

# Issues Paper

Ausgrid

## Electricity Distribution Determination

1 July 2024 to 30 June 2029

March 2023

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# 1 Introduction

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable and affordable energy future for Australia. We regulate electricity networks in all jurisdictions except Western Australia. Our primary role is in setting the maximum revenue that network businesses can recover from users of their networks. Our goal is to make decisions that ensure consumers pay no more than necessary for safe and reliable energy.

Ausgrid is one of three electricity distribution network service providers in New South Wales (NSW). The Ausgrid network serves customers in Greater Sydney, the Central Coast and the Hunter Valley.

On 31 January 2023, we received a revenue proposal from Ausgrid for the five-year regulatory period starting 1 July 2024 to 30 June 2029 (2024–29 period).<sup>1</sup> Our final decision on this proposal will set the revenue allowance that forms the major component of the revenue it proposes to recover from its customers.

Our Better Resets Handbook (Handbook), together with the regulatory framework, sets out our expectations for each network's revenue proposal. In addition to expectations on consumer engagement it sets out our expectations on the basis of estimation of the key revenue components, such as capital and operating expenditure (capex and opex), depreciation and Tariff structure statements (TSS). These expectations and the regulatory framework provide the framework for our assessment of the revenue components and may help guide stakeholders' submissions on the proposal. As we stated in the Handbook:

As the economic regulator of energy networks, we are required to make decisions that best advance the long-term interests of consumers, as expressed in the National Electricity Objective and National Gas Objective. If a network business meets our expectations this will increase the likelihood that its regulatory proposal advances the long-term interests of consumers, giving us the confidence to rely on a more targeted assessment to meet our obligations.<sup>2</sup>

However, over the 2024–29 period, there are several additional factors that may affect the total revenue that Ausgrid will recover from its consumers, including:

- economic factors outside of Ausgrid's control, such as inflation and interest rates<sup>3</sup>
- Renewable Energy Zone (REZ) projects under the NSW Infrastructure roadmap
- Australian Energy Market Commission's (AEMC) ongoing metering competition review
- cost pass through events defined in the National Electricity Rules (NER) and our decision.

This issues paper highlights some of the key elements of the proposal, and identifies issues that on preliminary review, are likely to be the focus of our assessment. Stakeholders can assist in our process by providing their views on these or any other aspects of the proposal.

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<sup>1</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023. Available at: [Ausgrid's 2024–29 revenue proposal](#).

<sup>2</sup> AER, *Better Resets Handbook*, December 2021, p.3.

<sup>3</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 16.

## 1.1 How can you get involved?

Consumer engagement is a valuable input to our determination. When we receive stakeholder submissions that articulate consumer preferences, address issues in a revenue proposal, and provide evidence and analysis, our decision-making process is strengthened.

You can contribute to our assessment by:

- making a written submission on the Ausgrid proposal to [AERresets2024-29@aer.gov.au](mailto:AERresets2024-29@aer.gov.au) by **12 May 2023**<sup>4</sup>.
- joining us, Ausgrid and our Consumer Challenge Panel (CCP26)<sup>5</sup> at an online public forum on **5 April 2023**. Details of how to register for this forum are available on our website and through [Eventbrite](#) (external link).<sup>6</sup>

Table 1 sets out the key milestones planned for this review.

**Table 1 Key dates for Ausgrid’s 2024-29 revenue determinations**

Milestone	Date
AER publishes Issues Paper on Ausgrid’s proposal	28 March 2023
AER holds public forum on Issues Paper and Ausgrid’s proposal	5 April 2023
Submissions due on Ausgrid’s proposals and Issues paper	12 May 2023
AER publishes draft decision	September 2023
AER holds public forum on draft decision (predetermination conference)	October 2023
Ausgrid submits revised proposal to AER	December 2023
Submissions due on draft decision and Ausgrid revised proposal	January 2024
AER publishes final decision	April 2024

Note: Timelines are indicative and subject to change.

<sup>4</sup> See [Ausgrid Submission](#) for full details on making a submission. For further information regarding the AER’s use and disclosure of information provided to it, see the [ACCC/ AER Information Policy](#).

<sup>5</sup> The role of the Consumer Challenge Panel is to assess and advise the AER on the quality of engagement undertaken by network businesses and whether the interests of customers are adequately reflected in regulatory proposals.

<sup>6</sup> Register for the Ausgrid, Endeavour Energy, Essential Energy Public forum through [Eventbrite](#) (external link).

## 2 Our initial observations

Ausgrid's proposal would allow it to recover \$9,764.2 million<sup>7</sup> (\$nominal, smoothed) from its customers over the 2024–29 period. This is 28.4% higher than what we approved for the 2019–24 period.<sup>8</sup> Ausgrid estimates this would flow through to customers as nominal increases of \$12 per year for residential electricity consumers, and \$33 per year for small businesses over the period.<sup>9</sup>

Ausgrid's proposed charges are for the network components of the electricity bill for their customers and determine the revenue allowance that Ausgrid will use to calculate network charges each year in accordance with its approved pricing methodology. The cost of the network components of the electricity supply chain makes up about 22% of the average electricity bill for both household and small business customers and are ultimately recovered through electricity retail charges.<sup>10</sup> This does not include Ausgrid's transmission revenue, which is recovered by Transgrid as the coordinating transmission network service provider for NSW.

Ausgrid's proposal is the first step in a 15-month review process. Over the course of this process, as we move from proposal to draft decision, and then to revised proposal and final decision, components of forecast revenue are likely to change. These changes may result from us taking a different view on the proposed revenue to Ausgrid. In addition, a standard part of our process is to update the forecast revenue for movements in market variables such as interest rates, bond rates and inflation. Movements in these market variables can have a material impact on the final revenue and, therefore, consumer bills. Therefore, projected bill impacts at this stage should be treated as no more than potential impacts subject to changes in interest rates and inflation.

**Table 2 Summary of proposed revenue (\$nominal, smoothed)**

(\$ million)	2024–25	2025–26	2026–27	2027–28	2028–29	Total 2024–29	Change from 2019–24
Ausgrid - distribution	1539.4	1640.1	1747.3	1861.5	1983.2	8771.5	1.9% <sup>1</sup>
Ausgrid - transmission <sup>2</sup>	155.2	174.4	195.9	220.0	247.2	992.7	95.7% <sup>1</sup>

Source: Ausgrid, *Attachment 4.1.b PTRM for distribution.xlsx*, January 2023; Ausgrid, *Attachment 4.1.d PTRM for transmission.xlsx*, January 2023.

Note 1: Change from 2019–24 reflect real percentage change in \$2023–24 terms. The large real revenue increase is due to a negative \$413.5 million revenue adjustment building block (due to the inclusion of a one-off remittance adjustment) in the 2019–24 period compared to a positive \$18.7 million revenue adjustment building block for the 2024–29 period.

Note 2: Ausgrid's proposal includes revenue for its transmission assets, which are recovered through TransGrid as the coordinating transmission network service provider for NSW and not through Ausgrid's distribution network tariffs.

<sup>7</sup> Includes distribution and transmission revenues.

<sup>8</sup> In real terms (\$2023–24), proposed total revenue is \$592.4 million (7.1 per cent) higher than approved for 2019–24 period.

<sup>9</sup> Distribution component only and exclusive of GST. Some Ausgrid revenue is included in the transmission component of bills. Ausgrid, *RIN.14 – 2024-2029 – Reset RIN – workbook 5 – Bill Impacts*, January 2023.

<sup>10</sup> Distribution component only. Some Ausgrid revenue is included in the transmission component of bills. Ausgrid, *RIN.14 – 2024-2029 – Reset RIN – workbook 5 – Bill Impacts*, January 2023. We will assess the appropriateness of Ausgrid's proposed distribution bill assumptions and update where necessary for the draft decision.

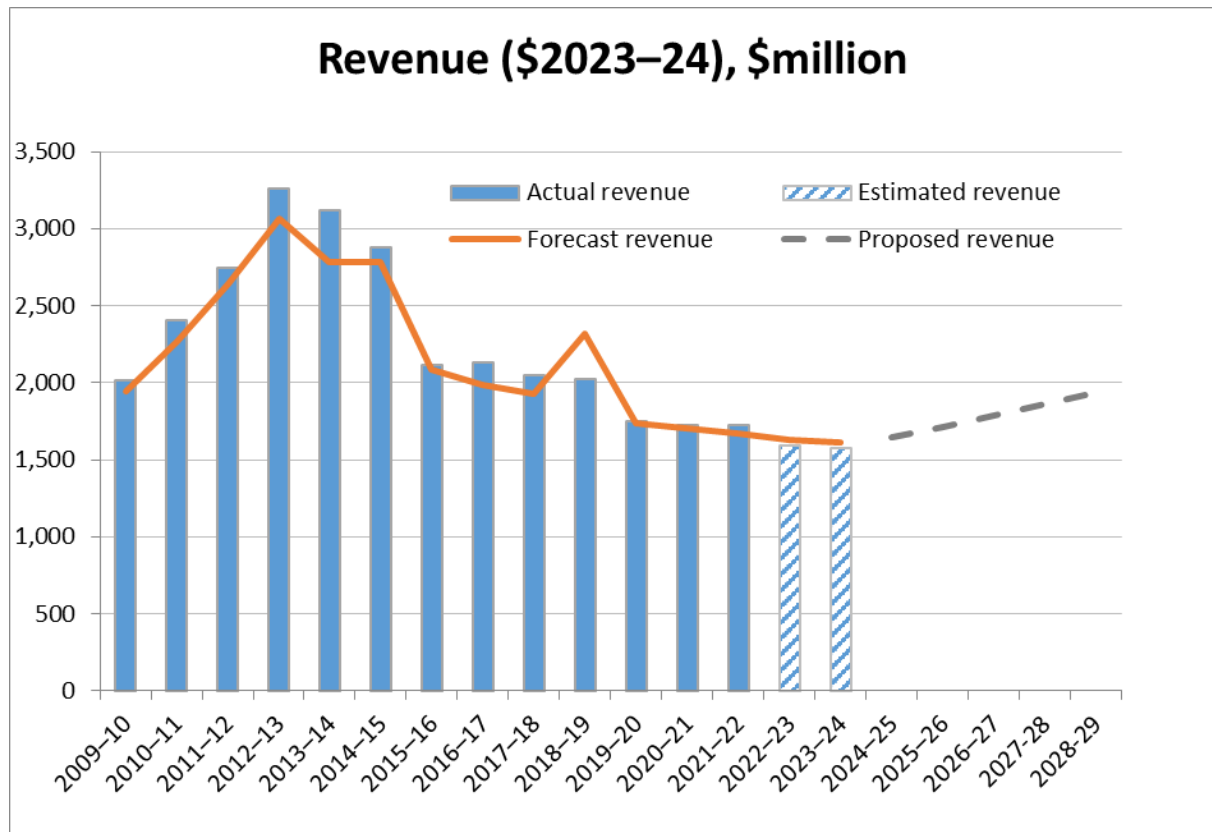
In its proposal, Ausgrid has outlined the extensive customer and stakeholder engagement they have undertaken in the development of its proposal. Ausgrid has told us that affordability, resilience and transforming the grid (including net zero) emerged as key areas of concern to the stakeholders.<sup>11</sup> Section 3 discusses the way Ausgrid sought, tested and included its customers priorities into its proposal.

## 2.1 Drivers of revenue in the proposal

To compare revenue from one regulatory period to the next on a like-for-like basis, we make an adjustment for the impact of inflation. To do this, we use “real” values based on a common year (in this case, 2023-24) which have been adjusted to remove the impact of inflation.

In real terms, as Figure 1 shows, the forecast revenue requirements proposed for 2024–29 are increasing. Ausgrid’s proposed revenue for 2024–29 is 7.1% higher in real terms than the revenue we approved in our original decision for 2019–24.

**Figure 1 Changes in regulated revenue over time (\$million, 2023–24)**



Source: AER analysis; includes transmission and distribution revenues.

Ausgrid notes the trend in revenue is primarily driven by;<sup>12</sup>

- ‘factors inside Ausgrid’s control’; such as delivering net zero, improving climate resilience, cyber protection and prioritising innovation

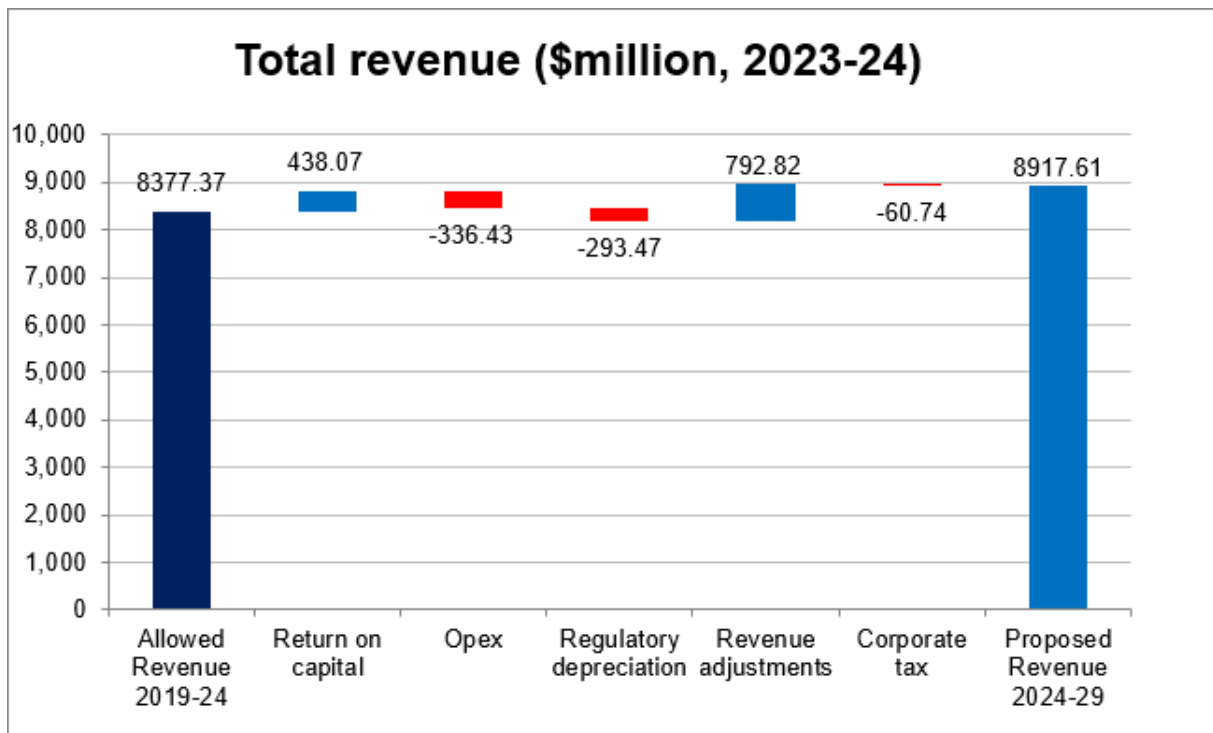
<sup>11</sup> Ausgrid, *2024–29 Regulatory Proposal Overview*- January 2023, p. 13.

