

# Draft Decision

## Directlink Electricity Transmission Determination 2025 to 2030 (1 July 2025 to 30 June 2030)

### Overview

September 2024

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**Amendment record**

Version	Date	Pages
1	27 September 2024	22

# Invitation for submissions

Directlink has the opportunity to submit a revised proposal in response to this draft decision by **2 December 2024**.

Interested stakeholders are invited to make a submission on both our draft decision and Directlink’s revised proposal (once submitted) by Friday, **17 January 2025**.

Submissions should be sent to: [Directlink2025@aer.gov.au](mailto:Directlink2025@ aer.gov.au) and addressed to Gavin Fox, General Manager. Alternatively, you can mail submissions to GPO Box 3131, Canberra ACT 2601.

Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. We will treat submissions as public documents unless otherwise requested.

Parties wishing to submit confidential information should:

1. Clearly identify the information that is the subject of the confidential claim.
2. Provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submission will be published on our website.

## Pre-determination conference

Consumer engagement is a valuable input to our determination. We encourage all interested stakeholders to join us, the Directlink predetermination conference at an online public forum on **14 October 2024**. Details of how to register for this forum are available on our website and through [Eventbrite](#).

## List of attachments

This attachment forms part of the Australian Energy Regulator's (AER's) draft decision on the transmission determination that will apply to Directlink for the 2025–30 period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Transmission Pricing methodology

Attachment 13 – Pass through events

# Executive summary

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 as it transitions to net zero emissions (the transition).

A regulated network business must periodically apply to us to determine the maximum allowed revenue it can recover from consumers for using its network. On 31 January 2024, we received revenue proposals from SA Power Networks, Ergon Energy, Energex and Directlink for the period 1 July 2025 to 30 June 2030 (2025–30 period).

It is our role to ensure that consumers pay no more than is necessary for an energy system that delivers safe, reliable, secure energy that contributes to the reduction of greenhouse gas emissions.

This draft decision relates to Directlink, which is owned by the APA Group.

## Efficient investment to deliver a safe and reliable network that meets consumer needs

The past decade has seen a phase of relatively contained capital and operating expenditure while maintaining service quality. However, recent regulatory proposals, including Directlink’s 2025–30 proposal, have included substantial forecast expenditure.

We acknowledge there are factors requiring network businesses to make investments, but this needs to be managed carefully, with a view to protecting the long-term interests of consumers. This underscores the importance of networks developing solid business cases that seek to find the most efficient investment options to meet demand and comply with state safety and technical standards obligations.

Directlink’s proposal comes at a time when asset utilisation across the National Electricity Market (NEM) is low by historical standards and network reliability near the highest it has been. We encourage network businesses and stakeholders to seek ways to improve asset utilisation to meet the challenges of the energy transition and to manage the network over the long term.

The regulatory proposals we have received also respond to the ongoing challenge of maintaining service reliability and improving network and system resilience to disruptive events. Floods, bushfires and cyber risks have all affected our distribution and transmission networks across the NEM in recent years. Our draft decision supports cost effective solutions to manage these risks for consumers.

Consumer needs should be a key focus of the network businesses’ regulatory proposals. To assist, we introduced the Better Resets Handbook (the Handbook)<sup>1</sup>, to further guide businesses to engage and design proposals that meet consumer needs through the energy transition.

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<sup>1</sup> AER, [Better Resets Handbook – towards consumer-centric network proposals](#), July 2024.

Directlink’s consumer engagement was broadly in line with expectations in the Handbook, particularly when the size of the business and the forecast bill impacts for consumers are considered.

Directlink indicated in its proposal that it would further engage with stakeholders following our draft decision. We encourage an ongoing consultative process on key elements of our draft decision to inform the revised proposal.

## **Our assessment of Directlink’s proposal**

This draft decision allows Directlink to recover \$123.8 million (\$ nominal, smoothed) in revenue from its customers for the 2025–30 period. This is \$14.7 million (or 10.6%) less than Directlink’s proposal.

Directlink’s proposal presented a total revenue of \$138.5 million (\$nominal, smoothed) for the 2025–30 period, an increase of \$60.0 million (76.5%) from the current period. We estimate that approximately a third of the nominal increase in Directlink’s proposal is driven by market factors including higher inflation and interest rates. The other two thirds of the increase is driven mainly by accelerated depreciation due to the technical end of life of the interconnector, and by associated programs including the proposed end of life operating expenditure and the spares management program.

As per the previous two regulatory control periods, Directlink has sought to align the economic lives of its assets with the remaining technical life, estimated to be 2041–42, to address stranded asset risk. This approach results in Directlink recovering its return of capital from consumers at a faster rate and is one of the key drivers of the increase in required revenue.

Directlink’s operating and capital expenditure forecasts are the other key drivers for the increase in required revenue over 2025–30. We have proposed reductions to both areas of expenditure following our assessment of Directlink’s business cases.

Our draft decision is to reduce the operating expenditure (opex) forecast from \$39.4 million to \$33.5 million (\$2024–25), a reduction of 15.0%, driven primarily by the removal of Directlink’s proposed provision for end-of-life costs of \$4.7 million. Directlink had made a similar provision in its 2020–25 proposal, which we did not accept in our final decision. As with our previous decision, we are not satisfied these costs reasonably reflect prudent and efficient expenditure for the 2025–30 period.

Our draft decision also provides a lower capital expenditure (capex) forecast from \$33.8 million to \$18.8 million (\$2024–25), a reduction of 44.4%, driven by a placeholder forecast of zero for the spares management program. We have been unable to approve this program due to the lack of supporting information. At the revised proposal we would like to see further evidence to support the proposed expenditure figures for the spares management program, including unit costs and failure rates.

In this Overview and the accompanying detailed attachments, we have set out the assessment approaches applied, and enquiries made as part of our review, which have enabled us to arrive at this draft decision.

This draft decision is the mid-point in our assessment of Directlink’s proposal. Directlink now has the opportunity to respond in a revised proposal that incorporates the substance of the changes required by, and addresses matters raised in, this draft decision.

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# 1 Our draft decision

Our draft decision allows Directlink to recover a total revenue of \$123.8 million (\$ nominal, smoothed) from its customers from 1 July 2025 to 30 June 2030.

Our draft decision total revenue is \$45.3 million or 57.7% more than Directlink’s total revenue in the 2020–25 period in nominal terms. In the sections below we briefly outline what is driving Directlink’s revenue, and the key differences between our draft decision revenue and the \$138.5 million in Directlink’s proposal.

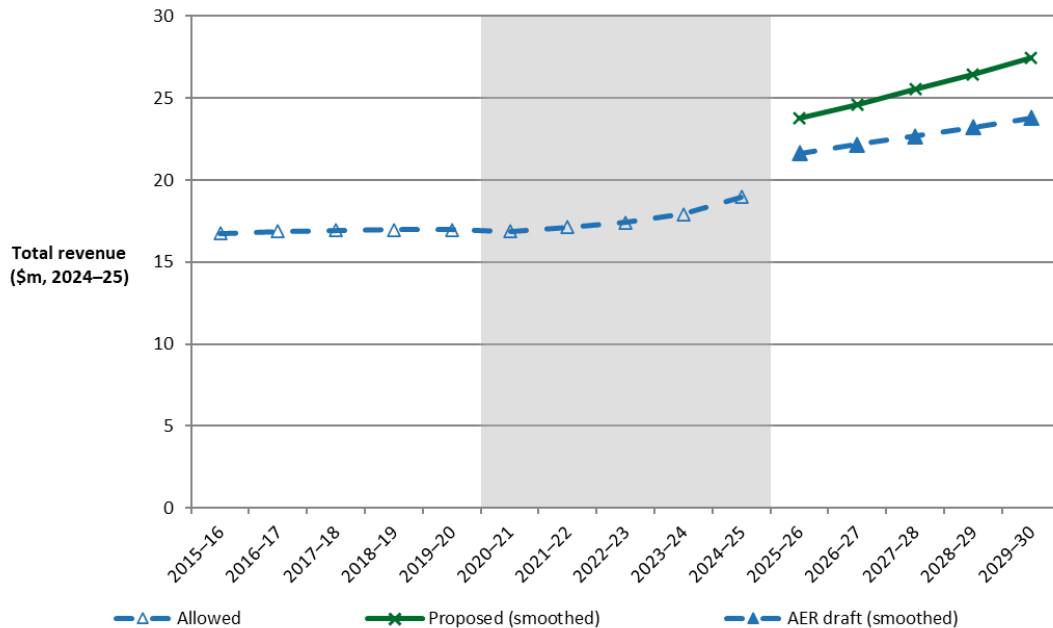
## 1.1 What is driving revenue?

