



FINAL DECISION
Evoenergy
Distribution Determination

2019 to 2024

Attachment 4
Regulatory depreciation

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 Evoenergy 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 6 – Operating 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 A – Negotiated framework

Attachment B – Pricing methodology

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
ERC	equity raising costs
NER	National Electricity Rules
NSW	New South Wales
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
SL	straight-line
WACC	weighted average cost of capital

4 Regulatory depreciation

Depreciation is the allowance provided so capital investors can recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by Evoenergy, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Evoenergy's 2019–24 regulatory control period 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 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 Evoenergy'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 \$211.1 million and \$39.6 million (\$ nominal) for Evoenergy's distribution and transmission networks respectively for the 2019–24 regulatory control period. These amounts represent increases of:

- \$0.4 million (or 0.2 per cent) on the \$210.7 million (\$ nominal) in Evoenergy's revised proposal for its distribution network
- \$0.4 million (or 0.9 per cent) on the \$39.2 million (\$ nominal) in Evoenergy's revised proposal for its transmission network.

This final decision provides for a slight increase in the regulatory depreciation allowance in our draft decision. In coming to this decision:

- We accept Evoenergy's revised proposed straight-line method to calculate the regulatory depreciation allowance, which is consistent with our draft decision.
- We accept Evoenergy'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 Evoenergy's remaining 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).

¹ NER, cl. 6.12.1, 6.4.3.

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

- We also accept Evoenergy's revised proposed asset classes and standard asset lives, which were consistent with our draft decision. However, we have changed the standard asset life for the 'Equity raising costs' asset class.³
- We made determinations on other components of Evoenergy's revised proposal, which affects the RAB and in turn impacts the forecast regulatory depreciation allowance. The increase to the regulatory depreciation allowance from the revised proposal reflects our adjustments to:
 - the opening RAB at 1 July 2019 (attachment 2)
 - the expected inflation rate (section 2.2 of the Overview)
 - forecast capital expenditure (attachment 5) and its effect on the projected 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 Evoenergy's 2019–24 regulatory control period for its distribution and transmission networks respectively.

Table 4.1 AER's final decision on Evoenergy'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	55.2	58.5	62.1	66.7	70.1	312.6
Less: inflation indexation on opening RAB	19.3	19.8	20.1	20.9	21.4	101.5
Regulatory depreciation	35.9	38.7	42.0	45.8	48.7	211.1

Source: AER analysis.

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

	2019–20	2020–21	2021–22	2022–21	2021–24	Total
Straight-line depreciation	10.9	11.4	12.2	13.0	13.6	61.0
Less: inflation indexation on opening RAB	4.3	4.2	4.3	4.3	4.3	21.4
Regulatory depreciation	6.6	7.2	7.9	8.7	9.3	39.6

Source: AER analysis.

³ This change for equity raising costs applies to Evoenergy's distribution and transmission networks.

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. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2019–24 regulatory control period.

Standard asset lives for 2019–24

For this final decision, we accept Evoenergy's revised proposed standard asset lives in respect of the forecast capex to be incurred in the 2019–24 regulatory control period. However, we have changed the standard asset life for the 'Equity raising costs' asset class to 'n/a'⁵ from 44.5 years and 26.6 years from 36.7 years for Evoenergy's distribution and transmission networks respectively.

In our draft decision, we updated the standard asset life for Evoenergy's transmission network 'Equity raising costs' asset class by using a weighted average (by opening RAB) calculation of the standard asset lives for all depreciable assets in the PTRM. Evoenergy's revised proposal adopted our draft decision approach for this standard asset life.

However, for our final decision we have further reviewed this weighted average approach to calculate the standard asset life for equity raising costs. We consider the equity raising costs asset life should 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.⁶ This results in the standard asset life for this asset class applying for Evoenergy's 2019–24 regulatory control period being revised to 26.6 years for its transmission network. In response to an information request from us, Evoenergy agreed with this revised approach.⁷ We note the standard asset life for the 'Equity raising costs' asset class needs to be reviewed each regulatory control period and updated where appropriate.

For this final decision there are no changes to the asset classes or standard asset lives as a result of the tax review (attachment 7). The changes arising from the tax review only affect Evoenergy's tax depreciation and do not impact the regulatory depreciation allowance.

Table 4.3 and Table 4.4 set out our final decision on Evoenergy'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 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 was first included in the RAB for Evoenergy.⁸

⁵ For this final decision, Evoenergy's distribution network no longer satisfy the requirements to incur benchmark equity raising costs associated with its forecast capex for the 2019–24 regulatory control period. We have therefore not assigned a standard asset life for this asset class for Evoenergy's distribution network.

⁶ For this reason, we used forecast net capex instead of the opening RAB as the weights to establish the weighted average standard asset life for amortising equity raising costs. See AER, *Draft Decision: Essential Energy Determination 2019-24, Attachment 4 - regulatory depreciation*, September 2018, p. 12.

⁷ Evoenergy, *Response to information request - IR#53 Updates to 2014-19 remittal decision PTRMs, change in ERC SL approach*, 13 February 2019.

⁸ NER, cl. 6.5.5(b)(1)–(2).

Remaining asset lives as at 1 July 2019

For this final decision, we accept Evoenergy's revised proposed weighted average method to calculate the remaining asset lives as at 1 July 2019. Evoenergy'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 Evoenergy'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 Evoenergy'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 RFM, such as 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.

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

Table 4.3 AER's final decision on Evoenergy'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
Opening distribution assets	9.7	n/a
Zone substation	36.2	40.0
Distribution substations	35.2	40.0
Distribution overhead lines	45.5	50.0
Distribution underground lines	55.6	60.0
IT & communication systems (networks)	7.1	10.0
Motor vehicles	4.5	7.0
Other non-system assets (networks)	3.8	5.0
IT systems (corporate)	4.4	5.0
Telecommunications (corporate) ^a	5.0	5.0
Other non-system assets (corporate)	3.2	5.0
Land	n/a	n/a
Buildings	53.9	60.0
Equity raising costs	37.9	n/a ^b

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, Evoenergy does not satisfy the requirements to incur benchmark equity 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 Evoenergy’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
Opening distribution assets	9.7	n/a
Sub-transmission overhead	35.0	40.0
Sub-transmission underground	59.7	60.0
Zone substation	34.7	40.0
IT & communication systems (networks)	7.3	10.0
Motor vehicles	4.7	7.0
Other non-system assets (networks)	3.8	5.0
IT systems (corporate)	4.3	5.0
Telecommunications (corporate) ^a	5.0	5.0
Other non-system assets (corporate)	3.1	5.0
Land	n/a	n/a
Buildings	54.5	60.0
Equity raising costs	38.2	26.6

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.

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, *Evoenergy 2019–24 – Draft decision – Attachment 4 – Regulatory depreciation*, September 2018, pp. 8–9.