<sup>12</sup> Ausgrid *2024-29 Regulatory Proposal* - January 2023 page 12

- ‘factors outside Ausgrid’s control’; such as rising interest rates, inflation, and insurance premiums
- ‘affordability measures’ proposed including; depreciation method, gifted asset tax decision, property disposals, and longer asset life for Enterprise Resource Planning (ERP).

Figure 2 below shows the broad changes in revenue at the “building block” level and these are covered in more detail in sections 4, 5 and 6 below where we highlight some of the key elements of the proposal and what is driving these outcomes.

**Figure 2 Changes in building blocks: Ausgrid’s total revenue 2019–24 to forecast revenue 2024–29 (\$million, 2023–24)**



Note: Allowed revenue and proposed revenue in the chart are unsmoothed total revenue for the regulatory period.

Source: AER analysis; includes transmission and distribution revenues.

The overall trend in building block revenue is primarily driven by:

- Increase in return on capital; which is being driven by an increase in the forecast rate of return and an increase in regulatory asset base (RAB) value.
- Higher revenue adjustment due to a negative \$267.5 million revenue adjustment building block (due to the inclusion of a one-off transmission remittal adjustment) in the 2019–24 period compared to a positive \$525.4 million (driven by large positive distribution opex EBSS adjustments) over the 2024–29 period.
- Offsets to the above are delivered by a fall in regulatory depreciation, opex and corporate tax amounts.



### 3 Ausgrid consumer engagement

Ausgrid is a natural monopoly supplying an essential service. Genuine, high quality consumer engagement by Ausgrid is essential to ensuring that its proposal is driven by consumer preferences, supports delivery of services that meet the needs of its consumers, and does so at a price that is affordable and efficient. We've seen through experience that a regulatory proposal developed through genuine engagement with consumers is more likely to be largely or wholly accepted in our decisions.

Our framework for considering consumer engagement in network revenue determinations is set out in the Handbook.<sup>13</sup> Used in conjunction with our technical analysis, the framework for our regulatory decision making allows us to place weight on the outcomes of the engagement activities undertaken by a business to assist in providing an overall assessment of a proposal.

Ausgrid's proposal has been shaped by extensive consultation with its customers and stakeholders over its 18-month engagement program. Ausgrid states that it has been guided by the Handbook, and while not on the early signal pathway, it has developed a proposal that reflects consumer preferences and is capable of being accepted by the AER.<sup>14</sup>

Ausgrid has demonstrated a turning point in its efforts to meaningfully engage and involve customers in its decision-making process. Our assessment as to the prudence and efficiency of proposed expenditures is incomplete and ongoing, however we are encouraged by Ausgrid's approach to its 2024–29 proposal. The evidence of strong levels of consumer engagement may provide the basis for a more constructive and efficient regulatory process.

We are interested in stakeholders' views on the extent to which Ausgrid has achieved its overarching goal, including whether specific changes are required to its proposal. Such information, as well as our own analysis of Ausgrid's efficient costs, will inform our assessment of its proposal and enable us to determine Ausgrid's maximum revenue for the 2024–29 period.

#### 3.1 Nature of engagement

The nature of engagement is about how networks engage with their consumers. Our expectations are that network businesses will sincerely partner with consumers and equip them to effectively engage in the development of their proposals.

Ausgrid outlines in its proposal that an independent challenge body was crucial to the engagement and co-design process<sup>15</sup> and in June 2021 established its Reset Customer Panel (RCP). The primary purpose being 'to represent the long-term perspectives of our customers and to challenge Ausgrid on key issues relating to the 2024–29 period.'<sup>16</sup> The Consumer Challenge Panel, sub-panel 26 (CCP26), and AER staff have also had the opportunity to observe Ausgrid's engagement, including meetings with its RCP.

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<sup>13</sup> AER, *Better Resets Handbook*, December 2021.

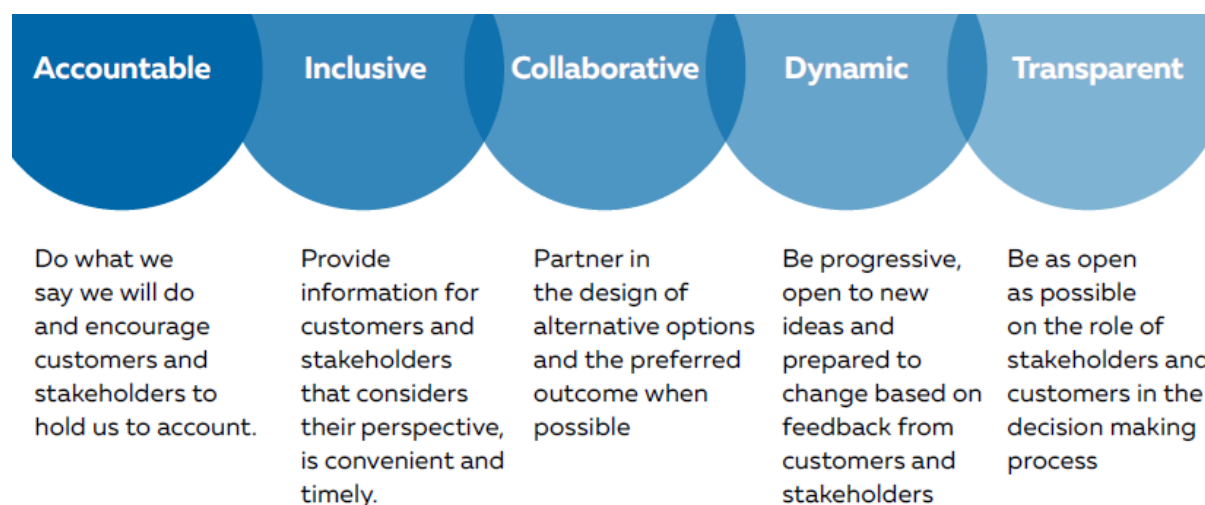
<sup>14</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, pp. 5, 14.

<sup>15</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 28.

<sup>16</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 28.

Ausgrid’s engagement focused on principles and objectives developed in partnership with its customer advocates and Figure 3 details the principles that guided this approach.

**Figure 3 Ausgrid’s engagement principles**



Source: Ausgrid, *Att. 3.4. – Engagement framework – 29 July 2022*, p. 10.

In developing its 2024–29 proposal, Ausgrid recognised the importance of strong governance in ensuring that what it hears from customers and stakeholders has a direct and tangible impact on decisions.<sup>17</sup> Stakeholders represented in its engagement governance model included Ausgrid’s Board and Executive, Customer Consultative Committee, Pricing Working Group, Network Innovation Advisory Committee, and its RCP.<sup>18</sup>

A core part of Ausgrid’s process has been its engagement approach with its RCP. Its work was guided by agreeing on four broad workstreams covering issues related to value for money, network investment, sustainability and the future grid, and customer experience.<sup>19</sup> The RCP collaborated with Ausgrid to select, shape, and refine potential options that would be presented to customers throughout the engagement process. Ausgrid advises that this collaboration was ‘intended to reduce the risk of biasing particular customers and to ensure our engagement was sincere and transparent.’<sup>20</sup>

One method that Ausgrid implemented to engage customer was through its Voice of Community Panel (VoC Panel). During these sessions, customers learnt and engaged with experts, sought independent advice, and spent 60 hours deliberating face-to-face as a group.<sup>21</sup>

<sup>17</sup> Ausgrid, *Att. 3.4. – Engagement framework – 29 July 2022*, p. 12.

<sup>18</sup> Ausgrid, *Att. 3.4. – Engagement framework – 29 July 2022*, p. 13. See Figure 3.3.2 Customer and stakeholder governance structure in Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 30 for further details.

<sup>19</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 32.

<sup>20</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 32.

<sup>21</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 39.

## 3.2 Breadth and depth of engagement

The breadth and depth of engagement is about the scope of engagement with consumers and the level of detail at which network businesses engage on issues. The breadth and depth of engagement also covers the range of avenues used to engage with consumers.

Using the objectives and principles that were set out in section 3.1, Ausgrid designed its engagement framework to reflect the International Association of Public Participation Spectrum (IAP2). A sample of the examples of engagement undertaken included:

- Inform – Ausgrid Board in attendance, transparent engagement tools, newsletters, information accessible at Ausgrid's YourSay website, map of Indigenous communities needs and aspiration, and data analysis
- Involve – Translation for key language groups, games (to reach low interest customers), surveys and street walks
- Consult – Interviews, forums, focus groups and round tables
- Collaborate – staff involvement, independent challenge and observation through the RCP and Citizen's Jury (VoC Panel).<sup>22</sup>

Ausgrid undertook a very significant, multi-faceted engagement plan, and as a result we can only highlight key elements here.<sup>23</sup> We note the strong support provided by Ausgrid's RCP, who were satisfied that the proposal met the requirements outlined in the Handbook, as it was based on a well-resourced, thoroughly prepared customer engagement program that was supported from the Board down.<sup>24</sup> The RCP report has acknowledged:

...Ausgrid should be congratulated for lodging what we believe is an exceptional revenue proposal. Prepared through a period of rising anxiety about inflationary cost pressures, Ausgrid has listened to its customers and agreed to a series of very significant initiatives including a new Customer Service Incentive Scheme (CSIS), a ground breaking set of governance principles around its Enterprise Resource Platform (ERP) and expanded ICT investment, and agreed to a set of affordability initiatives.<sup>25</sup>

## 3.3 Clearly evidenced impact

Ausgrid's engagement approach has driven the outcomes of its 2024–29 proposal. Regard has been given to identifying and understanding what is important to its customers and stakeholders, the IAP2 Spectrum best practice engagement, and guidance from the AER and CCP26. The RCP have acknowledged that the Ausgrid has shown commitment from staff at all levels to respond to inquiries and requests for information, and to be willingly challenged in its thinking.<sup>26</sup>

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<sup>22</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, pp. 32 – 33.

<sup>23</sup> See Ausgrid's Proposal submission documents, Chapter 3 – Our customers for further details.

<sup>24</sup> Ausgrid, *Reset Customer Panel - Att. 3.5 - Independent report on Ausgrid's 2024-29 revenue proposal*, 31 Jan 2023, pp. 6-7.

<sup>25</sup> Ausgrid, *Reset Customer Panel - Att. 3.5 - Independent report on Ausgrid's 2024-29 revenue proposal*, 31 Jan 2023, p. 5.

<sup>26</sup> Ausgrid, *Reset Customer Panel - Att. 3.5 - Independent report on Ausgrid's 2024-29 revenue proposal*, 31 Jan 2023, p. 2.

Ausgrid has held itself accountable to the consumer engagement principles outlined in the Handbook and developed a proposal that it considers reflects consumers preference and is capable of being accepted by the AER, which we applaud and encourage stakeholder views on.<sup>27</sup>

### Questions

1. Do you think Ausgrid's consumer engagement meets the expectations set out in the Handbook in delivering a consumer-centric proposal? Please give examples.

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<sup>27</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, pp. 5, 14.

## 4 Key elements of Ausgrid's revenue proposal

The regulatory framework governing electricity networks and our assessment of Ausgrid's proposal is set out in the National Electricity Law and Rules (NEL and NER). Our work is guided by the National Electricity Objective (NEO) which promotes efficient investment in, and operation and use of, electricity services in the long-term interests of consumers<sup>28</sup>.

The foundation of our regulatory approach is a benchmark incentive framework to setting maximum revenues: once regulated revenues are set for the five-year period, a network that keeps its actual costs below the regulatory forecast of costs retains part of the benefit. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. This delivers benefits to consumers as efficient costs are revealed over time and drive lower cost benchmarks in subsequent regulatory periods. By only allowing efficient costs in our approved revenues, we promote delivery of the NEO and ensure consumers pay no more than necessary for the safe and reliable delivery of electricity.

Ausgrid's proposed revenue reflect its forecasts of the efficient cost of providing its distribution network services over the 2024–29 period. Its 2024–29 proposal, and our assessment of it under the Law and Rules, are based on a “building block” approach which looks at five cost components:<sup>29</sup>

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business)
- depreciation of the RAB (or return of capital, to return the initial investment to investors over time)
- forecast operating expenditure (opex) – the operating, maintenance and other non-capital expenses, incurred in the provision of network services
- revenue increments or decrements resulting from the application of incentive schemes such as the opex Efficiency Benefit Sharing Scheme (EBSS), Capital Expenditure Sharing Scheme (CESS) and Demand Management Innovation Allowance (DMIA)
- the estimated cost of corporate income tax.

### 4.1 Rate of return

The return each business is to receive on its capital base (“return on capital”) is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the RAB value.

We estimate the rate of return by combining the returns of two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest rate on its loans and give a return on equity to investors.

A good estimate of the rate of return is necessary to promote efficient prices in the long-term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and

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<sup>28</sup> National Electricity Law (NEL or Law), s.7.

<sup>29</sup> See Figure 3.4 in AER, [State of the energy market](#), June 2022, p.65.

reliability may decline. Alternatively, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

The approach that Ausgrid, and we, must take to estimate the rate of return, including the return on debt and the return on equity, as well as the value of imputation credits, is set out in our binding Rate of Return Instrument. We publish a new Rate of Return Instrument every four years. For its proposal, Ausgrid has applied our current, 2018 Rate of Return Instrument (2018 Instrument)<sup>30</sup>. Our final decision on Ausgrid's proposal, which will be made in April 2024, we will apply the new 2022 Rate of Return Instrument published in February 2023. Therefore, stakeholders should treat the rate of return estimates submitted by Ausgrid as indicative, pending the application of the 2022 Rate of Return Instrument.