Revenue is driven by changes in real costs and inflation. To compare revenue from one period to the next on a like-for-like basis, we use ‘real’ values based on a common year (2024–25) that have been adjusted for the impact of inflation.

In real terms, this draft decision would allow Directlink to recover \$113.5 million (\$2024–25, smoothed) from consumers over the 2025–30 period. This is 28.5% higher than our decision for the current (2020–25) period.

Changes in Directlink’s revenue over time are shown in Figure 1.

**Figure 1** Changes in regulated revenue over time (\$ million, 2024–25)



Source: AER analysis.

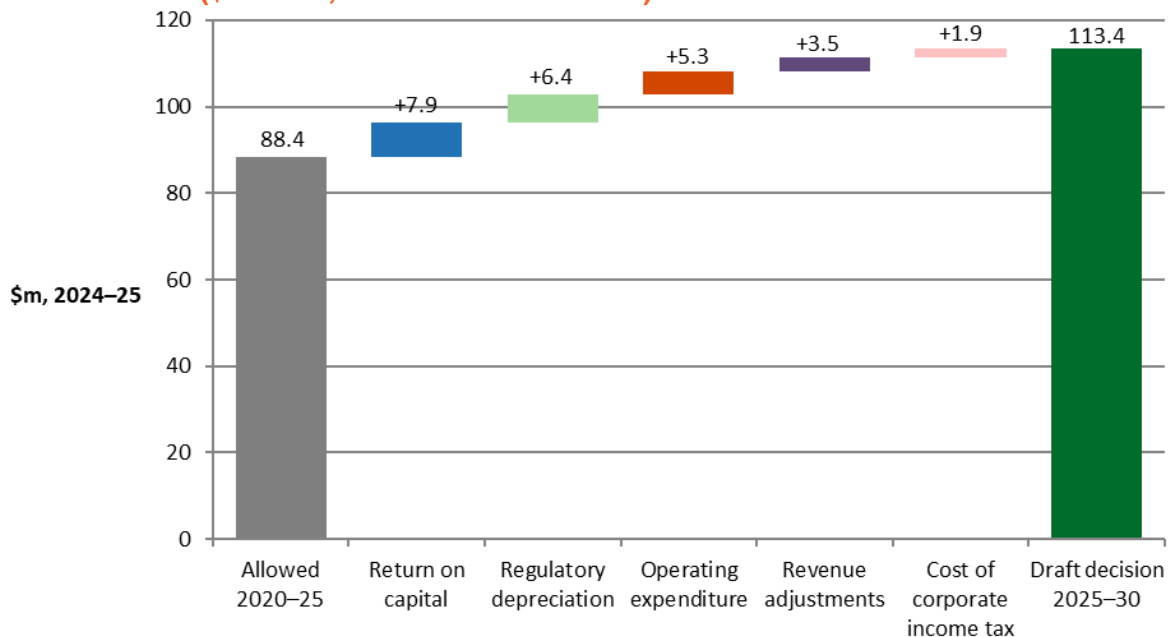
Figure 2 highlights the key drivers of the change in real terms between the revenue approved for Directlink for the 2020–25 period and this draft decision for the 2025–30 period. It shows that our draft decision provides for increases in the building blocks for:

- return on capital, which is based on the opening regulatory asset base (RAB), forecast capex and rate of return. This is \$7.9 million (20.9%) higher than the 2020–25 period, driven by:



- an increase in the opening RAB due in part to higher actual inflation in that period; and
- a higher rate of return being applied in the 2025–30 period, in accordance with the 2022 *Rate of Return Instrument*.
- return of capital (regulatory depreciation), which is \$6.4 million (25.6%) higher than the 2020–25 period, driven primarily by continuing the approach of shortening the asset lives to coincide with when Directlink is expected to cease operation in 2041–42
- net tax amount, which is \$1.9 million (210.8%) higher than the 2020–25 period, primarily due to a higher regulatory depreciation in this draft decision compared to the 2020–25 period<sup>2</sup>
- opex, which is \$5.3 million (18.8%) higher than the opex forecast we approved in the 2020–25 period, driven primarily by higher actual opex in the base year and insurance premium costs
- revenue adjustments, which are \$3.5 million (94.1%) higher than the 2020–25 period, mainly due to a positive capital expenditure sharing scheme (CESS) outcome and a lower efficiency benefit sharing scheme (EBSS) penalty applied in this draft decision.

**Figure 2** Changes in total revenue between 2020–25 period and 2025–30 period (\$ million, 2024–25 unsmoothed)



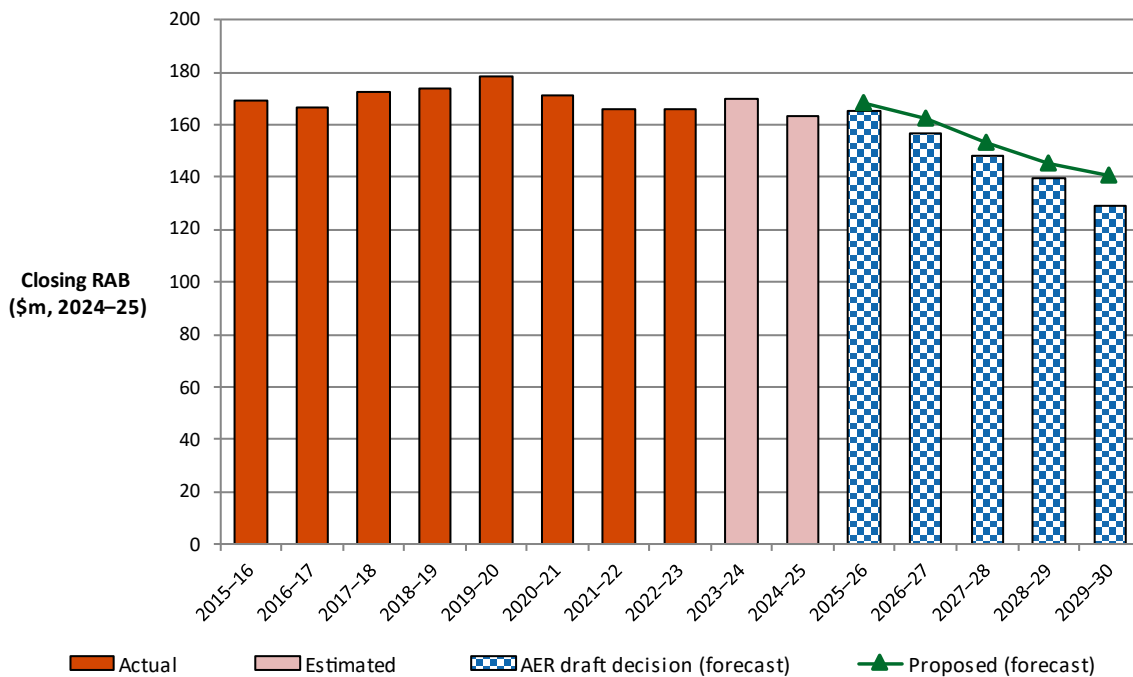
Source: AER analysis

Note: The total allowed revenue for the 2020–25 period and all building block components have been converted to 2024–25 dollar terms using a lagged consumer price index (CPI).

