



FINAL DECISION
Ausgrid
Distribution Determination

2019 to 2024

Attachment 2
Regulatory asset base

April 2019

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Note

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

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The attachments have been numbered consistently with the equivalent attachments to our longer draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

Attachment B – Pricing methodology

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
NER	National Electricity Rules
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 Ausgrid's opening regulatory asset bases (RABs) as at 1 July 2019 for its distribution and transmission (dual function assets) networks.¹ We also project Ausgrid's RABs for the 2019–24 regulatory control period.

Ausgrid'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 Ausgrid 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 final decision sets out that depreciation based on forecast capital expenditure is to be used for establishing the RAB as at the commencement of the 2024–29 regulatory control period.³

2.1 Final decision

Opening RABs as at 1 July 2019

Our final decision is to determine opening RAB values of \$13779.4 million and \$1901.7 million (\$ nominal) as at 1 July 2019 for Ausgrid's distribution and transmission networks respectively. These amounts are \$0.3 million and \$2.9 million lower than Ausgrid's revised proposed opening RAB values of \$13779.7 million and \$1904.6 million (\$ nominal) as at 1 July 2019 for its distribution and transmission assets respectively.⁴ We accept the revised proposed opening RABs, subject to the following revisions:

- updated the 2018–19 inflation rate with actual consumer price index (CPI) input for indexation in the RAB roll forward
- updated the 2017–18 capex for amended allocations of movements in capitalised provisions.

To determine the opening RAB as at 1 July 2019, we have rolled forward the RAB over the 2014–19 regulatory control period to determine a closing RAB value at

¹ NER, cl. 6.12.1(6).

² AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019*, July 2017, p. 13; NER, cl. 6.25,

³ NER, cl. 6.12.1(18).

⁴ Ausgrid, *Revised proposal RFMs*, January 2019.

30 June 2019 in accordance with our roll forward model (RFM).⁵ 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.⁶ However, this adjustment is not required for establishing Ausgrid's opening RABs as at 1 July 2019 since the approved opening RAB values at 1 July 2014 of \$12251.7 million and \$2035.7 million for its distribution and transmission networks respectively do not include any estimated capex. This is because 2014–15 was a transitional year for Ausgrid and we were able to include the actual capex values for 2013–14 in our determination for the 2014–19 regulatory control period.⁷

In our draft decision, we accepted Ausgrid's proposed opening RABs as at 1 July 2019 subject to the following revisions:⁸

- adjusted 2015–16 and 2016–17 actual gross capex for movements in capitalised provisions for Ausgrid's distribution network
- updated inputs to the RFMs due to changes in the 2014–19 post-tax revenue models (PTRMs) from Ausgrid's remittal proposal for the 2014–19 regulatory control period.

While Ausgrid's revised proposal RFMs incorporated our updates for the remittal decision it did not adopt our amendments for capitalised provisions in 2015–17 capex for its distribution network. In discussions subsequent to the draft decision, Ausgrid indicated that the capex values reported in its annual reporting regulatory information notices (RINs) for those years do not include any capitalised provisions. We have reviewed the information and are satisfied with Ausgrid's clarification of this issue. We therefore consider that we do not need to make any further adjustment for 2015–17 capex for Ausgrid's distribution network in this final decision.⁹

In Ausgrid's revised proposal for its transmission network RFM, it adjusted the 2016–17 capex for the capitalisation of a finance lease, which was previously omitted. This has the effect of increasing the opening RAB at 1 July 2019 by \$19.5 million and this adjustment is now shown in Ausgrid's amended 2016–17 annual reporting RIN.¹⁰ We have reviewed the information and we consider it is reasonable to include this finance lease amount in the opening RAB.

We also noted in the draft decision that the proposed capex for 2017–18 and 2018–19 were estimates and that Ausgrid would provide the actual capex for 2017–18 in its

⁵ AER, *Electricity distribution network service providers: Roll forward model (version 2)*, 15 December 2016.

