



FINAL DECISION

Jemena Distribution Determination 2021 to 2026

Attachment 2 Regulatory asset base

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 Jemena 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 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 18 – Connection policy

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Attachment A – Negotiating framework

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2 Regulatory asset base

Our distribution determination includes Jemena's opening regulatory asset base (RAB) value as at 1 July 2021 and the projected RAB value for the 2021–26 regulatory control period.¹ The value of the RAB substantially impacts Jemena's revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and return of capital (depreciation) components of the distribution determination.² This final decision sets out:

- the opening RAB as at 1 July 2021
- the forecast closing RAB as at 30 June 2026
- that depreciation based on forecast capital expenditure (capex) is to be used for establishing the RAB as at the commencement of the 2026–31 regulatory control period.³

2.1 Final decision

Opening RAB as at 1 July 2021

For this final decision, we accept Jemena's revised proposed opening RAB value as at 1 July 2021 of \$1517.9 million (\$ nominal).⁴ This final decision is \$6.4 million (or 0.4 per cent) lower than our draft decision value for Jemena's opening RAB of \$1524.4 million (\$ nominal).

To determine the opening RAB as at 1 July 2021, we have rolled forward the RAB over the 2016–20 regulatory control period and a further roll forward for the six month period of 1 January to 30 June 2021 (the six month 2021 period)⁵ to arrive at a closing RAB value at 30 June 2021 in accordance with our roll forward model (RFM). This roll forward includes an adjustment at the end of the 2016–20 regulatory control period to account for the difference between actual 2015 capex and the estimate approved in the 2016–20 determination.⁶

¹ National Electricity Rules (NER), cl. 6.12.1(6).

² The size of the RAB also impacts the benchmark debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

³ NER, cl. 6.12.1(18).

⁴ Subject to our update for equity raising costs for the six month period of 1 January to 30 June 2021 (the six month 2021 period). This update does not have a material impact on the RAB (less than \$0.01 million). Jemena, *Revised Regulatory Proposal - 03-01M SCS PTRM FY22-26*, updated 19 March 2021.

⁵ The additional roll forward for six months is due to the decision by the Victorian government to change the timing of the annual Victorian electricity network price changes to financial year basis from calendar year basis. This change means the current regulatory control period of 2016–20 is extended by six months and the next regulatory control period will commence on 1 July 2021.

⁶ The adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2016–20 determination.

In the draft decision, we reduced Jemena's proposed opening RAB as at 1 July 2021 by updating various inputs such as actual capex for 2019 and actual inflation for the six month 2021 period. Our draft decision also:⁷

- Amended the 2016 lagged actual consumer price index (CPI) to reflect June to June rather than September to September. This is consistent with the CPI method set out in the control mechanism for the 2016–20 regulatory control period.
- Amended the 2016 equity raising costs to reflect the amended 2016 CPI.
- Amended the forecast equity raising costs, nominal rate of return and depreciation inputs for the six month 2021 period.

We noted the roll forward of Jemena's RAB included estimated capex for 2020 and the six month 2021 period, because these actual values were not yet available.⁸

In its revised proposal, Jemena adopted our draft decision changes in full.⁹ In addition, Jemena's revised proposal RFM includes:¹⁰

- revised capex estimates for 2020 and for the six month 2021 period
- updated nominal rate of return for the six month 2021 period to reflect updated return on debt and equity values for the approved averaging periods.

We accept Jemena's revisions to the 2020 net capex estimate of \$109.6 million (\$ nominal) and six month 2021 period net capex estimate of \$71.9 million (\$ nominal).¹¹ The 2020 amount is \$16.6 million lower and the six month 2021 period amount is \$10.3 million higher compared to the amounts that we approved in our draft decision, reflecting more recent data. We note that the financial impact of any difference between actual and estimated capex for 2020 and the six month 2021 period will be accounted for at the next reset.

We also accept Jemena's update for the nominal rate of return for the six month 2021 period. Our final decision also amends the input for forecast equity raising costs for the six month 2021 period. This is discussed further below.

We also consider the extent to which our roll forward of the RAB to 1 July 2021 contributes to the achievement of the capital expenditure incentive objective.¹² As the Victorian distribution network service providers are moving from calendar regulatory

⁷ AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, pp. 4–5.

⁸ AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, p. 15.

⁹ Jemena, *Jemena Electricity Networks (Vic) Ltd 2021–26 Electricity Distribution Price Review Attachment 03-01 Response to AER's Draft Decision - Annual Revenue Requirement*, 03 December 2020, pp. 3–5.

¹⁰ Jemena, *Information Request #065*, January 2021.

¹¹ The 2020 amount remains an estimate while the actual for that period is being prepared. It includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB. The 2021 amount is also adjusted for WACC to reflect that it is added to the RAB at 30 June 2021.

