



FINAL DECISION

Directlink

Transmission Determination

2020 to 2025

Attachment 4

Regulatory depreciation

June 2020

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165

Email: AERInquiry@aer.gov.au

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Note

This attachment forms part of the AER's final decision on Directlink's 2020–25 transmission determination. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Directlink transmission determination 2020–25

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment A – Pricing methodology

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4 Regulatory depreciation

Depreciation is the allowance provided so capital investors recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by Directlink, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Directlink's 2020–25 regulatory control period.¹ The regulatory depreciation allowance is the net total of the straight-line depreciation less the indexation of the RAB.

This attachment sets out our final decision on Directlink's regulatory depreciation allowance, including an assessment of the proposed standard and remaining asset lives used for forecasting depreciation.

4.1 Final decision

Our final decision is to determine a regulatory depreciation allowance of \$22.4 million (\$nominal) for Directlink over the 2020–25 regulatory control period. This amount represents an increase of \$0.4 million (or 1.8 per cent) on the \$22.0 million (\$nominal) in Directlink's revised proposal. It also represents an increase in the regulatory depreciation allowance from our draft decision. In coming to this decision:

- we accept Directlink's revised proposed straight-line depreciation method to calculate the regulatory depreciation allowance which is consistent with our draft decision
- we accept Directlink's revised proposed remaining asset life of 21.2 years as at 1 July 2020 for depreciating its existing assets which is consistent with the draft decision.² This is because 21.2 years reflect the remaining technical life of Directlink's assets, after which Directlink will cease to operate. This approach is the same as that approved in our previous determination
- we accept Directlink's revised proposed asset classes and alignment of the standard asset lives to its remaining asset life of 21.2 years. We also accept the revised proposed new asset class of 'Transmission determination costs' and its associated standard asset life of 5 years

We have also made determinations on other components of Directlink's revised proposal, which affect the RAB and in turn impacts the forecast regulatory depreciation allowance. The increase to the regulatory depreciation allowance from the revised proposal primarily reflects our final decision expected inflation rate for the 2020–25 regulatory control period.

Our final decision for Directlink's straight-line depreciation component of regulatory depreciation is lower than the revised proposal by \$0.1 million due to our determination of the opening RAB as at 1 July 2020 (attachment 2). However, this reduction is offset

¹ NER, cl. 6A.5.4 and 6A.14.1.

² Allocated to 'Transmission assets' and 'Easements' asset classes.

by our final decision on the indexation of the RAB, which is \$0.5 million higher than the revised proposal. This is largely due to applying a lower expected inflation rate of 2.27 per cent per annum in this final decision (section 2.2 of the Overview) compared to Directlink’s revised proposal of 2.34 per cent per annum. Subsequently, the net effect is an increase in the regulatory depreciation allowance of \$0.4 million.

Table 4.1 sets out our final decision on the forecast regulatory depreciation allowance for Directlink over the 2020–25 regulatory control period.

Table 4.1 AER's final decision on Directlink's forecast regulatory depreciation for the 2020–25 regulatory control period (\$million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Straight-line depreciation	7.0	7.4	7.9	8.4	8.8	39.5
Less: inflation indexation on opening RAB	3.3	3.4	3.4	3.5	3.5	17.1
Regulatory depreciation	3.6	4.0	4.5	4.9	5.4	22.4

Source: AER analysis.

Standard and remaining asset lives

For this final decision, we accept Directlink’s revised proposal to assign a remaining asset life of 21.2 years for its depreciable asset classes, which is the remaining technical life of Directlink’s assets. As a consequence, Directlink will recover its RAB value by the time it ceases to operate in 2041–42. Further, we accept its revised proposal to align the standard asset lives for the depreciation of forecast capex over the 2020–25 regulatory control period to Directlink’s remaining technical life. This results in forecast capex being depreciated over the remaining life of the existing assets—i.e. 21.2 years.³ This approach is consistent with Directlink’s initial proposal, our draft decision for this determination and our decision for the previous determination. We also accept Directlink’s revised proposed new ‘Transmission determination costs’ asset class and its associated standard asset life of 5 years.

In our draft decision, we accepted Directlink’s proposal to merge its ‘Converter stations’ and ‘Transmission lines’ asset classes into one asset class labelled ‘Transmission assets’. We also accepted Directlink’s proposal to assign a standard and remaining asset life of 21.2 years for its depreciable asset classes, which reflects the remaining technical life of Directlink.⁴ However, we retained the ‘Easements’ asset class and

³ This is because we consider the revised proposed forecast capex are for ‘stay in business’ and ancillary equipment purposes and should depreciate over the same life as its existing asset base. We note Directlink’s assets would not have any economic life when Directlink ceases to operate in 2041–42. Therefore this proposed alignment of the standard and remaining asset lives is appropriate for regulatory depreciation purposes; NER, cl. 6A.6.3(b)(1).

