



FINAL DECISION

Powercor Distribution Determination 2021 to 2026

Attachment 4 Regulatory depreciation

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 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

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

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Negotiating framework

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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 Powercor, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Powercor'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 Powercor'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 \$805.3 million (\$ nominal) for Powercor for the 2021–26 regulatory control period. This amount represents an increase of \$88.9 million (or 12.4 per cent) to the \$716.4 million (\$ nominal) in Powercor's revised proposal.² It is \$94.7 million (or 13.3 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 Powercor'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 Powercor is \$12.1 million lower than its revised proposal. This is mainly due to the lower forecast capital expenditure (capex) in our final decision.

The indexation on the RAB is impacted by our decision on Powercor's opening RAB (Attachment 2), forecast capex (Attachment 5) and the expected inflation rate (Attachment 3). Our final decision indexation on Powercor's forecast RAB is \$101.0 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 Powercor 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.

¹ NER, cl. 6.12.1, 6.4.3.

² Powercor, *Revised Regulatory Proposal 2021–26 - MOD 10.02 - PTRM 2021–26*, updated 24 March 2021.

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

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

- We accept Powercor's revised proposed straight-line method to calculate the regulatory depreciation, which is consistent with our draft decision.
- We accept Powercor'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 Powercor's revised proposed asset classes and standard asset lives, which are consistent with our draft decision.
- We accept the inclusion of the new asset class of 'Accelerated depreciation assets' proposed by Powercor. However, we have updated the value of existing assets reallocated into this new asset class from the 'Distribution system assets' class. This is because we have amended some of the unit rates and volumes used in the calculations for this final decision.

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

Table 4.1 Final decision on Powercor'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	228.1	246.0	264.8	277.1	291.1	1307.2
Less: inflation indexation on opening RAB	90.3	95.6	101.6	105.7	108.7	501.9
Regulatory depreciation	137.9	150.4	163.2	171.4	182.4	805.3

Source: AER analysis.

Year-by-year tracking approach

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

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

depreciation.⁴ Powercor'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 Powercor'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. Powercor agreed with these amendments in response to our information request.⁵

Accelerated depreciation

For this final decision, we accept Powercor's approach in its revised proposal on accelerated depreciation for its existing assets that will be replaced and become redundant over the 2021–26 regulatory control period. This approach is consistent with our draft decision. We have updated the value of the assets for accelerated depreciation to \$30.3 million.

Powercor's revised proposal adopted our draft decision on the reallocation of existing assets for accelerated depreciation. Our draft decision reallocated \$29.5 million of existing assets to Powercor's proposed new asset class of 'Accelerated depreciation assets'. This was due to our amendments to replacement volumes, unit rates, remaining lives and scrapping factors in Powercor's accelerated depreciation model.

For this final decision, in Powercor's accelerated depreciation model we update the unit rates for some of the single-phase and three-phase surge arrestors to \$1,503 and \$1,700 respectively. This reflects our acceptance of Powercor's revised proposal for these unit rates. We also amend the volume for distribution transformers for solar enablement to correctly reflect the replacement volume approved in the draft decision.

Applying these amendments increases the accelerated depreciation to \$30.3 million.

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

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

⁵ Powercor, *Response to AER Information Request 087*, 10 February 2021.

⁶ ECA, *Submission and attachment on the Victorian EDPR Revised Proposal and draft decision 2021–26, Submission*, 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.

decided to reduce the proposed accelerated depreciation amount to \$29.5 million from \$74.5 million.⁷

Standard asset lives

For this final decision, we accept Powercor'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.

Powercor's revised proposal included benchmark equity raising costs of \$0.1 million for the 2021–26 regulatory control period, based on the method employed in the PTRM. For the final decision PTRM we estimate zero equity raising costs. Accordingly, we do not need to set a standard asset life for the 'Equity raising costs' asset class.

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 Powercor'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 Powercor.¹⁰

⁷ AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 4 – Regulatory Depreciation*, September 2020, pp. 12–16.

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: Powercor distribution determination 2021 to 2026, attachment 4 – Regulatory Depreciation*, September 2020, p. 18.

¹⁰ NER, cl. 6.5.5(b)(1)–(2).

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

Asset class	Standard asset life
Subtransmission	50.0
Distribution system assets	51.0
SCADA/Network control	13.0
Non-network general assets - IT	6.0
Non-network general assets - other	15.0
Land	n/a
In-house software ^a	5.0
Equity raising costs ^b	n/a

Source: AER analysis.

(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.

(b) For this final decision, the forecast capex determined for Powercor does not meet a level to trigger any benchmark equity raising costs.

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: Powercor 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