this amount.

Our proposed opex is 14% lower than our current period allowance and 10% higher than our current period forecast spend. This is mainly because we have added some step changes in response to regulatory changes, moved some capex to opex and because of other significant changes in our operating environment that affect our costs. After refining our forecasts, our proposed opex is 5% higher than we included in our Draft Plan. More detail on our opex forecast is provided in **Attachment 6.1 – Proposed operating expenditure**.

3.5 Other revenue adjustments

Our proposed revenue for the forthcoming 2024-29 period includes adjustments for the following which are each addressed in further detail below:

- 2 incentives schemes that applied in the current regulatory control period where penalties or rewards are added as revenue adjustments – the Efficiency Benefits Sharing Scheme (**EBSS**) and the Capital Expenditure Sharing Scheme (**CESS**);
- The Demand Management Innovation Allowance Mechanism (**DMIAM**) which we propose to apply for the forthcoming 2024-29 period, and adds to our proposed revenue in this period; and
- A negative adjustment for revenue earned from our shared assets.

3.5.1 Efficiency Benefit Sharing Scheme

The EBSS provides network businesses with a continuous incentive to pursue efficiency savings in their operating expenditure and provide a fair sharing of these between a distributor and network users. As **Attachment 6.1 – Proposed operating expenditure** discusses, we have reduced our opex significantly since 2015 and expect to spend less than our opex allowance for the current 2019-24 period. This means we expect a positive carryover amount in the 2024-29 period. **Figure 3.2** shows opex allowance and actuals for FY20-23. EBSS for FY24 will be calculated in the next regulatory determination, when actual opex for that year is known.

Figure 3.2 Opex allowance and actuals (\$m, real FY24)

| | FY20* | FY21 | FY22 | FY23 |
|--|--------|-------|-------|-------|
| Opex allowance (excluding debt raising costs) | 570.0 | 553.5 | 555.6 | 557.7 |
| Actual/forecast opex** | 616.3 | 462.9 | 401.5 | 408.6 |
| Incremental gain/(loss) | (46.3) | 136.9 | 63.4 | (4.9) |

*Note that FY20 opex allowance has been adjusted for a storm pass through event

**Opex after adjusting for DMIA and movement in provisions

Our calculation for EBSS departs from version 2 – the current version – of the EBSS. Version 2 of the EBSS calculates the first year incremental gain/loss by subtracting efficiency gains made in the previous regulatory after the base year. That is, taking account of efficiency gains between FY19 and FY20 actual opex. We have calculated incremental gain/loss for the first year of the current period, FY20, as the difference between actual and forecast opex which reflects version 1 of the EBSS. This is because our actual opex in FY18 was higher than the opex used to forecast opex for the 2019-24 period. If we applied the calculation per version 2, we would have a negative EBSS carryover if we spent exactly as forecast after FY18. We did not consider this was consistent with the intent of the EBSS, and would not produce a benefit to customers.

In 2019 we sought clarity from the AER on this matter, and received staff level agreement with our interpretation and proposal that we apply the version 1 calculation of incremental gain/loss for FY20.¹²

We have calculated this amount as \$419 million using the AER's EBSS model, which is 4% of our proposed total revenue, using the AER's model and our forecast opex spend in FY23. See **RIN.12 – 2024-29 – Reset RIN – Workbook 3 - EBSS** for more detail.

3.5.2 Capital Expenditure Sharing Scheme

The CESS provides network businesses with a continuous incentive to undertake efficient capital expenditure throughout the regulatory control period by rewarding efficiency gains and penalising efficiency losses. We expect our net capex over 2019-24 will be lower than the allowance in this period, mainly because our actual asset disposals have exceeded our forecast. This means we expect a positive carry over amount in the 2024-29 period.

We have calculated this amount as \$183 million using the AER's model and our forecast capex for FY23 and FY24. We have also adjusted this amount by negative \$35 million to account for our capex overspend in the final year of the previous 2014-19 period.