Figure 3 shows the value of Directlink’s RAB over time. After a RAB reduction of 8.6% over the 2020–25 period, our draft decision is expected to result in a further forecast decrease of the RAB by \$33.9 million (\$2024–25) or 20.8% over the 2025–30 period. This reduction is driven by lower forecast capex and higher forecast straight-line depreciation over the 2025–30 period compared to the 2020–25 period.

<sup>2</sup> All else being equal, a higher regulatory depreciation increases the cost of corporate income tax as it is a component of revenue for tax purposes.

**Figure 3 Directlink RAB value over time (\$ million, 2024–25)**



Source: AER analysis.

## 1.2 Key differences between our draft decision and Directlink’s proposal

Our draft decision made significant reductions to core components of Directlink’s proposal which have led to a lower revenue outcome. For the 2025–30 period, the main areas of difference between our draft decision and Directlink’s proposal are our reductions to:

- forecast capex, primarily driven by projects that did not have sufficient supporting information and smaller projects we do not consider appropriate under the capex category
- forecast opex, primarily driven by not including Directlink’s proposed end of life costs (as a category specific forecast) and apprenticeship program step change, as we do not consider these costs to be prudent and efficient.

We also made updates in our draft decision to reflect movements in some market variables, such as expected inflation and rate of return, which also contributed to the reductions on revenue outcomes for certain building blocks.

Overall, our draft decision includes:

- lower return on capital, driven by our reduction in the opening RAB as at 1 July 2025 and a lower rate of return<sup>3</sup>
- lower regulatory depreciation, driven by our decision on a lower forecast capex and a lower opening RAB as at 1 July 2025. The magnitude of the reduction is further

<sup>3</sup> Average rate of return over the 2025–30 period.

increased by a higher RAB indexation, largely due to applying a higher expected inflation than that proposed by Directlink

- lower cost of corporate income tax, driven primarily by our draft decision on a lower regulatory depreciation amount. The lower regulatory depreciation amount reduces the cost of corporate income tax as it is a component of tax income.

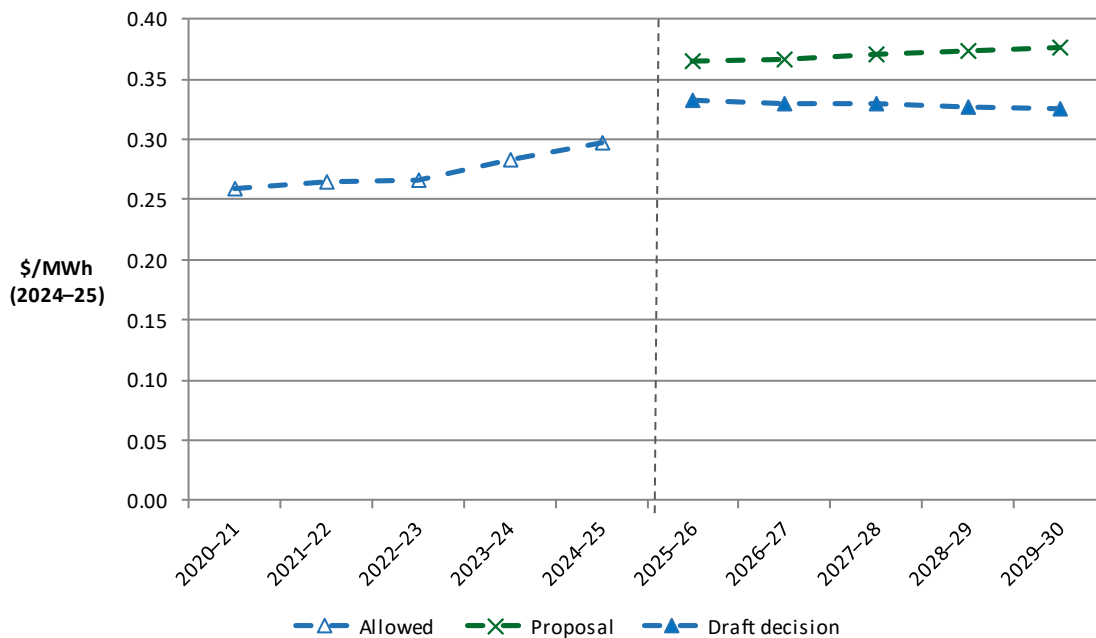
The reduction we made to Directlink’s total revenue is partially offset by our draft decision on higher revenue adjustments than Directlink’s proposed amounts, driven primarily by a positive CESS outcome applied in this draft decision.

### 1.3 Expected impact of our draft decision on electricity bills

Directlink’s revenue is recovered from NSW customers through Transgrid which is the main transmission network service provider (TNSP) for the NSW and the ACT region. This revenue does not directly translate to changes in annual electricity bills, principally because Directlink is a small component of the broader transmission network that serves NSW and the ACT.

For illustrative purposes only, we estimate the impact of this draft decision would be a total increase to the indicative transmission charges of around 23.0% in real terms by 2029–30 compared to 2024–25, or an average increase of 4.2% per annum. Figure 4 compares this indicative price path for the 2025–30 period to the 2020–25 period.

**Figure 4** Change in indicative transmission charges for 2020–25 to 2025–30 (\$2024–25, \$/MWh)



Source: AER analysis.

Notes: The indicative transmission charges are calculated by taking Directlink’s annual expected MAR determined in this draft decision and dividing it by the actual and forecast annual energy delivered in NSW/ACT as published by the Australian Energy Market Operator (AEMO). It reflects that Directlink contributes only to a small part of Transgrid’s transmission network services.

### 1.3.1 Potential bill impact

Transmission charges make up around 6% of a typical total electricity retail bill in NSW and Directlink’s revenue accounts for approximately 1.9% of total NSW transmission revenues. Therefore, Directlink’s revenue would be expected to account for 0.1% of the total electricity retail bill in NSW. Other components of the electricity supply chain—the cost of purchasing energy from the wholesale market, distribution network charges, environmental schemes and the costs and margins applied by electricity retailers in determining the prices they will charge consumers for supply—also contribute to the prices ultimately paid by consumers.<sup>4</sup> These sit outside the decision we are making here and will also continue to change throughout the period.

This is a draft decision, and final decision outcomes are likely to change. In nominal terms, which include the effect of expected inflation, the impact of this draft decision would be an increase to the transmission component of customers’ electricity bills. For illustrative purposes only, we estimate the impact of our draft decision on the average annual electricity retail bill for a customer in NSW, as it is today, would be:

- an increase of about \$1.00 (0.04%) by 2029–30, or an average of \$0.20 per annum for a residential customer
- an increase of about \$2.50 (0.05%) by 2029–30, or an average of \$0.50 per annum for a small business customer.<sup>5</sup>

Our draft decision on Directlink’s annual expected maximum allowed revenue (MAR) forms a small component of the broader transmission network charges for NSW and the ACT for the next 5 years. Transgrid is the main transmission network service provider in this region. Therefore, our 2023–28 transmission determination on Transgrid’s expected MAR is the principal determinant of the transmission network charges.

Over the 2025–30 period there are several additional mechanisms under the NER that may operate to increase or decrease Directlink’s revenue requirement. These include cost pass through events proposed by Directlink and approved in this draft decision. The triggers we have set out for these events in this decision will, if met, allow Directlink to apply for additional revenue throughout the period, at which point proposed costs will be subject to further consultation and assessment.

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<sup>4</sup> AEMC, *Data Portal*, [Trends in NSW supply chain components](#), 2023/24.

<sup>5</sup> Our estimated bill impact is based on the typical annual electricity usage of 4,357 kWh and 10,000 kWh for residential and small business customers in NSW, respectively; AER, *Revised final determination – Default Market Offer Prices 2024–25*, June 2024, p. 6.

