



DRAFT DECISION

AusNet Services Distribution Determination 2021 to 2026

Attachment 4 Regulatory depreciation

September 2020

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

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 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 - Customer service incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

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Attachment 19 – Tariff structure statement

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4 Regulatory depreciation

Depreciation is the amount 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 AusNet Services, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for AusNet Services' 2021–26 regulatory control period.¹ The regulatory depreciation amount is the net total of the straight-line depreciation less the indexation of the RAB.

This attachment sets out our draft decision on AusNet Services' regulatory depreciation. It also presents our draft decision on the proposed depreciation schedules, including an assessment of the proposed standard asset lives used for forecasting depreciation.

4.1 Draft decision

We determine a regulatory depreciation amount of \$733.5 million (\$ nominal) for AusNet Services for the 2021–26 regulatory control period. AusNet Services proposed a regulatory depreciation amount of \$784.0 million (\$ nominal).² Our decision represents a decrease of \$50.5 million or 6.4 per cent on the proposed amount.

For our draft decision on AusNet Services' regulatory depreciation:

- We accept AusNet Services' proposed asset classes, its straight-line depreciation method, and the standard asset lives (with the exception of the 'Equity raising costs' and three unused lease asset classes) used to calculate the regulatory depreciation amount.
- We accept the continuation of AusNet Services' year-by-year tracking approach to calculate straight-line depreciation of existing assets. However, we identified and corrected a few errors in AusNet Services' application of the year-by-year tracking approach in its depreciation model.
- We accept the inclusion of the 'Secondary systems (pre 2016)' asset class proposed by AusNet Services. However, we have amended the depreciation calculations by applying a year-by-year tracking approach rather than the proposed weighted average remaining life of 5.3 years. We also have reduced the overall amounts identified for the assets allocated to this asset class.
- We accept the proposed accelerated depreciation of approximately \$3.9 million of other assets, in particular high bushfire risk assets which have been, or are forecast to be, replaced as part of the safety programs approved in the rapid earth fault current limited contingent project applications. Further, we accept the proposed remaining asset life for accelerated depreciation of these assets.

¹ NER, cl. 6.12.1, 6.4.3.

² AusNet Services, *ASD - Distribution Proposal PTRM model (2022–26)*, January 2020.

- We have also consolidated the proposed lease asset classes for existing assets into a single new 'Non-network leasehold land & buildings - 1 July 2021' asset class (as discussed in attachment 2) and determined a single remaining asset life. AusNet Services also proposed five new asset classes for future lease expenditures. We have accepted two of these new asset classes, and the proposed standard asset lives, for the years forecast capex is expected to occur. We have removed the other three asset classes from the post-tax revenue model (PTRM).
- We made determinations on other components of AusNet Services' proposal which affect the forecast regulatory depreciation—for example, the opening RAB at 1 July 2021 (attachment 2), expected inflation (attachment 3), and forecast capital expenditure (capex) (attachment 5) including its effect on the projected RAB over the 2021–26 regulatory control period.³

Table 4.1 sets out our draft decision on the annual regulatory depreciation amount for AusNet Services' 2021–26 regulatory control period.

Table 4.1 AER's draft decision on AusNet Services' forecast depreciation for the 2021–26 regulatory control period (\$ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Straight-line depreciation	274.3	254.9	257.5	267.1	273.6	1327.5
Less: inflation indexation on opening RAB	111.8	114.9	118.6	122.5	126.0	594.0
Regulatory depreciation	162.5	140.0	138.9	144.5	147.6	733.5

Source: AER analysis.

4.2 AusNet Services' proposal

For the 2021–26 regulatory control period, AusNet Services proposed total forecast regulatory depreciation of \$784.0 million (\$ nominal). To calculate the depreciation amount, AusNet Services proposed to use:⁴

- the straight-line depreciation method employed in the AER's PTRM
- the closing RAB value at 30 June 2021 derived from the AER's roll forward model (RFM)
- proposed forecast capex for the 2021–26 regulatory control period

³ Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2021–26 regulatory control period.

⁴ AusNet Services, *ASD - Distribution Proposal PTRM model (2022-26)*; AusNet Services, *ASD - Distribution Proposal RFM (2016–21)*, January 2020.