#### 4.1.1 Inflation

In 2020, we concluded a review of our approach to estimating expected inflation. Ausgrid has applied the approach established in the review, but once again, the estimates provided by Ausgrid should be considered indicative because estimates of inflation may change as we move through the process.

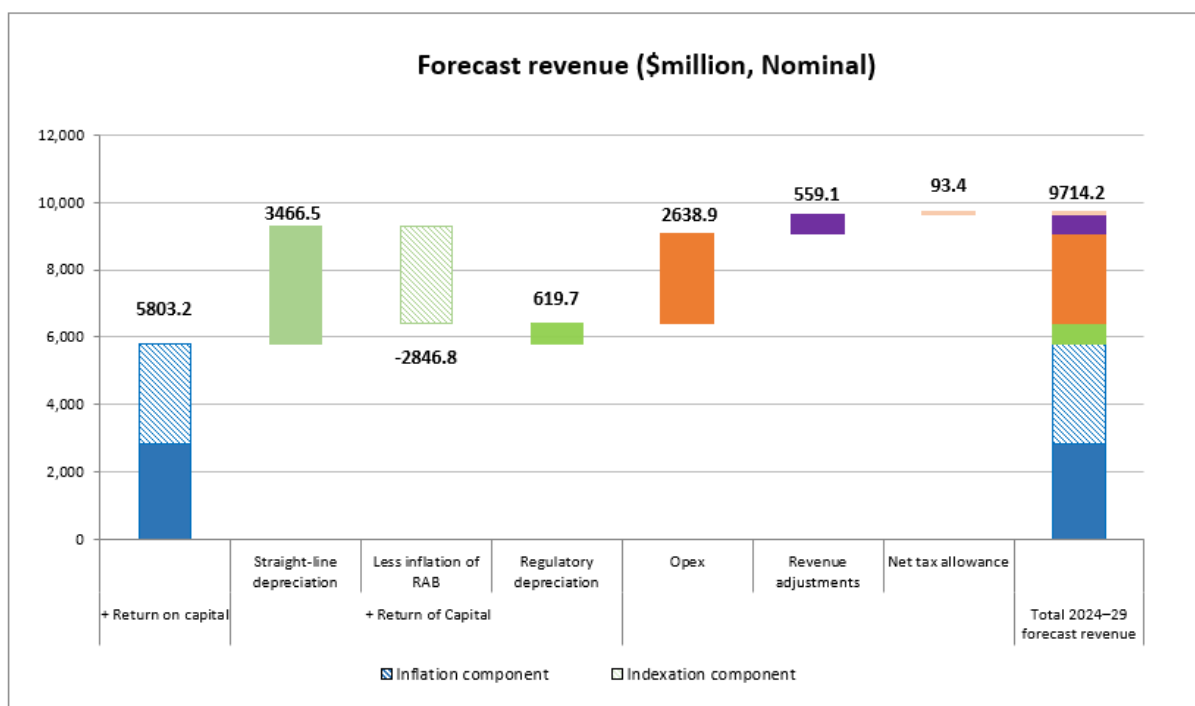
An allowance for expected inflation provides compensation for the risk to investors for the prospect of inflation eroding the investor's purchasing power. Figure 4 shows the interaction of expected inflation on the forecast building block revenue.

- The return on capital building block applies a nominal rate of return to the RAB. As the nominal rate of return includes expected inflation, part of that building block compensates for expected inflation. Higher expected inflation increases the return on capital mainly due to RAB and capex.
- The return of capital building block removes expected inflation indexation of the RAB from forecast depreciation. This avoids compensation arising from the effects of inflation being double counted by including it in the return on capital building block and also as a capital gain (through the indexation of the RAB). Higher expected inflation therefore reduces the regulatory depreciation allowance.
- Other building blocks (such as opex, and revenue adjustments) include an inflation component, as the costs forecast in real dollar terms are escalated to nominal dollars using expected inflation in determining the required nominal revenues. Higher expected inflation will increase opex and revenue adjustments.

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<sup>30</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 Jan 2023, p. 54.

**Figure 4 Ausgrid: Inflation components in proposal revenue building blocks (\$million, nominal)**



Note: The building blocks include distribution and transmission revenues. Proposed revenue in the chart is unsmoothed total revenue for the regulatory period.

Source: AER analysis.

## 4.2 Regulatory asset base and depreciation

The regulatory asset base (RAB) is the value of assets used by Ausgrid to provide distribution and transmission (dual function assets) network services. Ausgrid's dual function assets are high voltage assets which support the broader NSW/ACT transmission network owned and operated by Transgrid. Our final Framework and approach (F&A) established that we would apply transmission pricing rules to Ausgrid’s dual function assets.<sup>31</sup>

The value of the RAB substantially impacts Ausgrid's revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and depreciation components of the revenue determination.

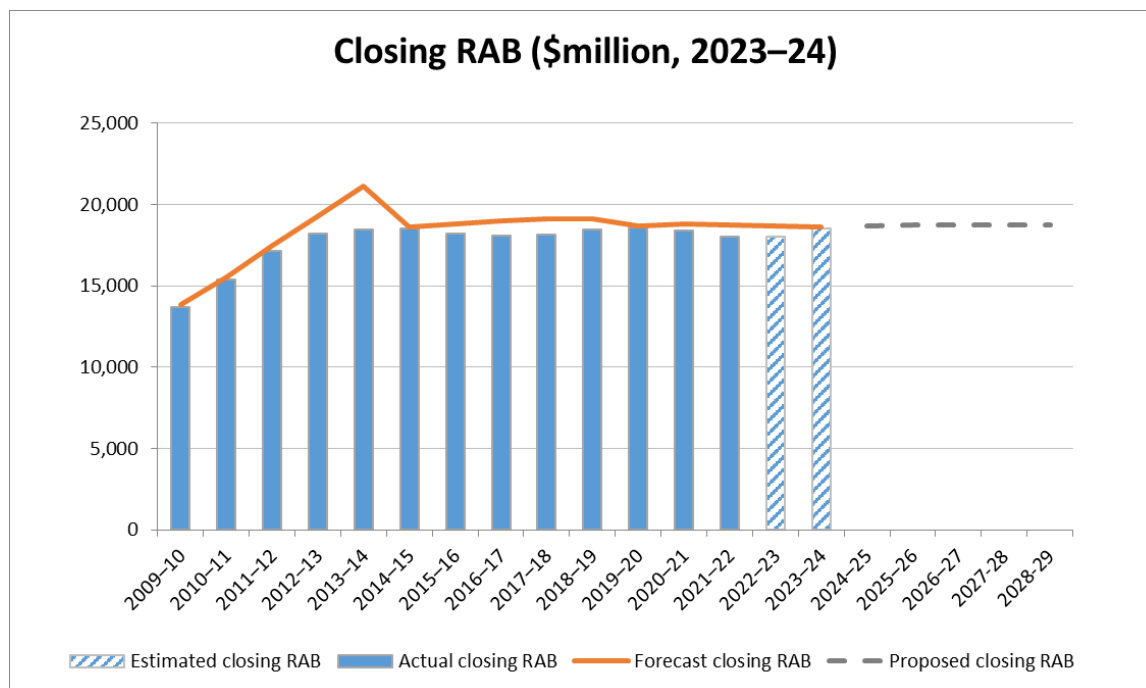
Ausgrid proposes a forecast combined RAB of \$21,561.8 million (\$ nominal) by the end of the 2024–29 period, which is \$3,015.9 million higher than the estimated RAB at the end of the 2019–24 period.<sup>32</sup> This follows an increase of \$2,864.9 million (\$ nominal) in the estimated RAB over the 2019–24 period.

In real terms (\$2023–24), Ausgrid’s proposed RAB will be \$167.1 million higher by the end of the 2024–29 period, driven by a higher forecast capex relative to the 2019–24 period. Figure 5 shows the growth in value of Ausgrid's RAB over time.

<sup>31</sup> AER, *Final framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory for the 2024-29 regulatory control period*, July 2022, p. 54; NER, cl. 6.25.

<sup>32</sup> Ausgrid, *2024–29 Regulatory proposal*, January 2023, p. 53.

**Figure 5 Ausgrid’s RAB value over time (\$million, 2023–24)**



Note: AER analysis; includes distribution and transmission assets.

Regulatory depreciation is provided so investors recover their investment over the economic life of the asset (“return of capital”).

The Handbook sets our expectations for depreciation. In summary, we expect a network business:

- to use the AER’s post-tax revenue model, roll forward model, and depreciation tracking module (where relevant) without amendments
- to apply the same asset classes from the last regulatory determination and the asset lives would also reflect those approved in previous decisions.

Ausgrid proposes regulatory depreciation of \$564.6 million (\$2023–24) for the 2024–29 period, which is \$293.5 million (34.2%) lower than for the 2019–24 period.<sup>33</sup> Ausgrid’s real straight-line depreciation has remained largely unchanged between the 2024–29 and 2019–24 period, therefore the lower regulatory depreciation is primarily driven by a higher forecast inflation indexation compared to the rate applied for the 2019–24 period.

Ausgrid initially planned to move to the year-by-year tracking approach for implementing straight-line depreciation from the current weighted average remaining lives approach. This would have resulted in faster depreciation and higher revenues over 2024–29. However, Ausgrid’s proposal notes that following consultation with its stakeholders it decided not to propose this change at this time due to recent affordability pressures. It estimates this decision has avoided adding \$97 million to its proposal.<sup>34</sup>

<sup>33</sup> Ausgrid, *Attachment 4.1.b PTRM for distribution.xlsx*, January 2023; Ausgrid, *Attachment 4.1.d PTRM for transmission.xlsx*, January 2023

<sup>34</sup> Ausgrid, *2024–29 Regulatory proposal*, January 2023, p. 56.



## Asset classes

Ausgrid also proposes to maintain the standard asset lives for its existing asset classes as approved for the 2019–24 period. Following consultation with its stakeholders, Ausgrid is proposing a new 'Enterprise resource platform' asset class and assigned a standard life of 15 years to better reflect the useful life of expenditure that would normally be allocated to existing asset classes such as 'IT systems' or 'In-house software', both of which have a 5-year standard asset life. Ausgrid estimates this decision results in a \$32 million reduction to its revenues.<sup>35</sup> Ausgrid is also proposing two new asset classes for network and non-network leases for its distribution assets and a new asset class for non-network leases for its transmission assets to reflect capitalisation of leases. Ausgrid has assigned a standard asset life of 7 years for the new leases asset classes.<sup>36</sup>

Overall, based on our initial assessment, we consider Ausgrid has performed well against the depreciation expectations as set out in the Handbook.

### Question

2. Do you have views on Ausgrid's proposed new asset classes and lives, as set out in its 2024–29 proposal?

## 4.3 Capital expenditure

Capital expenditure is added to Ausgrid's RAB, which is used to determine the return on capital and return of capital (regulatory depreciation) building block allowances. All else being equal, higher forecast capex will lead to a higher RAB and higher return on capital and regulatory depreciation allowances. Top-down testing is a starting point when assessing the overall reasonableness of a business' capex proposal. Where a business is responding to the incentives created by the Capital Expenditure Sharing Scheme, we consider current period spend is a good initial basis to test the reasonableness of capex required to maintain the network in the forecast period. This is particularly the case for recurrent types of expenditure such as replacement expenditure (repex) and recurrent ICT.

The Handbook sets our expectations for capex forecasts. In summary:

- The business should demonstrate that the proposed expenditure is not significantly above current period spending
- The components of capex should be well-justified, consistent with past spending for recurrent components, and, for repex, not materially above our repex model
- The business shows evidence of prudent and efficient decision-making on key projects/programs
- There should be evidence of genuine consumer engagement in developing the proposed forecast capex.

Ausgrid's forecast gross capex is 1% higher than the current period. Ausgrid has also used the AER repex model to cross-check and validate its repex forecast. Our initial observation is

<sup>35</sup> Ausgrid, *Attachment 4.1 - 2024–29 Proposed revenue*, January 2023, pp. 10-11.

<sup>36</sup> Ausgrid, *Attachment 4.1 - 2024–29 Proposed revenue*, January 2023, p. 11.

that Ausgrid performs well against the repex model, being 36 % below the repex model threshold.

Components of Ausgrid's proposal such as repex, growth and overheads have reduced, as compared to the 2019–24 period. We note that Ausgrid has submitted an annual 0.5% productivity adjustment to capitalised overheads, which the RCP encouraged Ausgrid to consider.<sup>37</sup> Ausgrid has proposed increases in existing categories such as ICT, fleet, and emerging areas of resilience and CER that did not feature in the last regulatory control period.

Ausgrid has taken on feedback and refreshed its approach to investment governance and applied quantitative analysis to prioritise its capex program.<sup>38</sup> Its approach and key drivers of its capex proposal are discussed further, as well as areas of focus for our assessment.

Overall, Ausgrid has proposed a total forecast gross capex of \$3.3 billion for the 2024–29 period — this is 1% higher than its expected capex for the 2019–24 period.<sup>39</sup> Figure 6 presents the time-series of Ausgrid's net capex. We note that Ausgrid has made significant asset disposals in the 2019–24 period, which makes the comparison on a net basis between the 2024–29 period and the 2019–24 period less meaningful in this particular case.

As can be seen from Figure 6, Ausgrid expects to significantly underspend its capex forecast by about \$540 million in the 2019–24 period,<sup>40</sup> despite stepping up its expected spend in the last two years of the current period. At this stage, the drivers of the underspend are unclear, though a significant contributor is likely the non-system land asset disposals. We will review the drivers of the underspend including efficiency gains and project deferrals. Ausgrid's proposal does not identify any specific project deferrals.