## 1.4 Directlink’s consumer engagement

Consumer engagement during the regulatory process is an important way to provide us with supporting evidence that proposals have been aligned with consumer interests and expectations. We introduced guidance on our expectations for consumer engagement to network businesses in December 2021.<sup>6</sup>

It is the responsibility of network businesses to ensure that consumer views are considered and represented in their regulatory proposal. Often consensus is not possible, in which case the views of the differing groups and how the network sought to make its decision should be reflected in its proposal. Our role is to consider the consumer engagement process and the stakeholder submissions when making our various draft decisions.

### 1.4.1 Directlink’s engagement on its proposal

Directlink began its consumer engagement with a co-creation workshop on 31 August 2023. This was followed by monthly meetings with different stakeholder groups. The last consumer consultation was in January 2024, when stakeholders had a final opportunity to give input on the draft proposal before lodgement on 31 January 2024.

Our observation was that, although short and targeted, Directlink’s consumer engagement was broadly in line with expectations in the Handbook, particularly when the size of the business and the forecast bill impacts for consumers are considered.

Directlink’s consultations offered a reasonable reflection of issues that were subject to influence from consumers. This included choices on capex coupled with more limited discussions on opex step changes and other category specific forecasts.

### 1.4.2 What we’ve heard from stakeholders

In our Issues Paper, we asked for stakeholder feedback on Directlink’s consumer engagement. We received one submission from the Energy Users’ Association of Australia (EUAA). The EUAA observed:

*This [engagement] was a considerable and very welcome improvement in stakeholder engagement compared with that which was done for the current regulatory period reset. There was a genuine effort put into ensuring wide stakeholder representation, their involvement in designing the engagement process, providing comprehensive information to stakeholders a reasonable time prior to meetings, ensuring the right company experts were available at each meeting, following up issues that arose and presenting those in this document.*

The EUAA also provided a range of feedback covering topics on capex, opex and incentive schemes. We have considered this and the feedback provided to Directlink during their pre-lodgement consultation in determining our draft decisions.

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<sup>6</sup> AER, [Better Resets Handbook – towards consumer-centric network proposals](#), July 2024.

## 2 Key components of our draft decision on revenue

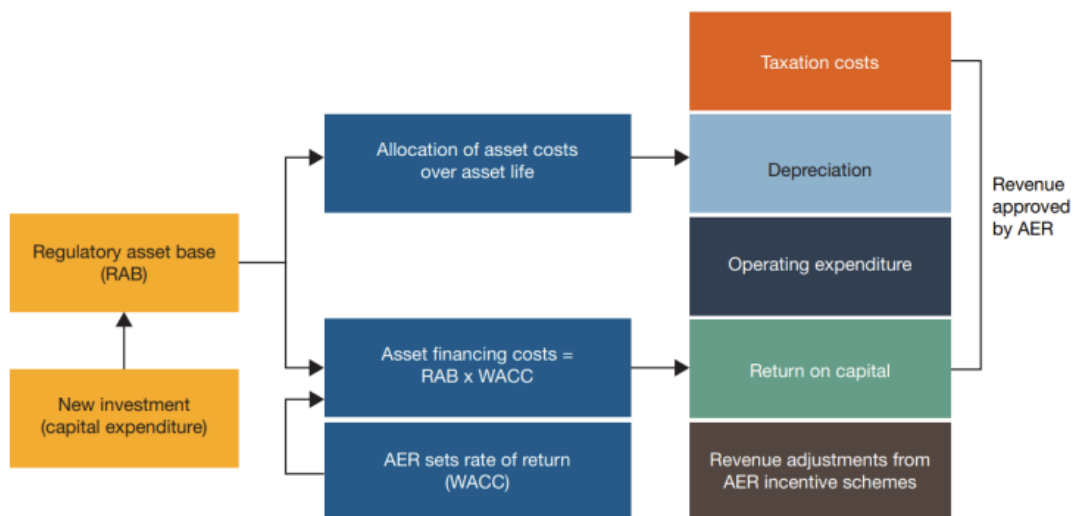
### Building block approach

The foundation of our regulatory approach is a benchmark incentive framework to setting maximum revenues: once regulated revenues are set for a 5-year period, a network that keeps its actual costs below the regulatory forecast of costs retains part of the benefit. This provides an incentive for service providers to become more efficient over time. It delivers benefits to consumers as efficient costs are revealed 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.

Directlink’s proposed revenue reflects its forecast of the efficient cost of providing transmission network services over the 2025–30 period. Its proposal, and our assessment of it under the NEL and NER, are based on a ‘building block’ approach which looks at five cost components (see Figure 5):

- 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 cost to investors over time
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services
- revenue increments/decrements – resulting from the application of incentive schemes, such as the EBSS and capital expenditure sharing scheme (CESS)
- estimated cost of corporate income tax.

**Figure 5 The building block model to forecast network revenue**



Source: AER.

## Revenue smoothing

Our draft decision includes a determination of Directlink’s annual building block revenue requirement (unsmoothed revenue) and annual MAR (smoothed revenue) across the 2025–30 period. The smoothed revenues we set in this draft decision are the amounts that Directlink will target for its annual pricing purposes and recover from its customers for the provision of prescribed transmission services for each year of the 2025–30 period.<sup>7</sup>

The annual building block revenue requirement is the sum of the various building block costs for each year of the regulatory control period, which can be lumpy over the period. To minimise price shocks, revenues are smoothed within a regulatory control period while maintaining the principle of cost recovery under the building block approach. As such, revenue smoothing requires diverting some of the cost recovery to adjacent years within the regulatory control period.

For this draft decision, we approved lower revenues than those in Directlink’s proposal. This is mainly driven by our reductions to Directlink’s proposed forecast opex and capex amounts. On the other hand, our draft decision allows for higher revenues than those determined in the 2020–25 period for the reasons discussed in section 1.1 of this Overview. We have smoothed the MARs over the 2025–30 period for Directlink, which results in an initial increase of 31.9% (nominal) in 2025–26, followed by average annual increases of 5.3% during the remaining 4 years of the 2025–30 period (2026–27 to 2029–30).

## 2.1 Regulatory asset base

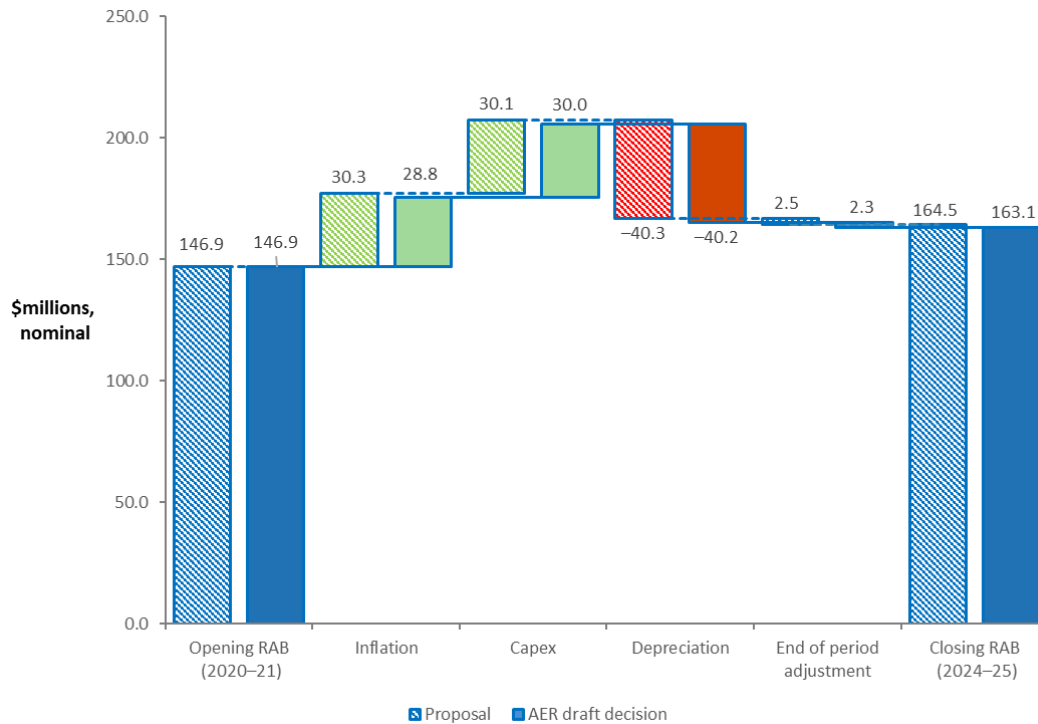
The RAB accounts for the value of regulated assets over time. To set the value of the RAB for a new regulatory period, we take the opening value of the RAB from the end of the last period and roll it forward each year by indexing it for inflation, adding new capex and subtracting depreciation and other possible factors (such as disposals). This gives us a closing value for the RAB at the end of each year of the regulatory period. The value of the RAB is used to determine the return on capital and regulatory depreciation building blocks. It substantially impacts Directlink’s revenue, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and regulatory depreciation components of the revenue determination.

