FINAL DECISION

AusNet Services
Distribution Determination
2021 to 2026

Attachment 4
Regulatory depreciation

April 2021

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Note

This attachment forms part of the AER's final 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 final decision.

The final 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 12 – Customer service incentive scheme

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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 final decision on AusNet Services' regulatory depreciation amount. It also presents our final decision on the proposed depreciation schedules, including an assessment of the proposed standard asset lives used for forecasting depreciation.

4.1 Final decision

Our final decision is to determine a regulatory depreciation amount of $850.4 million ($ nominal) for AusNet Services for the 2021–26 regulatory control period. This amount represents an increase of $81.6 million (or 10.6 per cent) to the $768.7 million ($ nominal) in AusNet Services' revised proposal.[2] It is $116.9 million (or 15.9 per cent) higher than the regulatory depreciation amount determined in the draft decision. The key reason for the increase compared to our draft decision is the lower expected inflation rate that resulted from our inflation review and was implemented in the most recent version of the post-tax revenue model (PTRM).[3]

The regulatory depreciation amount is the net total of the straight-line depreciation, less the inflation indexation of the RAB. The straight-line depreciation is impacted by our decision on AusNet Services' opening RAB as at 1 July 2021 (Attachment 2), forecast capital expenditure (Attachment 5) and asset lives. Our final decision straight-line depreciation for AusNet Services is $17.1 million lower that its revised proposal. This is mainly due to the lower forecast capital expenditure (capex) in our final decision.

The indexation on the RAB is impacted by our decision on AusNet Services' opening RAB (Attachment 2), forecast capex (Attachment 5) and the expected inflation rate (Attachment 3). Our final decision indexation on AusNet Services' forecast RAB is $98.7 million lower than its revised proposal. This is largely because we decided on an expected inflation rate of 2 per cent per annum for this final decision, compared with the inflation rate of 2.37 per cent per annum that AusNet Services included in its revised proposal. The lower indexation has more than offset the decrease in straight-line depreciation (since indexation is deducted from the straight-line depreciation),

[1] NER, cll. 6.12.1, 6.4.3.

[2] AusNet Services, *Revised Regulatory Proposal - PTRM Model (2022–26)*, updated 24 March 2021.

[3] AER, *Electricity distribution PTRM (version 5)*, April 2021.

which has resulted in a higher regulatory depreciation amount compared to the revised proposal.

In coming to this final decision on AusNet Services' straight-line depreciation:

- We accept AusNet Services' revised proposed straight-line method to calculate the regulatory depreciation, which is consistent with our draft decision.
- We accept AusNet Services' revised proposal to continue with the year-by-year tracking approach to implement straight-line depreciation of existing assets, consistent with our draft decision. However, we have updated the inputs in the depreciation model for the forecast equity raising costs, forecast depreciation and nominal rate of return inputs for the six month period of 1 January to 30 June 2021 (the six month 2021 period), consistent with the roll forward model (RFM).
- We accept AusNet Services' revised proposed asset classes and standard asset lives, which are consistent with our draft decision.
- We accept AusNet Services' revised proposed approach to calculate the accelerated depreciation of intelligent electronic devices relays and remote terminal units as it is consistent with our draft decision.
- We accept AusNet Services' revised 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 limiter contingent project applications. This is consistent with our draft decision.
- As discussed in Attachment 2, we accept AusNet Services' revised proposed end of period adjustment for capitalised property leases which adopted our draft decision approach. This included an update to the remaining life to 8.3 years from 8.4 years.[4]

Table 4.1 sets out our final decision on the forecast regulatory depreciation amount for AusNet Services over the 2021–26 regulatory control period.

Table 4.1 Final decision on AusNet Services' depreciation amount for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Straight-line depreciation	278.0	259.6	262.8	270.7	274.8	1345.9
Less: inflation indexation on opening RAB	93.1	96.3	99.8	102.3	104.0	495.6
Regulatory depreciation	**184.9**	**163.2**	**163.0**	**168.5**	**170.8**	**850.4**

Source: AER analysis.

[4] AusNet Services made this update to reflect actual 2019 capex.

Year-by-year tracking approach

For this final decision, we accept AusNet Services' revised proposal to continue using the year-by-year tracking approach to calculate the forecast straight-line depreciation amounts for its asset values as at 1 July 2021. This approach (in addition to grouping assets by type via asset classes) tracks the asset classes on a year-by-year basis to implement straight-line depreciation. This is consistent with our determination for AusNet Services' previous regulatory control period of 2016–20.

In the draft decision, we required some minor modelling adjustments to AusNet Services' year-by-year tracking depreciation model used for implementing straight-line depreciation.[5] AusNet Services' revised proposal adopted all our draft decision changes. It also updated the estimated capex for 2020 and the six month 2021 period in the revised proposed depreciation model.[6] For the reasons discussed in Attachment 2, we accept the updated capex in the revised proposed RFM. Therefore, we also accept that the updated capex in the depreciation model is appropriate as it is consistent with the RFM.