At our 2019-24 determination we proposed that expenditure on innovation, additional cyber security and implementation of the advanced distribution management system (**ADMS**) would be excluded from the CESS calculation.¹³ This was agreed by customer stakeholders at the time, and confirmed in 2022.¹⁴ We have separately identified costs associated with these categories and removed \$150 million (nominal, including half WACC) from the allowance and \$206 million (nominal, including half WACC) actual and forecast capex to calculate the CESS. Actuals are higher than allowance mainly due to overspends in the ADMS project caused by cyber-security requirements under Ausgrid's critical infrastructure licence conditions. Data is included in **RIN.13.a – 2024-29 – Reset RIN – Workbook 4 – CESS Distribution**.

Our adjustment for the CESS is \$148 million, which is 2% of proposed total revenue.

3.5.3 Demand Management Innovation Allowance Mechanism

The DMIAM provides distribution networks with funding for research and development on demand management projects that have the potential to reduce long-term network costs. It comprises:

- A fixed allowance of \$200,000 (\$, real FY17), plus 0.075% of the annual allowed revenue for each year;
- Project eligibility requirements; and
- Compliance reporting requirements.¹⁵

As shown in **Figure 3.3**, we have calculated our allowance under the DMIAM to be \$9 million, which is 0.1 % of our proposed total revenue.

Figure 3.3 DMIAM allowance (\$m, real FY24 except where noted)

¹² Letter received by EGM Strategy and Regulation (now Chief Customer Officer) 21 May 2019: Application of the EBSS in the 2019-24 regulatory control period.

¹³ Ausgrid (2019), [Revised regulatory proposal](#), p 150.

¹⁴ Discussion with the AER indicated that the approach to CESS exclusions should be supported by customer panels (email received from Sebastian Roberts 10 March 2022). It was also confirmed by members of RCP that exclusions were understood to be symmetrical i.e. whether there is an overspend or an underspend (email received from Mark Grenning 25 November 2021).

¹⁵ AER (2017), [Demand Management Innovation Allowance Mechanism](#), p 8.

| | FY25 | FY26 | FY27 | FY28 | FY29 | Total |
|--|------------|------------|------------|------------|------------|------------|
| Real annual revenue requirement (ARR) | 1,738.8 | 1,873.1 | 1,785.6 | 1,752.7 | 1,759.4 | 8,909.7 |
| ARR * 0.075% | 1.3 | 1.4 | 1.3 | 1.3 | 1.3 | 6.7 |
| Base amount | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 1.2 |
| Total (real FY24) | 1.6 | 1.7 | 1.6 | 1.6 | 1.6 | 7.9 |
| Total (nominal) | 1.6 | 1.8 | 1.7 | 1.8 | 1.8 | 8.6 |

3.5.4 Shared assets

“Shared assets” refers to those assets initially wholly captured in the value of the RAB but now used to provide both regulated and unregulated services. The AER may reduce Ausgrid’s annual revenue requirement for a regulatory year to share the benefit of using the asset for unregulated purposes with customers. In making this decision, the AER must have regard to:

- **Shared asset principles** – including that a shared asset cost reduction should be applied where the use of the assets, other than for SCS, is material; and
- **Shared asset guideline** – including reducing the annual revenue requirement of a network business to reflect the use of shared assets, including defining and calculating materiality. The use of shared assets is material when a DNSP’s annual unregulated revenue from shared assets is expected to be greater than 1% of its total smoothed revenue requirement for a particular regulatory year.¹⁶ If this materiality threshold is not met, no shared asset cost reduction applies.¹⁷

Applying the AER’s shared asset guideline, we calculate the materiality of our use of shared assets to earn unregulated revenue as shown in **Figure 3.4**.

