



FINAL DECISION
ActewAGL Distribution
Access Arrangement
2016 to 2021

Attachment 2 – Capital base

May 2016

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Note

This attachment forms part of the AER's final decision on the access arrangement for ActewAGL Distribution for 2016–21. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Services covered by the access arrangement

Attachment 2 - Capital base

Attachment 3 - Rate of return

Attachment 4 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency carryover mechanism

Attachment 10 - Reference tariff setting

Attachment 11 - Reference tariff variation mechanism

Attachment 12 - Non-tariff components

Attachment 13 - Demand

Contents

Note	2-2
Contents	2-3
Shortened forms	2-4
2 Capital base	2-6
2.1 Final decision	2-6
2.2 ActewAGL’s revised proposal	2-7
2.3 AER’s assessment approach	2-9
2.4 Reasons for final decision	2-9
2.4.1 Roll forward of capital base during the 2010–15 access arrangement period	2-10
Conforming capital expenditure in the 2010–15 access arrangement period	2-10
2.4.2 Projected capital base over 2015–16 and the 2016–21 access arrangement period	2-11
2.4.3 Capital base at the commencement of the 2021–26 access arrangement period	2-11

Shortened forms

Shortened form	Extended form
AA	Access Arrangement
AAI	Access Arrangement Information
AER	Australian Energy Regulator
ASA	Asset Services Agreement
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
CMF	construction management fee
CPI	consumer price index
DAMS	Distribution Asset Management Services
DRP	debt risk premium
EBSS	Efficiency Benefit Sharing Scheme
ECM	Efficiency Carryover Mechanism
EIL	Energy Industry Levy
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	value of imputation credits
GSL	Guaranteed Service Level
GTA	Gas Transport Services Agreement
ICRC	Independent Competition and Regulatory Commission
MRP	market risk premium
NECF	National Energy Customer Framework
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NPV	net present value
opex	operating expenditure

Shortened form	Extended form
PFP	partial factor productivity
PPI	partial performance indicators
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RoLR	retailer of last resort
RSA	Reference Service Agreement
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STTM	Short Term Trading Market
TAB	tax asset base
UAFG	unaccounted for gas
UNFT	Utilities Network Facilities Tax
WACC	weighted average cost of capital
WPI	Wage Price Index

2 Capital base

The capital base roll forward accounts for the value of ActewAGL's regulated assets over the access arrangement period. The opening capital base value for a regulatory year within the access arrangement period is rolled forward by indexing it for inflation, adding any conforming capex, and subtracting depreciation and other possible factors (for example, disposals or customer contributions).¹ Following this process, the AER arrives at a closing value of the capital base at the end of the relevant year. The opening value of the capital base is used to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

As discussed in the overview, our final decision applies a reconciliation (or 'true-up') of ActewAGL's revenue for the 2015–16 interval of delay. Consequently, we must make a decision on ActewAGL's opening capital base as at 1 July 2015. We must also make a decision on ActewAGL's projected capital base during 2015–16 and the 2016–21 access arrangement period. This attachment presents our final decision on these matters.

2.1 Final decision

We determine an opening capital base of \$338.4 million (\$nominal) as at 1 July 2015 for ActewAGL. This value is \$0.3 million (or 0.1 per cent) higher than ActewAGL's revised proposed value of \$338.1 million (\$nominal).² This is because we have updated the capital base roll forward to reflect the approved conforming capex for 2014–15.

We determine a projected closing capital base of \$417.8 million (\$nominal) as at 30 June 2021. This is \$14.9 million (or 3.4 per cent) lower than ActewAGL's revised proposed value of \$432.7 million (\$nominal).³ Our final decision on the closing capital base reflects our adjustments to the revised opening capital based as at 1 July 2015 (section 2.4.1), forecast inflation (attachment 3), forecast depreciation (attachment 5) and forecast net capex (attachment 6).

Table 2.1 summarises our final decision on the roll forward of ActewAGL's capital base during the 2010–15 access arrangement period.

We have revised the access arrangement having regard to our reasons for refusing to approve ActewAGL's proposal and the further matters identified in the NGR section 64(2). Our revisions are reflected in the *Approved Access Arrangement for ACT*,

¹ The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

² ActewAGL Distribution, *Access arrangement information for the ACT Queanbeyan and Palerang access arrangement—Revised in response to the AER's draft decision*, 6 January 2016, p. 10.

³ ActewAGL Distribution, *Access arrangement information for the ACT Queanbeyan and Palerang access arrangement—Revised in response to the AER's draft decision*, 6 January 2016, p. 10.

Queanbeyan and Palerang gas distribution network 2016–2021, which gives effect to this decision.

Table 2.1 AER’s final decision on ActewAGL’s capital base roll forward for 2010–15 access arrangement period (\$million, nominal)

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening capital base	278.1	288.6	302.2	313.8	326.9
Net capex	12.0	15.0	18.7	18.6	24.6
Indexation of capital base	7.9	9.8	5.3	7.7	8.1
Depreciation	–9.4	–11.2	–12.5	–13.2	–13.7
Closing capital base	288.6	302.2	313.8	326.9	345.9
Adjustment for difference between estimated and actual capital expenditure in 2009–10 ^a					–7.5
Opening capital base at 1 July 2015					338.4

Source: AER analysis.

