FINAL DECISION

CitiPower
Distribution Determination
2021 to 2026

Attachment 4
Regulatory depreciation

April 2021

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 CitiPower 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

Attachment 13 – Classification of services

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Attachment 15 – Pass through events

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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 CitiPower, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for CitiPower's 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 CitiPower's 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 $419.7 million ($ nominal) for CitiPower for the 2021–26 regulatory control period. This amount represents an increase of $31.4 million (or 8.1 per cent) to the $388.3 million ($ nominal) in CitiPower's revised proposal.[2] It is $35.6 million (or 9.3 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 CitiPower's opening RAB as at 1 July 2021 (Attachment 2), forecast capital expenditure (Attachment 5) and asset lives. Our final decision straight-line depreciation for CitiPower is $13.3 million lower than its revised proposal. This is mainly due to the lower opening RAB and lower forecast capital expenditure (capex) in our final decision.

The indexation on the RAB is impacted by our decision on CitiPower's opening RAB (Attachment 2), forecast capex (Attachment 5) and the expected inflation rate (Attachment 3). Our final decision indexation on CitiPower’s forecast RAB is $44.7 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 CitiPower 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), which has resulted in a higher regulatory depreciation amount compared to the revised proposal.

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1 NER, cll. 6.12.1, 6.4.3.

2 CitiPower, *Revised Regulatory Proposal – 2021–26 - MOD 10.02 - PTRM 2021–26,* updated 22 December 2020.

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

In coming to this final decision on CitiPower's straight-line depreciation:

- We accept CitiPower's revised proposed straight-line method to calculate the regulatory depreciation, which is consistent with our draft decision.
- We accept CitiPower's 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 2020 capex, and the forecast equity raising costs 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 CitiPower's revised proposed asset classes and standard asset lives, which are consistent with our draft decision. We have updated the equity raising costs standard asset life using our preferred weighted average approach.
- We accept CitiPower's revised proposed reallocation of $1.0 million of existing assets into its new asset class of 'Accelerated depreciation assets' from the 'Distribution system assets' class. This amount is consistent with our draft decision.

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

Table 4.1 Final decision on CitiPower's 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	110.0	117.7	126.0	133.6	140.3	627.6
Less: inflation indexation on opening RAB	39.4	40.6	41.8	42.7	43.3	207.9
Regulatory depreciation	**70.6**	**77.0**	**84.2**	**90.9**	**96.9**	**419.7**

Source: AER analysis.

Year-by-year tracking approach

For this final decision, we accept CitiPower's 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 CitiPower's previous regulatory control period of 2016–20.

In the draft decision, we required a few minor modelling adjustments to CitiPower's year-by-year tracking depreciation model used for implementing straight-line

depreciation.[4] CitiPower's revised proposal adopted all our draft decision changes, but it excluded an updated depreciation model. Consistent with our RFM amendments discussed in Attachment 2, we have amended the depreciation model to reflect CitiPower's updated capex estimate for 2020 and our amended inputs for the six month 2021 period for the nominal rate of return and forecast equity raising costs. CitiPower agreed with these amendments in response to our information request.[5]

Accelerated depreciation

For this final decision, we accept CitiPower's revised proposal on accelerated depreciation for its existing assets that will be replaced and become redundant over the 2021–26 regulatory control period. This is consistent with our draft decision.

CitiPower's revised proposal adopted our draft decision for the reallocation of $1.0 million of existing assets for accelerated depreciation.

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.[6] 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 decided to reduce the proposed accelerated depreciation amount to $1.0 million from $8.0 million.[7]

Standard asset lives

For this final decision, we accept CitiPower's 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.

The standard asset life for the 'Equity raising costs' asset class needs to be reviewed each regulatory control period. CitiPower's revised proposal adopted our draft decision approach to calculating the standard asset life for benchmark equity raising costs for the 2021–26 regulatory control period. Our draft decision approach was to calculate this life by taking the weighted average of the standard asset lives of total forecast net capex for each asset class over the 2021–26 regulatory control period. For this final

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4 AER, *Draft decision: CitiPower distribution determination 2021 to 2026, attachment 4 – Regulatory Depreciation*, September 2020, pp. 11–12.

5 CitiPower, *Response to AER Information Request 089*, 10 February 2021.

6 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.

7 AER, *Draft decision: Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, September 2020, pp. 12–15.

decision, we have updated the standard asset life for the 'Equity raising costs' asset class to reflect the lives of the mix of assets making up the approved forecast net capex because the equity raising cost benchmark is associated with that forecast. We therefore establish a standard asset life of 39.6 years for amortising the $1.8 million in equity raising costs.

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.[8] 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.[9] 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.

Table 4.2 sets out our final decision on CitiPower's 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 CitiPower.[10]

Table 4.2 Final decision on CitiPower's standard asset lives for the 2021–26 regulatory control period (years)

Asset class	Standard asset life
Subtransmission	50.0
Distribution system assets	49.0
SCADA/Network control	13.0
Non-network general assets - IT	6.0
Non-network general assets - other	10.0
Land	n/a
In-house software[a]	5.0
Equity raising costs	39.6

Source: AER analysis.

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

9 AER, *Draft decision: CitiPower distribution determination 2021 to 2026, Attachment 4 – Regulatory Depreciation*, September 2020, p. 16.

10 NER, cll. 6.5.5(b)(1)–(2).

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

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

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.[11]

[11] AER, *Draft decision: CitiPower 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 expenditure
RFM	roll forward model
SCADA	supervisory control and data acquisition
VCO	Victorian Community Organisations