- an expected inflation rate of 2.45 per cent per annum for the 2021–26 regulatory control period
- the year-by-year tracking depreciation model, which implements the straight-line method to calculate the forecast depreciation (over the 2021–26 regulatory control period) of the opening RAB at 1 July 2021
- the asset classes and standard asset lives for depreciating new assets associated with forecast capex for the 2021–26 regulatory control period (except for the 'Equity raising costs' asset class), which are consistent with those approved in the 2016–20 distribution determination
- a new asset class—'Secondary systems (pre 2016)'—with a remaining asset life of 5.3 years to accelerate the depreciation of \$209.1 million of existing intelligent electronic devices (IEDs) relays and remote terminal units (RTUs)
- three new asset classes—with prefix 'Accelerated depr'—for applying accelerated depreciation of approximately \$3.9 million of high bushfire risk assets over the 2021–26 regulatory control period⁵
- eight new asset classes associated with capitalised leases of different timeframes (see attachment 2)
- two new asset classes of 'Buildings' and 'In-house software' that were created for straight-line tax depreciation purposes arising from the AER's 2018 tax review (see attachment 7).

Table 4.2 sets out AusNet Services' proposed depreciation amount for the 2021–26 regulatory control period.

Table 4.2 AusNet Services' proposed forecast depreciation for the 2021–26 regulatory control period (\$ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Straight-line depreciation	253.7	269.8	280.2	293.5	306.0	1403.2
Less: inflation indexation on opening RAB	115.5	120.0	124.0	128.0	131.6	619.2
Regulatory depreciation	138.2	149.8	156.2	165.5	174.4	784.0

Source: AusNet Services, *ASD - Distribution Proposal PTRM model (2022–26)*, January 2020.

4.3 Assessment approach

We determine the regulatory depreciation amount using the PTRM as part of a service provider's annual revenue requirement.⁶ Where the year-by-year tracking approach has been adopted, a separate depreciation model is also used for existing assets and

⁵ AusNet Services revised the amount marginally in Information Request #041.

⁶ NER, cl. 6.4.3(a)(3) and (b)(3).

feeds into the PTRM. The calculation of depreciation in each year is governed by the value of assets included in the RAB at the beginning of the regulatory year, and by the depreciation schedules.⁷

Our standard approach to calculating depreciation is to employ the straight-line method set out in the PTRM. We consider the straight-line method satisfies the National Electricity Rules (NER) requirements in clause 6.5.5(b) as it provides an expenditure profile that reflects the nature of assets over their economic life.⁸

Once the method is set, regulatory practice has been to assign a standard asset life to each category of assets that represents the economic or technical life of the asset or asset class. We must consider whether the proposed depreciation schedules conform to the following key requirements:

- the schedules depreciate using a profile that reflects the nature of the assets or category of assets over the economic life of that asset or category of assets⁹
- the sum of the real value of the depreciation that is attributable to any asset or category of assets must be equivalent to the value at which that asset or category of assets was first included in the RAB for the relevant distribution system.¹⁰

If a service provider's building block proposal does not comply with the above requirements, then we must determine the depreciation schedules for the purpose of calculating the depreciation for each regulatory year.¹¹

The regulatory depreciation amount is an output of the PTRM. We therefore assessed AusNet Services' proposed regulatory depreciation amount by analysing the proposed inputs to the PTRM for calculating that amount. The key inputs include:

- the opening RAB at 1 July 2021
- the forecast net capex in the 2021–26 regulatory control period¹²
- the expected inflation rate for the above period
- the standard asset life for each asset class—used for calculating the depreciation of new assets associated with forecast net capex in the above period
- the depreciation associated with the opening RAB as at 1 July 2021—calculated in a separate year-by-year tracking depreciation model.

⁷ NER, cl. 6.5.5(a).

⁸ NER, cl. 6.5.5(b)(1).

⁹ NER, cl. 6.5.5(b)(1).

¹⁰ NER, cl. 6.5.5(b)(2).

¹¹ NER, cl. 6.5.5(a)(2)(ii).

¹² Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2021–26 regulatory control period.

Our draft decision on AusNet Services' regulatory depreciation amount reflects our determinations on the opening RAB at 1 July 2021, expected inflation, and forecast capex (the first three building block components in the above list).¹³ Our determinations on these components of the service provider's proposal are discussed in attachments 2, 3 and 5 respectively.

In this attachment, we assess AusNet Services' proposed standard asset lives against:

- the approved standard asset lives in the distribution determination for the 2016–20 regulatory control period
- the standard asset lives of comparable asset classes approved in our recent distribution determinations for other service providers
- the appropriate economic lives of the assets.