(a) Comprising the difference between the actual and estimated capex for 2009–10 and the return on that difference.

Table 2.2 sets out the projected roll forward of the capital base during 2015–16 and the 2016–21 access arrangement period.

Table 2.2 AER’s final decision on projected capital base roll forward for 2015–16 and the 2016–21 access arrangement period (\$million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21
Opening capital base	338.4	365.3	378.7	391.1	402.7	409.9
Net capex	31.4	18.8	18.6	18.5	15.0	16.6
Indexation of capital base	7.4	8.0	8.3	8.5	8.8	8.9
Depreciation	–11.8	–13.4	–14.4	–15.5	–16.6	–17.6
Closing capital base	365.3	378.7	391.1	402.7	409.9	417.8

Source: AER analysis.

2.2 ActewAGL’s revised proposal

ActewAGL's revised proposal submitted an opening capital base as at 1 July 2015 of \$338.1 million (\$nominal). ActewAGL adopted our draft decision to reverse the adjustment it made to the opening capital base as at 1 July 2015 for the ‘IT systems’

asset class. ActewAGL also updated its capital base roll forward for 2014–15 actual capex and corrected an error in its RFM for the reported allocation of actual capex between the 'contract meters' and 'tariff meters' asset classes.⁴ ActewAGL's revised proposed capital base roll forward during the 2010–15 access arrangement period is shown in Table 2.3.

Table 2.3 ActewAGL's revised proposed capital base roll forward during the 2010–15 access arrangement period (\$million, nominal)

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening capital base	278.1	288.6	302.2	313.8	326.9
Net capex	12.0	15.0	18.7	18.6	24.3
Indexation of capital base	7.9	9.8	5.3	7.7	8.1
Depreciation	–9.4	–11.2	–12.5	–13.2	–13.7
Closing capital base	288.6	302.2	313.8	326.9	346.0
Adjustment for 2009–10 capex ^a					–7.5
Opening capital base at 1 July 2015					338.1

Source: ActewAGL, *Revised proposed RFM*, January 2016; AER analysis.

(a) Comprising the difference between the actual and estimated capex for 2009–10 and the return on that difference.

ActewAGL did not adopt our draft decision on the projected closing capital base as at 30 June 2021. Instead, ActewAGL's revised proposal submitted a projected closing capital base of \$432.7 million (\$nominal). This value reflects its revised proposed opening capital base at 1 July 2015, forecast capex, forecast depreciation and forecast inflation over 2015–16 and the 2016–21 access arrangement period. The projected roll forward of the capital base during 2015–16 and the 2016–21 access arrangement period is shown in Table 2.4.

⁴ ActewAGL Distribution, *Response to the AER's draft decision: 2016–21 ACT, Queanbeyan and Palerang gas network access arrangement*, January 2016, pp. 30–31.

Table 2.4 ActewAGL's revised proposed projected capital base roll forward during 2015–16 and the 2016–21 access arrangement period (\$million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21
Opening capital base	338.1	365.5	380.1	393.9	408.2	423.0
Net capex	31.8	20.1	19.9	21.4	22.7	18.5
Indexation of capital base	7.4	8.0	8.3	8.6	8.9	9.3
Depreciation	-11.8	-13.4	-14.5	-15.6	-16.9	-18.0
Closing capital base	365.5	380.1	393.9	408.2	423.0	432.7

Source: ActewAGL, *Revised Proposed PTRM*, January 2016.

2.3 AER's assessment approach

We have not changed our assessment approach for the capital base from our draft decision. Section 2.3 of our draft decision details that approach.⁵

We received one submission from the CCP raising concerns over the rate of increase in the value of ActewAGL's capital base over the 11-year period spanning the current and previous access arrangements.⁶ The increase in ActewAGL's capital base is mostly driven by an increase in capex. We have carefully reviewed the cost drivers of ActewAGL's forecast capex in terms of prudence and efficiency. We have not accepted ActewAGL's forecast capex in its entirety and our assessment is detailed in attachment 6.

2.4 Reasons for final decision

We do not approve ActewAGL's proposed opening capital base of \$338.1 million (\$nominal) as at 1 July 2015. We determine an opening capital base of \$338.4 million (\$nominal) as at 1 July 2015 for ActewAGL. This is \$0.3 million (or 0.1 per cent) more than the revised proposed amount. This is because we have updated the capital base roll forward for the conforming capex for 2014–15.

We also do not approve ActewAGL's projected closing capital base of \$432.7 million (\$nominal) as at 30 June 2021. We instead determine a closing capital base of \$417.8 million (\$nominal) as at 30 June 2021, a reduction of \$14.9 million or 3.4 per cent from the proposed value. The main reasons for the reduction are our adjustments to ActewAGL's forecast inflation (attachment 3), forecast depreciation (attachment 5) and forecast net capex (attachment 6).