¹² NER, cl. 6.12.2(b) and 6.4A(a).

years to financial regulatory years, the review period of past capex for this distribution determination will apply to the 2014–19 calendar regulatory years.¹³

Jemena's actual capex incurred for 2014 to 2019 is below the forecast allowance set at the previous distribution determinations. Therefore, the overspending requirement for an efficiency review of past capex has not been satisfied.¹⁴ Given this, we consider the capex incurred in those years to be consistent with the capital expenditure criteria and can therefore be included in the RAB.¹⁵

For this final decision, we have included Jemena's estimated capex for 2020 and the six month 2021 period in the RAB roll forward to 1 July 2021. At the next reset, this capex will form part of the review period for whether past capex should be excluded for inefficiency reasons.¹⁶ 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).¹⁷ As such, we consider that the 2016–21 RAB roll forward contributes to an opening RAB (as at 1 July 2021) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.¹⁸

Table 2.1 sets out our final decision on the roll forward of Jemena's RAB for the 2016–21 period.

Table 2.1 AER's final decision on Jemena's RAB for the 2016–21 period (\$ million, nominal)

	2016	2017	2018	2019	2020 ^a	2021 ^b
Opening RAB	1186.8	1238.2	1312.5	1386.1	1428.4	1466.9
Capital expenditure ^c	115.9	134.7	128.4	100.2	109.6	71.9
Inflation indexation on opening RAB	17.9	12.7	25.4	28.8	22.8	17.9
Less: straight-line depreciation ^d	82.4	73.0	80.2	86.7	93.7	38.8
Interim closing RAB	1238.2	1312.5	1386.1	1428.4	1467.1	1517.9
Difference between estimated and actual capex in 2015					–0.2	

¹³ AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, pp. 14–15.

¹⁴ NER, cl. S6.2.2A(c).

¹⁵ AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 5 – Capital expenditure*, September 2020, Appendix B; NER, cl. S6.2.1(f).

¹⁶ 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.

¹⁷ AER, *Preliminary decision: Jemena distribution determination 2016 to 2020, attachment 2 – Regulatory Asset Base*, October 2015, p. 16.

¹⁸ NER, cll. 6.4A(a), 6.5.7(c) and 6.12.2(b).

	2016	2017	2018	2019	2020 ^a	2021 ^b
Return on difference for 2015 capex					-0.1	
Closing RAB as at 31 December 2020					1466.9	
Opening RAB as at 1 July 2021						1517.9

Source: AER analysis.

- (a) Based on estimated capex provided by Jemena. We will true-up the RAB for actual capex at the next reset.
- (b) The six month period of 1 January to 30 June 2021. Based on estimated capex provided by Jemena. We will true-up the RAB for actual capex at the next reset.
- (c) Net of disposals and capital contributions, and adjusted for actual CPI and half-year weighted average cost of capital (WACC).
- (d) Adjusted for actual CPI. Based on forecast capex.

Note: Summation of entries may not equal totals due to rounding.

Forecast inputs for the six month 2021 period

Our revenue decision for Jemena's six month extension period contained placeholder values for both the return on equity and the return on debt.¹⁹ Since the six month decision, we have updated these inputs in the six month post-tax revenue model (PTRM) with the return on debt and equity values reflecting the approved averaging periods.²⁰ This update in turn revised the benchmark equity raising costs for the six month PTRM. Jemena's revised proposal RFM contained an updated nominal rate of return for the six month 2021 period which reflected the updated return on debt and equity values. We accept Jemena's update for the nominal rate of return for the six month 2021 period. This update in turn revised the benchmark equity raising costs for the six month PTRM. For this final decision for the 2021–26 regulatory control period, we have made the corresponding equity raising costs update to the RFM.²¹ Jemena agreed with this update in its response to our information request.²²

Forecast closing RAB as at 30 June 2026

Once we have determined the opening RAB as at 1 July 2021, we roll forward that RAB by adding forecast capex and inflation, and reducing the RAB by depreciation to arrive at a forecast closing value for the RAB as at the end of the 2021–26 regulatory control period.²³

¹⁹ AER, *Final decision Jemena six-month extension – variation decision*, October 2020, pp. 2-12, 2-13

²⁰ AER, *Model - Final decision six-month extension - Jemena- 2021 HY Post-Tax Revenue Model - March 2021*.

We will use the amended forecast six month revenue to calculate an appropriate revenue true-up for the 2021–26 regulatory control period.

²¹ We have adjusted the equity raising costs value in the RFM for a half year inflation, consistent with our approach in the draft decision RFM.

²² Jemena, *Information request #069*, February 2021.

²³ NER, cl. S6.2.3.

For this final decision, we determine a forecast closing RAB value at 30 June 2026 of \$1902.1 million (\$ nominal) for Jemena. This is \$24.0 million (or 1.2 per cent) lower than Jemena's revised proposal of \$1926.1 million (\$ nominal). Our final decision on the forecast closing RAB reflects our final decisions on the expected inflation rate (Attachment 3), forecast depreciation (Attachment 4) and forecast capex (Attachment 5).²⁴

Table 2.2 sets out our final decision on the forecast RAB for Jemena over the 2021–26 regulatory control period.

