FINAL DECISION
Ausgrid
Distribution Determination

2019 to 2024

Attachment 4
Regulatory depreciation

April 2019

AUSTRALIAN ENERGY REGULATOR

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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

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Attachment A – Negotiating framework

Attachment B – Pricing methodology

Contents

Shortened forms

Shortened form	Extended form
ACT	Australian Capital Territory
AER	Australian Energy Regulator
capex	capital expenditure
disposal	asset disposal
NER	National Electricity Rules
NSW	New South Wales
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
WACC	weighted average cost of capital

4 Regulatory depreciation

Depreciation is the allowance provided so capital investors recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by Ausgrid, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Ausgrid's 2019–24 regulatory control period for its distribution and transmission (dual function assets) networks.[1]

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 regulatory depreciation allowance is the net total of the straight-line depreciation less the indexation of the RAB.

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

4.1 Final decision

Our final decision is to determine a regulatory depreciation allowance of $703.5 million and $83.8 million ($ nominal) for Ausgrid's distribution and transmission networks respectively for the 2019–24 regulatory control period. These amounts represent reductions of:

- $5.4 million (or 0.8 per cent) on the $708.9 million ($ nominal) in Ausgrid's revised proposal for its distribution network
- $0.1 million (or 0.1 per cent) on the $83.9 million ($ nominal) in Ausgrid's revised proposal for its transmission network.

This final decision is an increase of $61.0 million (or 8.4 per cent) compared to the regulatory depreciation allowance determined in our draft decision.[3] In coming to this decision:

- We accept Ausgrid's revised proposed straight-line method to calculate the regulatory depreciation allowance, which is consistent with our draft decision.
- We accept Ausgrid's revised proposed weighted average method to calculate the remaining asset lives as at 1 July 2019, which is consistent with our draft decision. In accepting the weighted average method, we have updated Ausgrid's remaining

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1 NER, cll. 6.12.1, 6.4.3.

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

3 This increase is driven mainly by a higher capex allowance approved for this final decision relative to our draft decision.

asset lives as at 1 July 2019 to reflect our amendments to the RAB roll forward for the 2014–19 regulatory control period (attachment 2).

- We also accept Ausgrid's revised proposed asset classes and standard asset lives subject to some changes arising from the tax review (attachment 7).
- We made determinations on other components of Ausgrid's revised proposal, which affects the RAB and in turn impacts the forecast regulatory depreciation allowance. The decrease to the regulatory depreciation allowance from the revised proposal reflects our adjustments to the opening RAB as at 1 July 2019 (attachment 2) and the forecast RAB over the 2019–24 regulatory control period.[4]

Table 4.1 and Table 4.2 set out our final decision on the forecast regulatory depreciation allowance for Ausgrid's 2019–24 regulatory control period for its distribution and transmission networks respectively.

Table 4.1 AER's final decision on Ausgrid's forecast regulatory depreciation allowance for the 2019–24 regulatory control period – distribution ($million, nominal)

	2019–20	2020–21	2021–22	2022–21	2021–24	Total
Straight-line depreciation	427.5	466.6	502.3	536.1	542.6	2475.0
Less: inflation indexation on opening RAB	334.1	346.1	355.9	364.0	371.4	1771.5
Regulatory depreciation	**93.3**	**120.5**	**146.4**	**172.1**	**171.2**	**703.5**

Source: AER analysis.

Table 4.2 AER's final decision on Ausgrid's forecast regulatory depreciation allowance for the 2019–24 regulatory control period – transmission ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Straight-line depreciation	55.9	61.2	66.3	70.8	72.6	326.8
Less: inflation indexation on opening RAB	46.1	47.6	48.9	49.6	50.9	243.0
Regulatory depreciation	**9.8**	**13.7**	**17.4**	**21.2**	**21.7**	**83.8**

Source: AER analysis.

[4] 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. We have accepted Ausgrid's revised proposed forecast capex for the 2019–24 regulatory control period (attachment 5). However we have amended the revised proposed rate of return (section 2.2 of the overview). Therefore, our final decision on the forecast RAB (attachment 2) also reflects our amendments to the rate of return for the 2019–24 regulatory control period.

Standard asset lives for 2019–24

For this final decision, we accept Ausgrid's revised proposed standard asset lives for its asset classes in respect of the forecast capex to be incurred for the 2019–24 regulatory control period subject to some changes arising from the tax review (attachment 7).

