



DRAFT DECISION
Evoenergy
Distribution Determination

2019 to 2024

Attachment 2
Regulatory asset base

September 2018

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Evoenergy for the 2019–2024 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

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

Attachment 12 – Classification of services

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Attachment 14 – Pass through events

Attachment 15 – Alternative control services

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Shortened forms

Shortened form	Extended form
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP 10	Consumer Challenge Panel, sub-panel 10
CESS	capital expenditure sharing scheme
CPI	consumer price index
distributor	distribution network service provider
NER	national electricity rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
WACC	weighted average cost of capital

2 Regulatory asset base

As part of our distribution determination, we make a decision on Evoenergy's opening regulatory asset bases (RABs) as at 1 July 2019 for its distribution and transmission (dual function assets) networks.¹ Evoenergy's dual function assets are high voltage assets which support the broader NSW/ACT transmission network owned and operated by TransGrid. The AER has decided to apply transmission pricing to these assets.² The RAB is the value of those assets that are used by Evoenergy to provide standard control services. We use the RAB at the start of each regulatory year to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

This attachment presents our draft decision on the opening RAB values as at 1 July 2019 for Evoenergy and roll forward of the forecast RABs over the 2019–24 regulatory control period. It also presents our draft decision on whether depreciation for establishing the RAB as at the commencement of the 2024–29 regulatory control period is to be based on actual or forecast capital expenditure.³

2.1 Draft decision

We determine opening RAB values of \$790.9 million and \$174.1 million (\$ nominal) as at 1 July 2019 for Evoenergy for its distribution and transmission networks respectively. Evoenergy proposed opening RAB values of \$791.4 million and \$174.2 million (\$ nominal) as at 1 July 2019 for its distribution and transmission assets respectively.⁴ We accept the proposed opening RABs, subject to the following revisions:

- updated the 2017–18 inflation rate with actual consumer price index (CPI) input for indexation in the RAB roll forward
- updated inputs to the RFMs due to changes in the 2014–19 PTRMs from the remittal decision for the 2014–19 regulatory control period.⁵ These updates included forecast:
 - inflation rate for the 2014–19 period
 - nominal vanilla WACC values for the 2014–19 period
 - equity raising costs in 2014–15
 - straight-line depreciation for the 2014–19 period.

¹ NER, cl. 6.12.1(6).

² AER, *Framework and approach ActewAGL Regulatory control period commencing 1 July 2019*, July 2017, p. 13

³ NER, cl. 6.12.1(18)

⁴ Evoenergy, *Regulatory proposal 2019–24 Attachment 7: Regulatory Asset Base* January 2018, p. 7–9, Table 7.12 and Table 7.13.

⁵ AER, *Draft Decision Evoenergy 2014–19 electricity distribution determination*, September 2018.

To determine the opening RAB as at 1 July 2019, we have rolled forward the RAB over the 2014–19 regulatory control period in accordance with our roll forward model (RFM)⁶ to determine a closing RAB value at 30 June 2019. Our approach to rolling forward the RAB generally involves an adjustment to account for the difference between actual capex and the estimate approved for the final year of the previous regulatory control period.⁷ However, this adjustment is not required for establishing Evoenergy's opening RABs as at 1 July 2019 since the approved opening RAB values at 1 July 2014 of \$693.5 million and \$154.0 million for its distribution and transmission networks respectively do not include any estimated capex. This is because 2014–15 was a transitional year for Evoenergy and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

Table 2.1 and Table 2.2 set out our draft decision on the roll forward of the RAB values for Evoenergy over the 2014–19 regulatory control period for its distribution and transmission networks respectively.

Table 2.1 AER's draft decision on Evoenergy's RAB for the 2014–19 regulatory control period – distribution (\$ million, nominal)

	2014–15	2015–16	2016–17	2017–18 ^a	2018–19 ^b
Opening RAB	693.5	729.7	743.3	749.2	773.1
Capital expenditure ^c	63.0	51.6	45.9	60.3	53.6
Inflation indexation on opening RAB ^d	17.3	11.0	9.5	14.6	15.5
Less: straight-line depreciation ^e	44.1	48.9	49.5	50.9	51.2
Interim closing RAB	729.7	743.3	749.2	773.1	790.9
Closing RAB as at 30 June 2019^f					790.9

Source: AER analysis.

- (a) Based on estimated capex. We will update the RAB roll forward for actual capex in the final decision.
- (b) Based on estimated capex provided by Evoenergy. We expect to update the RAB roll forward with a revised capex estimate in the final decision, and true-up the RAB for actual capex at the next reset.
- (c) Net of disposals and capital contributions, and adjusted for actual CPI.
- (d) We will update the RAB roll forward for actual CPI for 2018–19 in the final decision.
- (e) Adjusted for actual CPI. Based on forecast as-incurred capex.
- (f) There is no true-up required for 2013–14 capex as the approved opening RAB value of \$693.5 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for Evoenergy and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

⁶ AER, *Electricity distribution network service providers: Roll forward model (version 2)*, 15 December 2016.

⁷ The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2014–19 determination.

Table 2.2 AER's draft decision on Evoenergy's RAB for the 2014–19 regulatory control period – transmission (\$ million, nominal)

	2014–15	2015–16	2016–17	2017–18 ^a	2018–19 ^b
Opening RAB	154.0	159.7	163.3	165.5	166.7
Capital expenditure ^c	11.1	9.8	9.1	8.0	14.4
Inflation indexation on opening RAB ^d	2.6	2.7	2.4	3.2	3.3
Less: straight-line depreciation ^e	8.0	9.0	9.3	10.0	10.3
Interim closing RAB	159.7	163.3	165.5	166.7	174.1
Closing RAB as at 30 June 2019^f					174.1

Source: AER analysis.