⁶ The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2014–19 determination.

⁷ Although our 2015 determination for the 2014–19 period was set aside during the appeal process, the approved 2013–14 actual capex was not varied as part of our remade determination.

⁸ AER, *Draft Decision Ausgrid 2019–24 Distribution Determination Attachment 2: Regulatory Asset Base*, September 2018, p. 5

⁹ AER, *RE: Call to discuss RIN updates - movements in provisions*, emailed 13 February 2019.

¹⁰ Ausgrid, *RIN updates - movements in provisions*, emailed 12 March 2019.

revised proposal, and that it may revise the 2018–19 capex estimate. Ausgrid’s revised proposal provided these updates to the 2017–18 and 2018–19 capex.¹¹

We have checked the 2017–18 actual capex in the revised proposal and noted some discrepancies with Ausgrid’s annual RIN relating to the treatment of movements in capitalised provisions. We raised this issue with Ausgrid, and it subsequently provided an amended annual RIN with updated values for capitalised provisions.¹² We have confirmed with Ausgrid that the 2017–18 capex in the annual RIN includes capitalised provisions. Our final decision RFMs therefore incorporate adjustments to the 2017–18 actual gross capex for movements in capitalised provisions.

Further, we accept Ausgrid’s revision to the 2018–19 net capex estimate of \$824.8 million (\$ nominal).¹³ This amount is higher than what we approved in the draft decision, reflecting more recent data. We note that the financial impact of any difference between actual and estimated capex for 2018–19 will be accounted for at the next reset. Our final decision also updates the 2018–19 inflation input in the RFM with actual CPI for this year, which became available after Ausgrid submitted its revised proposal.

Our draft decision accepted Ausgrid’s proposed reclassification of \$254.7 million as at 1 July 2019 of dual function assets (transmission) to distribution. In its revised proposal, Ausgrid updated this reclassification by reducing the value of these transferring assets to \$254.0 million. Consistent with our draft decision, we accept this revision as we are satisfied that these assets no longer meet the definition of a dual function asset and therefore Ausgrid can reclassify them as distribution assets.¹⁴

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.¹⁵ As discussed in the draft decision, the review period for this distribution determination is limited to 2015–16 and 2016–17 capex.¹⁶ Consistent with our draft decision, the requirements for an efficiency review of past capex are not satisfied.¹⁷ Accordingly, we consider the capex incurred in those years are consistent with the capital expenditure criteria and can therefore be included in the RAB—this is discussed further in attachment 5 of our draft decision.¹⁸

¹¹ Ausgrid, *Revised proposal RFMs*, January 2019.

¹² Ausgrid, *RIN updates - movements in provisions*, emailed 12 March 2019.

¹³ This amount is for the distribution and transmission networks, and includes a half-year WACC allowance to compensate for the six month period before capex is added to the RABs.

¹⁴ NER, cl. 6.24.2.

¹⁵ NER, cll. 6.12.2(b) and 6.4A(a).

¹⁶ AER, *Draft Decision Ausgrid 2019–24 Distribution Determination Attachment 2: Regulatory Asset Base*, September 2018, p. 18; NER, cl. S6.2.2A(a1).

¹⁷ Ausgrid’s actual capex incurred in 2015–16 and 2016–17 are below the forecast allowance set at the previous regulatory determination; NER, cl. S6.2.2A(b).

¹⁸ AER, *Draft Decision: Ausgrid distribution determination 2019–24, Attachment 5, Capital expenditure*, November 2018.