For this draft decision, we have determined an opening RAB value of \$163.1 million (\$ nominal) as at 1 July 2025. This value is \$1.3 million (0.8%) lower than Directlink’s proposed opening RAB value of \$164.5 million. This reduction is largely due to the updates we made to the consumer price index (CPI) inputs for 2023–24 and 2024–25 in the roll forward model (RFM) to reflect more up-to-date values. Figure 6 shows the key drivers of change in Directlink’s RAB over the 2020–25 period compared to its proposal.

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<sup>7</sup> Our draft decision expected revenues have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

**Figure 6 Key drivers of change in the RAB over the 2020–25 period – proposal compared with AER’s draft decision (\$ million, nominal)**



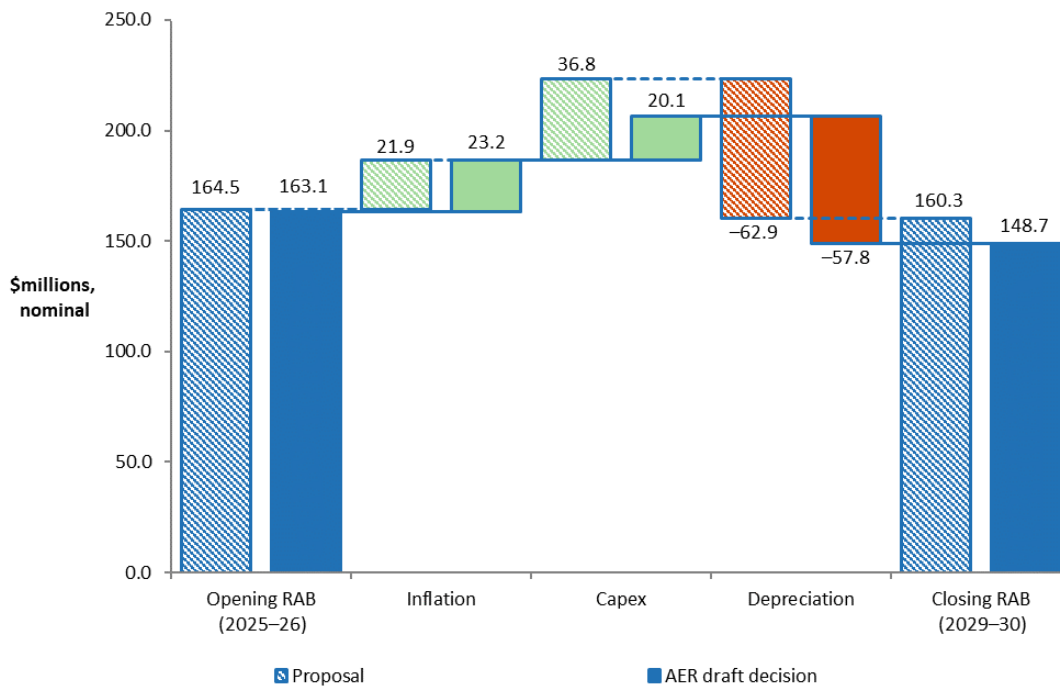
Source: AER analysis.

Note: Capex is net of disposals. It is inclusive of the half-year WACC to account for the timing assumptions in the RFM.

Figure 7 likewise shows the key drivers of change in Directlink’s forecast RAB over the 2025–30 period compared to its proposal. Our draft decision projects a reduction of \$14.4 million (8.8%) to the RAB by the end of the 2025–30 period compared to the \$4.2 million (2.5%) reduction in Directlink’s proposal. We have determined a projected closing RAB of \$148.7 million (\$ nominal) as at 30 June 2030, which is \$11.6 million (7.2%) lower than Directlink’s proposal of \$160.3 million. This lower value is mainly due to our draft decision on a lower forecast capex (discussed in Attachment 5).



**Figure 7** Key drivers of change in the RAB over the 2025–30 period – proposal compared with AER’s draft decision (\$ million, nominal)



Source: AER analysis.

Note: Capex is net of disposals. It is inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

## 2.2 Rate of return and value of imputation credits

The return each business is to receive on its capital base (the ‘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 value of the capital base. 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 gives a return on equity to investors.

Directlink’s proposal and this draft decision applies the 2022 Rate of Return Instrument:<sup>8</sup>

- Our draft decision applies a rate of return of 6.01% for the first year of the regulatory period, compared to the placeholder rate of return of 6.02% used in Directlink’s proposal. This difference is due to updates to the return on debt and the risk-free rate.
- Our draft decision and Directlink’s proposal apply a value of imputation credits (gamma) of 0.57 as set out in the 2022 Instrument.<sup>9</sup>

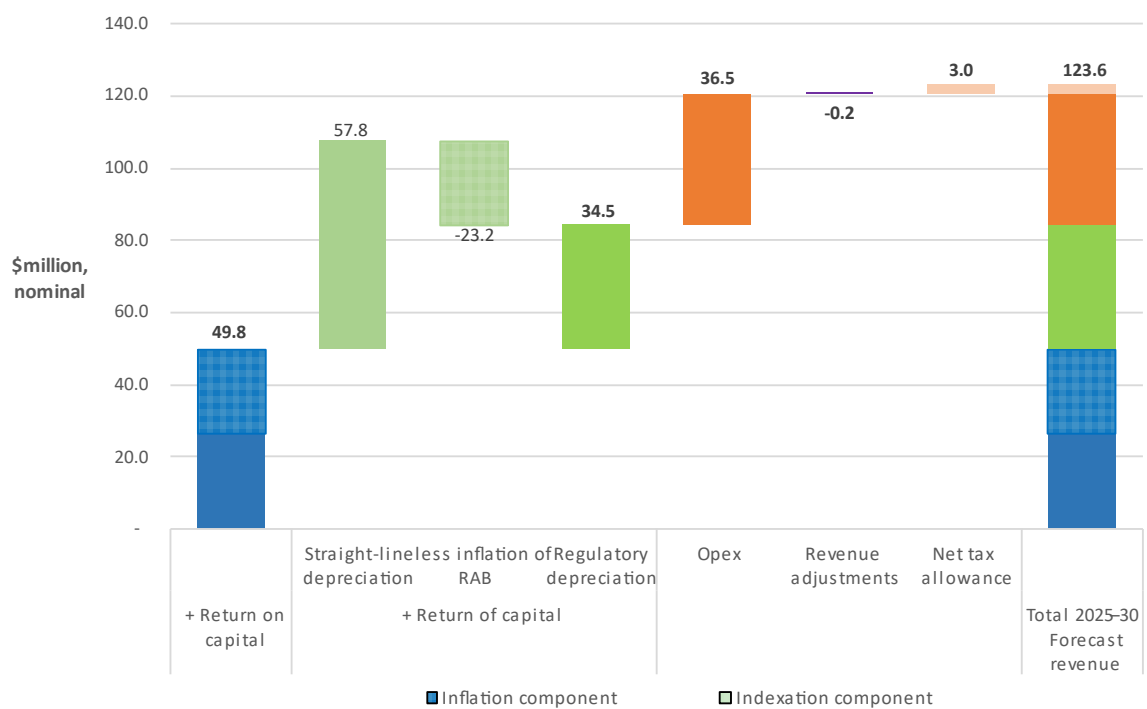
<sup>8</sup> The 2022 *Rate of Return Instrument* was amended in March 2024. See <https://www.aer.gov.au/publications/guidelines-schemes-models/rate-of-return-instrument-2022/final-decision>

<sup>9</sup> AER, *Rate of return Instrument 2022*, Clause 27. The 2022 *Rate of Return Instrument* was amended in March 2024. See <https://www.aer.gov.au/publications/guidelines-schemes-models/rate-of-return-instrument-2022/final-decision>

Our estimate of expected inflation for the purposes of this draft decision is 2.85% per annum. It is an estimate of the average annual rate of inflation expected over a five-year period based on the approach adopted in our 2020 Inflation Review<sup>10</sup> and the forecast from the Reserve Bank of Australia’s August 2024 Statement on Monetary Policy.<sup>11</sup> This is higher than the estimate used in Directlink’s proposal (2.62%), which was taken from an earlier Statement on Monetary Policy.