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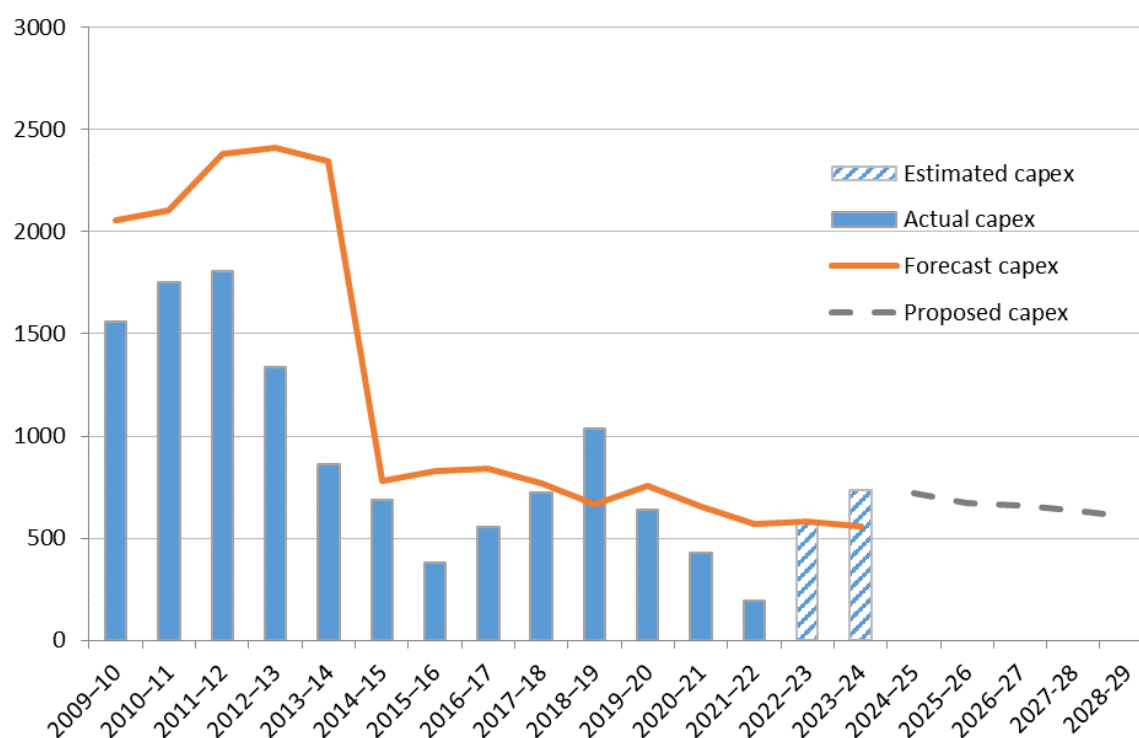
<sup>37</sup> Ausgrid, *Reset Customer Panel - Att. 3.5 - Independent report on Ausgrid's 2024-29 revenue proposal*, 31 Jan 2023, pp. 20-21.

<sup>38</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 71.

<sup>39</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 67.

<sup>40</sup> Ausgrid, *2024–29 CESS model - Distribution*, January 2023; and Ausgrid, *2024–29 CESS model - Transmission*, January 2023. A major contributor to the underspend appears to be due to a large increase in the actual asset disposals compared to the forecast asset disposals in 2019–24.

**Figure 6 Comparison of Ausgrid's past and forecast net capex (\$ million, 2023–24)**



Source: AER analysis of Roll-forward model and Post-tax revenue model.

Note: Net capex subtracts capital contributions and asset disposals from gross capex.

Ausgrid submits that one of the key improvements in its regulatory proposal is its response to the AER's feedback in the previous 2019–24 reset.<sup>41</sup> In particular, it states that it has refreshed its approach to investment governance and applies quantitative analysis to prioritise its capex program.<sup>42</sup> For repex, it submits that it has improved its risk modelling to support its forecast.<sup>43</sup>

Table 3 sets out the composition of Ausgrid's capex proposal. The main driver of its capex is repex, contributing 44% to the total capex forecast. We briefly outline Ausgrid's proposed repex and the other categories below.

**Table 3 Ausgrid's 2024–29 capex proposal compared to 2019–24 (\$ million, 2023–24)**

Driver	2019–24 capex	2024–29 capex	% change	% of gross capex
Repex	1,523	1,446	-5%	44%
Resilience	0	194	(n/a)	6%
Growth	207	190	-8%	6%
CER	4	47	(n/a)	1%
Operational Technology & Innovation	204	117	-43%	4%

<sup>41</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 73.

<sup>42</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 71.

<sup>43</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 72.

Driver	2019–24 capex	2024–29 capex	% change	% of gross capex
Information & Communications Technology	282	301	7%	9%
Fleet & plant	138	148	7%	4%
Non-network Property	174	145	-17%	4%
Overheads	743	724	-3%	22%
<b>Gross capex</b>	<b>3,275</b>	<b>3,312</b>	<b>1%</b>	

Source: AER analysis

### Replacement expenditure (repex)

Ausgrid's repex of \$1446 million is 5% lower than its current period spend. It submits that it has enhanced its approach to cost benefit analysis which cover 90% of the repex forecast, by developing advanced modelling techniques that more accurately predict asset failures.<sup>44</sup>

Its bottom-up forecast is then tested against our repex model. The repex model provides a top-down comparison of a DNSP's forecast modelled replacement expenditure against all other DNSPs. Ausgrid's modelled repex is 51% of total repex.<sup>45</sup> Our preliminary review of Ausgrid's repex model outcome is that it performs well against the repex model, being 36 % below the repex model threshold.

### Resilience capex

Ausgrid is proposing \$194 million in resilience capex (and \$8 million in opex). This is a new category of expenditure. Ausgrid submits that its forecast is nearly 40% less than suggested in its economic modelling. Using the outcomes from future climate scenario modelling, the forecast is based on the impact of extreme weather events on the Ausgrid network.

Ausgrid hosted many meetings with the RCP and customer advocates on co-designing an investment framework for resilience — the Climate Resilience Framework. This engagement, including implementation of the framework, is continuing post-lodgement of its proposal, which may lead Ausgrid to update its current resilience forecast before release of the draft decision, based on the feedback it hears from customers. Ausgrid has indicated that it is capping resilience investment at \$194 million for capex and \$8 million for opex in the 2024–29 period.

Ausgrid supports the RCP's proposal that resilience capex, on top of the capex allowed under the AER's repex model should be excluded from the CESS for the 2024–29 period, to ensure customers do not pay for expenditure that does not occur.<sup>46</sup>

We will review Ausgrid's proposal having regard to the AER's guidance note on network resilience, which we released in April 2022 to provide certainty to stakeholders on how we would treat resilience-related expenditure under the NER.<sup>47</sup> We acknowledge the

<sup>44</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 72.

<sup>45</sup> Calculated from the modelled repex categories in Reset RIN table 2.2 and Ausgrid's total replacement program including resilience and OTI.

<sup>46</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 146.

<sup>47</sup> AER, *Note on the key issues of network resilience*, April 2022.

considerable work undertaken by Ausgrid and its RCP to co-design an investment framework called *Promoting the long-term interest of consumers in a changing climate: A decision-making framework*,<sup>48</sup> which Ausgrid indicates is consistent with the AER's guidance note on network resilience.

### **Growth capex**

Ausgrid's proposed growth capex is composed of two parts: augex of \$138 million and connections capex of \$51 million. Ausgrid submits that there is a relationship between its growth capex and Customer energy resources (CER) integration capex because its CER program will deliver more capacity to the grid, complementing its growth capex needs.<sup>49</sup>

### **CER integration program**

Ausgrid proposes \$47 million capex for its CER integration program. It submits that this amount is for network-based investment and that elements of CER integration are also included in ICT (\$23 million) and innovation (\$20 million) capex programs.<sup>50</sup> Of the \$47 million of proposed capex, approximately \$37 million is for network augmentation and \$10 million is for community batteries. Ausgrid's proactive investment business case for CER integration also includes approximately \$36 million of opex. It submits that this approach provides the greatest economic benefits and is supported by customers.

We will review Ausgrid's proposal having regard to our DER Integration Expenditure Guidance note and Customer export curtailment value (CECV) methodology.<sup>51</sup> Ausgrid has indicated it has adopted and applied the AER's CECV.

### **Operational Technology and Innovation (OTI)**

Ausgrid proposes \$49.5 million for an Innovation program (plus \$5 million in opex) within its total \$117 million for OTI capex. The Innovation program tests different technologies through research, trials and pilots, with potential projects developed in consultation with customers and subject matter experts.<sup>52</sup> Ausgrid's proposed OT capex will be used to monitor and control physical devices and processes on its network and to automate manual processes.<sup>53</sup>

Ausgrid is also proposing to continue excluding innovation expenditure from the 2024–29 CESS calculation.<sup>54</sup> We discuss this further in section 5 on the CESS.

### **Information and Communications Technology (ICT)**

Ausgrid notes that about 40% of its ICT capex program is business-as-usual, with the remainder consisting of three large projects relating to cyber security, the replacement of its Enterprise Resource Planning (ERP) software and CER related ICT.

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<sup>48</sup> Ausgrid, *Promoting the long-term interest of consumers in a changing climate: A decision-making framework*, September 2022.

<sup>49</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 81.

<sup>50</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 86.

<sup>51</sup> AER, [DER integration expenditure guidance note](#), June 2022; and AER, [Customer export curtailment value methodology](#), June 2022.

<sup>52</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 95.

<sup>53</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 95.

<sup>54</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 146.

Ausgrid proposes \$91 million in cyber security capex. Amendments to the *Security of Critical Infrastructure Act 2018* now place obligations on NSPs to implement and maintain a risk management program to address a range of prescribed risks including cyber security and physical security risks.

### **Non-network capex**

Ausgrid proposes \$148 million in capex for its fleet of vehicle and trucks, which is 7% higher than the 2019–24 period. Ausgrid submits that this reflects a catch-up strategy to address its previous underinvestment in fleet and to transition towards a smoother investment profile in the later years of the 2024–29 period and beyond.<sup>55</sup>

Ausgrid proposes \$145 million in non-network property capex for the 2024–29 period. Ausgrid also notes that there has been sale of property in the 2019–24 period.<sup>56</sup> This is reflected in a significant asset disposals amount in that period, as mentioned previously in the comparison of net capex in the 2019–24 period against the 2024–29 period.

### **Capitalised overheads**

Ausgrid proposes \$724 million in capitalised overheads. It submits that it has developed a capitalised overhead forecast that applies the AER's standard approach.<sup>57</sup> We acknowledge Ausgrid's proposal to promote affordability by applying a 0.5% productivity growth adjustment to capitalised overheads.

### **Key areas of focus**

Based on our preliminary review of Ausgrid's capex proposal, the key areas of focus for us are CER integration, resilience-related capex, and cyber ICT. These are new and emerging areas relevant to a number of current regulatory proposals. Other areas of focus include fleet, innovation, non-recurrent ICT, and key projects and programs in repex.

The RCP recommends we undertake a detailed review to assess the prudence and efficiency of a number of programs for resilience, CER integration, ICT and fleet.<sup>58</sup>

### **Questions on capex;**

3. Do you consider Ausgrid's capex proposal addresses the concerns of electricity consumers as identified in the course of its engagement on the proposal?
4. Do you consider Ausgrid's forecast capex for the 2024–29 period reasonably reflects the efficient costs of a prudent operator?
5. Has Ausgrid engaged constructively with its stakeholders on its capex proposal? Please provide examples for your response.
6. Are there particular areas of Ausgrid's capex proposal that you would expect further engagement on?

<sup>55</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 116.

<sup>56</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 119.

<sup>57</sup> Ausgrid, *2024–29 regulatory proposal*, 31 January 2023, p. 121.

<sup>58</sup> Ausgrid Reset Customer Panel, *Independent report on Ausgrid 2024–29 revenue proposal*, January 2023, p. 80.

## 4.4 Operating expenditure

Operating expenditure (opex) refers to the operating, maintenance and other non-capital expenditure incurred in the provision of network services. It includes labour costs and other non-capital costs that a prudent service provider is likely to require for the efficient operation of its network. We have outlined our approach to assessing a network service provider's total opex forecast in our Expenditure Forecast Assessment Guideline.<sup>59</sup>

The Handbook sets our expectations for opex forecasts. In summary:

- the business will use our base-trend-step approach, including our standard assumptions
- step changes will be small in number and well-justified
- category specific costs will be small in number and well-justified
- there should be evidence of genuine consumer engagement.

Based on our initial assessment, Ausgrid has adopted a base-trend-step approach, choosing 2022–23 as the proposed base year. Ausgrid applied three proposed base adjustments, which are a significant driver of forecast opex. The proposed rate of change applied to base opex appears consistent with our standard approach and assumptions. Ausgrid has also proposed seven step changes totalling \$64.2 million, or 2.7% of total forecast opex. Ausgrid sought feedback from its customers and stakeholders about its opex forecast, particularly around step changes, and made changes to its opex forecast in response to this feedback.<sup>60</sup>

### 4.4.1 Ausgrid's opex proposal

Ausgrid proposed total opex of \$2,420.5 million (\$2023–24) for the 2024–29 period, which is:<sup>61</sup>

- \$250.8 million (11.6%) more than Ausgrid's actual/estimated opex for the 2019–24 period
- \$423.8 million (14.9%) less than the opex forecast we approved for the 2019–24 period.

Figure 7 shows the trend in Ausgrid's opex over time.

By the end of the current period, Ausgrid expects to have reduced its annual opex by \$441m (\$2023–24), or 52%, compared to its opex in 2014–15. Under our revealed cost approach to forecasting opex, these revealed efficiencies should be passed on to network users through lower forecast opex in subsequent regulatory control periods. This allows networks users to share the benefits of these efficiency gains.