Figure 3.4 Materiality of shared assets revenue (\$ million, nominal)

| | FY25 | FY26 | FY27 | FY28 | FY29 | Total |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|---------------|
| Forecast shared assets revenue | 29.3 | 32.6 | 38.0 | 39.2 | 41.9 | 181.1 |
| Smoothed revenue | 1,694.7 | 1,814.4 | 1,943.2 | 2,081.5 | 2,230.4 | 9,764.2 |
| Materiality (%) | 1.73% | 1.80% | 1.96% | 1.88% | 1.88% | 1.85% |
| Revenue decrement | (2.9) | (3.1) | (3.5) | (3.5) | (3.6) | (16.6) |

We currently expect that the revenue we will receive from these shared assets will become material in the 2024-29 period. Because of this, we have reduced our proposed total revenue by 10% of the forecast shared asset revenue. We have calculated this amount as \$17 million (nominal), which represents a 0.2% reduction to our proposed revenue.

3.6 Taxation allowance

¹⁶ AER, [Shared asset guideline](#), November 2013, p 8.

¹⁷ AER, [Shared asset guideline](#), November 2013, p 6.

The 'taxation' building block is an allowance to meet income tax liabilities, taking into account the benefit that shareholders receive from imputation credits.

In October 2020, the Full Court of the Federal Court of Australia made a unanimous decision relating to the tax treatment of capital contributions in Victoria,¹⁸ under which capital contributions subject to the decision are not added to revenue for the purpose of calculating tax. Consequently, the AER did not allow the relevant capital contributions to be included in the Victorian networks' taxable revenue for the purpose of calculating their tax allowance in the recent decisions.

It is unclear whether the ruling would apply in other jurisdictions. Our expert tax advice indicates that the ruling does not apply in NSW because of the different capital contribution frameworks. However, AER staff have indicated that their preferred approach is not to treat capital contributions as taxable revenue because it is not clear to them that the ruling does not apply in NSW. Given this, we have prepared our proposal using the AER's preferred approach. However given the complexity and significance of this issue (both for Ausgrid and other networks), we believe this is a matter for ongoing consideration. To support regulatory certainty and transparency, the AER may wish to seek (and publish with its draft decision) expert tax advice on the applicability of the VPN Decision in each jurisdiction it regulates.

We have incorporated forecasts for immediately expensed capital expenditure in the calculation of the tax allowance. Our forecasting approach for immediately expensed capex is based on our expectation for assets that will be decommissioned over the 2024-29 period and the associated decommissioning costs that will be immediately deductible, in accordance with our current tax policy. We have no intention of changing our tax policy on immediate expensing of capital expenditure from the current policy.

We have calculated the tax allowance using the AER's methodology as \$93 million, which is 1% of our proposed total revenue. This includes an adjustment for imputation credits based on the AER's 2018 RORI value for gamma of 0.585, as shown in **Figure 3.5**.

Figure 3.5 Tax building block (\$ million, nominal)

| | FY25 | FY26 | FY27 | FY28 | FY29 | Total |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| Taxable income | 154.0 | 151.7 | 148.1 | 152.1 | 144.3 | 750.3 |
| Income tax payable | 46.2 | 45.5 | 44.4 | 45.6 | 43.3 | 225.1 |
| Less value of imputation credits | (27.0) | (26.6) | (26.0) | (26.7) | (25.3) | (131.7) |
| Tax building block | 19.2 | 18.9 | 18.4 | 18.9 | 18.0 | 93.4 |

¹⁸ *Victoria Power Networks v Commissioner of Taxation* [2020] FCAFC 169 (VPN Decision).
15 | Attachment 4.1 – 2024-29 proposed revenue

4. Smoothed revenue

Annual revenue requirements might fluctuate from year to year over the course of a regulatory control period, which can cause price volatility. This volatility can be smoothed so that prices do not fluctuate with the timing of expenditure programs during a regulatory period. This smoothed revenue is calculated so that Ausgrid is no better or worse off in net present value terms as a result of the revenue smoothing.

