FINAL DECISION

Powercor
Distribution Determination
2021 to 2026

Attachment 2
Regulatory asset base

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 Powercor 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

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2 Regulatory asset base

Our distribution determination includes Powercor'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 Powercor'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

Our final decision is to determine an opening RAB value of $4514.5 million ($ nominal) as at 1 July 2021 for Powercor. Powercor's revised proposal adopted our draft decision opening RAB of $4496.9 million ($ nominal).[4] However, our final decision has included minor updates to the opening RAB amount so it is $17.6 million (or 0.4 per cent) higher than the amount in Powercor's revised proposal.

It reflects our update to the roll forward model (RFM) for Powercor's updated capex estimate for 2020 and our amended inputs for the six month period of 1 January to 30 June 2021 (the six month 2021 period) for nominal rate of return and equity raising costs.

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 2021 period[5] to arrive at a closing RAB value at 30 June 2021 in accordance with our 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

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 Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 64.

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.

approved in the 2016–20 determination.[6] All other end of period adjustments are applied at 30 June 2021 to establish the opening RAB value at 1 July 2021.[7]

In the draft decision, we reduced Powercor'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:[8]

- Amended the forecast equity raising costs, nominal rate of return, depreciation and gross capex and customer contributions inputs for the six month 2021 period.
- Amended the 2018 capex inputs based on amendments to movements in capitalised provisions.
- Amended the 2016 equity raising costs value and 2017–20 forecast depreciation to be consistent with the values in the most recent update of Powercor's 2016–20 post-tax revenue model (PTRM).[9]

We noted the roll forward of Powercor's RAB included estimated capex for 2020 and the six month 2021 period, because these actual values were not yet available.[10]

Powercor's revised proposal adopted our draft decision changes and did not include an updated RFM.[11] Subsequent to its revised proposal, it has revised its capex estimate for 2020 but not for the six month 2021 period.[12]

We accept Powercor's revision to the 2020 net capex estimate of $411.5 million ($ nominal).[13] This amount is $17.3 million higher than we approved in our draft decision, reflecting more recent data. We also accept its estimate for the six month 2021 period of $233.5 million ($ nominal) which is consistent with the draft decision.[14]

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

7 These end of period adjustments are applied at the end of the final year of the roll forward period which in this case is 30 June 2021. For Powercor this includes reallocation for accelerated depreciation purposes for assets associated with its Rapid Earth Fault Current Limiters (REFCL) program and other assets.

8 AER, *Draft decision: Powercor distribution determination 2021 to 2026, Attachment 2 – Regulatory Asset Base,* September 2020, pp. 4–5.

9 This is the 2016–20 PTRM updated for 2020 return on debt and also expenditure for tranche 3 of the REFCL contingent project. The forecast depreciation updates are for the 'Equity raising costs' in years 2017–20, for 'Distribution system assets' in 2020 and 'SCADA/Network control' in 2020. AER, *AER - Powercor distribution determination - REFCL contingent project T3 - PTRM - PUBLIC - January 2020*

10 AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, p. 16.

11 Powercor*, Revised regulatory proposal 2021–26*, 03 December 2020, pp. 64.

12 Powercor referred to this updated estimate for 2020 capex as 'unaudited actuals'. Powercor, *Information Request #082,* February 2021.

13 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.

14 Powercor did not revise its as-incurred capex estimate for the six month 2021 period. This final decision net capex estimate reflects the updates for equity raising costs and is adjusted for the updated nominal rate of return for the six month 2021 period to reflect that it is added to the RAB at 30 June 2021.

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.

Our final decision also amends the forecast inputs for nominal rate of return and 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.[15] As the Victorian distribution network service providers are moving from calendar regulatory years to financial regulatory years, the review period of past capex for this distribution determination will apply to the 2014–19 calendar regulatory years.[16]

Powercor'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.[17] 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.[18]

For this final decision, we have included Powercor'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.[19] 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).[20] 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.[21]

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

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15 NER, cll. 6.12.2(b) and 6.4A(a).

16 AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, pp. 15–16.

17 NER, cl. S6.2.2A(c).

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

19 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.

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

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

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

	2016	2017	2018	2019	2020[a]	2021[b]
Opening RAB	3307.0	3453.2	3646.3	3871.7	4089.2	4332.0
Capital expenditure[c]	282.0	336.0	350.4	355.7	411.5	233.5
Inflation indexation on opening RAB	50.0	35.3	70.5	80.4	65.1	52.8
Less: straight-line depreciation[d]	185.7	178.3	195.5	218.6	229.7	103.8
Interim closing RAB	3453.2	3646.3	3871.7	4089.2	4336.1	4514.5
Difference between estimated and actual capex in 2015					–3.2	
Return on difference for 2015 capex					–0.9	
Closing RAB as at 31 December 2020					4332.0	
Opening RAB as at 1 July 2021						**4514.5**

Source: AER analysis.