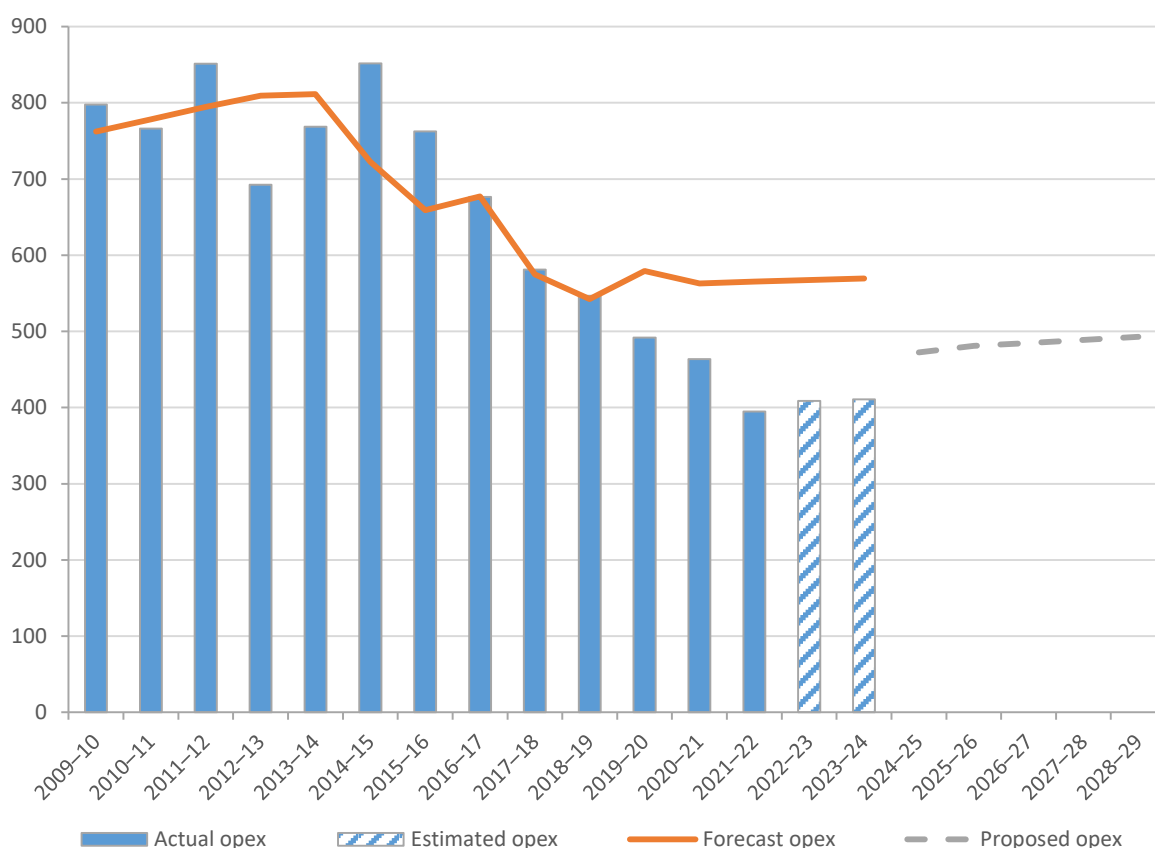
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<sup>59</sup> AER, *Expenditure Forecast Assessment Guideline*, November 2013.

<sup>60</sup> Ausgrid, *2024–29 Regulatory proposal*, 31 January 2023, pp. 127–128.

<sup>61</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 January 2023, p. 126.

**Figure 7 Comparison of Ausgrid's past and forecast opex (\$ million, 2023–24)**



Source: Ausgrid, *Economic benchmarking – Regulatory Information Notice response 2009–22*; AER, *Final decision PTRM 2009–14*; AER, *Final decision 2014–19 PTRM*; AER, *Final decision 2019–24 PTRM and Opex model*; Ausgrid, *2024–29 Regulatory proposal*, January 2023; AER analysis.

#### 4.4.2 Key drivers of the opex proposal

Ausgrid used a base-trend-step approach to forecast opex for the 2024–29 period. This is broadly consistent with our approach to assessing opex, as outlined in our Expenditure Forecast Assessment Guideline.<sup>62</sup> Ausgrid used an estimate of opex in 2022–23 as the base to forecast (\$2,042.8 million (\$2023–24)). Ausgrid chose 2022–23 as the proposed base year because it will be the most recent year with audited actual data by the time of our final decision. It also considered it is representative of the efficient annual costs it needs to operate and maintain its network.<sup>63</sup> Ausgrid then:

- added \$213.2 million (\$2023–24) to base opex, reflecting the sum of:
  - **software-as-a-service** costs that will be reported as opex, rather than capex, in the forecast period to reflect a change in accounting guidance (\$154.7 million, \$2023–24)
  - costs to be moved from alternative control services to standard control services under a **new Cost Allocation Method (CAM)**, which we approved in October 2022, and which will apply from 1 July 2024 (\$36.7 million, \$2023–24)

<sup>62</sup> AER, *Expenditure Forecast Assessment Guideline*, November 2013.

<sup>63</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 January 2023, p. 129.



- additional '**nature induced costs**' for the difference between a five-year average of emergency response costs and a single year estimate (\$21.8 million, \$2023–24).
- added \$10.1 million to reflect the change in opex between the base year (2022–23) and final year (2023–24), using the approach outlined in the Expenditure Forecast Assessment Guideline
- applied a rate of change comprised of:<sup>64</sup>
  - forecast **input price growth**, averaging 0.6% per year (\$48.3 million, \$2023–24). Ausgrid used labour and non-labour weights of 59.2% and 40.8% respectively. For its labour price growth rate, Ausgrid used an average two state specific utilities industry wage price index growth forecasts (from BIS Oxford Economics and KPMG). It assumed no real price growth for non-labour inputs.<sup>65</sup> This approach is consistent with our standard approach.
  - forecast **output growth**, averaging 0.5% per year (\$30.4 million, \$2023–24). Ausgrid stated that it used the output measures and weights from our 2022 Annual Benchmarking Report, consistent with our standard approach.<sup>66</sup>
  - forecast **productivity growth** of 0.5% per year (–\$34.1 million, \$2023–24). This is consistent with our review of our approach to forecasting opex productivity growth for electricity distributors,<sup>67</sup> and our Better Resets Handbook.<sup>68</sup>
- added seven step changes totalling \$64.2 million (\$2023–24) for:<sup>69</sup>
  - \$20.6 million (\$2023–24) to uplift Ausgrid's capability to respond to the frequency and severity of cyber-attacks (**cyber security**)
  - \$9.5 million (\$2023–24) to address increasing **insurance premiums**
  - \$8.4 million (\$2023–24) to investigate community solutions other than network capex through community engagement, coordination with other resilience actors, and research / trials for alternate solutions (**community resilience**)
  - \$24.9 million (\$2023–24) to purchase **smart meter data** that is not in Ausgrid's base year due to increased smart meter uptake on the network as a result of the AEMC's smart meter review
  - \$5.0 million (\$2023–24) to replace existing **Network Innovation Program** capex for opex to enable research and development through partnership
  - \$10.4 million (\$2023–24) to deliver some projects in the **ICT enablement program for CER** integration as opex rather than capex
  - –\$14.5 million (\$2023–24) to remove opex associated with **property** disposals in the current period.
- added \$45.4 million (\$2022–23) for **debt raising costs**.

Figure 8 shows how each of these components contributes to Ausgrid's total opex forecast.

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<sup>64</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 January 2023, p. 141.

<sup>65</sup> Ausgrid, *2024–29 Regulatory Proposal, Attachment 6.1: Proposed operating expenditure*, 31 January 2023, pp. 38–39.

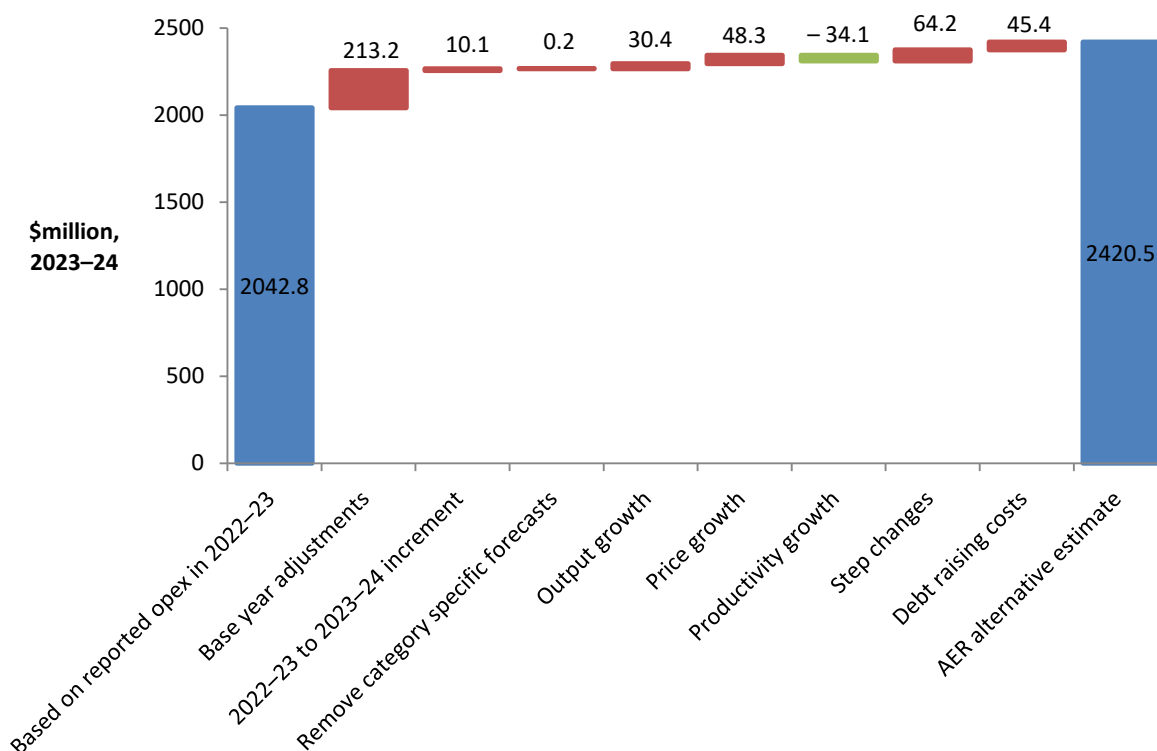
<sup>66</sup> Ausgrid, *2024–29 Regulatory Proposal, Attachment 6.1: Proposed operating expenditure*, 31 January 2023, p. 39.

<sup>67</sup> AER, *Final decision, Forecasting productivity growth for electricity distributors*, March 2019.

<sup>68</sup> AER, *Better Resets Handbook, Towards Consumer Centric Network Proposals*, December 2021, p. 27.

<sup>69</sup> Ausgrid, *2024–29 Regulatory Proposal*, 31 January 2023, p. 133.

**Figure 8 Breakdown of Ausgrid's opex forecast (\$million, \$2023–24)**



Source: AER analysis. Note: Including debt raising costs.

As part of our assessment of Ausgrid's opex forecast, we are interested in stakeholder views on how well its proposal addresses the views and concerns of electricity consumers as identified during its engagement on its proposal.

Based on our initial review of Ausgrid’s regulatory proposal, the base adjustments it has proposed are a significant driver of its forecast opex. Our view is that these proposed base adjustments will be a key focus of our review, as they potentially have a material impact on our alternative estimate of total opex.<sup>70</sup> Our review will consider whether the proposed adjustment for nature induced costs is consistent with our guidance on the treatment of one-off factors in the base year and the interaction these have with the EBSS.

Step changes are another area of Ausgrid’s proposal where we are particularly interested in stakeholders’ views. While Ausgrid did engage with its customers on its proposed step changes, the seven step changes proposed, totalling \$64.2 million in additional opex, will be another key focus of our review. The RCP noted it supported the proposed step changes, subject to the AER demonstrating the proposed expenditure to be prudent and efficient.<sup>71</sup>

Given the potentially material impact they may have on our alternative estimate of total opex, we consider our view on Ausgrid’s proposed base adjustments and step changes will likely determine whether we accept or reject Ausgrid’s proposed opex forecast.

<sup>70</sup> AER, *Better resets handbook*, December 2021, p. 29.

<sup>71</sup> Ausgrid Reset Customer Panel, *Independent report on Ausgrid 2024–29 revenue proposal*, January 2023, p. 81.

### Question

7. Do you consider Ausgrid's opex proposal addresses the concerns identified by electricity consumers during its engagement on the 2024–29 proposal?

8. Do you consider Ausgrid's forecast opex for the 2024–29 period reasonably reflects the efficient costs of a prudent operator?

9. Do you consider Ausgrid's proposed base adjustments are required to produce an opex forecast that reasonably reflects the efficient costs of a prudent operator?

10. Do you consider Ausgrid's proposed step changes are required to produce an opex forecast that reasonably reflects the efficient costs of a prudent operator?

## 4.5 Corporate income tax

The building block approach to calculating the annual revenue includes an amount for the estimated cost of corporate income tax payable by the business. We forecast tax in accordance with the requirements of the NER.<sup>72</sup> Using the approach set out in the post-tax revenue model, Ausgrid proposes a forecast corporate income tax amount of \$85.9 million (\$2023–24) for the 2024–29 period. We note that Ausgrid has:

- proposed \$16.2 million forecast immediate expensing of capex for the 2024–29 period using an approach consistent with its current tax policy
- adopted the diminishing value method for tax depreciation to all future capex, except for a limited number of assets which must be depreciated using the straight-line depreciation method under the tax law.

We will assess the appropriateness of the proposed amounts of immediate expensing and capex allocated for straight-line depreciation, based on the approach we have taken in recent revenue determinations.

### Question

11. Do you have views on the approach to corporate income tax in Ausgrid's 2024–29 proposal?

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<sup>72</sup> NER, cl. 6.5.3.

## 5 Incentive schemes

Incentive schemes are a component of incentive-based regulation and complement our approach to assessing efficient costs. They provide important balancing incentives under network determinations, encouraging businesses to pursue expenditure efficiencies while maintaining the reliability and overall performance of its network.

Our final F&A for Ausgrid, Endeavour and Essential Energy noted our intention to apply the five incentive schemes and allowances in the 2024–29 period that are set out below.<sup>73</sup> Essential agreed with this approach in its 2024–29 proposal. We will decide if, and how we will apply the schemes as part of our determinations, considering the information submitted.

- **Efficiency benefit sharing scheme (EBSS):** This provides Ausgrid with a continuous incentive for distributors to pursue efficiency improvements in opex, and to fairly share these between Ausgrid and consumers. Consumers benefit from improved efficiencies through lower network tariffs in future regulatory control periods.

Ausgrid proposed EBSS carryover amounts totalling \$398.3 million (\$2023–24) from the application of the EBSS in the 2019–24 period. Ausgrid proposed that we apply the EBSS again in the 2024–29 regulatory period, subject to the following costs being excluded, in addition to the exclusion required by the EBSS.<sup>74</sup>

- debt raising costs
- costs associated with the DMIAM
- innovation expenditure
- community resilience expenditure.

Ausgrid proposed that innovation expenditure and community resilience expenditure be excluded from the EBSS, in part, based on feedback from its reset customer panel.<sup>75</sup>

- **Capital expenditure sharing scheme (CESS):** This incentivises businesses to undertake efficient capex throughout the regulatory control period by rewarding efficiency gains and penalising efficiency losses (each measured by reference to the difference between forecast and actual capex).