- (a) Based on estimated capex. We will update the RAB roll forward for actual capex in the final decision.
- (b) Based on estimated capex provided by Evoenergy. We expect to update the RAB roll forward with a revised capex estimate in the final decision, and true-up the RAB for actual capex at the next reset.
- (c) Net of disposals and capital contributions, and adjusted for actual CPI.
- (d) We will update the RAB roll forward for actual CPI for 2018–19 in the final decision.
- (e) Adjusted for actual CPI. Based on forecast as-incurred capex.
- (f) There is no true-up required for 2013–14 capex as the approved opening RAB value of \$154.0 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for Evoenergy and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

We determine forecast closing RAB values of \$847.1 million and \$159.8 million (\$ nominal) as at 30 June 2024 for Evoenergy's distribution and transmission networks respectively. Evoenergy proposed closing RAB values of \$906.3 million and \$173.6 million (\$ nominal) as at 30 June 2024 for its distribution and transmission networks respectively.⁸ Our draft decision on the forecast closing RAB values reflects the updated opening RAB as at 1 July 2019, and our draft decisions on the expected inflation rate (attachment 3), forecast depreciation (attachment 4) and forecast capex (attachment 5).

Table 2.3 and Table 2.4 set out our draft decision on the forecast RAB values for Evoenergy over the 2019–24 regulatory control period for its distribution and transmission networks respectively.

⁸ Evoenergy, *Regulatory proposal 2019–24 Attachment 7: Regulatory Asset Base* January 2018, p. 7–9, Table 7.12 and Table 7.13.

Table 2.3 AER's draft decision on Evoenergy's RAB for the 2019–24 regulatory control period – distribution (\$ million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	790.9	803.2	815.1	821.5	840.0
Capital expenditure ^a	47.7	50.2	47.5	62.5	54.4
Inflation indexation on opening RAB	19.4	19.7	20.0	20.1	20.6
Less: straight-line depreciation	54.8	57.9	61.1	64.1	67.9
Closing RAB	803.2	815.1	821.5	840.0	847.1

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-WACC allowance to compensate for the six month period before capex is added to the RAB for revenue modelling.

Table 2.4 AER's draft decision on Evoenergy's RAB for the 2019–24 regulatory control period – transmission (\$ million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	174.1	172.6	168.5	164.8	162.2
Capital expenditure ^a	5.0	3.0	4.0	5.6	6.6
Inflation indexation on opening RAB	4.3	4.2	4.1	4.0	4.0
Less: straight-line depreciation	10.7	11.3	11.8	12.3	13.0
Closing RAB	172.6	168.5	164.8	162.2	159.8

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-WACC allowance to compensate for the six month period before capex is added to the RAB for revenue modelling.

We accept Evoenergy's proposal that the forecast depreciation approach is to be used to establish the opening RAB values at the commencement of the 2024–29 regulatory control period.⁹ We consider this approach is consistent with the capital expenditure incentive objective in that it will provide sufficient incentives for Evoenergy to achieve capex efficiency gains over the 2019–24 regulatory control period.

⁹ NER, cl. 6.12.1(18).

2.2 Evoenergy's proposal

Evoenergy used our roll forward model (RFM) to establish opening RABs as at 1 July 2019 and our post-tax revenue model (PTRM) to roll forward the RABs over the 2019–24 regulatory control period.

Evoenergy proposed opening RAB values of \$693.5 million and \$154.0 million (\$ nominal) as at 1 July 2014 for its distribution and transmission networks respectively. Rolling forward these RABs and using depreciation based on forecast capex, Evoenergy proposed closing RAB values of \$791.4 million and \$174.2 million (\$ nominal) as at 30 June 2019 for its distribution and transmission networks respectively. Table 2.5 and Table 2.6 present Evoenergy's proposed roll forward of its RABs during the 2014–19 regulatory control period for its distribution and transmission networks respectively.¹⁰

Table 2.5 Evoenergy's proposed RAB for the 2014–19 regulatory control period – distribution (\$million, nominal)

	2014–15	2015-16	2016-17	2017–18 ^a	2018–19 ^a
Opening RAB	693.5	729.7	743.4	749.3	773.6
Capital expenditure ^b	63.1	51.6	45.9	60.3	53.6
Inflation indexation on opening RAB	17.3	11.0	9.5	15.0	15.5
Less: straight-line depreciation ^c	44.1	48.9	49.5	50.9	51.2
Closing RAB	729.7	743.4	749.3	773.6	791.4
Closing RAB as at 30 June 2019^d					791.4

Source: Evoenergy, *Regulatory proposal*, January 2018, *RFM*.

- (a) Based on estimated capex.
- (b) Net of disposals and capital contributions, and adjusted for CPI and half-WACC.
- (c) Adjusted for actual CPI. Based on forecast as-incurred capex.
- (d) There is no true-up required for 2013–14 capex as the approved opening RAB value of \$693.5 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for Evoenergy and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

¹⁰ Evoenergy, *Regulatory proposal 2019–24 Attachment 7: Regulatory Asset Base* January 2018, p. 7–5, Table 7.5 and Table 7.6.

Table 2.6 Evoenergy's proposed RAB for the 2014–19 regulatory control period – transmission (\$million, nominal)

	2014–15	2015-16	2016-17	2017–18 ^a	2018–19 ^a
Opening RAB	154.0	159.8	163.3	165.5	166.8
Capital expenditure ^b	11.1	9.8	9.1	8.0	14.4
Inflation indexation on opening RAB	2.6	2.7	2.4	3.3	3.3
Less: straight-line depreciation ^c	8.0	9.0	9.3	10.0	10.4
Interim closing RAB	159.8	163.3	165.5	166.8	174.2
Closing RAB as at 30 June 2019^d					174.2

Source: Evoenergy, *Regulatory proposal*, January 2018, *RFM*.

