



FINAL DECISION

TasNetworks

Transmission Determination

2019 to 2024

Attachment 4

Regulatory depreciation

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
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

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 \$121.7 (\$nominal) for TasNetworks over the 2019–2014 regulatory control period. This amount represents a reduction of \$2.5 million (or 2.0 per cent) on the \$124.2 million (\$nominal) in TasNetworks' revised proposal. It represents a slight decrease in 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.
- we accept TasNetworks' revised proposed asset classes and standard asset lives, subject to a change arising from the tax review (attachment 7). However, we did not retain the proposed new 'Business management systems' asset class and the associated standard asset life of 10 years. We consider our decision on TasNetworks' standard asset lives would lead to a depreciation schedule that reflects the nature of the assets over their economic lives.²
- 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)

¹ NER, cl. 6A.5.4 and 6A.14.1.

² NER, cl. 6A.6.3(b)(1).

- expected inflation rate (section 2.2 of the Overview)
- 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	51.6	58.5	62.1	64.1	69.3	305.5
Less: inflation indexation on opening RAB	35.0	36.1	36.9	37.6	38.2	183.8
Regulatory depreciation	16.5	22.4	25.2	26.4	31.1	121.7

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.⁴ TasNetworks' revised proposal has adopted all our draft decision changes, and made updates to 2017–18 and 2018–19 capex.⁵

TasNetworks' revised proposal included adjustments to the year-by-year tracking depreciation model to remove future depreciation associated with assets that are being removed from the RAB.⁶ We accept TasNetworks' proposal to remove the forecast depreciation associated with these assets from the tracking depreciation model. However, we consider an amendment is required in the model to properly account for the removal of the forecast depreciation associated with these assets. TasNetworks' revised proposal used the standard life of the removed assets in deriving the future

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 AER, *TasNetworks 2019–24 - Transmission - Draft decision - Attachment 4 - Regulatory depreciation*, September 2018, pp. 13–14.

⁵ TasNetworks, *Revised Tasmanian Transmission Revenue and Distribution Regulatory Proposals 2019-24*, November 2018, p. 86.

⁶ These assets are changing classification from providing prescribed transmission services to negotiated services. TasNetworks, *Tasmanian Transmission and Distribution Revised Proposals 2019–24*, November 2018, p. 82.

depreciation schedule of these assets. Instead, we determine that the remaining asset lives of the removed assets should be used. In response to an information request, TasNetworks provided the remaining lives of the removed assets,⁷ and has indicated that it has no issues with our approach.⁸

We have also updated TasNetworks' year-by-year tracking calculations with actual CPI for 2018–19, which became available after TasNetworks submitted its revised proposal.

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 forecast capex for the 2019–24 regulatory control period subject to a change arising from the tax review (attachment 7). However, consistent with our draft decision, we did not retain the proposed new asset class for 'Business management systems' and the associated standard asset life of 10 years assigned for this asset class in the PTRM.

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 'Other – medium life (40)' 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 that is consistent with the 'Other – medium life (40)' 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.⁹

In the draft decision, we accepted the majority of TasNetworks' proposed standard asset lives. However, we did not retain TasNetworks' proposed new asset class for 'Business Management Systems' and the associated standard asset life of 10 years in the PTRM. This was because TasNetworks had not proposed any forecast capex allocated to this asset class during the 2019–24 regulatory control period. As a result, we were not required to assess the proposed standard asset life for this asset class for depreciation purposes. TasNetworks' revised proposal PTRM still contained this asset class, which had no allocation for forecast capex in the 2019–24 regulatory control. We therefore maintain our approach from the draft decision of removing this asset class from the PTRM. TasNetworks agreed with this amendment in its response to our information request on this matter.¹⁰

⁷ TasNetworks, *Response to information request #043, Revised proposal modelling issues (transmission)*, 24 January 2019, p. 5.

⁸ TasNetworks, *Response to information request #049, Revised proposal depreciation tracking model*, 21 February 2019, p. 4.

⁹ TasNetworks, *Response to AER email: Implementation of the tax review - TasNetworks*, 15 March 2019.

¹⁰ TasNetworks, *Response to information request – Transmission RFM, PTRM & depreciation models*, January 2019.

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.¹¹

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
Transmission line assets – long life (60)	60.0
Transmission line assets – medium life (45)	45.0
Transmission line assets – short life (10)	10.0
Substation assets – long life (60)	60.0
Substation assets – medium life (45)	45.0
Substation assets – short life (15)	15.0
Protection and control – short life (15)	15.0
Protection and control – short life (4)	4.0
Transmission operations – short life (10)	10.0
Transmission operations – short life (4)	4.0
Other – medium life (40)	40.0
Other – short life (9)	9.0
Other – short life (4)	4.0
Land and easements ^a	n/a
Communication assets – long life (45)	45.0
Communication assets – medium life (10)	10.0
Communication assets – short life (5)	5.0
Buildings	40.0
Equity raising costs ^b	n/a

Source: AER analysis; TasNetworks, *Post Tax Revenue Model (PTRM) Transmission*, 31 January 2019.

n/a not applicable.

(a) We have not assigned a standard asset life to this asset class because the assets allocated to it are not subject to depreciation.

¹¹ NER, cl. 6A.6.3(b)(1)-(2).

- (b) For this final decision, TasNetworks does not satisfy the requirements to incur benchmark equity raising costs associated with its forecast capex for the 2019–24 regulatory control period. Therefore, a standard asset life for equity raising costs is not required for the 2019–24 period.

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.¹²

¹² AER, *TasNetworks 2019–24 - Transmission - Draft decision - Attachment 4 - Regulatory depreciation*, September 2018, pp. 8–12.