Our standard approach for depreciating a service provider's existing assets in the PTRM uses the remaining asset lives at the start of a regulatory control period as determined in the RFM. However, for the 2016–20 regulatory control period, AusNet Services adopted an approach where (in addition to grouping assets by type via asset classes) it tracks the asset classes on a year-by-year basis to implement straight-line depreciation—known as the year-by-year tracking approach. In our distribution determination for AusNet Services' 2016–20 regulatory control period, we approved the year-by-year tracking approach and determined that it met the depreciation provisions of the NER. We reaffirm this decision for the 2021–26 regulatory control period, as discussed in section 4.4.1.

AusNet Services' proposal also included accelerated depreciation of certain assets. Our assessment approach for accelerated depreciation aligns with our general approach. One key consideration is whether the accelerated depreciation produces depreciation schedules that reflect the economic life of the affected assets, as set out in clause 6.5.5(b)(1) of the NER.

4.3.1 Interrelationships

The regulatory depreciation is a building block component of the annual revenue requirement.¹⁴ Higher (or quicker) depreciation leads to higher revenues over the regulatory control period. It also causes the RAB to reduce more quickly (excluding the impact of further capex). This reduces the return on capital amount, although this impact is usually smaller than the increased depreciation amount in the short to medium term.¹⁵

¹³ Our final decision will update the opening RAB as at 1 July 2021 for revised estimates of actual capex and inflation.

¹⁴ The PTRM distinguishes between straight-line depreciation and regulatory depreciation, the difference being that regulatory depreciation is the straight-line depreciation minus the indexation adjustment.

¹⁵ This is generally the case because the reduction in the RAB amount feeds into the higher depreciation building block, whereas the reduced return on capital building block is proportionate to the lower RAB multiplied by the WACC.

Ultimately, however, a service provider can only recover the capex that it incurred on assets once. The depreciation amount reflects how quickly the RAB is being recovered, and it is based on the remaining and standard asset lives used in the depreciation calculation. It also depends on the level of the opening RAB and the forecast capex, with any increase in these factors also increasing the depreciation amount.

The RAB has to be maintained in real terms, meaning the RAB must be indexed for expected inflation.¹⁶ The return on capital building block has to be calculated using a nominal rate of return (WACC) applied to the opening RAB.¹⁷ As noted in attachment 1, the total annual revenue requirement is calculated by adding up the return on capital, depreciation, operating expenditure, tax and revenue adjustments building blocks. Because inflation on the RAB is accounted for in both the return on capital—based on a nominal rate—and the depreciation calculations—based on an indexed RAB—an adjustment must be made to the revenue requirement to prevent compensating twice for inflation.

To avoid this double compensation, we make an adjustment by subtracting the annual indexation gain on the RAB from the calculation of total revenue.¹⁸ Our standard approach is to subtract the indexation of the opening RAB—the opening RAB multiplied by the expected inflation for the year—from the RAB depreciation. The net result of this calculation is referred to as regulatory depreciation.¹⁹ Regulatory depreciation is the amount used in the building block calculation of total revenue to ensure that the revenue equation is consistent with the use of a RAB, which is indexed for inflation annually.

This approach produces the same total revenue requirement and RAB as if a real rate of return had been used in combination with an indexed RAB. Under an alternative approach where a nominal rate of return was used in combination with an un-indexed (historical cost) RAB, no adjustment to the depreciation calculation of total revenue would be required. This alternative approach produces a different time path of total revenue compared to our standard approach. In particular, overall revenues would be higher early in the asset's life (as a result of more depreciation being returned to the service provider) and lower in the future—producing a steeper downward sloping profile of total revenue.²⁰ Under both approaches, the total revenues being recovered are in present value neutral terms—that is, returning the initial cost of the RAB.

¹⁶ NER, cl. 6.5.1(e)(3).

¹⁷ AER, *Rate of return instrument*, cl. 1, cl. 3(a), cl. 36(c), December 2018.