Figure 8 isolates the impact of expected inflation from other parts of our draft decision to illustrate its effect on the return on capital and regulatory depreciation building blocks, and the total revenue allowance. Other elements held constant, lower expected inflation reduces the return on capital, but increases regulatory depreciation.

**Figure 8** Inflation components in draft decision revenue building blocks (\$ million, nominal)



Source: AER analysis.

<sup>10</sup> AER, *Final position – Regulatory treatment of inflation*, December 2020.

<sup>11</sup> RBA, *Statement on Monetary Policy, Table 3.1: Detailed Forecast Table*, August 2024, p. 57.

## 2.3 Regulatory depreciation (return of capital)

Depreciation is a method used in our decision to allocate the cost of an asset over its useful life. It is the amount provided so capital investors recover their investment over the economic life of the asset (otherwise referred to as ‘return of capital’). When determining total revenue, we include an amount for the depreciation of the projected RAB. The regulatory depreciation amount is the net total of the straight-line depreciation less the indexation of the RAB.

Our draft decision determines a regulatory depreciation amount of \$34.5 million (\$ nominal) for the 2025–30 period. This is a reduction of \$6.4 million (15.7%) from Directlink’s proposal of \$40.9 million.

This reduction is primarily due to our draft decision on the lower straight-line depreciation for the 2025–30 period compared to Directlink’s proposal, due to a lower opening RAB as at 1 July 2025 (Attachment 2) and a lower forecast capex (Attachment 5). The magnitude of the reduction is further increased by a higher RAB indexation,<sup>12</sup> largely due to applying a higher expected inflation than that proposed by Directlink.

## 2.4 Capital expenditure

Capital expenditure—the expenditure incurred to provide network services— mostly relates to assets with long lives, the costs of which are recovered over several regulatory periods. Capex is added to Directlink’s RAB, which is used to determine the return on capital and return on capital (regulatory depreciation) building block allowances. All else being equal, higher forecast capex will lead to a higher projected RAB value and higher return on capital and regulatory depreciation allowances.

Our draft decision is to not accept Directlink’s forecast of \$33.8 million (\$2024–25) for the 2025–30 period. Our alternative forecast is \$18.8 million which is 44.4% lower than Directlink’s forecast.

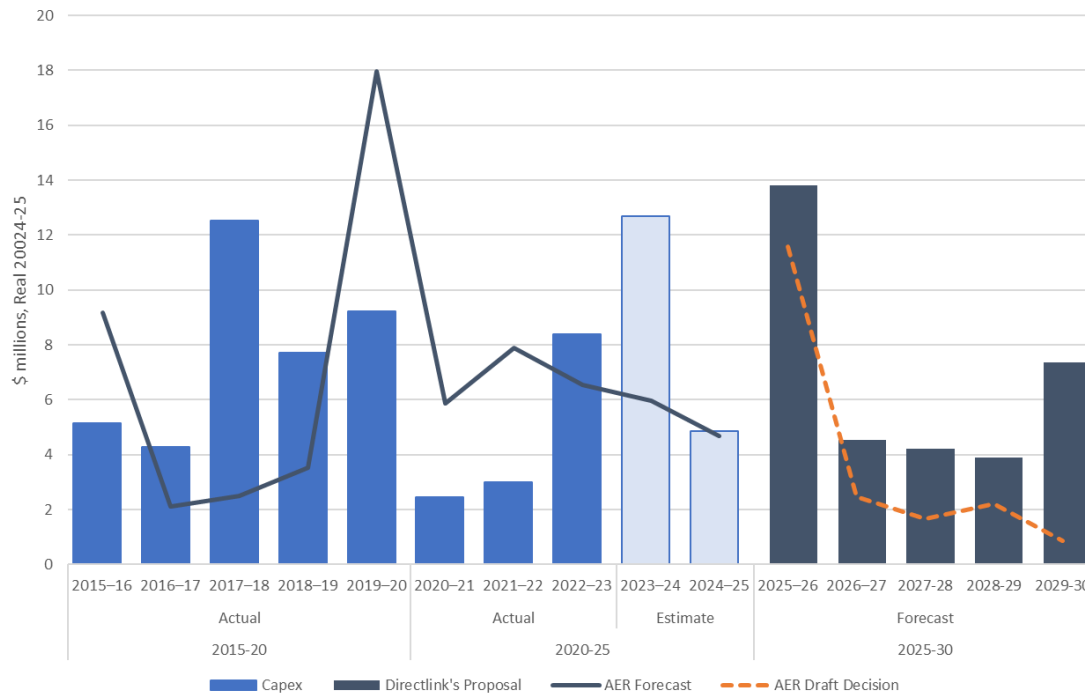
We are satisfied that our alternative forecast of total capex of \$18.8 million reasonably reflects the capex criteria. We have not yet accepted Directlink’s forecast. We found a lack of information in support of its forecast, especially for its spares management project and reactor cooling enhancements. We also did not accept Directlink’s proposed \$0.3 million in regulatory reset costs.

Figure 9 depicts Directlink’s historical capex trend, its proposed forecast for the 2025–30 regulatory control period, and our draft decision. As can be seen from Figure 9, Directlink will incur an immaterial overspend during the 2020–25 period. The main driver of the overspend was its isolated gate bipolar transistor (IGBT) project, where external factors such as Covid-19 and supply issues contributed to higher than forecasted costs.

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<sup>12</sup> Since RAB indexation is deducted from straight-line depreciation, the higher RAB indexation has also resulted in a lower regulatory depreciation.

**Figure 9 Directlink’s historical and forecast capex (\$2024–25, million)**



Source: AER analysis

As noted from Figure 9, Directlink’s historical capex does not exhibit a clear trend that we can refer to for a top-down analysis. For this reason, we focused on a bottom-up approach. The forecast capex we have approved in this draft decision will allow Directlink to continue the safe, reliable, and secure operation of its network.

Overall, our bottom-up review revealed a lack of information to support the prudence and efficiency of Directlink’s forecast. We make the following observations:

- Spares management (\$12.5 million) – Our draft decision is to not include this project into the total capex forecast. Our acceptance of the total capex forecast in Directlink’s proposal is made based on information before us, which was not enough to demonstrate the project met the capex criteria. Should Directlink seek, in its revised proposal, to materially change the total capex forecast it has submitted as part of its proposed spares management project, we anticipate the need to re-examine existing elements of that forecast and whether they remain appropriate as part of a holistic capex program.
- Reactor cooling enhancements (\$2.1 million) – Our draft decision is to not accept Directlink’s forecast. We support the need to maintain safe and reliable components. However, we consider Directlink has not provided enough information to demonstrate the equipment is deteriorating and how it will reduce the operating life of the component.
- AC Isolators and DC disconnectors (\$271,524 and \$431,970) – Our draft decision includes \$247,599 and \$416,515, which is \$23,925 and \$15,455 lower than Directlink’s forecast respectively. We recognise the need to replace the proposed components and extra spare to avoid lead times. However, we do not consider the additional installation and commissioning costs for the extra spare to be prudent during the 2025–30 period.