Ausgrid proposes a CESS benefit of \$168 million for the 2019–24 period, reflecting a significant underspend of about \$540 million.<sup>76</sup>

For the 2019–24 period, we understand Ausgrid came to an agreement with its customers about excluding innovation expenditure from the CESS. Ausgrid's proposed CESS excludes the capex allowance and expenditure for three projects: Advanced Distribution Management System, Operational Technology Security, and the Network

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<sup>73</sup> AER, *Final framework and approach for Ausgrid, Endeavour Energy and Essential Energy for the 2024-29 regulatory control period*, July 2022

<sup>74</sup> Ausgrid, *2024–29 Regulatory proposal*, 31 January 2023, p. 145.

<sup>75</sup> Ausgrid, *2024–29 Regulatory proposal*, 31 January 2023, p. 145.

<sup>76</sup> Ausgrid, *2024–29 CESS model - Distribution*, January 2023; and Ausgrid, *2024–29 CESS model - Transmission*, January 2023. A major contributor to the underspend appears to be due to a large increase in the actual asset disposals compared to the forecast asset disposals in 2019–24.

Innovation Program.<sup>77</sup> Our current CESS guideline does not allow for specific project/program exclusions of this nature and we did not endorse or agree to this proposed approach in our 2019–24 final decision.<sup>78</sup> The CESS calculation only allows for adjustments relating to deferrals and ex post exclusions of capex from the RAB.<sup>79</sup> We are interested in stakeholder views on Ausgrid's proposed exclusions from the 2019–24 capex incentive calculation.

From the CESS models provided, Ausgrid has indicated it has overspent in 2019–24 on the three mentioned projects but excluded these from the CESS calculation. We will review these proposed CESS exclusions to ensure networks are appropriately incentivised to pursue genuine efficiency improvements and share these with consumers as intended by the scheme. For the 2024–29 period, Ausgrid has proposed to continue excluding innovation expenditure from the CESS calculation. We also note Ausgrid and its RCP have considered a portion of resilience capex should be excluded from the 2024–29 CESS calculation. We are interested in stakeholder views on these exclusions.

- **Service target performance incentive scheme (STPIS):** This provides a financial incentive to Ausgrid to maintain and improve service reliability performance.<sup>80</sup> The STPIS is intended to ensure that distributors' service levels do not deteriorate due to distributors' effort to achieve efficiency gains under our expenditure schemes, which are typically associated with a reduction in expenditure.

The STPIS provides incentives to distributors to improve existing service levels where electricity consumers are willing to pay for these improvements.<sup>81</sup> In other words, the scheme provides incentives for distributors to be cost effective in their attempts to improve services to customers. Distributors receive penalties for not meeting service targets.

- **Customer service incentive scheme (CSIS):** This creates an incentive for distributors to maintain and improve customer services not covered by the STPIS, or other mechanisms.<sup>82</sup> The CSIS is a flexible 'principles based' scheme that can be tailored to the specific preferences and priorities of a distributor's customers—as informed through consumer engagement.

To apply the CSIS, Ausgrid must demonstrate to us that its customer engagement has been genuine and that its customers support the proposed customer service parameters and incentives. This differs from a prescriptive scheme (like the STPIS) that specifies precisely what is incentivised as well as how penalties and rewards are calculated.<sup>83</sup> Ausgrid should note that robust data oversight is a vital component of the CSIS.

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<sup>77</sup> Ausgrid, *2024–29 CESS model - Distribution*, January 2023; and Ausgrid, *2024–29 CESS model - Transmission*, January 2023.

<sup>78</sup> AER, *Capital expenditure incentive guideline for electricity network service providers – explanatory statement*, November 2013, p. 37; and AER, *Final decision – Ausgrid 2019–24 – Attachment 9 – capital expenditure sharing scheme*, April 2019, p. 9–9.

<sup>79</sup> AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, pp. 9, 13–20.

<sup>80</sup> AER, *Electricity distribution network service providers - service target performance incentive scheme v2*, November 2018.

<sup>81</sup> Using the value of customer reliability values.

<sup>82</sup> AER, *Explanatory Statement Customer Service Incentive Scheme*, July 2020, p. 4.

<sup>83</sup> AER, *Explanatory Statement Customer Service Incentive Scheme*, July 2020, pp. 5–9.

Ausgrid opted to apply a CSIS in its 2024–29 regulatory period, to drive improvements in its service delivery performance and to focus on areas of service that are the most valuable to its customers.<sup>84</sup>

- **Demand management incentive scheme (DMIS) and innovation allowance mechanism (DMIAM):** These fund Ausgrid for research and development of demand management projects that have the potential to reduce long-term network costs. Projects to be funded under the DMIAM and DMIS must meet the approval criteria in both schemes.

### Questions

12. Do you have any views on the proposed application of any of the above incentive mechanisms?

### EBSS

13. Do you consider the EBSS carryover amounts proposed by Ausgrid provide for a fair sharing of the efficiency gains and losses it has achieved in the 2019–24 period?

14. Do you consider applying the EBSS to Ausgrid again in the 2024–29 period would provide it a continuous incentive to reduce its opex?

15. If we apply the EBSS to Ausgrid in the 2024–29 period, are there any cost categories that we should exclude from the scheme, such as innovation expenditure and community resilience expenditure as proposed by Ausgrid?

### CESS

16. Do you consider Ausgrid's proposed CESS payment of \$168 million provides a fair sharing of the efficiency gains it has achieved in the 2019–24 period?

17. Do you consider applying the CESS to Ausgrid in the 2024–29 period would provide Ausgrid a continuous incentive to reduce its capex?

18. Do you consider Ausgrid should be able to exclude certain innovation projects/programs from the 2019–24 CESS calculation?

19. If we apply the CESS to Ausgrid in the 2024–29 period, do you agree with Ausgrid's proposed exclusions for innovation expenditure and resilience expenditure from the CESS?

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<sup>84</sup> AER, *Final Framework and Approach Ausgrid, Endeavour Energy and Essential Energy (New South Wales) Regulatory control period commencing 1 July 2024*, pp. 48–49; Ausgrid, *2024-29 Regulatory Proposal*, 31 January 2023, pp. 149–150.

## 6 Network Pricing

In the final F&A, we set out our intended classification of the services Ausgrid provides to its customers. Our classification of services determines which services we regulate and how distributors will recover the cost of providing those services.

Standard control services are those that can only be provided by the relevant distributor, and are common to most, if not all, of a distributor's customers. The costs of providing these services are captured in the building block revenue determination we've discussed in the previous sections of this paper and shared between all customers. Ausgrid has proposed updates to its' tariffs in its structure statement (TSS), which sets out the tariff structure through which it will recover their regulated revenue for standard control services. We discuss Ausgrid's TSS proposal in section 6.2, below.

Alternative control services are either:

- services that can only be provided by the relevant distributor, but will only be required by some of its customers, some of the time; or
- services that can be purchased from the relevant distributor, but which can also—or have the potential to be—purchased from a competing provider.

The cost of providing alternative control services is recovered from users of those services only, through a capped price on the individual service.<sup>85</sup> We discuss the alternative control services proposals in section 6.3.

### 6.1 Control mechanisms

A distribution determination must impose controls over the prices and/or revenues of direct control services (standard and alternative control services). The form and formulae of the control mechanisms in our distribution determination are set out in the relevant F&A. There are only limited circumstances in which the AER can depart from this.

Ausgrid accepted the form and formulae of the control mechanisms as set out in the F&A.

In our distribution determinations, we provide further definition for elements of these control mechanisms. We also define other mechanisms that are not required to be incorporated in the F&A, such as the side constraint and unders/overs mechanisms. In November 2022, we published our final decision on the side constraint mechanism that will be applied in our draft decisions, following stakeholder engagement.<sup>86</sup> We are interested in stakeholder's feedback in relation to the aspects detailed below.

#### 6.1.1 Quoted services price cap control formula

As set out in section 6.6, quoted services prices are determined at the time of a customer's enquiry and reflect each customers' individual requirements. They are subject to a price cap form of control based on a build-up of inputs such as labour, contactor costs, materials.

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<sup>85</sup> AER, *Framework & Approach for Ausgrid, Endeavour Energy and Essential Energy 2019-24*, July 2017, p. 41.

<sup>86</sup> AER, *Annual pricing proposal review*. See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/annual-pricing-process-review>.

In our final F&A, we identified the quoted services price cap control formulae was inconsistently applied across jurisdictions. As such, we proposed the inclusion of margin and tax components to reflect the desirability of consistency between regulatory arrangements for similar services, as well as cost reflectivity. However, we did not define the margin and tax components. This will be done in our distribution determinations.

The distributors have proposed various definitions for the margin and tax components.

Some distributors proposed the margin to be the nominal weighted average cost of capital (WACC) either for a particular year or an average of the forecast nominal WACC over the 2024–29 period (at present, these values are around 6%). Others have proposed a fixed value margin set close to the forecast nominal WACC, such as 6%.

For the tax component, a pragmatic approach would be to set the rate at the corporate tax rate of 30%. However, some distributors have proposed the tax rate could be set at a rate that better reflects the actual tax payable, which may differ from the corporate tax rate. We are interested in stakeholder views on the appropriate definitions for these components.

### 6.1.2 Metering form of control

The AEMC is currently undertaking a review of the regulatory framework for metering services which includes an indicative timeline to retire legacy meters by 2030. The AEMC's final report is due prior to our draft decision on Ausgrid's 2024–29 determination.

We consider that if the AEMC's metering review constitutes a material change in circumstances, it may allow us to depart from the form of control set in the F&A. An alternative form of control might be warranted if it provides better consumer outcomes. We address metering issues further in section 6.5 of this paper.

#### Questions

20. What do you consider to be an appropriate rate for a margin recovered on quoted services? Should this be set at the average nominal WACC for the period, or some fixed value (e.g., 6%)?
21. Do you consider the tax component of the quoted services price control formulae should be set at the corporate tax rate of 30%, or an alternative rate?
22. Do you consider the AER should review the current price cap form of control for legacy metering services following the AEMC's decision?
23. More generally, do you have any comments on Ausgrid's proposed control mechanisms?

## 6.2 Tariff structure statement

As part of their regulatory proposal, distributors are required to submit to us a tariff structure statement (TSS).<sup>87</sup> The TSS will apply for the 5-year regulatory control period. A TSS must set out a distributor's:

- proposed network tariffs
- network tariff structures

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<sup>87</sup> This requirement came out of the AEMC 2014 rule change for distribution pricing.



- charging parameters
- policies and procedures the distributor will use to assign customers to network tariffs or reassign customers from one network tariff to another.

The tariff structures provide the charging framework through which distributors collect their annual allowed revenue. Once approved, a TSS becomes a compliance document against which the AER assesses the distributor's annual pricing proposals.

TSSs are also how distributors progressively reform their network tariffs for standard control services to better signal to customers the cost of providing network services. As customers ultimately pay for upgrades to network services, tariff reform that encourages more efficient use of the network will lead to lower network costs for all customers.

We note that network tariffs are targeted at retailers who package them with other costs, such as the cost of wholesale energy, in their service offerings to electricity customers. As such, the retail electricity tariff may not directly reflect the network tariff.

This is the third regulatory period for which Ausgrid has submitted a TSS and it continues the process of incremental tariff reform.

Based on our initial review we consider Ausgrid has provided a TSS that meets our expectations. It provides a transition to tariffs that supports efficient use of its network while including measures to manage any adverse impacts to consumers. We will review more thoroughly its consideration and management of any adverse impacts. Two-way pricing is a new feature of this round of TSSs so we intend to also closely examine Ausgrid's two-way pricing proposal, along with all distributors' two-way pricing proposals.

### Question

24. Do you consider there are any aspects of Ausgrid's proposed TSS that requires adjustment before our acceptance?

#### 6.2.1 Expectations for tariff structure statements

The Better Resets Handbook sets out our expectations for TSSs:

- Demonstrate progression of tariff reform consistent with the network pricing objective and pricing principles set out in the Electricity Rules
  - Ausgrid's proposal would increase the cost reflectivity of its tariffs: better align peak charges to network peak loads, introduce an export reward tariff to encourage more efficient use of consumer energy resources, and introduce embedded network tariffs.
- Demonstrate incorporation of its tariff strategy in its overall business plan
  - Ausgrid linked its proposed TSS to its network expenditure, and designed tariffs to manage customer network usage.
- Demonstrate significant stakeholder engagement and broad stakeholder support
  - Ausgrid undertook significant stakeholder engagement and responded to customer feedback in developing its proposed TSS.
- Demonstrate insight into and management of any adverse customer impacts

- Ausgrid modelled customer impacts and proposed to manage adverse impacts to residential and small business customers moving to its cost reflective network tariffs primarily through a 12-month introductory demand tariff
- Ausgrid proposed to manage adverse impacts to customers moved to its new embedded network tariffs by introducing the changes over a 5-year transition period.

### 6.2.2 Progress on tariff reform

Ausgrid proposed tariffs which respond to the increasing number of consumer energy resources connected to its network. This included introducing export reward tariffs for residential and small business customers, and for large batteries. Further key reforms include:

- streamlining its tariff offering by closing 10 obsolete tariffs
- introducing 3 embedded network tariffs
- moving its peak period charging window to later in the day for its time of use (TOU) demand/capacity network tariffs and extending the peak period to weekends for residential customers
- a contingency to shift its peak charging window back 1 hour in July 2027 if its network demand peak shifts to after 9pm.<sup>88</sup>

Contingent tariff adjustments are a new feature of this round of TSSs. The rapid pace of change makes it difficult for distributors to accurately forecast the rate of uptake of consumer energy resources over the regulatory period, particularly electric vehicles. To be flexible in response to potential step changes in load that may result from rapid but unpredictable uptake, some distributors, including Ausgrid, are proposing tariff adjustments they would only introduce if load profiles shift in ways that could induce network constraints (i.e. contingent tariff adjustments). We consider incorporation of a contingent adjustment to tariff parameters is, when well defined and its trigger is made clear, a reasonable way of balancing certainty and flexibility.

### 6.2.3 Electric vehicles

The uptake of electric vehicles poses opportunities but also challenges for electricity networks. Ausgrid did not include an electric vehicle-specific tariff for residential and small business customers. For electric vehicle charging stations, it proposed to move its capacity tariff threshold from 40 MWh to 100 MWh, over a three-year period. Customers consuming between 40 MWh and 100 MWh, including applicable charging stations, would be assigned to default demand tariffs rather than capacity tariffs, and would be able to opt out to TOU tariffs.<sup>89</sup>

### 6.2.4 Export reward tariffs

Ausgrid proposed to introduce two-way pricing (providing rewards and charges for customers who export electricity to the grid) as allowed for under the AEMC's Access, pricing and

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<sup>88</sup> Ausgrid, *Att. 8.1, Tariff Structure Statement*, January 2023, p. 19.