Table 2.2 AER's final decision on Jemena's RAB for the 2021–26 regulatory control period (\$ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening RAB	1517.9	1629.4	1727.6	1802.1	1864.9
Capital expenditure ^a	163.6	154.9	134.1	126.5	105.3
Inflation indexation on opening RAB	30.3	32.6	34.5	36.0	37.3
Less: straight-line depreciation	82.5	89.2	94.2	99.7	105.4
Closing RAB	1629.4	1727.6	1802.1	1864.9	1902.1

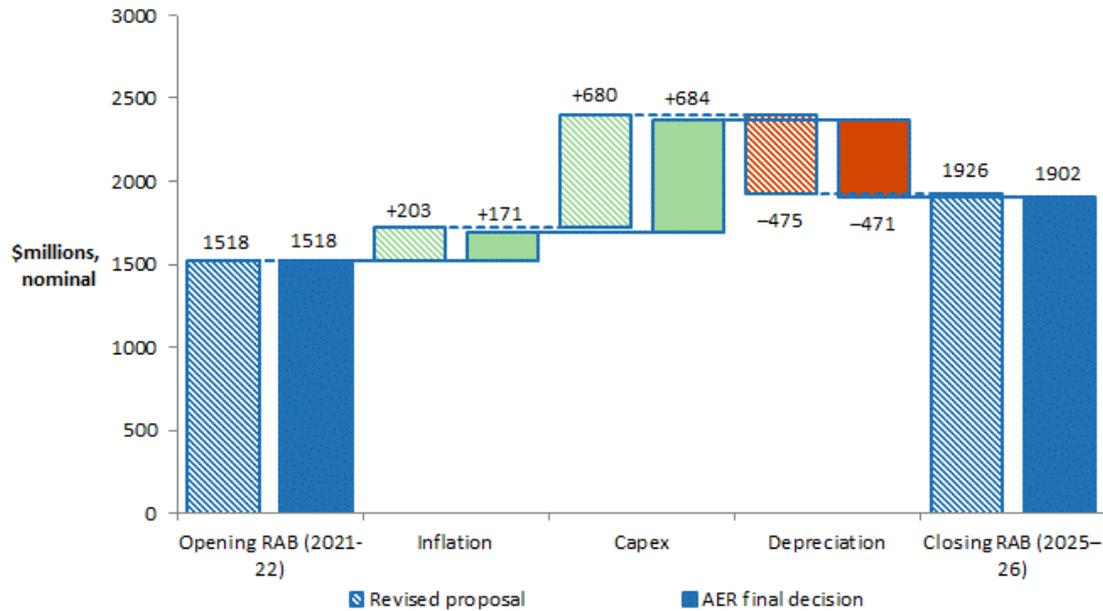
Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the 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 shows the key drivers of the change in Jemena's RAB over the 2021–26 regulatory control period for this final decision. Overall, the closing RAB at the end of the 2021–26 regulatory control period is forecast to be 25.3 per cent higher than the opening RAB at the start of that period, in nominal terms. The approved forecast net capex increases the RAB by 45.1 per cent, while expected inflation increases it by 11.3 per cent. Forecast depreciation, on the other hand, reduces the RAB by 31.0 per cent.

²⁴ Capex enters the RAB net of forecast disposals. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2021–26 regulatory control period (section 2.2 of the Overview).

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



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

Forecast net capex is a significant driver of the increase in the RAB. In our final decision, we accept Jemena's revised proposed forecast capex of \$627.2 million (\$2020–21)²⁵ for the 2021–26 regulatory control period as we are satisfied that it reasonably reflects the capex criteria. We have made some adjustments and updates and therefore amended Jemena's revised proposed capex for the 2021–26 regulatory control period to \$636.0 million (\$2020–21). Refer to section 5.3 of Attachment 5 for the discussion on forecast capex.

Application of depreciation approach in RAB roll forward for next reset

When we roll forward Jemena's RAB for the 2021–26 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 2026–31 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2021–26 regulatory control period.²⁶

²⁵ This amount is net of capital contributions, disposals and equity raising costs, and excludes the half-year WACC adjustment.

²⁶ NER, cl. 6.12.1(18).

As discussed in Attachment 9, we will also apply the CESS to Jemena over the 2021–26 regulatory control period. We consider that the CESS will provide sufficient incentives for Jemena 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, Jemena'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.

²⁷ Our ex post capex measures are set out in the capex incentive 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: Jemena distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, p. 18; Jemena, *2021–26 Revised Regulatory Proposal - Overview*, December 2020, p. 23; AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy – Regulatory control period commencing 1 January 2021*, January 2019, pp. 83–85.

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