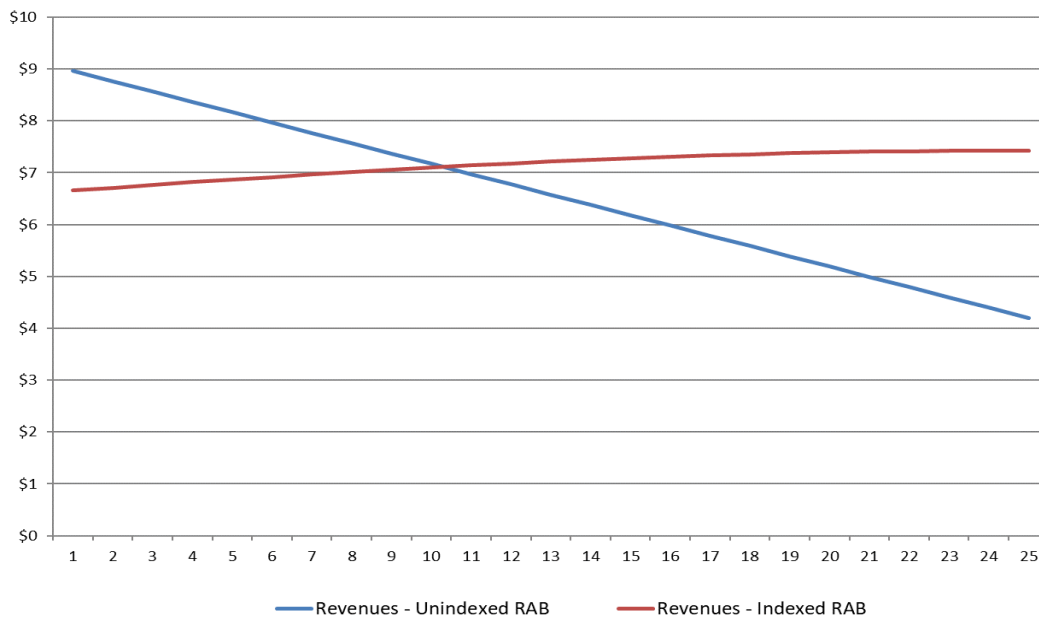
¹⁸ NER, cl. 6.4.3(b)(1)(ii).

¹⁹ If the asset lives are extremely long, such that the RAB depreciation rate is lower than the inflation rate, then negative regulatory depreciation can emerge. The indexation adjustment is greater than the RAB depreciation in such circumstances.

²⁰ A change of approach from an indexed RAB to an un-indexed RAB would result in an initial step change increase in revenues to preserve NPV neutrality.

Figure 4.1 shows the recovery of revenue under both approaches using a simplified example.²¹ Indexation of the RAB and the offsetting adjustment made to depreciation results in smoother revenue recovery profile over the life of an asset than if the RAB was un-indexed. The indexation of the RAB also reduces price shocks when the asset is replaced at the end of its life.²²

Figure 4.1 Revenue path example – indexed vs un-indexed RAB (\$ nominal)



Source: AER analysis.

Figure 2.1 (in attachment 2) shows the relative size of the inflation and straight-line depreciation and their impact on the RAB based on AusNet Services' proposal. A 10 per cent increase in the straight-line depreciation causes revenues to increase by about 3.9 per cent.²³

4.4 Reasons for draft decision

We accept AusNet Services' proposed straight-line depreciation method for calculating the regulatory depreciation amount as set out in the PTRM and the year-by-year

²¹ The example is based on the initial cost of an asset of \$100, a standard economic life of 25 years, a real WACC of 2.5%, expected inflation of 2.4% and nominal WACC of 4.96%. Other building block components such as opex, tax and capex are ignored for simplicity as they would affect both approaches equally.

²² In year 26 the revenues in the example for the un-indexed approach would jump from about \$4 to \$9, assuming the asset is replaced by an asset of roughly similar replacement cost as the initial asset. In contrast, in the same circumstances, the indexed approach would see revenues stay at roughly \$7.

²³ We have analysed the sensitivity of straight-line depreciation relative to total revenue based on input data provided in AusNet Services' proposal PTRM.

tracking approach to implement this method, subject to correcting some errors. We also accept the proposed asset classes and standard asset lives (with the exception of the 'Equity raising costs' and three unused lease asset classes).

We have also consolidated AusNet Services' proposed three new asset classes for existing lease assets of 'Non-network leasehold land & buildings - 1 Apr 2019', 'Non-network leasehold land & buildings - CY20' and 'Non-network leasehold land & buildings - Jan-Jun 2021', into a single new 'Non-network leasehold land & buildings - 1 July 2021' asset class, as discussed in attachment 2. Further, we determine a remaining life of 8.4 years for this consolidated asset class based on the weighted average of the three proposed asset classes.