⁴ AER, *Directlink 2020–25 – Draft decision – Attachment 4 – Regulatory depreciation*, October 2019, p. 14.

added two new asset classes labelled 'Land' and 'Buildings'.⁵ We also did not accept Directlink's proposed new 'Restoration and rectification' asset class because we did not approve the forecast capex associated with this asset class.

Directlink's revised proposal has adopted all of our draft decision changes to its asset classes. It also maintained the remaining and standard asset life of 21.2 years for its depreciable asset classes, which our draft decision accepted.⁶ However, Directlink has included a new asset class labelled 'Transmission determination costs' with a standard asset life of 5 years for the 2020–25 regulatory control period.

Standard asset life for the 'Transmission determination costs' asset class

In our draft decision, we did not accept Directlink's proposal to capitalise forecast expenditure associated with the regulatory reset process in the 2020–25 regulatory control period. Our view was these costs were unlikely to attract any future economic benefits and should be recognised as operating expenditure (opex) rather than capex.⁷

Directlink's revised proposal did not adopt our draft decision to treat the forecast regulatory reset determination costs as opex. It has instead proposed a new asset class to capture this expenditure, labelled 'Transmission determination costs' with a standard asset life of 5 years.

As discussed in attachment 5 of this final decision, we approve the revised proposed forecast capex associated with this new asset class.⁸ Accordingly, we are required to determine a standard asset life for the 2020–25 regulatory control period for amortising these costs. As this capex relates to Directlink's costs in developing and preparing its next regulatory determination proposal for the 2025–30 regulatory control period, we consider Directlink's revised proposed standard asset life of 5 years to be reasonable. This is because a standard asset life of 5 years reflects the length of the regulatory control period and these costs are incurred for the purpose of receiving economic benefits over that period.

Table 4.2 sets out our final decision on the standard asset lives for Directlink over the 2020–25 regulatory control period and its remaining asset lives as at 1 July 2020. We are satisfied the approved asset lives would lead to a depreciation schedule that reflects the nature of the assets over the economic lives of the asset classes. Further, the sum of the real value of the depreciation attributable to the assets would be equivalent to the value at which the assets were first included in the RAB for Directlink.⁹

⁵ AER, *Directlink 2020–25 – Draft decision – Attachment 4 – Regulatory depreciation*, October 2019, pp. 12–13.

⁶ Directlink, *Revised transmission determination proposal*, December 2019, pp. 25–26.

⁷ AER, *Directlink 2020–25 – Draft decision – Attachment 5 – Capital expenditure*, October 2019, pp. 23–24; AER, *Directlink 2020–25 – Draft decision – Attachment 6 – Operating expenditure*, October 2019, pp. 15–16.

⁸ AER, *Directlink 2020–25 – Final decision – Attachment 5 – Capital expenditure*, April 2020, p. 5.

⁹ NER, cll. 6A.6.3(b)(1)–(2).

Table 4.2 AER’s final decision on Directlink's standard and remaining asset lives at 1 July 2020 (years)

Asset class	Remaining asset life as at 1 July 2020	Standard asset life
Transmission assets	21.2	21.2
Transmission determination costs	n/a	5.0
Easements	21.2	n/a
Land	n/a	n/a
Buildings	n/a	21.2
Equity raising costs	n/a	n/a

Source: AER analysis; Directlink, *Revised proposal PTRM*, 10 December 2019.

n/a: Not applicable. We have not assigned a standard or remaining asset life to the 'Land' asset class because land assets are not subject to depreciation. We have not assigned a standard asset life to the 'Easements' and 'Equity raising costs' asset classes as it does not have any forecast capex allocated to it. We have not assigned a remaining asset life to the 'Transmission determination costs', 'Buildings' and 'Equity raising costs' asset classes because they do not have opening RAB values as at 1 July 2020.

4.2 Assessment approach

We did not change our assessment approach for regulatory depreciation from our draft decision. Attachment 4 (section 4.3) of our draft decision details that approach.¹⁰

¹⁰ AER, *Directlink 2020–2025 Draft Decision – Attachment 4 – Regulatory depreciation*, October 2019.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
NER	national electricity rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
WACC	weighted average cost of capital