- (a) Based on estimated capex.
- (b) Net of disposals and capital contributions, and adjusted for CPI and half WACC.
- (c) Adjusted for actual CPI. Based on forecast as-incurred capex.
- (d) There is no true-up required for 2013–14 capex as the approved opening RAB value of \$154.0 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for Evoenergy and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

Evoenergy proposed forecast closing RAB values as at 30 June 2024 of \$906.3 million and \$173.6 million (\$ nominal) for its distribution and transmission assets respectively. These values reflect its proposed opening RAB values, forecast capex, expected inflation, and depreciation (based on forecast capex) over the 2019–24 regulatory control period. Its projected RABs over the 2019–24 regulatory control period are shown in Table 2.7 and Table 2.8.

Table 2.7 Evoenergy's proposed RAB for the 2019–24 regulatory control period – distribution (\$million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	791.4	815.4	843.4	870.2	892.5
Capital expenditure ^a	59.0	66.1	68.0	67.7	62.7
Inflation indexation on opening RAB	19.8	20.4	21.1	21.8	22.3
Less: straight-line depreciation	54.8	58.4	62.3	67.2	71.2
Closing RAB	815.4	843.4	870.2	892.5	906.3

Source: Evoenergy, *Regulatory proposal*, January 2018, *PTRM*.

- (a) Net of forecast disposals and capital contributions. Inclusive of equity raising costs and the half-WACC to account for the timing assumptions in the PTRM.

Table 2.8 Evoenergy's proposed RAB for the 2019–24 regulatory control period – transmission (\$million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	174.2	174.2	170.9	178.4	175.8
Capital expenditure ^a	6.3	3.8	15.3	6.0	7.2
Inflation indexation on opening RAB	4.4	4.4	4.3	4.5	4.4
Less: straight-line depreciation	10.8	11.4	12.0	13.1	13.8
Closing RAB	174.2	170.9	178.4	175.8	173.6

Source: Evoenergy, *Regulatory proposal*, January 2018, *PTRM*.

(a) Net of forecast disposals and capital contributions. Inclusive of equity raising costs and the half-WACC to account for the timing assumptions in the PTRM.

Evoenergy proposed to apply a forecast depreciation approach to establish the RAB at the commencement of the 2024–29 regulatory control period, consistent with the approach set out in our *Framework and approach* paper.¹¹

2.3 Assessment approach

We roll forward Evoenergy's RAB during the 2014–19 regulatory control period to establish the opening RAB at 1 July 2019. This value can be adjusted for any differences in the estimated and actual capex.¹² It may also be adjusted to reflect any changes in the use of the assets, with only assets used in the provision of standard control services to be included in the RAB.¹³

To determine the opening RAB, we developed an asset base RFM that a service provider must use in preparing its regulatory proposal.¹⁴ The RFM rolls forward the RAB from the beginning of the final year of the 2009–14 regulatory control period, through the 2014–19 regulatory control period, to the beginning of the 2019–24 regulatory control period. Our approach to rolling forward the RAB generally involves an adjustment to account for the difference between the actual capex and the estimate approved for the final year of the previous regulatory control period.¹⁵ However, this adjustment is not required for establishing Evoenergy's opening RABs as at 1 July 2019 as the approved opening RAB values at 1 July 2014 do not include any estimated capex. This is because 2014–15 was a transitional year for Evoenergy and we were

¹¹ Evoenergy, *Regulatory proposal 2019–24 Attachment 7: Regulatory Asset Base* January 2018, p. 7–9.

¹² NER, cl. S6.2.1(e)(3).

¹³ NER, cl. S6.2.1 See also NER, cl. 6.24.2(b) services provided by means of dual function assets are deemed to be standard control services.

¹⁴ NER, cll. 6.5.1(b), 6.5.1(e), S6.1.3(7); AER, *Electricity distribution network service providers: Roll forward model (version 2)*, 15 December 2016.

¹⁵ NER, cl. S6.2.1(e)(3); The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2014–19 determination.

able to include the actual values for 2013–14 in our final decision for the 2014–19 regulatory control period.

The roll forward for each year of the above period occurs by:

- Adding actual inflation (indexation) adjustment to the opening RAB for the relevant year. This adjustment is consistent with the inflation factor used in the control mechanism.¹⁶
- Adding actual or estimated capex to the RAB for the relevant year.¹⁷ We review a distributor's past capex and may exclude past capex from being rolled into the RAB where total capex exceeds the regulatory allowance.¹⁸ The details of our assessment approach for capex overspending are set out in the *Capital expenditure incentive guideline*.¹⁹ We note that under the transitional rules, our review of past capex does not apply to Evoenergy prior to 1 July 2015.²⁰ Also, the review of past capex does not include the last two years of the 2014–19 regulatory control period—these will instead be reviewed at the next reset.²¹ We check actual capex amounts against audited annual reporting RIN data and generally accept the capex reported in those RINs in rolling forward the RAB.²² However, there may be instances where adjustments are required to the annual reporting RIN data.²³
- Subtracting depreciation from the RAB for the relevant year, calculated in accordance with the relevant distribution determination for the previous regulatory control period.²⁴ Depreciation based on forecast or actual capex can be used to roll forward the RAB.²⁵ For this draft decision, we use depreciation based on forecast capex for rolling forward Evoenergy's RAB values over the 2014–19 regulatory control period.²⁶ Depreciation based on forecast capex will also be used for the 2019–24 regulatory control period RAB roll forward at the next reset.²⁷

¹⁶ NER, cl. 6.5.1(e)(3).