- Master Controller-FEED (\$132,000) – Our draft decision is to not accept Directlink’s forecast. We understand the benefits of running its systems appears prudent, but we do not have enough information to determine whether the forecast amount is efficient. Directlink has also not made it clear why the project should be considered capex.
- Transmission determination cost (\$283,150) – Our draft decision is to not accept Directlink’s forecast. As stated in our previous determination, we do not consider this type of expenditure appropriate under the capex categorisation.

Our reasoning behind these positions is outlined in further detail in Attachment 5.

## 2.5 Operating expenditure

Our draft decision is to not accept Directlink’s proposed opex forecast of \$39.4 million (\$2024–25), including debt raising costs.<sup>13</sup> This is because our alternative estimate of \$33.5 million is materially different (-\$5.9 million or 15.0% lower) from Directlink’s total opex forecast proposal. Therefore, we consider that Directlink’s total opex forecast does not reasonably reflect the opex criteria, having regard to the opex factors.<sup>14</sup>

Our draft decision is to include our alternative estimate of total forecast opex for the 2025–30 period of \$33.5 million. This draft decision is:

- \$5.9 million (15.0%) lower than Directlink’s proposed opex for the 2020–25 period
- \$2.7 million (8.6%) more than Directlink’s actual and estimated opex for the 2020–25 period
- \$4.3 million (14.9%) more than the opex forecast we approved for the 2020–25 period.

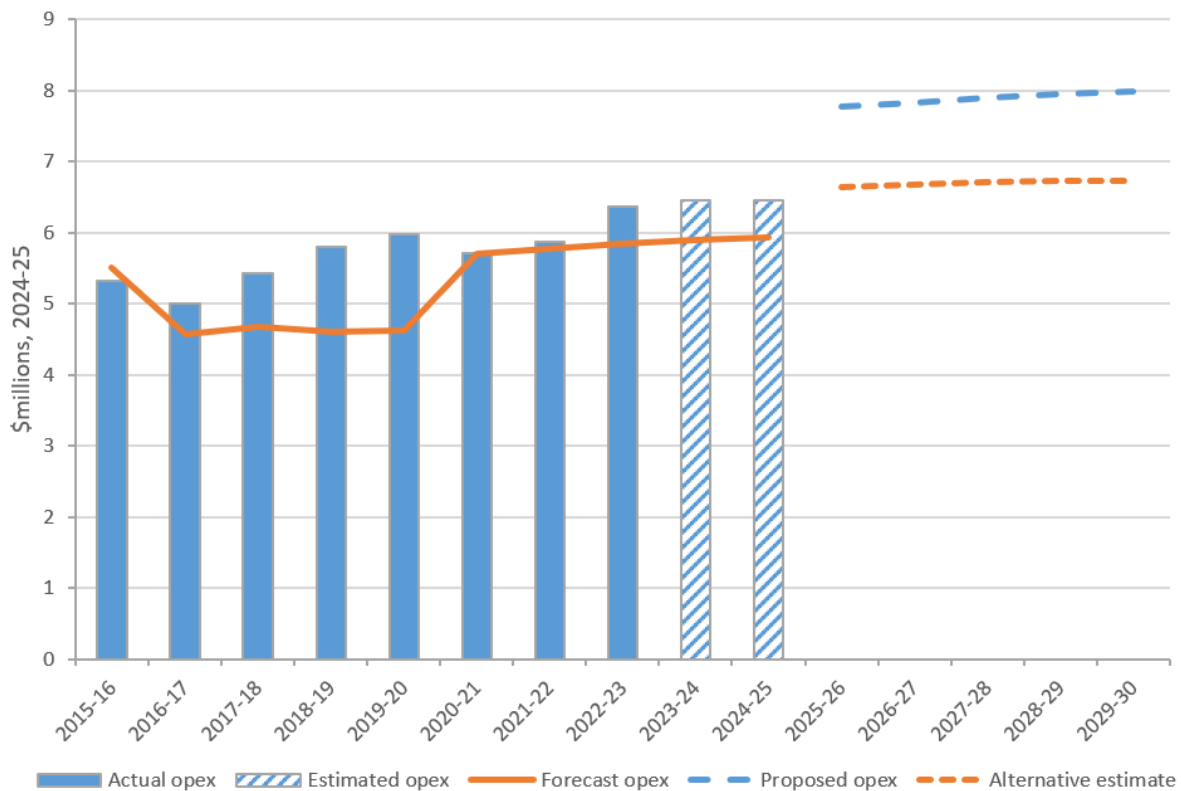
Figure 10 compares our alternative estimate of opex to Directlink’s proposal for the next regulatory control period. We also show the forecasts we approved for the last two regulatory control periods and Directlink’s actual and estimated opex over these periods.

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<sup>13</sup> All dollar amounts in this attachment reflect \$2024–25 terms, unless otherwise indicated.

<sup>14</sup> NER, cl. 6A.6.6(c) and cl. 6A.6.6(e).

**Figure 10 Historical and forecast opex (\$2024–25)**



Source: Directlink, *2019-20 - Annual Regulatory Accounts - RIN Response - Consolidated*, 20 October 2020; Directlink, *2022-23 - Regulatory Accounts - RIN Response - Consolidated*, 12 October 2023; Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Our lower alternative estimate of total opex for Directlink is primarily due to:

- Removal of Directlink’s proposed category specific forecast to set aside provision for end of life costs (-\$4.7 million or -11.9%). We consider there is not sufficient certainty around the need, timing and quantum of these costs to be satisfied they reasonably reflect prudent and efficient expenditure for the 2025–30 period.
- Removal of Directlink’s proposed apprenticeship program step change (-\$0.9 million or -2.2%). We consider that these costs are business as usual in nature, and do not meet our criteria for a step change in expenditure above base year opex.
- Inclusion of a productivity growth factor (-\$0.5 million or -1.2%). This is consistent with our 2023–28 Murraylink revenue determination, where we included a productivity growth factor in our alternative estimate of forecast opex for an interconnector.<sup>15</sup>

Our reasoning behind these positions is outlined in further detail in Attachment 6.

<sup>15</sup> AER, *Murraylink 2023-28 – Draft Decision – Attachment 6 – Operating Expenditure*, September 2022, p. 8.

## 2.6 Corporate income tax

Our determination of the total revenue requirement includes the estimated cost of corporate income tax for 2025–30 period. Under the post-tax framework, this amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM).

Our draft decision determines an estimated cost of corporate income tax amount of \$3.0 million (\$ nominal) for Directlink over the 2025–30 period. This is a reduction of \$0.7 million (19.7%) from Directlink’s proposal of \$3.8 million.

This reduction is primarily due to our draft decision on a lower regulatory depreciation amount (Attachment 4). Regulatory depreciation is a component of revenue for tax purposes. Therefore, lower regulatory depreciation reduces the estimated taxable income for Directlink which in turn decreases the estimated cost of corporate income tax.

## 2.7 Revenue adjustments

Our calculation of Directlink’s total revenue includes adjustments for incentive schemes that applied in its determination for the current period, such as under the EBSS and CESS. These mechanisms provide a continuous incentive for Directlink to pursue efficiency improvements in opex and capex, and a fair sharing of these between Directlink and its users. Our draft decision includes:

- EBSS – a carryover amount totalling negative \$0.6 million (\$2024–25) from the application of the EBSS in the 2020–25 period. This is in line with Directlink’s proposal. We have updated our EBSS model to reflect the latest available data for inflation.
- CESS – a revenue adjustment of \$0.4 million (\$2024–25) under the CESS. This is higher than Directlink’s proposed penalty of \$0.04 million (\$2024–25) because we have used the most recent data and adjustments for the 2019–20 carryover true-up. The full detail on our draft decision for the CESS is in Attachment 9.