The AER’s standard smoothing method is for the first year revenue to be the same as the building block revenue, and the final year revenue to be no more than 3% different than the building block revenue. If we were to apply the standard method for the forthcoming 2024-29 period:

- There would be a significant increase in revenue between the final year of the current period and the first year of the 2024-29 period; and
- The price increase between FY24 and FY25 would be in the region of [11]% nominal, and the following 4 years would be fairly flat.

We are proposing not to apply this method for the forthcoming 2024-29 period because we do not think it would be appropriate to push through such a material price increase in one year, particularly in the current inflationary environment. We have also considered price movements in other sections of the industry, which could materially impact customers over the coming years. We do not consider a 11% increase in FY25, after forecast heightened wholesale electricity prices in 2023 and 2024,¹⁹ to be a good customer outcome.

Instead of the AER’s standard method, we are proposing to smooth revenue so that the annual price increases will be roughly similar each year. This results in a final year difference between smoothed and unsmoothed revenue of 8.9% for distribution and 19.2% for dual function assets.

To test our thinking, we raised the prospect of different smoothing methods in our Draft Plan and at our Town Hall on 15 October 2022:

- We did not receive specific feedback to this question in submissions made to our Draft Plan; and
- At the Town Hall, we presented the implications of departing from the standard smoothing method on prices in the forthcoming regulatory period and, importantly, the potential implications for price changes in Year 1 of the subsequent regulatory period (FY30). We noted that – all else being equal – we would expect prices to decrease in the subsequent period because we have recovered more revenue in the later years under our proposed method. 15 of the 21 of the attendees that voted on this matter (71%) agreed with the method we had employed in the Draft Plan to have equal price increase over the period.²⁰

Figure 4.1 shows the proposed X-factors used to smooth revenue. **Figure 4.2** shows building block and smoothed revenue for distribution, and **Figure 4.3** shows building block and smoothed revenue for dual function assets.

Figure 4.1 Proposed X-factors for the 2024-29 period

| | FY25 | FY26 | FY27 | FY28 | FY29 |
|-----------------------------|---------|--------|--------|--------|--------|
| Distribution | -3.00% | -3.56% | -3.56% | -3.56% | -3.56% |
| Dual function assets | -30.00% | -9.20% | -9.20% | -9.20% | -9.20% |
| Weighted average | -5.00% | -4.08% | -4.10% | -4.13% | -4.16% |

¹⁹ AER (November 2022), [Wholesale Markets Quarterly Q3 2022](#), p 26.

²⁰ Mosaiclab (2022), Voice of Community Panel & Wider Customer Feedback “What was said” report, p 28.

Figure 4.2 Unsmoothed and smoothed revenue – distribution (\$ million, nominal)

| | FY25 | FY26 | FY27 | FY28 | FY29 | Total |
|---------------------------|---------------|----------------|-------------|-------------|--------------|--------------|
| Unsmoothed revenue | 1,613.7 | 1,787.4 | 1,746.2 | 1,761.8 | 1,821.6 | 8,730.8 |
| Smoothed revenue | 1,539.4 | 1,640.1 | 1,747.3 | 1,861.5 | 1,983.2 | 8,771.5 |
| Difference | (74.3) | (147.3) | 1.1 | 99.7 | 161.6 | 40.8 |

Figure 4.3 Unsmoothed and smoothed revenue – dual function assets (\$ million, nominal)

| | FY25 | FY26 | FY27 | FY28 | FY29 | Total |
|---------------------------|---------------|---------------|--------------|-------------|-------------|--------------|
| Unsmoothed revenue | 176.6 | 196.7 | 199.6 | 203.0 | 207.4 | 983.5 |
| Smoothed revenue | 155.2 | 174.4 | 195.9 | 220.0 | 247.2 | 992.6 |
| Difference | (21.4) | (22.4) | (3.8) | 17.0 | 39.7 | 9.2 |