(a) Based on estimated capex provided by Powercor. 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 Powercor. We will true-up the RAB for actual capex at the next reset.

(c) Net of disposals and capital contributions, and adjusted for actual consumer price index (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 Powercor's six month extension period contained placeholder values for both the return on equity and the return on debt.[22] Since the six month decision, we have updated these inputs in the six month PTRM with the return on debt and equity values reflecting the approved averaging periods.[23] 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 corresponding equity raising costs and nominal rate of return updates to the RFM.[24] Powercor agreed with these updates in its response to our information request.[25]

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

23 AER, *Model - Final decision six-month extension - Powercor - 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.

24 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.

25 Powercor, *Information request #087*, February 2021.

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.[26]

For this final decision, we determine a forecast closing RAB value at 30 June 2026 of $5557.5 million ($ nominal) for Powercor. This is $204.3 million (or 3.5 per cent) lower than Powercor's revised proposal of $5761.8 million ($ nominal). Our final decision on the forecast closing RAB reflects the amended opening RAB as at 1 July 2021, and our final decisions on the expected inflation rate (Attachment 3), forecast depreciation (Attachment 4) and forecast capex (Attachment 5).[27]

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

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

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening RAB	4514.5	4782.3	5081.6	5286.1	5436.7
Capital expenditure[a]	405.7	449.7	367.7	322.0	303.2
Inflation indexation on opening RAB	90.3	95.6	101.6	105.7	108.7
Less: straight-line depreciation	228.1	246.0	264.8	277.1	291.1
Closing RAB	**4782.3**	**5081.6**	**5286.1**	**5436.7**	**5557.5**

Source: AER analysis.

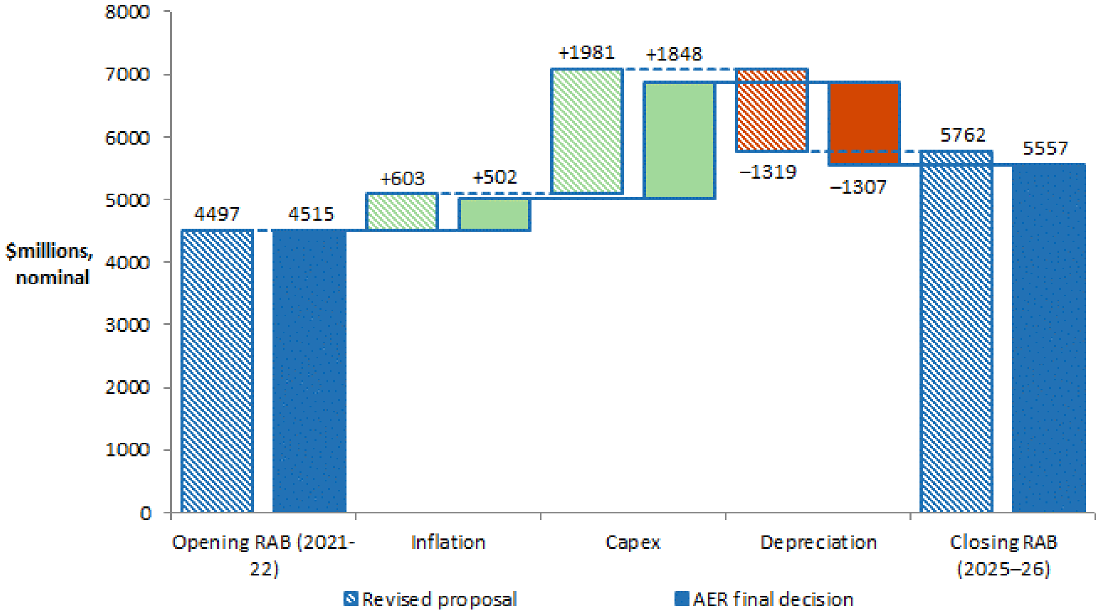
(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling.

Figure 2.1 shows the key drivers of the change in Powercor'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 23.1 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 40.9 per cent, while expected inflation increases it by 11.1 per cent. Forecast depreciation, on the other hand, reduces the RAB by 29.0 per cent.

26 NER, cl. S6.2.3.

27 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—Powercor'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 are not satisfied that Powercor's revised proposed forecast capex of $1836.3 million ($2020–21)[28] for the 2021–26 regulatory control period reasonably reflects the capex criteria. We have therefore amended Powercor's revised proposed capex for the 2021–26 regulatory control period to $1728.4 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 Powercor'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.[29]

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

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

29 NER, cl. 6.12.1(18).

incentives for Powercor 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.[30] Further, this approach is consistent with our draft decision, Powercor's initial proposal and our *Framework and approach*.[31]

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.

30 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.

31 AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 2 – Regulatory Asset Base*, September 2020, p. 19; Powercor, *Revised regulatory proposal 2021–26*, December 2020, p. 69; 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
RIN	regulatory information notice
RFM	roll forward model
WACC	weighted average cost of capital