



FINAL DECISION

TasNetworks Transmission Determination 2019 to 2024

Attachment 2 Regulatory asset base

April 2019

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Note

This attachment forms part of the AER's final decision on TasNetworks' 2019–24 transmission determination. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

TasNetworks transmission determination 2019–24

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment A – Pricing methodology

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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
WACC	weighted average cost of capital

2 Regulatory asset base

Our revenue determination includes TasNetworks' opening regulatory asset base (RAB) value as at 1 July 2019 and the projected RAB value for the 2019–24 regulatory control period.¹ The value of the RAB substantially impacts TasNetworks' revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and depreciation (return of capital) components of the revenue determinations.² This final decision sets out that depreciation based on forecast capital expenditure is to be used for establishing the RAB as at the commencement of the 2024–29 regulatory control period.³

2.1 Final decision

Opening RAB as at 1 July 2019

Our final decision is to determine an opening RAB value of \$1445.3 million (\$nominal) as at 1 July 2019 for TasNetworks. This amount is \$9.8 million (or 0.7 per cent) lower than TasNetworks' revised proposed opening RAB of \$1455.0 million (\$nominal) as at 1 July 2019.⁴ It reflects the update to the roll forward model (RFM) for 2018–19 actual inflation that is now available as well as a number of minor modelling corrections. This final decision is \$14.2 million (or 1.0 per cent) lower than our draft decision value for TasNetworks' opening RAB of \$1459.4 million (\$nominal).

To determine the opening RAB as at 1 July 2019, we have rolled forward the RAB over the 2014–19 regulatory control period to determine a closing RAB value at 30 June 2019 in accordance with our RFM.⁵ Our approach to rolling forward the RAB generally involves an adjustment to account for the difference between actual capex and the estimate approved for the final year of the previous regulatory control period.⁶ However, this adjustment is not required for establishing TasNetworks' opening RAB as at 1 July 2019 since the approved opening RAB value at 1 July 2014 of \$1410.3 million does not include any estimated capex. This is because 2014–15 was a transitional year for TasNetworks and we were able to include the actual capex values for 2013–14 in our determination for the 2014–19 regulatory control period.⁷

¹ NER, cl. 6A.14.1(5E).

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. 6A.14.1(5F).

⁴ TasNetworks, *Transmission and Distribution Revised Revenue Proposals 2019-2024*, November 2018, p. 82; This RAB value is based on as-incurred capex.

⁵ AER, *Electricity transmission network service providers: Roll forward model (version 3)*, 23 October 2015.

⁶ The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2014–19 determination.

⁷ AER, *Final decision, TasNetworks transmission determination 2015–19 – Overview*, April 2015, p. 12.

In the draft decision, we reduced TasNetworks' proposed opening RAB as at 1 July 2019 by correcting minor input issues and updating various inputs such as the actual 2017–18 CPI in the RFM.⁸ We noted the roll forward of TasNetworks' RAB included estimated capex for 2017–18 and 2018–19, and estimated inflation for 2018–19, because these actual values were not yet available.

In its revised proposal, TasNetworks adopted our draft decision changes in full.⁹ In addition, it has updated 2017–18 estimated capex with actuals and revised the 2018–19 estimate of capex with latest figures.¹⁰ TasNetworks has also included a negative adjustment to its closing RAB as at 30 June 2019 to account for assets changing classification to provide negotiated services.

We have checked the 2017–18 actual capex in the revised proposal and identified values which were inconsistent with those presented in TasNetworks' annual regulatory accounts for that year.¹¹ We have raised this with TasNetworks, and it has acknowledged this issue as an input error in its revised proposal RFM.¹² We therefore corrected TasNetworks' actual capex for 2017–18 in the RFM to reflect the values reported in the 2017–18 annual regulatory accounts. We accept TasNetworks' revision to the 2018–19 net capex estimate of \$62.1 million (\$nominal).¹³ This amount is higher than what we approved in our draft decision, reflecting more up-to-date data. We note that the financial impact of any difference between actual and estimated capex for 2018–19 will be accounted for at the next reset. Our final decision also updates the 2018–19 inflation input in the RFM with actual CPI for this year, which became available after TasNetworks submitted its revised proposal.

TasNetworks' revised proposal modified the RFM by making manual formula adjustments to the output summary worksheet¹⁴ to remove a number of connection assets from the RAB, as they are changing classification from providing prescribed services to become negotiated services. We accept TasNetworks' proposed removal of these assets from the RAB. However, we have made the adjustments using the 'Forecast final year (2018–19) asset adjustments' section of the 'RFM input' worksheet. This has the same effect as the approach TasNetworks has proposed, but without

⁸ AER, *Draft Decision: TasNetworks transmission determination 2019–24, Attachment 2, Regulatory asset base*, September 2018, pp. 14–16.

⁹ TasNetworks, *Transmission and Distribution Revised Revenue Proposals 2019-2024*, November 2018, pp. 81–82.