We reduced AusNet Services' proposed forecast regulatory depreciation by \$50.5 million (or 6.4 per cent) to \$733.5 million (\$ nominal). This amendment mainly reflects our corrections to the depreciation tracking model proposed by AusNet Services (section 4.4.1) and a reduction to its proposed accelerated depreciation of relays and remote terminal units (section 4.4.2). It also reflects our determinations regarding other components of AusNet Services' regulatory proposal that affect the forecast regulatory depreciation—the opening RAB at 1 July 2021 (attachment 2), expected inflation over the 2021–26 regulatory control period (attachment 3) and forecast capital expenditure (attachment 5) including its effect on the projected RAB over the 2021–26 regulatory control period.²⁴

Our assessment of AusNet Services' continuation of the year-by-year tracking depreciation approach, proposed accelerated depreciation, and its proposed standard asset lives are discussed in turn in the following subsections.

4.4.1 Year-by-year tracking approach

From the beginning of the 2016–20 regulatory control period, AusNet Services has implemented the straight-line method for the calculation of its forecast regulatory depreciation using the year-by-year tracking approach. We accepted this approach in our 2016–20 distribution determination. AusNet Services' proposal is to continue using the year-by-year tracking approach for calculating depreciation of its existing assets.

We accept that AusNet Services' proposed year-by-year tracking approach meets the requirements of the NER in that it will result in depreciation schedules that:

- reflect the nature of the assets and their economic life²⁵
- ensure that total depreciation (in real terms) equals the initial value of the assets²⁶

²⁴ Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2021–26 regulatory control period.

²⁵ NER, cl. 6.5.5(b)(1).

²⁶ NER, cl. 6.5.5(b)(2).

- allows the economic lives of existing assets to be consistent with those determined on a prospective basis in our 2016–2020 distribution determination.²⁷

AusNet Services prepared a separate depreciation model to implement year-by-year tracking.²⁸ It builds on the depreciation model used for the 2016–20 distribution determination and accounts for the additional half year in 2021.²⁹ We have reviewed AusNet Services' year-by-year tracking depreciation model and updated it with the latest CPI and WACC estimate for 2021 in the depreciation model, which were not available at the time of the proposal.

We also corrected some minor errors in the depreciation model, which AusNet Services agreed with.³⁰ In particular, we have made the following adjustments:

- We corrected and updated the links of some inputs in the model.
- We used the actual 2015 capex (rather than estimated 2015 capex) for depreciation as a line item for each asset class and the 2015 capex true up adjustment reflects the real return on the difference between actual and estimated capex. This approach is consistent with our final decision for TasNetworks' 2019–24 distribution determination and our draft decision for the SA Power Networks 2020–25 distribution determination.³¹
- We corrected the formula for a number of asset classes to ensure correct profile of depreciation.

Overall, the materiality of these errors is small, resulting in 0.1 per cent decrease to nominal straight-line depreciation over the 2021–26 regulatory control period. We also made a significant change in the model in relation to how the accelerated depreciation is calculated, as discussed in the next subsection.

4.4.2 Accelerated depreciation

AusNet Services proposed accelerated depreciation of \$209.1 million of existing IED protection relays and RTUs acquired from 1997 to 2016. This proposal adds about 4.7 per cent to AusNet Services' total revenues for the 2021–26 regulatory control period.

The IED relays and RTUs in question have historically been included in the broad 'Distribution systems' and 'Sub-transmission' asset classes with remaining asset lives

²⁷ NER, cl. 6.5.5(b)(3).

²⁸ AusNet Services, *Depreciation tracking model (2016–21)*, January 2020.

²⁹ For the 2026 reset, AusNet Services will be required to use the AER's recently developed depreciation tracking model published with the RFM (version 3). Due to timing issues, that was not possible for this reset.

³⁰ AusNet Services, *Response to AER information request #031*, 12 June 2020.

³¹ AER, *Final decision – TasNetworks Distribution Determination 2019 to 2024 – Attachment 4 – Regulatory depreciation*, April 2019, p. 7; AER, *Draft decision – SA Power Networks Distribution Determination 2020 to 2025 – Attachment 4 – Regulatory depreciation*, October 2019, p. 13.

of over 30 years each.³² AusNet Services submitted that these existing assets have much shorter remaining asset lives. We agree that these assets are likely to have shorter remaining asset lives than the weighted average remaining asset life of the existing broader asset classes. However, separating the assets is not straight forward. There are various ways this could be done.