¹⁷ NER, cl. S6.2.1(e)(4).

¹⁸ NER, cl. S6.2.2A. Under the NER, cl S6.2.2A(b), the exclusion of inefficient capex could only come from three areas: overspend in capex, margin paid to third party and capitalisation of opex as defined in cl. S6.2.2A (c), (d) and (e) of the NER.

¹⁹ AER, *Capital expenditure incentive guideline*, November 2013, pp. 12–20.

²⁰ NER, cl.11.56.5(a).

²¹ NER, cl. S6.2.2A(a1). The two year lag ensures that actual capex (instead of estimated capex) is available when the review of past capex commences.

²² We will update any estimated capex with actual capex at the time of the next reset.

²³ For example, we make adjustment for movements in provisions if the actual capex amounts reported in the RIN include capitalised provisions.

²⁴ NER, cl. S6.2.1(e)(5).

²⁵ NER, cl. 6.12.1(18).

²⁶ The use of forecast depreciation is consistent with the depreciation approach established in the 2014–19 distribution determination for Evoenergy. See AER, *ActewAGL distribution determination Final Decision 2015–16 to 2018–19 Attachment 2 – Regulatory asset base*, April 2015, p. 2–7.

²⁷ Refer to section 2.4.3 for the reasons.

- Subtracting any gross proceeds for asset disposals for the relevant year, by way of netting from capex to be added to the RAB.²⁸ We check these amounts against audited annual reporting RIN data.

These annual adjustments give the closing RAB for any particular year, which then becomes the opening RAB for the following year. Through this process the RFM rolls forward the RAB to the end of the 2014–19 regulatory control period. The PTRM used to calculate the annual revenue requirement for the 2019–24 regulatory control period generally adopts the same RAB roll forward approach as the RFM, although the annual adjustments to the RAB are based on forecasts, rather than actual amounts.²⁹

The opening RAB for the 2024–29 regulatory control period can be determined using depreciation based either on forecast or actual capex incurred during the 2019–24 regulatory control period.³⁰ To roll forward the RAB using depreciation based on forecast capex, we would use the forecast depreciation contained in the PTRM for the 2019–24 regulatory control period, adjusted for actual inflation. If the approach to roll forward the RAB using depreciation based on actual capex was adopted, we would recalculate the depreciation based on actual capex incurred during the 2019–24 regulatory control period.

Our decision on whether to use actual or forecast depreciation must be consistent with the capex incentive objective. We must have regard to:³¹

- the incentives the service provider has to undertake efficient capex
- substitution possibilities between assets with different lives and the relative benefits of each
- the extent of overspending and inefficient overspending relative to the allowed forecast
- the capex incentive guideline
- the capital expenditure factors.

2.3.1 Interrelationships

The RAB is an input into the determination of the return on capital and depreciation (return of capital) building block allowances.³² Factors that influence the RAB will therefore flow through to these building block components and the annual revenue requirement. Other things being equal, a higher RAB increases both the return on capital and depreciation allowances.

²⁸ NER, cl. S6.2.1(e)(6).

²⁹ NER, cl. S6.2.3.

³⁰ NER, cl. S6.2.2B.

³¹ NER, cl. S6.2.2B(b) and (c).

³² The size of the RAB also impacts the benchmark debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

The RAB is determined by various factors, including:

- the opening RAB (meaning the value of existing assets at the beginning of the regulatory control period)
- net capex³³
- depreciation
- indexation adjustment – so the RAB is presented in nominal terms, consistent with the rate of return.

The opening RAB depends on the value of existing assets and will depend on actual net capex, actual inflation outcomes and depreciation in the past.

The RAB when projected to the end of the regulatory control period increases due to both forecast new capex and the indexation adjustment. The size of the indexation adjustment depends on expected inflation (which also affects the nominal rate of return or WACC) and the size of the RAB at the start of each year.

Depreciation reduces the RAB. The depreciation allowance depends on the size of the opening RAB, the forecast net capex and depreciation schedules applied to the assets. By convention, the indexation adjustment is also offset against depreciation to prevent double counting of inflation in the RAB and WACC, which are both presented in nominal terms. This reduces the depreciation building block that feeds into the annual revenue requirement.

We maintain the RAB in real terms by indexing for inflation.³⁴ A nominal rate of return (WACC) is multiplied by the opening RAB to produce the return on capital building block.³⁵ To prevent the double counting of inflation through the nominal WACC and indexed RAB,³⁶ the regulatory depreciation building block has an offsetting reduction for indexation of the RAB.³⁷ 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. If the RAB was un-indexed, there would be no need for an offsetting adjustment to the depreciation calculation of total revenue. This alternative approach provides for overall revenues being higher early in the asset's life (as a result of more depreciation being returned to the distributor) and lower in the

³³ Net capex is gross capex less disposals and capital contributions. The rate of return or WACC also influences the size of the capex. This is because the capex is not depreciated in the year it is first incurred, but added to the RAB at the end of the year. Instead, the capex amount is escalated by half a WACC to arrive at an end of year value. It then begins depreciating the following year.

³⁴ NER, cll. 6.3.2(a)(2) and 6.5.1(e)(3).

³⁵ NER, cll. 6.5.2(a) and 6.5.2(d)(2).