¹⁰ TasNetworks, *Transmission and Distribution Revised Revenue Proposals 2019-2024*, November 2018, pp. 81–82; TasNetworks, *Revised roll forward model*, November 2018.

¹¹ TasNetworks has not included incurred disposals for the 'Other - short life (9)' asset class in its RFM, resulting in net capex being overestimated.

¹² TasNetworks, *Response to information request #043 revised proposal modelling issues (transmission)*, January 2019, p. 4.

¹³ This amount includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB.

¹⁴ Specifically, the formula adjustments were made to the 'PTRM input summary' worksheet.

requiring modification of the RFM. In response to an information request TasNetworks has agreed to this change.¹⁵

We also consider the extent to which our roll forward of the RAB to 1 July 2019 contributes to the achievement of the capital expenditure incentive objective.¹⁶ As discussed in the draft decision, the review period for this transmission determination is limited to 2015–16 and 2016–17 capex.¹⁷ Consistent with our draft decision, the requirements for an efficiency review of past capex are not satisfied.¹⁸ Accordingly, we consider the capex incurred in those years are consistent with the capital expenditure criteria and can therefore be included in the RAB—this is discussed further in attachment 5 of our draft decision.¹⁹

For the purposes of this final decision, we have included TasNetworks' actual capex for 2017–18 and estimated capex for 2018–19 in the RAB roll forward to 1 July 2019. At the next reset, the 2017–18 and 2018–19 actual capex will form part of the review period for whether past capex should be excluded for inefficiency reasons.²⁰ Our RAB roll forward applies the incentive framework approved in the previous transmission determination, which included the use of a forecast depreciation approach in combination with the application of the capital expenditure sharing scheme (CESS).²¹ As such, we consider that the 2014–19 RAB roll forward contributes to an opening RAB (as at 1 July 2019) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.²²

Table 2-1 sets out our final decision on the roll forward of TasNetworks' RAB for the 2014–19 regulatory control period.

Table 2-1 AER's final decision on TasNetworks' RAB for the 2014–19 regulatory control period (\$million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19 ^a
Opening RAB	1410.3	1407.2	1399.3	1410.9	1430.1
Capital expenditure ^b	26.0	25.5	52.3	53.6	61.9

¹⁵ TasNetworks, *Response to information request #043 revised proposal modelling issues (transmission)*, January 2019, p. 5.

¹⁶ NER, cl. 6A.14.2(b) and 6A.5A(a).

¹⁷ AER, *Draft Decision: TasNetworks transmission determination 2019–24, Attachment 2, Regulatory asset base*, September 2018, pp. 15–16; NER, cl. S6A.2.2A(a1).

¹⁸ TasNetworks' actual capex incurred in 2015–16 and 2016–17 are below the forecast allowance set at the previous transmission determination; NER, cl. S6A.2.2A(b).

¹⁹ AER, *Draft Decision: TasNetworks transmission determination 2019–24, Attachment 5, Capex*, September 2018, Appendix F.

²⁰ Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NER, cl. S6A.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.

²¹ AER, *Final decision: TasNetworks transmission determination 2015-19*, April 2015, p. 14.

²² NER, cl. 6A.5A(a), 6A.6.7(c) and 6A.14.2(b).

Inflation indexation on opening RAB	24.2	23.8	20.7	26.9	25.5
Less: straight-line depreciation ^c	53.2	57.2	61.3	61.4	62.8
Interim closing RAB	1407.2	1399.3	1410.9	1430.1	1454.7
Final year asset adjustment					-9.5 ^d
Closing RAB as at 30 June 2019					1445.3^e

Source: AER analysis.

- (a) Based on estimated capex provided by TasNetworks.
- (b) As incurred, net of disposals, and adjusted for actual CPI and half-year WACC.
- (c) Adjusted for actual CPI. Based on forecast as-commissioned capex.
- (d) This adjustment reflects the value of connection assets being removed from the RAB, reflecting the change of classification from providing prescribed services to become negotiated services.
- (e) There is no true-up required for 2013–14 capex as the approved opening RAB value of \$1410.3 million at 1 July 2014 does not include any estimated capex. This is because 2014–15 was a transitional year for TasNetworks and we were able to include the actual capex values for 2013–14 in our final decision for the 2014–19 regulatory control period.

Forecast closing RAB as at 30 June 2024

Once we have determined the opening RAB as at 1 July 2019, 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 at the end of the 2019–24 regulatory control period.²³

For this final decision, we determine a forecast closing RAB as at 30 June 2024 of \$1585.5 million for TasNetworks. This is \$28.7 million (or 1.8 per cent) lower than TasNetworks' revised proposal of \$1614.3 million (\$nominal). Our final decision on the forecast closing RAB reflects the amended opening RAB as at 1 July 2019 and our final decisions on the expected inflation rate (section 2.2 of the Overview), forecast depreciation (attachment 4) and forecast capex (attachment 5).²⁴

Table 2-2 sets out our final decision on the forecast RAB for TasNetworks over the 2019–24 regulatory control period.