AusNet Services proposed creating a new asset class called 'Secondary systems (pre 2016)' for depreciating these assets over a shorter remaining asset life. The key issues for assessment are the value of the assets to be included in this new asset class and the adjustment that should be made to the remaining asset lives of these assets.³³

AusNet Services had to estimate the written down value of these assets as no records of the actual written down value of the assets exist. It estimated the remaining asset life of these assets is currently 32.5 years in the broader asset classes, but AusNet Services has proposed that this life be reduced to 5.3 years.

AusNet Services' approach to determining the written down value of the assets started with current replacement costs (including 10 per cent overheads) of the units in question, adjusted this value for inflation, and to reflect when the assets were acquired. For example, a relay acquired in 2010 had 10 years of the previous depreciation rate applied to it to determine the written down value in 2020. Each asset's remaining asset life was then determined by assuming a 15 year standard asset life for these types of assets. Accordingly, for an asset acquired in 2010, it would have a 5 year remaining asset life by 2020—that is, 15 years of expected life less 10 years of use. The calculation included three asset types that were combined to determine a current weighted average remaining asset life for the assets and a revised weighted average remaining life for the new asset class.

Despite no actual written down values being available, we consider AusNet Services approach is reasonable at a high level. In principle, we consider the proposal is consistent with the rules for these assets to be separately depreciated so as to better reflect their economic life. We investigated the calculations made and the various inputs and assumptions used in the calculations.³⁴ We accept the general modelling approach and calculations made, but require adjustment to two aspects of the calculations. In total, these adjustments reduce the amount of accelerated depreciation by \$43.4 million in the 2021–26 regulatory control period. A summary of the key components of calculation follows:

- The historical standard asset life assumed for the separated assets – We need to determine a reasonable standard asset life for these assets if they are separated

³² From 2016 they have been included in a separate 'SCADA/Network control' asset class with a standard asset life of 10 years.

³³ We need to also assess how the value and remaining asset lives of the existing asset classes are impacted by this separation. However, given these asset make up just under 5 per cent of the value of these asset classes, the impacts are minor on the existing asset classes.

³⁴ AusNet Services provided a separate confidential model that included these calculations.

from the broader asset class. We consider the 15 years used by AusNet Services for the standard life of these asset types is reasonable, despite it being at the lower end of a possible range of 15–25 years we have observed for these asset types.

- The current replacement unit rate³⁵ – The unit rate is made of various components. We require an adjustment to the unit rate to remove a ‘nominal risk allowance’. We engaged with AusNet Services on why this allowance had been included in the unit rates, but were not persuaded that it serves a purpose that is in the best interests of consumers.³⁶ In our assessment, this allowance simply provides an extra financial buffer for AusNet Services against any potential cost over runs. Removing this allowance has reduced the estimated values of the assets subject to accelerated depreciation by about \$12.5 million (or 6.0 per cent).
- Overheads – An overhead allowance of 10 per cent of the current unit rate was included in the calculations. We engaged with AusNet Services on this matter and accept this amount as being reasonable for present purposes.³⁷
- The use of a weighted average remaining life for the assets subject to accelerated depreciation – AusNet Services uses year-by-year tracking for all its assets but proposed a weighted average remaining life of 5.3 years for these assets in this case. However, given the data available, we consider these assets can also be tracked by using the three asset types (IED relays>66kv, IED relays<66kv, and RTUs). Doing so results in about \$30.9 million of the accelerated depreciation amount being recovered in the 2026–31 regulatory control period, rather than in the 2021–26 regulatory control period. We have amended the depreciation tracking model accordingly.³⁸

AusNet Services also proposed accelerated depreciation of approximately \$3.9 million of other assets, in particular high bushfire risk assets which have been, or are forecast to be, replaced as part of the safety programs approved in the rapid earth fault current limited contingent project applications. The proposed accelerated depreciation for these assets are consistent with similar programs approved in our previous decision for the 2016–20 regulatory control period. As such, we accept this aspect of the proposal. Further, we accept the proposed remaining asset life of 2 years for accelerated depreciation purposes, as it reflects the expected economic life of these assets.

A number of submissions raised concerns with the revenue impacts of AusNet Services' proposed accelerated depreciation. They stated the AER should closely investigate the proposal.³⁹ We have done so by seeking further information

³⁵ These rates are commercial in confidence.

³⁶ AusNet Services, *Response to Information Request #026*, 9 June 2020.

³⁷ AusNet Services, *Response to Information Request #016*, 18 May 2020.

³⁸ The details of the depreciation tracking of these assets is contained in a separate confidential model used to determine the value of the assets subject to accelerated depreciation.