<sup>89</sup> Ausgrid, *Att. 8.2, Tariff structure explanatory statement*, January 2023, p. 31.

incentive arrangements for distributed energy resources rule change.<sup>90</sup> Ausgrid included customer protections as required by the NER, including:

- a basic export level (the amount of electricity a customer may to export at no cost)
- an export tariff transition strategy
- not assigning existing customers to a two-way tariff before 1 July 2025.

**Table 4 Ausgrid’s proposed two-way pricing**

Proposed tariff(s)	Assignment	Basic Export Level	Export charge and rewards (NUoS)
Small customer secondary export tariff.	Opt-in from 2024. Default from 1 July 2025 for all residential and small business customers with demand or TOU tariffs. No opt-out applies.	2500kWh / year. Applied in retailer billing as 6.85 kWh per number of days in the billing period.	Monthly export charge 10am-3pm: 1.2148c/kWh Monthly export reward 4pm to 9pm 2.2.2570 c/kWh. <sup>91</sup> No BEL applies before the application of energy rewards.

Source: AER analysis

Our Export Tariff Guidelines published in May 2022 sets out considerations<sup>92</sup> distributors should have regard to in proposing two-way tariffs.<sup>93</sup> In the context of the updated rules and our guidelines, Ausgrid proposed an export reward tariff for small customers, incorporating an export reward almost double the level of its proposed export charge.

Ausgrid submitted documents supporting its two-way pricing and export tariff transition strategy. To inform its basic export level Ausgrid analysed the intrinsic hosting capacity of its network using 16 case studies.

Ausgrid estimated for FY26 that its proposed export reward tariff will result in \$1.5 million less distribution revenue being recovered from non-solar customers than would be the case without two-way pricing.<sup>94</sup> Ausgrid modelling indicated that most residential export customers will see network bill decreases relative to not being assigned to an export reward tariff.<sup>95</sup> For exporting customers currently on the residential demand tariff the introduction of Ausgrid’s export reward tariff will result in 74% of customers being better off and 18% worse off. For exporting customers on the small business demand tariff the introduction of an export reward tariff will result in 49% being better off and 39% worse off.

### 6.3 Alternative control services

Alternative control services are services provided by Ausgrid to specific customers. The costs of providing these services are not included in the revenue proposals we discussed in

<sup>90</sup> In 2021 the AEMC made a new rule change, Access, pricing and incentive arrangements for distributed energy resources, to integrate distributed energy resources more efficiently into grid and allow two-way pricing.

<sup>91</sup> Ausgrid, *Att.8.17 Indicative pricing schedule - NUOS*, January 2023, p. 17.

<sup>92</sup> AER, *Export tariff guidelines*, May 2022, p. 5.

<sup>93</sup> These include: Individual network circumstances to warrant the introduction of two-way pricing, including the network’s intrinsic hosting capacity, how customers may be impacted if two-way pricing is not introduced, evidence of current or estimates of future DER penetration on the network and its impact on network costs and stakeholder feedback. AER, *Export tariff guidelines*, May 2022, p. 5.

<sup>94</sup> Ausgrid, *Att.8.2 Tariff structure explanatory statement*, January 2023, p. 17.

<sup>95</sup> Ausgrid, *Att.8.3, Network bill impacts*, January 2023.

sections 4, 5 and 6. They are recovered separately in accordance with an approved pricing mechanism, with most charged on a 'user pays' basis.

There are three broad categories of alternative control services in these proposals:

- public lighting
- metering
- ancillary (or miscellaneous) network services.

## 6.4 Public lighting

Public lighting services include the provision, construction and maintenance of public lighting assets. Customers of public lighting services primarily are local government councils and jurisdictional main roads departments.

There are a number of different tariff classes and prices for public lights. The factors influencing prices for a particular installation include which party is responsible for capital provision, and which party is responsible for maintaining and/or replacing installations. In NSW, the date of installation also influences public lighting prices.

Public lighting prices comprise of capital and opex prices for assets installed either pre or post 2009.

Ausgrid developed its proposed capital prices for the pre 2009 asset base using a building block approach, an annuity approach for post 2009 assets.<sup>96</sup>

For opex prices, important drivers include asset failures rates, spot and bulk maintenance cycles, labour rates and traffic controller assumptions.

Corporate overheads are also a material driver of public lighting prices.

### NSW Public Lighting Code

The NSW Public Lighting Code (Code) informs the relationship between Public Lighting Service Providers (including Ausgrid) and their customers. The Code details the obligations Service Providers must adhere to in providing public lighting services.

An amended Code, version 1.3, will come into effect from 1 July 2023 with some substantive items coming into force from 1 July 2024. Version 1.3 offers a number of improvements including more transparent compliance with service standards and additional incentives to encourage adherence.

Ausgrid submitted that its public lighting forecasts reflect its adherence to the minimum standards and guaranteed service levels set out in the Code.<sup>97</sup>

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<sup>96</sup> Ausgrid, *2024–29 Regulatory proposal*, 31 January 2023, p. 166.

<sup>97</sup> Ausgrid, *2024–29 Regulatory proposal*, 31 January 2023, pp. 3–5. Ausgrid's proposal refers to an earlier version of the Code (dated 1 July 2019). We will clarify with Ausgrid whether this was intentional or whether they developed their public lighting proposal for the 2024–29 regulatory control period on the basis of version 1.3 of the Code.

## Ausgrid's pre-lodgement engagement

Stakeholder engagement is important to better tailor service offerings to customers. This is pertinent as customers are the ones who request these services. For example, stakeholders may request simplification of service offerings for greater ease of understanding the services and/or request new services not currently provided.

Ausgrid engaged with councils across its network area and the Southern Sydney Regional Organisation of Councils (SSROC). Ausgrid held two dedicated public lighting forums and discussed the issues raised in these forums with its RCP in May 2022. In November 2022, Ausgrid shared a copy of the public lighting model with SSROC and held subsequent sessions to discuss the underlying calculations for 2024–29 public lighting prices. Ausgrid stated SSROC provided in-principle support to Ausgrid's proposed changes.<sup>98</sup>

## Ausgrid's service and price offerings

Ausgrid's public lighting customers supported rationalising the number of public lighting tariffs, provided they do not significantly reduce cost reflectivity and are clearly explained.<sup>99</sup>

On this basis, Ausgrid's proposal rationalises its capital price list for brackets from 26 to 6 categories, while adding five new prices for new bracket categories included in the LED rollout.<sup>100</sup> Ausgrid did not propose to rationalise its capital price list for luminaires due to councils' feedback that luminaire prices should be cost reflective.<sup>101</sup>

For opex prices, Ausgrid proposed to group similar luminaires together and calculate one maintenance price for each group. This reduces the number of opex prices from 50 to 6. Ausgrid also proposed 4 new opex prices for new LED luminaires.<sup>102</sup>

The public lighting pricing models contain Ausgrid's proposed suite of public lighting services and prices for the 2024–29 period.<sup>103</sup> Ausgrid's regulatory proposal describes the inputs and assumptions in the public lighting model.<sup>104</sup>

## Accelerated payment option of pre 2009 asset base

Ausgrid noted the value of its pre 2009 asset base will be fully or mostly depreciated during the 2024–29 regulatory control period. However, poles will not be fully depreciated until 2044, requiring some councils to continue paying a small annual charge for these assets.<sup>105</sup>

Ausgrid consulted on the option for councils to accelerate payment of the remaining pre 2009 capital values by the end of the 2024–29 regulatory control period.<sup>106</sup> Ausgrid received responses on this option from 14 councils with 11 councils responding positively. Ausgrid

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<sup>98</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 6.

<sup>99</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, pp. 7–8 and 20.

<sup>100</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, pp. 20–21.

<sup>101</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 21.

<sup>102</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 22.

<sup>103</sup> Ausgrid, *Attachment 9.1a – Public lighting – pre 2009 fixed charge model FY24-29*, 31 January 2023; Ausgrid, *Attachment 9.1b – Public lighting model FY24-29*, 31 January 2023.

<sup>104</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, pp. 10–16, 18–22 and 25–26.

<sup>105</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 18.

<sup>106</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 8.

therefore only applied accelerated depreciation to the 11 councils that responded positively.<sup>107</sup>

### **LED and other new technologies**

During pre-lodgement engagement, Ausgrid received feedback that councils want a faster transition to LED luminaires – including the introduction of smart controllers – to facilitate smart city application.<sup>108</sup>

Ausgrid stated it is committed to working with councils to install LED luminaires for all public lighting in its distribution area and is part way through the transition.<sup>109</sup> The transition to LED luminaires will change the cost of public lighting services for each council depending on factors such as the mix of luminaires in their area. However, Ausgrid expects the transition to LED lighting will reduce the overall cost of public lighting services for councils.<sup>110</sup>

### **Minor Capital Works**

The public lighting minor capital works (MCW) service is an ancillary network service associated with administration, management and engineering design as defined by the Public Lighting Code and Ausgrid's Public Lighting Management Plan."<sup>111</sup>

During pre-lodgement engagement, councils stated they want the approval process for public lighting MCW to be simpler. They also requested the time to install light poles to be shortened and the pricing to be made more transparent.<sup>112</sup>

Ausgrid clarified the fee for this service will be the quoted hours multiplied by the relevant labour classification, which are Administration (R1), Technical Specialist (R2), Engineer (R3) or Field Worker (R4). Ausgrid will provide a quote to the customer prior to performing the service.<sup>113</sup>

### **Questions**

25. Do you consider Ausgrid's public lighting proposal generally incorporates stakeholder inputs from this pre-lodgement engagement? If not, did Ausgrid communicate these potential departure points to stakeholders and provide adequate explanation during pre-lodgement engagement?

26. Do you support Ausgrid's proposed suite of public lighting services and prices?

27. Do you support Ausgrid's proposed framework for minor public lighting capital works and the pricing that has been proposed?

28. Do you have any other comments on Ausgrid's public lighting proposal and their pre-lodgement engagement?

<sup>107</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 18.

<sup>108</sup> Ausgrid, *2024–29 Regulatory proposal*, 31 January 2023, p. 164; Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 8.

<sup>109</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 5 and 8.

<sup>110</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, pp. 5–6.

<sup>111</sup> Ausgrid, *Attachment 9.3 – Ancillary network services*, 31 January 2023, p. 49.

<sup>112</sup> Ausgrid, *Attachment 9.1 – Public lighting services*, 31 January 2023, p. 8.

<sup>113</sup> Ausgrid, *Attachment 9.3 – Ancillary network services*, 31 January 2023, p. 20.

## 6.5 Metering

Metering services are currently provided by electricity distributors, retailers and other third parties. Since the AEMC's Power of Choice reform, retailers and/or other third parties have been responsible for the installation and replacement of meters, with smart meters now being the meters installed. Ausgrid is responsible for providing services, including operation and maintenance, for the accumulation meters it historically installed (legacy meters). As outlined in section 6.1, the AEMC metering review will be released prior to our draft decision.

Due to the retirement of legacy meters, we are interested in stakeholder's feedback in relation to the aspects detailed below. Our consideration of these aspects will also be influenced by the AEMC's final report.

### 6.5.1 Cost recovery

The current framework for the cost recovery of legacy meters involves a separation of metering charges into capital and non-capital charges. These are charged to individual customers (user pays) and are regulated under a price cap.

Capital charges relate to the recovery of costs associated with installation and management of the legacy metering asset base. All customers who had a legacy meter prior to 30 June 2015 incur capital charges, regardless of whether they still have a legacy meter or not. Non-capital charges relate to the recovery of costs associated with the operation of the remaining legacy meters and are charged to customers who still have Ausgrid-owned legacy meters installed at their premises.

As legacy meters are replaced by smart meters, the per unit cost of operating and maintaining legacy meters increases. Greater distances are required to be travelled to do manual meter reads, testing or maintenance of legacy meters. Other operational costs required to meet minimum standards are spread over a lower number of customers. As more legacy meters are retired, customers with legacy meters could face material increases in their charges.

Additionally, customers who have had smart meters installed will experience costs related to the smart meters, as well as ongoing capital costs related to their historical legacy meter.

We are interested in stakeholder views on whether the current cost recovery framework (user-pays approach) is appropriate. An alternative approach could include the socialisation of operating expenditure (spread across all customers) to ensure customers who are last to transition to smart meters do not incur substantive prices for these services, particularly if they are vulnerable customers. The socialisation of these costs may occur through removing the capital/non-capital split for cost recovery, or by reconsidering the service classification for legacy metering services and shifting them to standard control services.

Our initial view is that we see merit in moving legacy meter charges into standard control services by revising the service classification. This would allow costs to be spread across the entire customer base. We consider that the expected accelerated rollout of smart meters from the AEMC metering review will constitute a material change in circumstances required to depart from the Framework and Approach. We propose to make this change in our draft decision and would like stakeholder views before we lock-in the change.

We are aware that retailers generally socialise both network metering charges (for legacy meters) and their own metering charges (for smart meters) across their customer base. We

note this approach is not mandated for retailers and therefore socialisation of these costs may be better suited at the network level which would create a universal and more equitable approach.

### 6.5.2 Accelerated depreciation

The ongoing cost recovery of the historical legacy metering asset base is expected to continue for some networks until the 2034–39 regulatory control period. Some DNSPs have engaged with stakeholders on the accelerated depreciation of these remaining asset bases to ensure cost recovery is finalised within the upcoming 2024–29 period.

We are interested in stakeholder views on whether accelerated depreciation of these asset bases is appropriate. The benefits of this include the avoided regulatory and administrative burden of the recovery of those asset bases in future regulatory control periods. We note that accelerated depreciation will increase costs in the short term. Increases may be accentuated by other expected short-term cost increases resulting from the increasing per-unit cost of operating expenditure, and any accelerated retirement of legacy meters.

We see merit in accelerating depreciation because it means that customer will not continue to pay for assets that are no longer in service. If we were to accelerate the depreciation of these meters, the impact would be to increase network charges for all customers by an estimated \$0.01 per year.

#### Questions

29. Do you consider legacy metering cost recovery should be socialised at the network level, or be left to retailers?
30. Do you consider accelerated depreciation of the legacy metering asset bases to be preferable to phase-out legacy metering charges?
31. More generally, do you have any comments on Ausgrid's proposed cost recovery for legacy metering services?