Accelerated depreciation

For this final decision, we accept AusNet Services' revised proposal on accelerated depreciation for its existing assets over the 2021–26 regulatory control period. This is consistent with our draft decision.

AusNet Services' revised proposal adopted our draft decision for accelerated depreciation comprising:

- A reallocation of $196.6 million for the 'Secondary systems (pre 2016)' asset class. Of this reallocation, $155.3 million will depreciate over the 2021–26 regulatory control period.
- A reallocation of $3.9 million for other primarily high bushfire risk assets.

Energy Consumers Australia (ECA) submitted that there is not currently a consistent and agreed approach for accelerated depreciation and that we need to review our approach in the context of affordability and consistency.[7] It therefore did not support adopting accelerated depreciation for the revised proposals from the Victorian distributors.

We note ECA's concern, but we have considered this matter in detail in our draft decision. As set out in our draft decision, we reviewed the information before us and

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5 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, Attachment 4 – Regulatory Depreciation*, September 2020, pp. 11–12.

6 AusNet Services, *EDPR 2022–26 Revised Proposal – PTRM Model (2022-26),* updated 24 March 2021.

7 ECA, *Submission and attachment on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, pp. 5–6.
ECA (via its consultant Spencer&Co), *Submission and attachment on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 12.

decided to reduce the proposed accelerated depreciation amount for the 'Secondary systems (pre 2016)' asset class by $43.4 million.[8] We also considered the available data gave us scope to track the depreciation for the different asset types, resulting 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.

Standard asset lives

For this final decision, we accept AusNet Services' revised proposed standard asset lives for its asset classes in respect of the forecast capex to be incurred for the 2021–26 regulatory control period. They are consistent with our draft decision.

AusNet Services' revised proposal did not forecast any benchmark equity raising costs for the 2021–26 regulatory control period, based on the method employed in the PTRM. Consistent with this, for the final decision PTRM we estimate zero equity raising costs. Accordingly, we do not need to set a standard asset life for the 'Equity raising costs' asset class.

The Victorian Community Organisations (VCO) submitted that the Victorian distributors apply different depreciation schedules with asset lives that also differ from replacement capital expenditure (repex) assessments.[9] As we noted in the draft decision, the repex assessments look at assets in more detail at a disaggregated level than the broader depreciation assessment.[10] We also note that in addition to asset lives, repex models also consider performance of the asset as part of assessing when repex should occur. We note the VCO's concerns, but consider that the asset lives used in depreciation schedules of the Victorian distributors are appropriate based on the composition of each asset class.

The VCO's submission also raised an additional concern that AusNet Services' accelerated depreciation does not affect the remaining life of the broader 'source' asset class(es) from which faster-depreciating assets are being removed.[11] It submitted that the remaining life of any such source asset class should be increased 'so that the average depreciation is the same before and after the change'.[12]

We consider that by definition, accelerated depreciation will increase the straight-line depreciation amount in the short term. We also consider that the depreciation profile of a broader source asset class should be appropriately adjusted to reflect the removal of

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8 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 4 – Regulatory Depreciation*, September 2020, pp. 12–15.

9 VCO, (via its consultant Headberry Partners), *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, pp. 31-32.

10 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 4 – Regulatory Depreciation*, September 2020, p. 17.

11 In AusNet Services' case, these asset classes are 'Subtransmission' and 'Distribution system assets'.

12 VCO (via its consultant Headberry Partners), *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26* January 2021, pp. 31–32.

the faster-depreciating assets. Therefore, a year-by-year tracking depreciation model will typically reflect a reallocation of such assets for accelerated depreciation as:

- A positive depreciation adjustment for the target asset class into which the faster-depreciating assets are transferring.
- A negative depreciation adjustment for the source asset class from which the faster-depreciating assets are being removed. This negative depreciation adjustment therefore reduces the total rate of depreciation for the source asset class.

We are satisfied that the above adjustments have been appropriately made in AusNet Services' depreciation model.

Table 4.2 sets out our final decision on AusNet Services' standard asset lives for the 2021–26 regulatory control period. We are satisfied the 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.[13]

Table 4.2 Final 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[b]	n/a

Source: AER analysis.

(a) New asset class 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.

13 NER, cll. 6.5.5(b)(1)–(2).

(b) For this final decision, the forecast capex determined for AusNet Services does not meet a level to trigger any benchmark equity raising costs.

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.

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.[14]

[14] AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, Attachment 4 – Regulatory Depreciation*, September 2020, pp. 6–10.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
ECA	Energy Consumers Australia
IT	information technology
NER	national electricity rules
PTRM	post-tax revenue model
RAB	regulatory asset base
repex	replacement capital expenditure
RFM	roll forward model
SCADA	supervisory control and data acquisition
VCO	Victorian Community Organisations