For the purposes of this final decision, we have included Ausgrid’s actual capex for 2017–18 and estimated capex for 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.¹⁹ 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).²⁰ As such, we consider that the 2014–19 RAB roll forward contributes to an opening RAB (as at 1 July 2019) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.²¹

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

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

	2014–15	2015–16	2016–17	2017–18	2018–19 ^a
Opening RAB	12251.7	12615.9	12656.1	12677.9	12991.6
Capital expenditure ^b	498.1	319.7	358.4	540.1	768.8
Inflation indexation on opening RAB	304.8	190.3	161.6	247.0	248.3
Less: straight-line depreciation ^c	438.6	469.8	498.3	473.4	483.4
Interim closing RAB	12615.9	12656.1	12677.9	12991.6	13525.3
Final year asset adjustment moving from transmission to distribution					254.0
Closing RAB as at 30 June 2019^d					13779.4

Source: AER analysis.

- (a) Based on estimated as-incurred capex provided by Ausgrid.
- (b) Net of disposals and capital contributions, and adjusted for actual CPI and half-year 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 \$12251.7 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for Ausgrid and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

¹⁹ 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.

²⁰ AER, *Ausgrid distribution determination Final Decision 2015–16 to 2018–19 Attachment 2 – Regulatory asset base*, April 2015, p. 2–10

²¹ NER, cl. 6.4A(a), 6.5.7(c) and 6.12.2(b)

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

	2014–15	2015–16	2016–17	2017–18	2018–19 ^a
Opening RAB	2035.7	2067.4	2027.8	2091.2	2133.6
Capital expenditure ^b	60.1	–7.4	105.4	73.9	56.0
Inflation indexation on opening RAB	35.0	34.9	29.9	39.9	38.1
Less: straight-line depreciation ^c	63.3	67.1	72.0	71.4	72.0
Interim closing RAB	2067.4	2027.8	2091.2	2133.6	2155.7
Final year asset adjustment moving from transmission to distribution					–254.0
Closing RAB as at 30 June 2019^d					1901.7

Source: AER analysis.

- (a) Based on estimated as-incurred capex provided by Ausgrid.
- (b) Net of disposals and capital contributions, and adjusted for actual CPI and half-year 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 \$2035.7 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for Ausgrid and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

Forecast closing RABs as at 30 June 2024

Once we have determined the opening RABs as at 1 July 2019, we roll forward the RABs by adding forecast capex and inflation, and reducing by depreciation to arrive at forecast closing values for the RABs at the end of the 2019–24 regulatory control period.²²

For this final decision, we determine forecast closing RAB values of \$15619.9 million and \$2143.1 million (\$ nominal) as at 30 June 2024 for Ausgrid's distribution and transmission networks respectively. This is \$2.0 million higher and \$3.2 million lower than Ausgrid's revised proposed closing RAB values of \$15617.9 million and \$2146.2 million (\$ nominal) for its distribution and transmission networks respectively. Our final decision on the forecast closing RAB values reflects the updated opening RAB as at 1 July 2019, and our final decisions on the expected inflation rate (section 2.2 of the Overview), forecast depreciation (attachment 4) and forecast capex (attachment 5).

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

²² NER, cl. S6.2.3.

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

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	13779.4	14272.8	14677.7	15010.7	15315.1
Capital expenditure ^a	586.8	525.4	479.4	476.5	476.0
Inflation indexation on opening RAB	334.1	346.1	355.9	364.0	371.4
Less: straight-line depreciation	427.5	466.6	502.3	536.1	542.6
Closing RAB	14272.8	14677.7	15010.7	15315.1	15619.9

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-year WACC allowance to compensate for the six month period before capex is added to the RAB for revenue modelling.