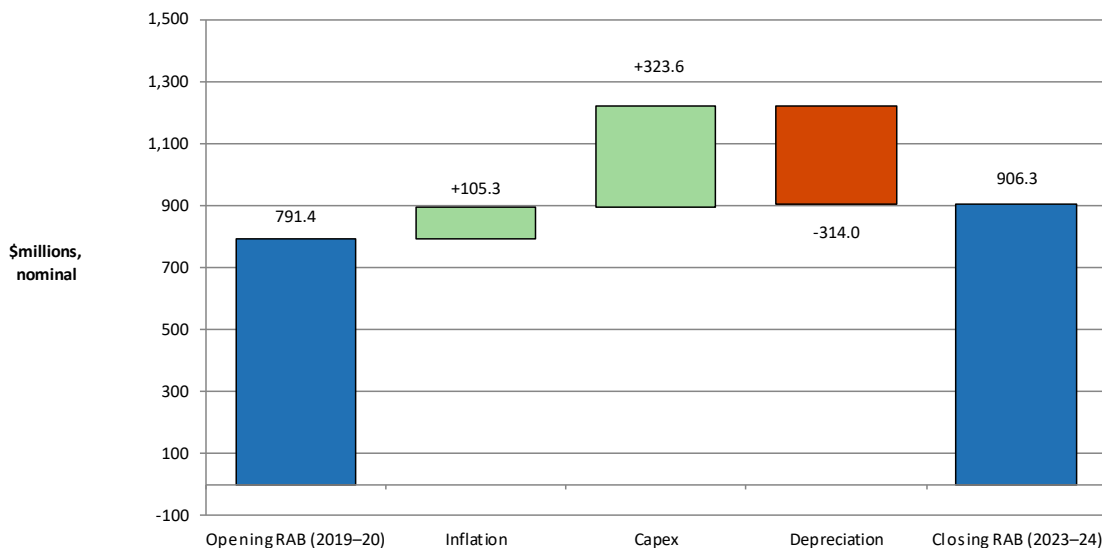
³⁶ NER, cl. 6.4.3(b)(1)(ii).

³⁷ 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. Please also refer to section 4.3.1 of attachment 4 of this draft decision for further explanation of the offsetting adjustment to the depreciation.

future—producing a steeper downward sloping profile of total revenue.³⁸ The implications of an un-indexed RAB are discussed further in attachment 4.

Figure 2.1 and Figure 2.2 show the key drivers of the changes in the RABs over the 2019–24 regulatory control period as proposed by Evoenergy for its distribution and transmission networks respectively. Overall, the closing RAB at the end of the 2019–24 regulatory control period would be 14.5 per cent higher for the distribution network and 0.4 per cent lower for the transmission network than the respective opening RABs at the start of that period based on the proposal, in nominal terms. The proposed forecast net capex increases the RAB by about 40.9 per cent for the distribution network and 22.1 per cent for the transmission network. Expected inflation increases it by about 13.3 per cent for the distribution network and 12.5 per cent for the transmission network. Forecast depreciation, on the other hand, reduces the RAB by about 39.7 per cent for the distribution network and 35.0 per cent for the transmission network.

Figure 2.1 Key drivers of changes in the RAB – distribution (\$ million, nominal)

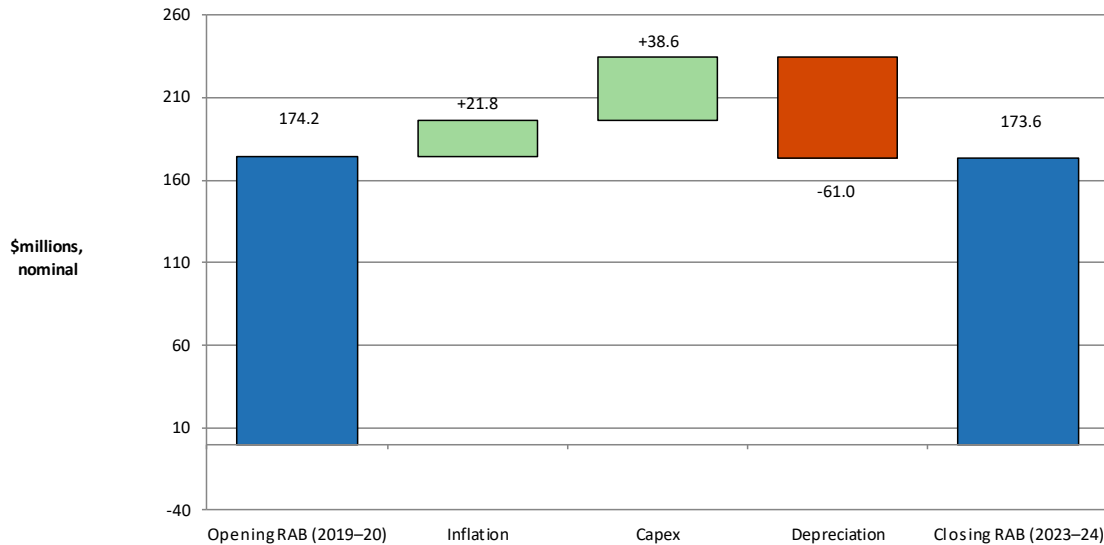


Source: Evoenergy, *Regulatory proposal PTRM*, January 2018.

Note: Capex is net of forecast disposals and capital contributions. It is Inclusive of equity raising costs and the half-WACC to account for the timing assumptions in the PTRM.

³⁸ 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 2.2 Key drivers of changes in the RAB – transmission (\$ million, nominal)



Source: Evoenergy, *Regulatory proposal PTRM*, January 2018.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of equity raising costs and the half-WACC to account for the timing assumptions in the PTRM.

Evoenergy forecast depreciation of \$314.0 million (\$ nominal) for its distribution network and \$61.0 million for its transmission network (\$ nominal) for the 2019–24 regulatory control period.³⁹ We have largely accepted Evoenergy's depreciation proposal, subject to some input updates, as it satisfies the requirements of the NER in terms of the assigned remaining and standard asset lives. This is discussed in attachment 4. The depreciation amount largely depends on the opening RAB (which in turn depends on capex in the past).