Table 2-2 AER's final decision on TasNetworks' RAB for the 2019–24 regulatory control period (\$million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
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²³ NER, cl. S6A.2.4.

²⁴ 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. Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2019–24 regulatory control period (section 2.2 of the Overview).

Opening RAB	1445.3	1487.1	1522.1	1552.2	1573.4
Capital expenditure ^a	58.4	57.4	55.2	47.7	43.3
Inflation indexation on opening RAB	35.0	36.1	36.9	37.6	38.2
Less: straight-line depreciation ^b	51.6	58.5	62.1	64.1	69.3
Closing RAB	1487.1	1522.1	1552.2	1573.4	1585.5

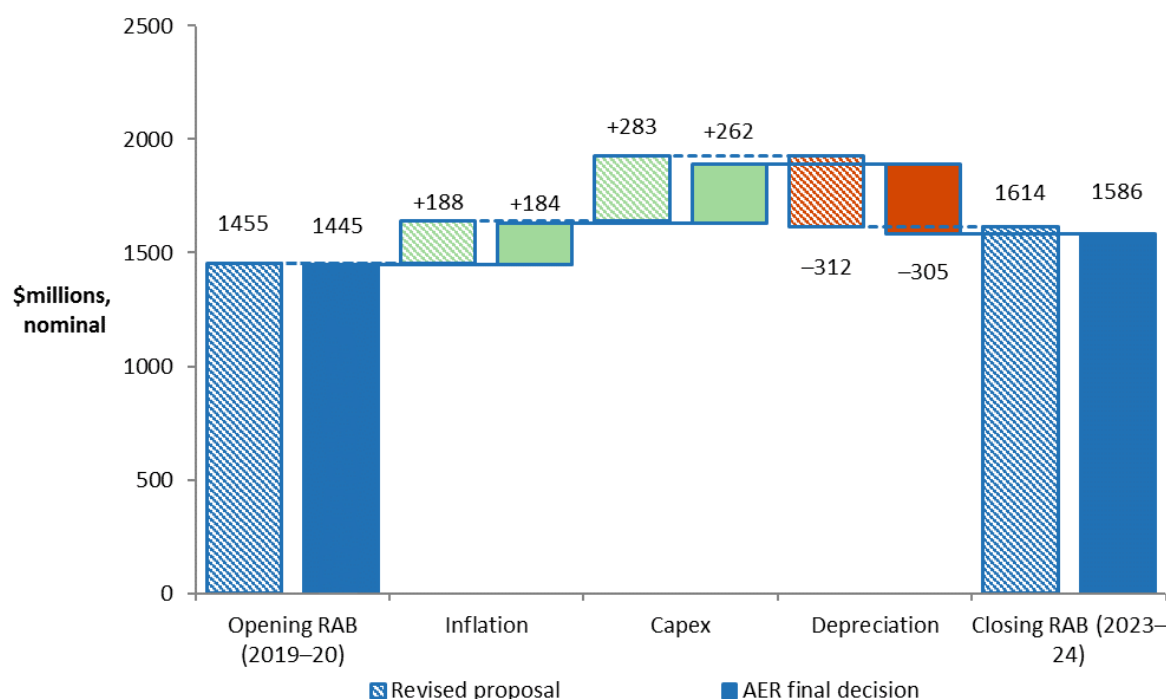
Source: AER analysis.

(a) As-incurred, and net of forecast disposals. 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.

(b) Based on as-commissioned capex.

Figure 2-1 shows the key drivers of the change in TasNetworks' RAB over the 2019–24 regulatory control period for this final decision. Overall, the closing RAB at the end of the 2019–24 regulatory control period is forecast to be 9.7 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 18.1 per cent, while expected inflation increases it by 12.7 per cent. Forecast depreciation, on the other hand, reduces the RAB by 21.1 per cent.

Figure 2-1 Key drivers of changes in the RAB—TasNetworks' revised proposal compared with AER's final decision (\$million, nominal)



Source: AER analysis.

Forecast net capex is a significant driver of the increase in the RAB. In our final decision, we are not satisfied that TasNetworks' revised proposed total forecast capex of \$260.4 million (\$2018–19)²⁵ for the 2019–24 regulatory control period reasonably reflects the capex criteria. We have therefore determined a total forecast capex of \$241.4 million (\$2018–19) for the 2019–24 regulatory control period. Refer to attachment 5 for the discussion on forecast capex.

Application of depreciation approach in RAB roll forward for next reset

When we roll forward TasNetworks' RAB for the 2019–24 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 2024–29 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2019–24 regulatory control period.²⁶

As discussed in attachment 9, we will also apply the CESS to TasNetworks over the 2019–24 regulatory control period. We consider that the CESS will provide sufficient incentives for TasNetworks 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 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.

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

²⁶ NER, cl. 6A.14.1(5F).

²⁷ Our ex post capex measures are set out in the capex incentives 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 – Attachment 2 – Regulatory asset base*, September 2018, pp. 18–19; AER, *Final framework and approach for TasNetworks distribution and transmission*, July 2017, p. 71.