FINAL DECISION

TasNetworks
Distribution Determination
2019 to 2024

Attachment 4
Regulatory depreciation

April 2019

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on TasNetworks' 2019–24 distribution determination. 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 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

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Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment B – Negotiating framework

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CPI	consumer price index
NEM	national electricity market
NER	national electricity rules
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
WACC	weighted average cost of capital

4 Regulatory depreciation

Depreciation is the allowance 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 TasNetworks, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for TasNetworks' 2019–24 regulatory control period.[1] The regulatory depreciation allowance is the net total of the straight-line depreciation less the indexation of the RAB.

This attachment sets out our final decision on TasNetworks' regulatory depreciation allowance, including an assessment of the proposed asset lives used for forecasting depreciation.

4.1 Final decision

Our final decision is to determine a regulatory depreciation allowance of $341.5 million ($nominal) for TasNetworks over the 2019–24 regulatory control period. This amount represents a reduction of $5.3 million (or 1.5 per cent) on the $346.8 million ($nominal) in TasNetworks' revised proposal.[2] It represents a slight decrease to the regulatory depreciation allowance in our draft decision. In coming to this decision:

- we accept TasNetworks' revised proposed straight-line method to calculate the regulatory depreciation, which is consistent with our draft decision.
- we accept TasNetworks' revised proposed asset classes and standard asset lives, subject to a change arising from the tax review (attachment 7). Further, we have changed the standard asset life for the 'Equity raising costs' asset class to 34.0 years.
- we accept TasNetworks' revised proposal to apply the year-by-year tracking approach for depreciating its existing assets, consistent with our draft decision. In accepting this approach, we have made minor adjustments to the year-by-year tracking depreciation model to correct for a minor modelling issue. We have also updated the year-by-year tracking calculations with actual CPI for 2018–19.
- we made determinations on other components of TasNetworks' revised proposal, which affects the RAB and in turn impacts the forecast regulatory depreciation allowance. The decrease to the regulatory depreciation allowance from the revised proposal reflects our adjustments to:
    - the opening RAB as at 1 July 2019 (attachment 2)
    - expected inflation rate (section 2.2 of the Overview)

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1 NER, cll. 6.12.1, 6.4.3.

2 TasNetworks, *Revised Tasmanian Transmission Revenue and Distribution Regulatory Proposals 2019-24, Post Tax Revenue Model Standard Control Distribution*, November 2018.

- forecast capital expenditure (attachment 5) and its effect on the projected RAB over the 2019–24 regulatory control period.[3]

Table 4-1 sets out our final decision on the forecast regulatory depreciation allowance for TasNetworks over the 2019–24 regulatory control period.

Table 4-1 AER's final decision on TasNetworks' forecast regulatory depreciation for the 2019–24 regulatory control period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Straight-line depreciation	100.0	107.8	116.3	122.3	128.7	575.2
Less: inflation indexation on opening RAB	42.9	45.1	47.0	48.5	50.1	233.7
Regulatory depreciation	**57.1**	**62.7**	**69.3**	**73.8**	**78.6**	**341.5**

Source: AER analysis.

Year-by-year tracking approach

For this final decision, we accept TasNetworks' revised proposal to use the year-by-year tracking approach to calculate the forecast straight-line depreciation amounts for its asset values as at 1 July 2019. This is consistent with TasNetworks' initial proposal and our draft decision.

Our draft decision required an adjustment to the depreciation model to ensure that any small residual asset values as at 1 July 2019 are fully depreciated. TasNetworks' revised proposal has adopted all our draft decision changes, and made updates to 2017–18 and 2018–19 capex.[4]

In accepting TasNetworks' revised proposal, however, we have made a further adjustment to the depreciation model to address an issue with the timing of 2016–17 actual capex for depreciation purposes. This is to ensure that the NPV of future depreciation better aligns with the opening RAB as at 1 July 2019 as calculated in the RFM. In response to an information request seeking its comments on this adjustment, TasNetworks did not raise any concerns with our approach.[5]

We have also updated TasNetworks' year-by-year tracking calculations for the following:

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[3] 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. Our final decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2019–24 regulatory control period.

[4] TasNetworks, *Revised Tasmanian Transmission Revenue and Distribution Regulatory Proposals 2019-24,* November 2018, p. 86.

[5] TasNetworks, *Response to information request #043 - Revised proposal modelling issues,* January 2019 pp. 6–7; TasNetworks, *Response to information request #051 - Distribution tracking model*, March 2019.