Forecast net capex is a significant driver of the increase in the RAB. The Consumer Challenge Panel 10 (CCP10) made a submission which encouraged the AER to investigate the effect on the RAB of capex and depreciation of assets with short lives, particularly IT-related assets.⁴⁰ In our draft decision, we are not satisfied Evoenergy's proposed total forecast capex of \$329.8 million (\$ 2018–19)⁴¹ for the 2019–24 regulatory control period reasonably reflects the capex criteria.⁴² We have therefore rejected Evoenergy's proposed capex and have substituted our estimate of \$261.4

³⁹ This is the forecast straight-line depreciation.

⁴⁰ Consumer Challenge Panel 10 (CCP10), *CCP10 Response to Evoenergy regulatory Proposal 2019-24 and AER Issues Paper*, May 2018.

⁴¹ This amount is net of capital contributions, disposals and equity raising costs and excludes half-WACC adjustment.

⁴² Evoenergy's proposed net capex amount of \$329.8 million comprises \$294.7 million and \$35.1 million for its distribution and transmission networks respectively.

million (\$ 2018–19) for the 2019–24 regulatory control period.⁴³ Refer to attachment 5 for the discussion on forecast capex.

A ten per cent increase in the opening RABs at 1 July 2019 causes revenues to increase by about 6.2 per cent for the distribution network and 6.9 per cent for the transmission network. However, the impact on revenues of the annual change in RAB depends on the source of the RAB change, as some drivers affect more than one building block cost.⁴⁴

2.4 Reasons for draft decision

We determine Evoenergy's opening RAB values for its distribution and transmission networks to be \$790.9 million and \$174.1 million (\$ nominal) respectively, as at 1 July 2019. This represents decreases of \$0.5 million or 0.1 per cent and \$0.2 million or 0.1 per cent from the proposed values respectively. We have forecast closing distribution and transmission RAB values of \$847.1 million and \$159.8 million (\$ nominal) respectively, as at 30 June 2024. This represents reductions of \$59.3 million or 6.5 per cent and \$13.8 million (\$ nominal) or 8.0 per cent compared to Evoenergy's proposal. The reasons for our decision are discussed below.

2.4.1 Opening RABs as at 1 July 2019

We determine opening RAB values of \$790.9 million and \$174.1 million (\$ nominal) as at 1 July 2019 for Evoenergy for its distribution and transmission networks respectively. These values are \$0.5 million and \$0.2 million lower than Evoenergy's proposed opening RAB values.⁴⁵ This is because we have:

- updated the inflation input for 2017–18 using the actual December 2017 CPI published by the Australian Bureau of Statistics⁴⁶
- updated inputs to the RFMs due to changes in the 2014–19 PTRMs from the remittal decision for the 2014–19 regulatory control period.⁴⁷ These updates included forecast:
 - inflation rate for the 2014–19 period
 - nominal vanilla WACC values for the 2014–19 period

⁴³ Our draft decision net capex amount of \$261.4 million comprises \$239.3 million and \$22.1 million for Evoenergy's distribution and transmission networks respectively.

⁴⁴ If capex causes the RAB increase, return on capital, depreciation, and debt raising costs all increase too. If a reduction in depreciation causes the RAB increase, revenue could increase or decrease. In this case, the higher return on capital is offset (perhaps more than offset) by the reduction in depreciation allowance. Inflation naturally increases the RAB in nominal terms.

⁴⁵ Evoenergy, *Regulatory proposal 2019–24 Attachment 7: Regulatory Asset Base* January 2018, p. 7–5, Table 7.5 and Table 7.6.

⁴⁶ The December quarter CPI is used as a proxy for the June financial year in the 2014–19 regulatory control period. As discussed in attachment 13, the December quarter CPI will still be used as a proxy for the June financial year for the 2019–24 regulatory control period.

⁴⁷ AER, *Draft Decision Evoenergy 2014–19 electricity distribution determination*, September 2018

- equity raising costs in 2014–15
- depreciation for the 2014–19 period.

To determine the opening RAB values for Evoenergy's distribution and transmission networks as at 1 July 2019 we have rolled forward the respective RABs over the 2014–19 regulatory control period to determine closing RAB values as at 30 June 2019. In doing so we reviewed the key inputs of Evoenergy's proposed RFMs, such as asset lives, actual gross capex values, asset disposal values, capital contribution values, actual inflation and rate of return. We found these were generally correct and they reconcile with relevant data sources such as annual reporting RIN data and the 2014–19 decision models.⁴⁸ However, we consider Evoenergy's proposed RFMs should be updated for 2017–18 actual CPI as it is now available.⁴⁹ Similarly, we consider the RFMs should be updated with relevant inputs from the 2014–19 remittal decision.

We also consider the extent to which our roll forward of the RAB to 1 July 2019 contributes to the achievement of the capital expenditure incentive objective.⁵⁰ We note that under the transitional rules, in making this distribution determination, the review of past capex does not apply to Evoenergy prior to 1 July 2015.⁵¹ Given this, the review period for this distribution determination is limited to 2015–16 and 2016–17 capex.⁵² Evoenergy's actual capex incurred for 2015–16 and 2016–17 are below the forecast allowance set at the previous distribution determination. Therefore, the overspending requirement for an efficiency review of past capex is not satisfied.⁵³ For the reasons discussed in attachment 5, we consider the capex incurred in those years is consistent with the capital expenditure criteria and can therefore be included in the RAB.