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

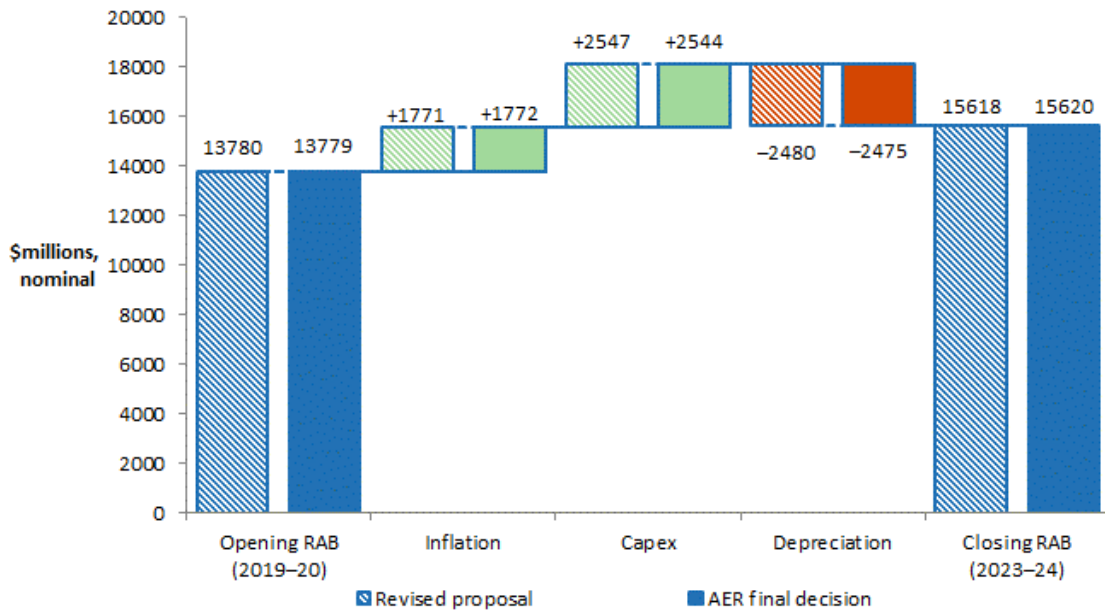
	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	1901.7	1961.2	2015.3	2046.4	2097.8
Capital expenditure ^a	69.3	67.8	48.5	72.5	67.0
Inflation indexation on opening RAB	46.1	47.6	48.9	49.6	50.9
Less: straight-line depreciation	55.9	61.2	66.3	70.8	72.6
Closing RAB	1961.2	2015.3	2046.4	2097.8	2143.1

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-year WACC allowance to compensate for the six month period before capex is added to the RAB for revenue modelling.

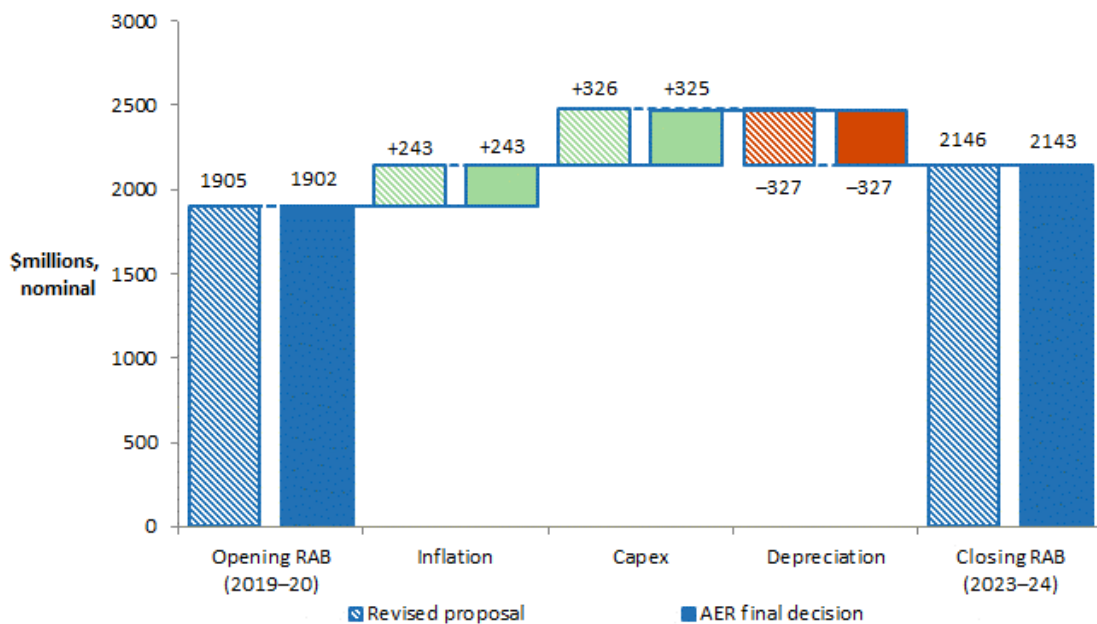
Figure 2.1 and Figure 2.2 show the key drivers of the change in Ausgrid's RAB over the 2019–24 regulatory control period for this final decision for its distribution and transmission networks respectively. Overall, the closing RABs at the end of the 2019–24 regulatory control period are forecast to be 13.4 per cent and 12.7 per cent higher 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 18.5 per cent for the distribution network and 17.1 per cent for the transmission network. Expected inflation increases the RABs by about 12.9 per cent for the distribution network and 12.8 per cent for the transmission network. Forecast depreciation, on the other hand, reduces the RABs by about 18.0 per cent for the distribution network and 17.2 per cent for transmission network.