The combined effect of these revenue adjustments is a negative \$0.2 million (\$2024–25) revenue adjustment building block in this draft decision compared to the negative \$0.6 million in Directlink’s proposal.

### 3 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 draft decision is that the following incentive schemes will apply to Directlink in the 2025–30 period:

- Efficiency benefit sharing scheme (EBSS). This provides a continuous incentive to pursue efficiency improvements in opex and provide for a fair sharing of these between Directlink and network users. Consumers benefit from improved efficiencies through lower opex in regulated revenues for future periods.
- Capital expenditure sharing scheme (CESS). This incentivises efficient capex throughout the period by rewarding efficiency gains and penalising efficiency losses, each measured by reference to the difference between forecast and actual capex. Consumers benefit from improved efficiencies through a lower RAB, which is reflected in regulated revenues for future periods. We have not accepted Directlink’s proposal to exclude its IGBT project from the CESS as we consider this is not consistent with the intended application of the CESS. Our reasoning behind this position is outlined in further detail in Attachment 9.
- Service target performance incentive scheme (STPIS). This balances incentives to reduce expenditure with the need to maintain or improve service quality, by providing financial incentives to maintain and improve service performance where consumers are willing to pay for these improvements. Once improvements are made, consumers benefit as the benchmark performance targets will be tightened in future years.

Our Framework and Approach Paper proposed not to apply the Demand Management Innovation Allowance Mechanism (DMIAM) to Directlink.<sup>16</sup> Directlink has not proposed to apply the DMIAM and our draft decision is that the DMIAM will not apply. Under the current operational framework, we consider that there will be very limited utility to energy users were Directlink to invest in researching demand management opportunities through the DMIAM.

Our draft decision on the application of these schemes and allowances is consistent with the position taken in our Framework and Approach paper and is set out in Attachments 8-10 of this draft decision.

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<sup>16</sup> AER, [Final Framework and approach, Directlink 2025-30](#), June 2023, p. 7



## 4 Constituent decisions

Our draft decision on Directlink’s transmission determination for the 2025–30 regulatory control period includes the following constituent components:<sup>17</sup>

Constituent component
<p>In accordance with clause 6A.14.1(1)(i) of the NER, the AER’s draft decision is not to approve the total revenue cap set out in Directlink’s building block proposal. Our draft decision on Directlink’s total revenue cap is \$123.8 million (\$ nominal, smoothed) for the 2025–30 regulatory control period. The reasons for our draft decision are set out in Attachment 1 of this draft decision.</p>
<p>In accordance with clause 6A.14.1(1)(ii) of the NER, the AER’s draft decision is not to approve the maximum allowed revenue (MAR) for each regulatory year of the 2025–30 regulatory control period set out in Directlink’s building block proposal. Our decision on Directlink’s MAR for each year of the 2025–30 regulatory control period is set out in Attachment 1 of this draft decision.</p>
<p>In accordance with clause 6A.14.1(1)(iii) of the NER, the AER’s draft decision is to apply the service component and market impact component of Version 5 of the service target performance incentive scheme (STPIS) to Directlink for the 2025–30 regulatory control period. The values and parameters of the STPIS that are approved by the AER are set out in Attachment 10 of this draft decision.</p>
<p>In accordance with clause 6A.14.1(1)(iv) of the NER, the AER’s draft decision on the values that are to be attributed to the parameters for the efficiency benefit sharing scheme (EBSS) that will apply to Directlink in respect of the 2025–30 regulatory control period are set out in Attachment 8 of this draft decision.</p>
<p>In accordance with clause 6A.14.1(1)(v) of the NER, the AER’s draft decision is to approve the commencement and length of the regulatory control period as Directlink proposed in its revenue proposal. The regulatory control period will commence on 1 July 2025 and the length of this period is five years, expiring on 30 June 2030.</p>
<p>In accordance with clause 6A.14.1(2)(ii) of the NER and acting in accordance with clause 6A.6.7(d), the AER’s draft decision is to not accept Directlink’s proposed total net forecast capital expenditure of \$33.8 million (\$2024–25) for the 2025–30 regulatory control period. Our draft decision therefore includes an alternative estimate of \$18.8 million (\$2024–25). The reasons for our draft decision are set out in Attachment 5 of this draft decision.</p>
<p>In accordance with clause 6A.14.1(3)(ii) of the NER and acting in accordance with clause 6A.6.6(d), the AER’s draft decision is to not accept Directlink’s proposed total forecast</p>

<sup>17</sup> NEL, s. 16(1)(c).

<b>Constituent component</b>
operating expenditure inclusive of debt raising costs of \$39.4 million (\$2024–25). Our draft decision therefore includes an alternative estimate of \$33.5 million (\$2024–25) including debt raising costs. The reasons for our draft decision are set out in Attachment 6 of this draft decision.
Directlink did not propose any contingent projects and therefore the AER has not made a draft decision under clause 6A.14.1(4) of the NER.
In accordance with clause 6A.14.1(5A) of the NER, the AER’s draft decision is that the capital expenditure sharing scheme (CESS) as set out in the 2023 Capital Expenditure Incentives Guideline will apply to Directlink in the 2025–30 regulatory control period. The reasons for our draft decision are set out in Attachment 9 of this draft decision.
In accordance with clause 6A.14.1(5A) of the NER, the AER’s draft decision is that the demand management innovation allowance mechanism (DMIAM) for electricity transmission networks will not apply to Directlink in the 2025–30 regulatory control period.
In accordance with clause 6A.14.1(5B) of the NER, the AER’s draft decision is that the allowed rate of return for the 2025–26 regulatory year is 6.01% (nominal vanilla), as set out in Attachment 3 of this draft decision. The rate of return for the remaining regulatory years of the 2025–30 period will be updated annually because our draft decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.
In accordance with clause 6A.14.1(5C) of the NER, the AER’s draft decision is that the value of allowed imputation credits is 0.57. The reasons for our draft decision are set out in Attachment 3 of this draft decision.
In accordance with clause 6A.14.1(5D) of the NER, the AER’s draft decision, in accordance with clause 6A.6.1 and schedule 6A.2, is that the opening regulatory asset base (RAB) as at the commencement of the 2025–30 regulatory control period, being 1 July 2025, is \$163.1 million (\$ nominal). The reasons for our draft decision are set out in Attachment 2 of this draft decision.
In accordance with clause 6A.14.1(5E) of the NER, the AER’s draft decision is that the depreciation approach to be used to establish the RAB at the commencement of Directlink’s regulatory control period as at 1 July 2030 is to be based on forecast capex (forecast depreciation). The reasons for our draft decision are set out in Attachment 2 of this draft decision.
In accordance with clause 6A.14.1(8) of the NER, the AER’s draft decision is to not approve Directlink’s proposed pricing methodology for the 2025–30 regulatory control period. The reasons for our draft decision are set out in Attachment 12 of this draft decision.

### Constituent component

In accordance with clause 6A.14.1(9) of the NER, the AER's draft decision is to apply the following nominated pass through events to Directlink for the 2025–30 regulatory control period in accordance with clause 6A.6.9:

- Insurance coverage event
- Insurer's credit risk event
- Terrorism event
- Natural disaster event

The definitions of these events and the reasons for our draft decision are set out in Attachment 13 of this draft decision.

## 5 List of submissions

We received one submission in response to Directlink 2025-30 transmission revenue proposal. This is listed below.<sup>18</sup>

Submission from
Energy Users' Association of Australia (EUAA)

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<sup>18</sup> Submission is available on the AER website at <https://www.aer.gov.au/industry/registers/determinations/directlink-determination-2025-30/proposal#submissions>

## Shortened forms

Terms	Definition
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Capex	capital expenditure
CESS	capital expenditure sharing scheme
TNSP	Transmission Network Service Provider
EBSS	efficiency benefit sharing scheme
EUAA	Energy Users' Association of Australia
F&A	framework and approach
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
STPIS	service target performance incentive scheme