FINAL DECISION

Jemena
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 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

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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 Jemena, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Jemena'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 Jemena'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 $300.2 million ($ nominal) for Jemena for the 2021–26 regulatory control period. This amount represents an increase of $28.4 million (or 10.5 per cent) to the $276.8 million ($ nominal) in Jemena's revised proposal.[2] It is $26.1 million (or 9.5 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 Jemena'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 Jemena is broadly consistent with its revised proposal. This is due to our acceptance of Jemena's opening RAB and forecast capital expenditure (capex) in our final decision.

The indexation on the RAB is impacted by our decision on Jemena's opening RAB (Attachment 2), forecast capex (Attachment 5) and the expected inflation rate (Attachment 3). Our final decision indexation on Jemena’s forecast RAB is $32.7 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 Jemena included in its revised proposal. Since indexation is deducted from the straight-line depreciation, the lower indexation 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 Jemena, *Revised Regulatory Proposal - 05-01M SCS Opex Model FY22–26*, updated 19 March 2021.

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

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

- We accept Jemena's revised proposed straight-line method to calculate the regulatory depreciation, which is consistent with our draft decision.
- We accept Jemena'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.[4]
- We accept Jemena'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.

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

Table 4.1 Final decision on Jemena'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	82.5	89.2	94.2	99.7	105.4	471.0
Less: inflation indexation on opening RAB	30.3	32.6	34.5	36.0	37.3	170.8
Regulatory depreciation	**52.2**	**56.6**	**59.6**	**63.7**	**68.1**	**300.2**

Source: AER analysis.

Year-by-year tracking approach

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

In the draft decision, we required some minor modelling adjustments to Jemena's year-by-year tracking depreciation model used for implementing straight-line depreciation.[5] Jemena's revised proposal adopted all our draft decision changes. It also updated the estimated capex for 2020 and the six month 2021 period in the

4 Consistent with our RFM update, we have updated equity raising costs for the six month period of 1 January to 30 June 2021 (the six month 2021 period) in Jemena's year-by-year tracking depreciation model. This update does not have a material impact on the RAB or depreciation (less than $0.01 million).

5 AER, *Draft decision: Jemena distribution determination 2021 to 2026, Attachment 4 – Regulatory Depreciation*, September 2020, pp. 10–11.

revised proposed depreciation model to be consistent with its revised proposed roll forward model (RFM).[6]

For the reasons discussed in Attachment 2, we accept these updated inputs to the RFM. As a result, we also accept these updates for the year-by-year tracking depreciation model.

Standard asset lives

For this final decision, we accept Jemena'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.

In the draft decision, we accepted Jemena's proposed reduction of the standard asset life for the 'Non network - IT' to 5 years from 5.2 years. We considered this change to be appropriate because it reflects the economic life of the mix of assets in the class and is still comparable with other Victorian distributors' standard life for this asset class. However, we amended the standard asset life for Jemena's 'Non-network - other' asset class. Jemena's initial proposal reduced the standard asset life for this asset class to 5 years from 24.2 years. It submitted that this reduction reflected the change in the mix of assets included in the forecast capex, mainly due to the reallocation of buildings capex. After reviewing additional information provided by Jemena and based on our analysis of the composition of the forecast capex, we assigned a new standard asset life of 10.5 years for this asset class. Jemena's revised proposal adopted our draft decision amendment.

The standard asset life for the 'Equity raising costs' asset class needs to be reviewed each regulatory control period. Jemena's revised proposal approach to calculating the standard asset life for benchmark equity raising costs for the 2021–26 regulatory control period is consistent with its initial proposal and our draft decision. This approach was to calculate the standard asset 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 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 41.6 years for amortising the $4.0 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.[7] As we noted in the draft decision, the repex assessments look at assets in more detail at a disaggregated level than the broader

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[6] Jemena, *Response to AER Information Request 065*, 22 January 2021.

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

depreciation assessment.[8] 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 Jemena'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 Jemena.[9]

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

Asset class	Standard asset life
Subtransmission	53.4
Distribution system assets	49.5
SCADA/Network control	10.0
Non-network - IT	5.0
Non-network - other	10.5
Land	n/a
Buildings - capital works[a]	40.0
In-house software[a]	5.0
Equity raising costs	41.6

Source: AER analysis.

(a) New asset classes created for the PTRM version 4 in order to separate components of buildings and 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.

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8 AER, *Draft decision: Jemena distribution determination 2021 to 2026, Attachment 4 – Regulatory Depreciation*, September 2020, pp. 13–14.

9 NER, cll. 6.5.5(b)(1)–(2).

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.[10]

[10] AER, *Draft decision: Jemena 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
IT	information technology
NER	national electricity rules
PTRM	post-tax revenue model
RAB	regulatory asset base
repex	replacement capital expenditure
RFM	roll forward model
SCADA	supervisory control and data acquisition
VCO	Victorian Community Organisations