The changes relate to different methods of calculation of tax depreciation for different asset classes, which resulted in the addition of two new asset classes to the PTRMs and a reallocation of forecast capex. However, these changes do not impact the regulatory depreciation allowance because we assign the same standard asset lives as the classes for which the forecast capex were originally allocated.

The two new asset classes are:

- 'In-house software' – where the forecast capex was originally allocated to the 'IT systems' asset class for both the distribution and transmission networks
- 'Buildings (system)' – where the forecast capex was originally allocated to the 'Substations' asset class for the distribution network or 'Transmission buildings 132/66kV' asset class for the transmission network.

For each asset class we have assigned a standard asset life that is consistent with the asset class from which the forecast capex were reallocated. Therefore, for the 'In-house software' asset class we have assigned a standard asset life of 5 years that is consistent with the standard life of the 'IT systems' asset class.

For the 'Buildings (system)' asset class, in the distribution PTRM we have assigned a standard asset life of 46.8 years that is consistent with the standard life of the 'Substations' asset class. In the transmission PTRM, we have assigned a standard asset life of 60 years that is consistent with the 'Transmission buildings 132/66kV' asset class. In response to an information request, Ausgrid stated that it has no concerns with this approach.[5]

In Ausgrid's revised proposal for its transmission PTRM, it also included a new asset class labelled 'Transmission leases (network)' to accommodate the depreciation of a capitalised finance lease and assigned a standard asset life of 50 years to this new asset class. We did not retain this standard asset life in the PTRM because Ausgrid has not proposed any forecast capex for this asset class during the 2019–24 regulatory control period. As a result, we are not required to assess the proposed standard asset life for this asset class for depreciation purposes.[6]

Table 4.3 and Table 4.4 set out our final decision on Ausgrid's standard asset lives for the 2019–24 regulatory control period for its distribution and transmission networks respectively. We are satisfied the standard asset lives would lead to a depreciation

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5 Ausgrid, *Response to AER email: Implementation of the tax review - Ausgrid*, 5 March 2019.

6 We therefore assign a value of 'n/a' for this standard asset life in the PTRM.

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 Ausgrid.[7]

Remaining asset lives as at 1 July 2019

For this final decision, we accept Ausgrid's revised proposed weighted average method to calculate the remaining asset lives as at 1 July 2019. Ausgrid's revised proposal adopted our draft decision, where we accepted its initial proposal's application of the approach as set out in our roll forward model (RFM). In accepting the weighted average method, we have updated Ausgrid's remaining asset lives to reflect our adjustments to the revised proposed RFMs. As discussed in attachment 2, we made some updates to inputs in Ausgrid's revised proposed RFMs and accordingly updated the remaining asset lives as at 1 July 2019. This is because some of the inputs in the RFMs, such as capex and actual inflation, affect the value of assets in the RAB and in turn, the calculation of the remaining asset lives as at 1 July 2019. Our approach to updating is consistent with our draft decision.

For the new 'In-house software' and 'Buildings (system)' asset classes we have not assigned remaining asset lives as there are no opening asset values for these asset classes, only forecast capex are being allocated to these asset classes over the 2019–24 regulatory control period. We therefore record 'n/a' in the PTRMs for these asset classes.

For the new 'Transmission leases (network)' asset class, Ausgrid assigned a remaining asset life of 46 years in its revised proposal. In response to an information request, Ausgrid provided clarification around the calculation of this asset life.[8] It advised that the lease was first recognised in the 2014–15 financial statements and that 46 years reflects the remaining economic life of the lease, which is 50 years less the 4 years between 2014–15 and 2018–19. Having reviewed the information provided by Ausgrid, we consider this remaining asset life is appropriate for regulatory depreciation purposes as it reflects the economic life of the lease at 1 July 2019.

In Ausgrid's distribution RFM, we have amended the remaining asset life at 1 July 2019 for the $254.0 million of dual function assets transferring to distribution from transmission. We consider the remaining asset life for these transferring assets should be consistent across both the distribution and the transmission RFMs. This amendment reduces Ausgrid's regulatory depreciation allowance by $5.3 million ($ nominal) for its distribution network. This approach is consistent with Ausgrid's initial proposal and our draft decision.