- actual CPI for 2018–19, which became available after TasNetworks submitted its revised proposal
- 2017–18 and 2018–19 capex in line with the adjustments we have made to the RAB roll forward in the RFM (attachment 2).

Standard asset lives for 2019–24

For this final decision, we accept TasNetworks' revised proposed standard asset lives for its asset classes in respect of the forecast capex to be incurred for the 2019–24 regulatory control period subject to a change arising from the tax review (attachment 7). Further, we have changed the standard asset life for the 'Equity raising costs' asset class to 34.0 years from 40.6 years.

The tax change relates to different methods of calculation of tax depreciation for different asset classes, which resulted in the addition of a new 'Buildings' asset class to the PTRM and a reallocation of forecast capex from the existing 'Non-system property' asset class. However, this change does not impact the regulatory depreciation allowance because we assign the same standard asset life as the class for which the forecast capex was originally allocated. Specifically, we have assigned a standard asset life of 40 years for the 'Buildings' asset class which is consistent with the 'Non-system property' asset class from which the forecast capex was reallocated. In response to an information request, TasNetworks stated that it has no concerns with this approach.[6]

In the draft decision, we accepted TasNetworks' proposed method of calculating the standard asset life for the 'Equity raising costs' asset class by using the weighted average (by opening RAB) of the standard asset lives for all depreciable assets in the PTRM. TasNetworks' revised proposal adopted our draft decision approach on this standard asset life.

However, for our final decision we have further reviewed this weighted average approach to calculate the standard asset life for equity raising costs. We consider the equity raising costs asset life should 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.[7] This results in the standard asset life for this asset class applying for TasNetworks' 2019–24 regulatory control period being revised to 34.0 years. In response to an information request from us, TasNetworks did not raise any concerns with the change to the standard asset life for equity raising costs.[8] We note the standard asset life for the 'Equity raising costs' asset class needs to be reviewed each regulatory control period and updated where appropriate.

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6 TasNetworks, *Response to AER email: Implementation of the tax review - TasNetworks*, 15 March 2019.

7 For this reason, we used forecast net capex instead of the opening RAB as the weights to establish the weighted average standard asset life for amortising equity raising costs. See AER, *Draft Decision: Essential Energy Determination 2019-24, Attachment 4 - regulatory depreciation,* September 2018, p. 12.

8 TasNetworks, *Response to information request #043 - Revised proposal modelling issues,* January 2019, p. 5.

Table 4-2 sets out our final decision on the standard asset lives for TasNetworks over the 2019–24 regulatory control period. We are satisfied the approved 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 would be equivalent to the value at which the assets were first included in the RAB for TasNetworks.[9]

Table 4-2 AER's final decision on TasNetworks' standard asset lives for the 2019–24 regulatory control period (years)

Asset class	Standard asset life
Overhead subtransmission lines (urban)	50.0
Underground subtransmission lines (urban)	60.0
Urban zone substations	40.0
Rural zone substations	40.0
SCADA	10.0
Distribution switching stations (ground)	40.0
Overhead high voltage lines urban	35.0
Overhead high voltage lines rural	35.0
Voltage regulators on distribution feeders	40.0
Underground high voltage lines	60.0
Underground high voltage lines SWER	60.0
Distribution substations HV (pole)	40.0
Distribution substations HV (ground)	40.0
Distribution substations LV (pole)	40.0
Distribution substations LV (ground)	40.0
Overhead low voltage lines underbuilt urban	35.0
Overhead low voltage lines underbuilt rural	35.0
Overhead low voltage lines urban	35.0
Overhead low voltage lines rural	35.0
Underground low voltage lines	60.0
Underground low voltage common trench	60.0
HVST service connections	40.0

9 NER, cll. 6.5.5(b)(1)-(2).

HV service connections	40.0
HV metering CA service connections	40.0
HV/LV service connections	40.0
Business LV service connections	35.0
Business LV metering CA service connections	25.0
Domestic LV service connections	35.0
Domestic LV metering CA service connections	20.0
Emergency network spares	n/a
Motor vehicles	6.0
Minor assets	5.0
Non-system property	40.0
Spare parts	n/a
NEM assets	5.0
Business management systems	10.0
Land	n/a
Easements	n/a
Buildings	40.0
Equity raising costs	34.0

Source: AER analysis.

n/a not applicable. We have not assigned a standard asset life to some asset classes because the assets allocated to those asset classes are not subject to depreciation.

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, *TasNetworks 2019–24 - Distribution - Draft decision - Attachment 4 - Regulatory depreciation*, September 2018, pp. 9–12.