³⁹ EnergyAustralia, *Victorian Electricity Distribution determinations 2021–26 – Regulatory proposals*, 3 June, pp. 9–10. Origin Energy, *RE: Submission to Victorian electricity distributors' regulatory proposals*, 3 June 2020, pp. 3–4. Victorian Community Organisations, *2021–2026 Victorian EDPR, Joint submission from Victorian community*

from AusNet Services and challenging the various aspects of the proposal, as noted above.

EnergyAustralia stated that clause 6.5.5(b)(2) of the NER appears to require assets to be valued as at the time they were first included in the RAB. EnergyAustralia submitted that this may preclude use of current unit replacement cost estimates, deflated to 1997 dollars, as proposed by AusNet Services.⁴⁰ We do not agree with this view. The assets included in the RAB reflect the value at the time they were first included. AusNet Services' proposal changes the depreciation profile for a proportion of these assets, not their value. The proposal aims to better give effect to clause 6.5.5(b)(1) of the NER, developing a depreciation schedule that reflects the assets' economic lives.

The CCP17 suggested the accelerated depreciation (if accepted) for AusNet Services should occur over two regulatory control periods.⁴¹ Given our decision to track the three asset types subject to accelerated depreciation, the CCP17's suggestion will be met in part.

The Energy Users Association of Australia (EUAA) stated it was unfortunate that the accelerated depreciation proposal was outside the Customer Forum's scope and that accelerated depreciation offset most drivers for price reductions.⁴² Although not in the Customer Forum's scope during the preparation of the proposal, and despite our largely positive endorsement above, AusNet Services could give further consideration to consumers' views in preparing its revised proposal in this area.

4.4.3 Standard asset lives

We accept AusNet Services' proposed standard asset lives, with the exception of the standard asset life for the 'Equity raising costs' and three unused leases asset classes. We have calculated the standard asset life of equity raising costs by taking the weighted average of the standard asset lives of total forecast capex for each asset class over the 2021–26 regulatory control period. We also accept the introduction of two new asset classes arising from the 2018 tax review (attachment 7).

AusNet Services proposed the same standard asset lives for its existing asset classes in respect of the forecast capex to be incurred in the 2021–26 regulatory control period, except for the 'Equity raising costs' asset class. We accept the unchanged asset lives as they are consistent with those approved for the 2016–20 regulatory control period

organisations – summary document, May 2020, pp. 5, 11. CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*, 10 June 2020, pp. 32–33. ECA, *Victorian Electricity Distributors Regulatory Proposals 2021–2026 – Submission*, June 2020, p. 17. EUAA, *Submission – AusNet Services EPDR 2021–26*, June 2020, p. 2.

⁴⁰ EnergyAustralia, *Victorian Electricity Distribution determinations 2021–26 – Regulatory proposals*, 3 June, pp. 9–10.

⁴¹ CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*, 10 June 2020, pp. 32–33.

⁴² EUAA, *Submission - AusNet Services EPDR 2021–26*, June 2020, p. 2.

and are largely comparable with the standard asset lives approved in our recent determinations for other distributors.⁴³

The standard asset life for the 'Equity raising costs' asset class needs to be reviewed each regulatory control period. We consider the standard asset life for this asset class should reflect the lives of the mix of assets making up the approved forecast net capex, because the equity raising cost benchmark is associated with that forecast.⁴⁴ However, no equity raising cost have been determined in our draft decision modelling. This is because AusNet Services does not satisfy the requirements to incur benchmark equity raising costs associated with the approved forecast capex. There is no impact from this draft decision, since AusNet Services' proposal also did not forecast any equity raising costs.

In order to implement the changes arising from the tax review, AusNet Services reallocated a proportion of its forecast capex related to buildings and IT assets for the 2021–26 regulatory control period into two new asset classes. The two new asset classes are:

- 'Buildings - capital works'⁴⁵
- 'In-house software'.

Discussed further in attachment 7, the tax review acknowledged different methods of calculation of tax depreciation for different asset classes, which resulted in the addition of these asset classes to the PTRM and a reallocation of forecast capex to these asset classes. For each asset class a standard asset life has been proposed that is consistent with the standard asset lives determined for these asset classes in recent AER decisions.⁴⁶ Therefore, for the 'Buildings - capital works' asset class we accept assigning a standard asset life of 40 years, while for 'In-house software' we accept assigning a standard asset life of 5 years.