Table 4.3 and Table 4.4 set out our final decision on the remaining asset lives as at 1 July 2019 for Ausgrid's distribution and transmission networks respectively.

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7 NER, cll. 6.5.5(b)(1)–(2).

8 Ausgrid, *Response to IR#59,* 21 February 2019.

Table 4.3 AER's final decision on Ausgrid's standard and remaining asset lives at 1 July 2019 – distribution (years)

Asset class	Remaining asset life as at 1 July 2019	Standard asset life
Sub-transmission lines and cables	31.2	46.3
Cable tunnel (dx)	62.9	70.0
Distribution lines and cables	43.9	58.0
Substations	32.4	46.8
Transformers	27.6	45.9
Low voltage lines and cables	38.8	52.1
Customer metering and load control	9.5	25.0
Customer metering (digital)[a]	1.0	n/a
Communications (digital) - dx	7.8	10.0
Total communications[b]	5.0	10.2
System IT (dx)	6.3	7.0
Ancillary substation equipment (dx)	11.3	15.0
Land and easements	n/a	n/a
Furniture, fittings, plant and equipment	10.1	17.4
Land (non-system)[b]	5.0	n/a
Other non-system assets	4.6	29.4
IT systems	4.4	5.0
Motor vehicles	5.7	10.2
Buildings (system)	n/a	46.8
Buildings (non-system)	29.2	35.9
In-house software	n/a	5.0
Equity raising costs[c]	38.4	n/a

Source: AER analysis.

n/a not applicable. We have not assigned a standard asset life to some asset classes because the assets allocated to those asset classes are not subject to depreciation.

(a) This asset class has a very small residual value. We have set the remaining asset life to 1 year to fully depreciate the amount and remove it from the RAB in the 2019–24 regulatory control period. We do not expect this asset class to be used in subsequent regulatory control periods because metering expenditure is classified as alternative control services.

(b) This asset class has a negative value. The remaining asset life is 5 years to remove it from the RAB by the end of the 2019–24 regulatory control period.

(c) For this final decision, Ausgrid does not satisfy the requirements to incur benchmark equity raising costs associated with its forecast capex for the 2019–24 regulatory control period. Therefore, a standard asset life for equity raising costs is not required for the 2019–24 period.

Table 4.4 AER's final decision on Ausgrid's standard and remaining asset lives at 1 July 2019 – transmission (years)

Asset class	Remaining asset life as at 1 July 2019	Standard asset life
Transmission & zone land & easements	n/a	n/a
Transmission buildings 132/66kV	44.4	60.0
Zone buildings 132/66kV	45.5	60.0
Transmission transformers 132/66kV	33.6	50.0
Zone transformers 132/66kV	31.1	50.0
Transmission substation equip 132/66kV	32.8	45.0
Zone substation equip 132/66kV	33.8	45.0
Ancillary substation equipment (tx)	10.3	15.0
132kV tower lines	42.9	60.0
132kV concrete & steel pole lines	42.4	55.0
132kV wood pole lines	25.3	45.0
132kV feeders underground	33.5	45.0
Cable tunnel (tx)	55.1	70.0
Network control & com systems	12.5	37.2
Communications (digital) - tx	6.9	10.0
System IT (tx)[a]	5.0	7.0
IT systems	4.2	5.0
Furniture, fittings, plant and equipment	9.9	17.4
Motor vehicles	5.3	10.2
Land (non-system)[a]	5.0	n/a
Other non-system assets	10.0	29.4
Transmission Leases (Network)	46.0	50.0
Buildings (system)	n/a	60.0
Buildings (non-system)	27.9	35.9
In-house software	n/a	5.0
Equity raising costs[b]	36.7	n/a

Source: AER analysis.

n/a not applicable. We have not assigned a standard asset life to some asset classes because the assets allocated to those asset classes are not subject to depreciation.

(a) This asset class has a negative value. The remaining asset life is 5 years to remove it from the RAB by the end of the 2019–24 regulatory control period.

(b) For this final decision, Ausgrid does not satisfy the requirements to incur benchmark equity raising costs associated with its forecast capex for the 2019–24 regulatory control period. Therefore, a standard asset life for equity raising costs is not required for the 2019–24 period.

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.[9]

[9] AER, *Ausgrid 2019–24 – Draft decision – Attachment 4 – Regulatory depreciation*, November 2018, pp. 8–9