## 6.6 Ancillary network services

Ancillary network services are non-routine services provided to individual customers on request. These services are either charged on a fee or quotation basis.

Fee-based services tend to be homogeneous in nature and can be costed in advance of supply with reasonable certainty. Quoted service prices are determined at the time of a customer's enquiry and reflect each customers' individual requirements.

Prices for these services are developed using a cost build up. In March 2022, we published a standardised model for use by electricity distributors to develop their prices. The standardised model streamlines our assessment, increases consistency, and provides stakeholders greater scope to engage in our distribution determinations.

Labour costs make a large proportion of ancillary network service costs. Another significant cost element is the time taken to perform the service, including travel time. Our assessment includes review of these elements for the most requested ancillary network services. We also benchmark proposed labour rates and prices for fee-based services across distribution networks as well as with prices from the current regulatory period.



Ancillary network services are regulated by price cap. Our distribution determination sets first year price caps for fee-based services, labour escalators are used to escalate prices for the remaining years of the regulatory period, and capped labour rates used in quoted services.

### 6.6.1 Ausgrid's engagement and service offering

Stakeholder engagement is important to better tailor service offerings to customers. This is pertinent as customers are the ones who request these services. For example, stakeholders may request simplification of service offerings for greater ease of understanding of the services and/or request new services not currently provided.

Ausgrid's stakeholder engagement involved its customers, retailers, and accredited service providers (ASPs). One key feedback from ASPs was to simplify the list of fees and to make service descriptions clearer. In response, Ausgrid's proposal consolidated its ASP authorisations, training, and security lighting services. It also updated descriptions of other services for clarity.

Ausgrid has proposed fee-based prices for some current quoted services, such as disconnections and metering services, in response to feedback for greater price certainty. However, Ausgrid does not intend to separate its disconnection and reconnection fees despite customer feedback. It gave two reasons: that retailers who request disconnection receive the benefits of disconnection and therefore should also incur those costs, and retailers can use more cost-effective options such as requesting remote de-energisation.<sup>114</sup>

Ausgrid further proposed new services in relation to supporting the advanced meter rollout, the supply of conveyancing information, development application approvals and training. It also proposed to add public lighting minor capital works as a quoted service.

### 6.6.2 Benchmarking labour rates

Labour rates are a key cost input for ancillary network service prices. The distributors proposed labour rates are assessed against benchmark efficient maximum labour rates developed using a bottom-up cost build up across six categories (administration, field worker, technical specialist, engineer, senior engineer, and engineering manager)<sup>115</sup>.

The benchmark rates include increases to the superannuation allowance and the vehicle allowance because of the changes in the superannuation guarantee and inflation. The 'transmission line design engineer' has been removed from the engineer benchmark category as this occupation is not an appropriate benchmark for distributors' engineers.

The NSW distributors engaged consultant CutlerMerz to review their proposed labour rates.<sup>116</sup> The report assumed a 36-hour workweek in its benchmarking, reflecting NSW distributors' enterprise agreements instead of 40 hours used in our methodology. This results in higher labour rates per hour, keeping all other factors constant.

Ausgrid's proposed labour rates are higher than our preliminary maximum efficient benchmark rates (these preliminary rates are based on inputs which will be updated for our

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<sup>114</sup> Ausgrid, *Att 9.3 – Ancillary network services*, January 2023, p. 7.

<sup>115</sup> Marsden Jacob Associates, *Review of ancillary network services: Advice to the Australian Energy Regulator*, September 2018.

<sup>116</sup> CutlerMerz, *Ausgrid Att. 9.3.b – NSW ANS labour rates review*, 4 August 2022.

draft decision). They are also higher than Ausgrid's current approved rates (we escalate the current rates to compare them on a like-for-like basis).

Our draft decision on Ausgrid's labour rates will be dependent on the updated maximum efficient benchmark rates we determine after applying the most recent inputs.

### 6.6.3 Benchmarking fee-based services prices

Proposed fee-based services are also benchmarked against prices from the current regulatory control period as well as similar services supplied by other distributors. Cost inputs may also be benchmarked. Ausgrid has proposed modest increases to its current prices for fee-based services relative to the other NSW distributors.

#### Questions

32. Do you consider Ausgrid's reasoning to not separate its disconnection and reconnection fees to be reasonable?

33. Do you consider that sufficient justification has been provided in the provision of new services?

34. Do you consider the proposed labour rates and fee-based prices to be reasonable?

## 6.7 Transmission pricing

Our determination for Ausgrid must specify a transmission pricing methodology for its dual function assets, which provide prescribed transmission services.<sup>117</sup> Its role is to answer the question "who should pay how much" in order for a business to recover its costs.<sup>118</sup>

Ausgrid's proposed transmission pricing methodology for the 2024–29 period is largely identical to the 2019–24 period's pricing methodology. The major amendments address the requirements of the NER change relating to efficient management of system strength on the power system (system strength final rule).<sup>119,120</sup>

In NSW, including the ACT, there are multiple networks that provide transmission services – Transgrid, Evoenergy, Ausgrid and Directlink. Where there are multiple transmission service providers, a coordinating network service provider (CNSP) is appointed to be responsible for allocating all the AER-determined regulated revenue in that region. Transgrid is the CNSP and System Strength Service Provider for NSW.

Transgrid is responsible for a number of elements of Ausgrid's pricing methodology, including the system strength charging arrangements.<sup>121</sup> As such, Ausgrid's proposed pricing

<sup>117</sup> NER, cl. 6.26(d) and 6A.2.2(4); AER, *Final framework and approach for Ausgrid, Endeavour and Essential Energy for the 2024-29 regulatory control period*

<sup>118</sup> AEMC, *Rule determination: National Electricity Amendment (Pricing of Prescribed Transmission Services)*, 21 December 2006.

<sup>119</sup> Ausgrid, *Attachment. 8.8, Transmission pricing methodology*, 31 Jan 2023, Public, pp. 3-7 and 13.

<sup>120</sup> AEMC, *Rule determination: Efficient management of system strength*, 21 October 2021.

<sup>121</sup> Ausgrid, *Attachment. 8.8, Transmission pricing methodology*, 31 Jan 2023, Public, pp. 5, 6 and 13

methodology for 2024–29 includes updates to reflect the Transgrid's approved 2023–28 pricing methodology.<sup>122, 123</sup>

Ausgrid clarified it will recover the annual system strength charge determined by Transgrid for the system strength connection point from the relevant Transmission Network User on a pass through basis.<sup>124</sup> Ausgrid also stated it will replicate as far as reasonably practical, the amount, structure and timing of the annual system strength charge, in accordance with the charging information provided and billed by Transgrid.<sup>125</sup>

On this basis, we consider this proposed pricing methodology is capable of acceptance.

### Questions

35. Do you consider Ausgrid's proposed changes to its pricing methodology for the 2024–29 period appropriate and that they give effect to the pricing principles for prescribed transmission services and the pricing methodology guidelines?<sup>126, 127</sup>

36. More generally, do you have any comments on Ausgrid's proposed pricing methodology for the 2024–29 period?

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<sup>122</sup> Transgrid's 2023–28 pricing methodology was approved by the AER in its Draft Determination. See: [AER, *Transgrid 2023-28, Draft Decision – Overview*, September 2022 and Transgrid, *2023-2028 Pricing Methodology*, 30 Nov 2022, Public]

<sup>123</sup> Ausgrid, *Attachment. 8.8, Transmission pricing methodology*, 31 Jan 2023, Public, p. 3.

<sup>124</sup> Ausgrid, *Attachment. 8.8, Transmission pricing methodology*, 31 Jan 2023, Public, pp. 4, 6 and 13.

<sup>125</sup> On 30 November 2022, Ausgrid submitted proposed system strength amendments to its 2019–24 pricing methodology as required by the system strength final rule. On 31 January 2023, the AER published its final decision accepting these amendments. The system strength components of Ausgrid's proposed pricing methodology for the 2024–29 regulatory control period is largely identical to those we approved in January 2023.

<sup>126</sup> NER, cl. 6A.23.

<sup>127</sup> AER, *Pricing methodology guidelines 2022 – System strength pricing*, 25 August 2022.

## Summary of questions

<p><b>Consumer engagement approach</b></p> <p>1. Do you think Ausgrid's consumer engagement meets the expectations set out in the Handbook in delivering a consumer-centric proposal? Please give examples.</p>
<p><b>Regulatory asset base and depreciation</b></p> <p>2. Do you have views on Ausgrid's proposed new asset classes and lives, as set out in its 2024–29 proposal?</p>
<p><b>Capital expenditure</b></p> <p>3. Do you consider Ausgrid's capex proposal addresses the concerns of electricity consumers as identified in the course of its engagement on the proposal?</p> <p>4. Do you consider Ausgrid's forecast capex for the 2024–29 period reasonably reflects the efficient costs of a prudent operator?</p> <p>5. Has Ausgrid engaged constructively with its stakeholders on its capex proposal? Please provide examples for your response.</p> <p>6. Are there particular areas of Ausgrid's capex proposal that you would expect further engagement on?</p>
<p><b>Operating expenditure</b></p> <p>7. Do you consider Ausgrid's opex proposal addresses the concerns identified by electricity consumers during its engagement on the 2024–29 proposal?</p> <p>8. Do you consider Ausgrid's forecast opex for the 2024–29 period reasonably reflects the efficient costs of a prudent operator?</p> <p>9. Do you consider Ausgrid's proposed base adjustments are required to produce an opex forecast that reasonably reflects the efficient costs of a prudent operator?</p> <p>10. Do you consider Ausgrid's proposed step changes are required to produce an opex forecast that reasonably reflects the efficient costs of a prudent operator?</p>
<p><b>Corporate income tax</b></p> <p>11. Do you have views on the approach to corporate income tax in Ausgrid's 2024–29 proposal?</p>
<p><b>Incentive schemes</b></p> <p>12. Do you have any views on the proposed application of any of the above incentive mechanisms?</p> <p><b>EBSS</b></p> <p>13. Do you consider the EBSS carryover amounts proposed by Ausgrid provide for a fair sharing of the efficiency gains and losses it has achieved in the 2019–24 period?</p> <p>14. Do you consider applying the EBSS to Ausgrid again in the 2024–29 period would provide it a continuous incentive to reduce its opex?</p> <p>15. If we apply the EBSS to Ausgrid in the 2024–29 period, are there any cost categories that we should exclude from the scheme, such as innovation expenditure and community resilience expenditure as proposed by Ausgrid?</p> <p><b>CESS</b></p> <p>16. Do you consider Ausgrid's proposed CESS payment of \$168 million provides a fair sharing of the efficiency gains it has achieved in the 2019–24 period?</p> <p>17. Do you consider applying the CESS to Ausgrid in the 2024–29 period would provide Ausgrid a continuous incentive to reduce its capex?</p> <p>18. Do you consider Ausgrid should be able to exclude certain innovation projects/programs from the 2019–24 CESS calculation?</p> <p>19. If we apply the CESS to Ausgrid in the 2024–29 period, do you agree with Ausgrid's proposed exclusions for innovation expenditure and resilience expenditure from the CESS?</p>

**Network Pricing**

***Control mechanisms***

- 20. What do you consider to be an appropriate rate for a margin recovered on quoted services? Should this be set at the average nominal WACC for the period, or some fixed value (e.g., 6%)?
- 21. Do you consider the tax component of the quoted services price control formulae should be set at the corporate tax rate of 30%, or an alternative rate?
- 22. Do you consider the AER should review the current price cap form of control for legacy metering services following the AEMC's decision?
- 23. More generally, do you have any comments on Ausgrid's proposed control mechanisms?

***Tariff structure statement***

- 24. Do you consider there are any aspects of Ausgrid's proposed TSS that requires adjustment before our acceptance?

***Public lighting***

- 25. Do you consider Ausgrid's public lighting proposal generally incorporates stakeholder inputs from this pre-lodgement engagement? If not, did Ausgrid communicate these potential departure points to stakeholders and provide adequate explanation during pre-lodgement engagement?
- 26. Do you support Ausgrid's proposed suite of public lighting services and prices?
- 27. Do you support Ausgrid's proposed framework for minor public lighting capital works and the pricing that has been proposed?
- 28. Do you have any other comments on Ausgrid's public lighting proposal and their pre-lodgement engagement?

***Metering***

- 29. Do you consider legacy metering cost recovery should be socialised at the network level, or be left to retailers?
- 30. Do you consider accelerated depreciation of the legacy metering asset bases to be preferable to phase-out legacy metering charges?
- 31. More generally, do you have any comments on Ausgrid's proposed cost recovery for legacy metering services?

***Ancillary network services***

- 32. Do you consider Ausgrid's reasoning to not separate its disconnection and reconnection fees to be reasonable?
- 33. Do you consider that sufficient justification has been provided in the provision of new services?
- 34. Do you consider the proposed labour rates and fee-based prices to be reasonable?

***Transmission pricing***

- 35. Do you consider Ausgrid's proposed changes to its pricing methodology for the 2024–29 period appropriate and that they give effect to the pricing principles for prescribed transmission services and the pricing methodology guidelines? ,
- 36. 36. More generally, do you have any comments on Ausgrid's proposed pricing methodology for the 2024–29 period?

## Shortened forms

Terms	Definition
ACS	alternative control services
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulatory
ASP	Accredited Service Provider
capex	capital expenditure
CCP26	Consumer Challenge Panel, sub-panel 26
CESS	capital expenditure sharing scheme
CNSP	Coordinating network service provider
CSIS	customer service incentive scheme
DER	Distributed Energy Resources
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
DNSP or distributor	Distribution Network Service Provider
DUoS	Distribution Use of System Charges
EBSS	efficiency benefit sharing scheme
ECA	Energy Consumers Australia
ENA	Energy Networks Australia
ESB	Energy Security Board
F&A	framework and approach
GSL	guaranteed service level
ICT	information and communication technologies
NEL	National Electricity Laws
NEM	National Electricity Market
NEO	National Electricity Objectives
NER	National Electricity Rules
opex	operating expenditure
RAB	regulated asset base
repex	replacement expenditure
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SAPS	stand-alone power systems
SCS	standard control service
Service classification guideline	Electricity distribution service classification guideline 2018
STPIS	service target performance incentive scheme
VCR	value of customer reliability
WACC	weighted average cost of capital