Further, for the purposes of this draft decision, we have included Evoenergy's estimated capex in 2017–18 and 2018–19 in the RAB roll forward to 1 July 2019. At the next reset, the 2017–18 and 2018–19 capex will form part of the review period for whether past capex should be excluded for inefficiency reasons.⁵⁴ Our RAB roll forward applies the incentive framework approved in the previous distribution determination, which included the use of a forecast depreciation approach in combination with the application of the capital expenditure sharing scheme (CESS).⁵⁵ As such, we consider that the 2014–19 RAB roll forward contributes to an opening

⁴⁸ At the time of this draft decision, the roll forward of Evoenergy's RAB includes estimated capex values for 2017–18 and 2018–19. We will update the 2017–18 estimated capex with actuals in the final decision. We may also update the 2018–19 estimated capex with a revised estimate in the final decision.

⁴⁹ In our final decision we will update the estimate for 2018–19 expected inflation with actual CPI.

⁵⁰ NER, cl. 6.12.2(b).

⁵¹ NER, cl. 11. 56.5(a).

⁵² NER, cl. S6.2.2A(a1).

⁵³ NER, cl. S6.2.2A(c).

⁵⁴ Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NER, cl. S6.2.2A. The details of our ex post assessment approach for capex are set out in AER, *Capital expenditure incentive guideline*, November 2013, pp. 12–20.

⁵⁵ AER, *Final Decision ActewAGL distribution determination 2015–16 to 2018–19, Attachment 2 – Regulatory asset base, April 2015, p 2-7.*

RAB (as at 1 July 2019) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.⁵⁶

2.4.2 Forecast closing RABs as at 30 June 2024

We forecast closing RAB values of \$847.1 million and \$159.8 million (\$ nominal) by 30 June 2024 for Evoenergy's distribution and transmission networks respectively. This represents a reduction of \$59.3 million (6.5 per cent) for its distribution network and a reduction of \$13.8 million (8.0 per cent) for its transmission network compared to the proposal. These reductions reflect our draft decision on the inputs for determining the forecast RABs in the PTRMs.

The submission from the CCP10 on Evoenergy's proposal raised concerns with the increase to the size of Evoenergy's RAB over the 2019–24 regulatory control period.⁵⁷ The change in the size of the RAB depends on our assessment of its various components including forecast capex (attachment 5), expected inflation (attachment 3) and forecast depreciation (attachment 4). Inflation and capex increase the RAB, while depreciation and disposals reduce it.

To determine the forecast RAB values for Evoenergy, we amended the following PTRM inputs:

- We reduced Evoenergy's proposed opening RAB values by \$0.5 million and \$0.2 million (\$ nominal) as at 1 July 2019 for its distribution and transmission networks respectively (section 2.4.1).
- We reduced Evoenergy's proposed forecast capex for the 2019–24 regulatory control period by \$68.4 million (\$ 2018–19) or 20.7 per cent (attachment 5).⁵⁸
- We updated Evoenergy's proposed expected inflation rate of 2.50 per cent per annum to 2.45 per cent per annum (attachment 3). This results in a decrease to the indexation of the RAB component for the 2019–24 regulatory control period by \$2.2 million (2.1 per cent) and \$0.5 million (2.1 per cent) (\$ nominal) for its distribution and transmission networks respectively.⁵⁹
- We reduced Evoenergy's proposed forecast straight-line depreciation for the 2019–24 regulatory control period by \$8.1 million (2.6 per cent) and \$1.9 million (3.1 per cent) (\$ nominal) for its distribution and transmission networks respectively (attachment 4).

⁵⁶ NER, cll. 6.4A(a), 6.5.7(a), 6.5.7(c) and 6.12.2(b).

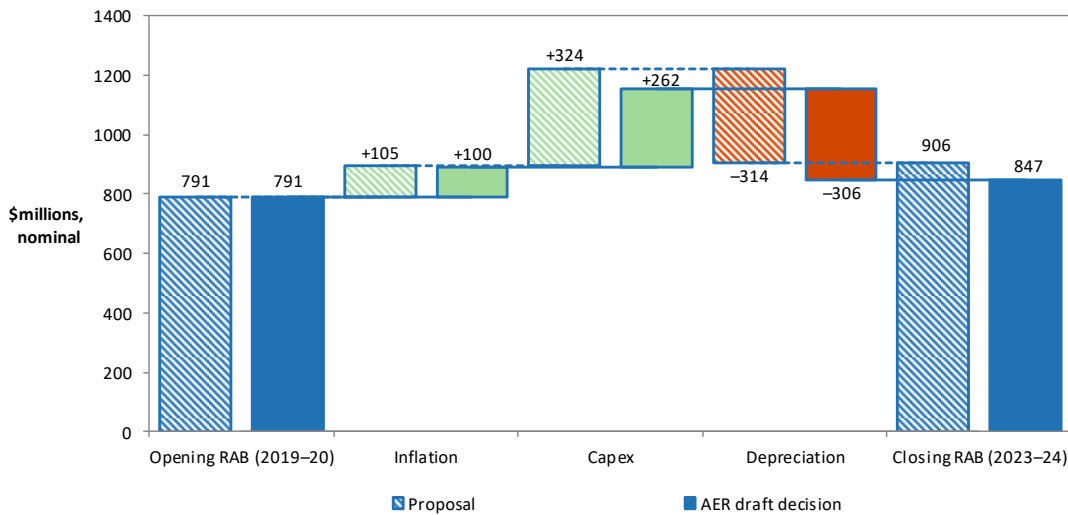
⁵⁷ Consumer Challenge Panel 10 (CCP10), *CCP10 Response to Evoenergy regulatory Proposal 2019–24 and AER Issues Paper*, May 2018.