AusNet Services also proposed five new asset classes for future lease expenditures. We accept two of these new asset classes, and the proposed standard asset lives proposed, for the years forecast capex is expected to occur. We are satisfied the proposed standard asset lives reflect the lease terms and therefore the expected economic lives of the leases. However, we have removed the other three asset classes from the PTRM where no capex is forecast.

⁴³ AER, *Final decision: TasNetworks distribution determination 2019 to 2024, attachment 4*, April 2019, pp. 9–10; AER, *Final decision: Evoenergy distribution determination 2019 to 2024, attachment 4*, April 2019, p. 9; AER, *Final decision: Essential Energy distribution determination 2019 to 2024, attachment 4*, April 2019, p. 8; AER, *Final decision: Ausgrid distribution determination 2019 to 2024, attachment 4*, April 2019, p. 9; AER, *Final decision: Endeavour Energy distribution determination 2019 to 2024, attachment 4*, April 2019, p. 10; AER, *Final decision: Power and Water Corporation distribution determination 2019 to 2024, attachment 4*, April 2019, pp. 8–9.

⁴⁴ For this reason, we used forecast net capex as the weights to establish the weighted average standard asset life for amortising equity raising costs.

⁴⁵ We relabelled this asset class from 'Buildings' as proposed by AusNet Services to 'Buildings - capital works' to be clear that only capital works can be included in this asset class.

⁴⁶ AER, *Energex - Final decision - PTRM*, May 2020; AER, *Ergon Energy - Final decision - PTRM*, May 2020; AER, *SA Power Networks - Final decision - PTRM*, May 2020.

The Victorian Community Organisations submitted that the Victorian distributors apply different depreciation schedules with asset lives that also differ from replacement expenditure (repex) assessments. The submission advocated applying a standard depreciation schedule across the Victorian distributors.⁴⁷ We encourage consistency in asset lives for similar assets. However, differences can appear to emerge when assets are aggregated into asset classes. The depreciation schedules have evolved over time. In certain aspects they are a carryover from the previous jurisdictional arrangements in Victoria. In this regard, a key feature of the Victorian distributors' depreciation schedules is that they are based on relatively few asset classes. This means that there can be a greater variety of assets in an asset class with otherwise similar names. Where this is the case, differences in the asset lives stem purely from the mix of assets that are expected to make up that asset class. For example, the 'Non-network general assets – IT' asset class may encompass short lived standard IT assets (e.g. office computers and general word processing software), as well as more specialised IT assets (e.g. data servers and storage system). We consider it is reasonable that these assets may have different useful lives. Similarly, the repex assessments look at assets in more detail than the broader depreciation assessment. We consider the depreciation schedules across the Victorian distributors are comparable to each other and to the repex assessment when these differences are recognised. We have also discussed this matter in our previous Victorian distributor decisions.⁴⁸

Table 4.3 sets out our draft decision on AusNet Services' standard asset lives for the 2021–26 regulatory control period. We are satisfied the approved standard 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 is equivalent to the value at which the assets were first included in the RAB for AusNet Services.⁴⁹

⁴⁷ VCO, *2021-2026 Victorian EDPR: Joint submission from Victorian community organisations – summary document*, May 2020, p. 11.

⁴⁸ See for example: AER, *Final Decision: AusNet Services distribution determination 2016 to 2020, Attachment 5 – Regulatory depreciation*, May 2016, pp. 9–10.

⁴⁹ NER, cll. 6.5.5(b)(1)–(2).

Table 4.3 AER’s draft decision on AusNet Services' standard asset lives for the 2021–26 regulatory control period (years)

Asset class	Standard asset life
Subtransmission	45.0
Distribution system assets	50.0
SCADA/Network control	10.0
Non-network general assets - IT	5.0
Non-network general assets - other	5.0
Land	n/a
Non-network leasehold land & buildings – 2021–22	23.7
Non-network leasehold land & buildings – 2025–26	5.0
Buildings - capital works ^a	40.0
In-house software ^a	5.0
Equity raising costs	n/a

Source: AER analysis.

(a) New asset classes were created for the PTRM version 4 in order to separate components of buildings and IT related assets that must be depreciated using the straight-line method for tax purposes. Refer to attachment 7 (corporate income tax) for more detail.

n/a not applicable. We have not assigned a standard asset life to the 'Land' asset class because the assets allocated to it are non-depreciating assets.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CCP17	Consumer Challenge Panel, sub-panel 17
CPI	consumer price index
IED	intelligent electronic devices
NER	National Electricity Rules
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RTU	remote terminal units
WACC	weighted average cost of capital