Figure 2.1 Key drivers of changes in the RAB—Ausgrid’s revised proposal compared with AER’s final decision – distribution (\$ million, nominal)



Source: AER analysis.

Figure 2.2 Key drivers of changes in the RAB—Ausgrid’s revised proposal compared with AER’s final decision – transmission (\$ million, nominal)



Source: AER analysis.

Forecast net capex is a significant driver of the increase in the RAB. The Energy Users Association of Australia (EUAA) made a submission which raised concerns about the real increase in Ausgrid's forecast RAB in its revised proposal.²³

We note these concerns, however, we are satisfied that Ausgrid's revised proposed total forecast capex of \$2638.4 million (\$ 2018–19)²⁴ for the 2019–24 regulatory control period reasonably reflects the capex criteria.²⁵ We have therefore accepted Ausgrid's revised proposed capex for the 2019–24 regulatory control period. Refer to attachment 5 for the discussion on forecast capex.

Application of depreciation approach in RAB roll forward for next reset

When we roll forward Ausgrid's RABs for the 2019–24 regulatory control period at the next reset, we must adjust for depreciation. For this final decision, we determine that the depreciation approach to be applied to establish the RAB at the commencement of the 2024–29 regulatory control period 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.²⁶

As discussed in attachment 9, we will also apply the CESS to Ausgrid over the 2024–29 regulatory control period. We consider that the CESS will provide sufficient incentives for Ausgrid 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.²⁷ Further, this approach is consistent with our draft decision, Ausgrid's initial proposal and our *Framework and approach*.²⁸

2.2 Assessment approach

We did not change our assessment approach for the RAB from our draft decision. Attachment 2 (section 2.3) of our draft decision details that approach.

²³ Energy Users Association of Australia, *Submission NSW DNSP's 2018-24 Revenue Reset*, January 2019, p. 2.

²⁴ This amount is net of capital contributions, disposals and equity raising costs, and excludes the half-year WACC adjustment

²⁵ Ausgrid's revised proposed net capex amount of \$2638.4 million comprises \$2340.1 million and \$298.4 million for its distribution and transmission networks respectively.

²⁶ NER, cl. 6.12.1(18).

²⁷ 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 and 20–21. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.

²⁸ AER, *Draft Decision Ausgrid 2019–24 Distribution Determination Attachment 2: Regulatory Asset Base*, November 2018, p. 24; Ausgrid, *Regulatory proposal 2019–24 Attachment 9.01: Application of incentive schemes*, April 2018, p. 8; AER, *Framework and approach Ausgrid, Endeavour Energy and Essential Energy Regulatory control period commencing 1 July 2019*, July 2017, p. 13.