⁵⁸ Capex is net of capital contributions, disposals and equity raising costs and excludes half-WACC adjustment. Evoenergy's proposed net capex amount of \$329.8 million comprises \$294.7 million and \$35.1 million for its distribution and transmission networks respectively. Our draft decision net capex amount of \$261.4 million comprises \$239.3 million and \$22.1 million for Evoenergy's distribution and transmission networks respectively.

⁵⁹ The calculated decreases to the RAB indexation component amounts due to updates in expected inflation are based on input data provided in Evoenergy's proposal PTRMs.

Figure 2.3 and Figure 2.4 show the key drivers of the change in Evoenergy's RAB over the 2019–24 regulatory control period for this draft decision for its distribution and transmission networks respectively. Overall, the closing RABs at the end of the 2019–24 regulatory control period are forecast to be 7.1 per cent higher and 8.2 per cent lower than the opening RABs at the start of that period for the distribution and transmission networks respectively, in nominal terms. The approved forecast net capex increases the RAB by about 33.2 per cent for the distribution network and 13.9 per cent for the transmission network. Expected inflation increases the RABs by about 12.6 per cent for the distribution network and 11.9 per cent for the transmission network. Forecast depreciation, on the other hand, reduces the RABs by about 38.7 per cent for the distribution network and 34.0 per cent for transmission network.

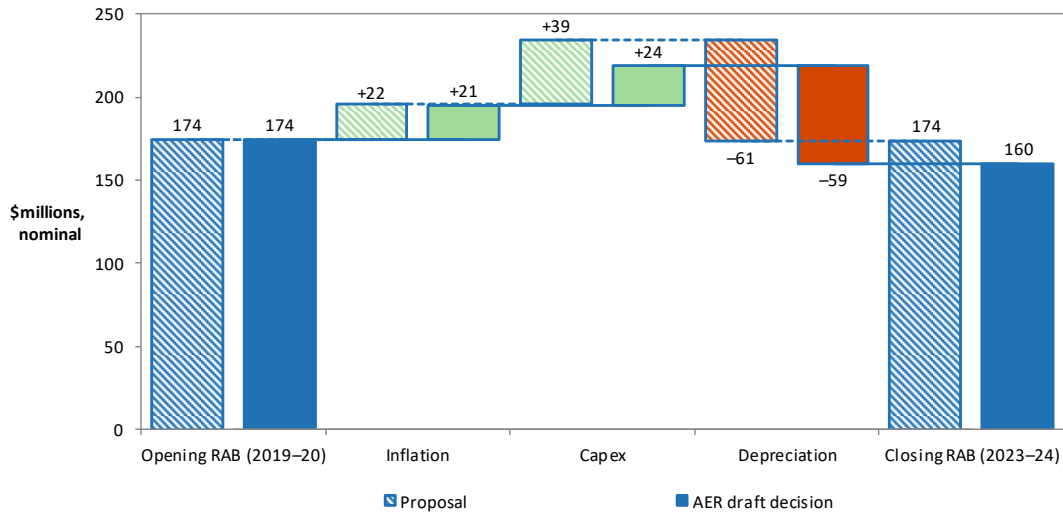
Figure 2.3 Key drivers of changes in the RAB – Evoenergy's proposal compared with AER's draft decision – distribution (\$ million, nominal)



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of equity raising costs and the half-WACC to account for the timing assumptions in the PTRM.

Figure 2.4 Key drivers of changes in the RAB – Evoenergy's proposal compared with AER's draft decision – transmission (\$ million, nominal)



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of equity raising costs and the half-WACC to account for the timing assumptions in the PTRM.

2.4.3 Application of depreciation approach in RAB roll forward for next reset

We accept Evoenergy's proposal on the depreciation approach to be applied to establish the RABs at the commencement of the 2024–29 regulatory control period. We determine that the depreciation approach will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2019–24 regulatory control period.⁶⁰

Evoenergy proposed to use the forecast depreciation approach to roll forward the RABs for the commencement of its 2024–29 regulatory control period,⁶¹ consistent with our *Framework and approach*.⁶²

We stated in the *Framework and approach* that depreciation used to roll forward the RAB could be based on either:⁶³

- Actual capex incurred during the regulatory control period (actual depreciation). We roll forward the RAB based on actual capex less the depreciation on the actual capex incurred by the distributor, or

⁶⁰ NER, cl. 6.12.1(18) and S6.2.2B.

⁶¹ Evoenergy, *Regulatory proposal Attachment 7: Regulatory Asset Base*, January 2018, p.7-9.

⁶² AER, *Framework and approach ActewAGL Regulatory control period commencing 1 July 2019*, July 2017, p. 13.

⁶³ AER, *Framework and approach ActewAGL Regulatory control period commencing 1 July 2019*, July 2017, p. 69.

- The capex allowance forecast at the start of the regulatory control period (forecast depreciation). We roll forward the RAB based on actual capex less the depreciation on the forecast capex approved for the regulatory control period.

We have used forecast depreciation for this draft decision when rolling forward the opening RAB at the commencement of the 2019–24 regulatory control period (section 2.4.1). The use of forecast depreciation to establish the opening RAB for the commencement of the 2024–29 regulatory control period at the next reset therefore maintains the current approach.

As discussed in attachment 9, Evoenergy is currently subject to the CESS for the 2014–19 regulatory control period, but not in the transitional 2014–15 regulatory year. We will continue to apply the CESS to Evoenergy over the 2019–24 regulatory control period. We consider that the CESS will provide sufficient incentives for Evoenergy to achieve capex efficiency gains over that period. We are satisfied that the use of a forecast depreciation approach in combination with the application of the CESS and our other ex post capex measures are sufficient to achieve the capex incentive objective.⁶⁴

⁶⁴ Our ex post capex measures are set out in the capex incentives guideline, AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, pp. 13–19, 20–21. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.