⁵ AER, *Draft decision: ActewAGL distribution access arrangement, attachment 2*, November 2015, pp. 10-11.

⁶ CCP, *Advice to AER from Consumer Challenge Panel sub-panel 8 regarding the AER Draft Decision and ActewAGL Distribution's Revised Access Arrangement 2016–21 proposal*, March 2016, p. 3.

We are satisfied each of these amendments is necessary having regard to the requirements of the NGR. The reasons for our decision are discussed below.

2.4.1 Roll forward of capital base during the 2010–15 access arrangement period

We determine ActewAGL's opening capital base as at 1 July 2015 to be \$338.4 million (\$nominal). This amount is \$0.3 million (or 0.1 per cent) more than ActewAGL's revised proposed value of \$338.1. This is because we have updated the capital base roll forward for the conforming capex for 2014–15.

In our draft decision, we did not approve ActewAGL's proposed exclusion of its over-depreciated IT systems capital base value (resulting in a negative value for the 'IT systems' asset class) from the opening capital base. ActewAGL has adopted our draft decision on this issue in its revised proposal.⁷

We note that ActewAGL's revised proposal has corrected an error in its RFM for the reported allocation of actual capex between the 'contract meters' and 'tariff meters' asset classes.⁸ We accept this correction as it does not change the value of the opening capital base.

Conforming capital expenditure in the 2010–15 access arrangement period

In determining the opening capital base as at 1 July 2015, we assessed whether ActewAGL's proposed capex amounts for the 2010–15 access arrangement are properly accounted for in the capital base roll forward. Our assessment of ActewAGL's conforming capex (net of customer contributions) for the 2010–15 access arrangement period is set out in the capex attachment 6.

For this final decision, we updated ActewAGL's revised proposed capex for 2014–15. This is because ActewAGL has further revised the actual capex 2014–15 after the submission of the revised proposal. As shown in attachment 6, we have accepted the updated actual capex 2014–15 as conforming capex. Our final decisions on ActewAGL's capital base roll forward for the 2010–15 access arrangement period reflects the conforming capex for 2014–15 which is consistent with the requirements of the NGR.⁹

⁷ ActewAGL Distribution, *Response to the AER's draft decision–2016-21 ACT, Queanbeyan and Palerang gas network access arrangement*, January 2016, p. 30.

⁸ ActewAGL Distribution, *Response to the AER's draft decision–2016-21 ACT, Queanbeyan and Palerang gas network access arrangement*, January 2016, p. 31.

⁹ NGR, r. 77(2)(b).

2.4.2 Projected capital base over 2015–16 and the 2016–21 access arrangement period

We do not approve ActewAGL's projected capital base as at 30 June 2021 in its revised proposal. Instead, we forecast ActewAGL's projected capital base at 30 June 2021 to be \$417.8 million (\$nominal), a reduction of \$14.9 million or 3.4 per cent from ActewAGL's revised proposal. This results from our final decision on the inputs to the determination of the projected capital base. We have amended the inputs in the following ways:

- reduced ActewAGL's revised proposed forecast inflation to 2.18 per cent per annum for 2015–16 and the 2016–21 access arrangement period from 2.19 per cent per annum. Our assessment of ActewAGL's revised proposed forecast inflation is set out in attachment 3.
- reduced ActewAGL's revised proposed forecast straight-line depreciation over 2015–16 and the 2016–21 access arrangement period by \$0.9 million (\$nominal) or 1.0 per cent. Our assessment of the revised proposed forecast depreciation is set out in attachment 5.
- reduced ActewAGL's revised proposed forecast net capex over 2015–16 and the 2016–21 access arrangement period by \$15.4 million (\$nominal) or 11.5 per cent. Our assessment of the revised proposed forecast capex is set out in attachment 6.

2.4.3 Capital base at the commencement of the 2021–26 access arrangement period

The capital base at the commencement of the 2021–26 access arrangement period will be subject to adjustments consistent with the NGR.¹⁰ The adjustments for ActewAGL include (but are not limited to) actual inflation and approved depreciation over 2015–16 and the 2016–21 access arrangement period.¹¹

We note ActewAGL's revised proposal adopted our draft decision on the use of forecast depreciation (as approved in this final decision for 2015–16 and the 2016–21 access arrangement period) for establishing the opening capital base at 1 July 2021.¹² This approach is consistent with the approach outlined in the AER's *Access arrangement guideline*.¹³ We therefore maintain our draft decision position on this issue for this final decision.

¹⁰ NGR, r. 77(2).

¹¹ For this final decision we have included the actual capex for the last year of the 2010–15 access arrangement period (2014–15). Therefore, there is no need to make a true-up adjustment for 2014–15 capex at the next access arrangement review.

¹² ActewAGL Distribution, *Response to the AER's draft decision, 2016–21 ACT, Queanbeyan and Palerang gas network access arrangement*, January 2016, p. 30.

¹³ AER, *Final access arrangement guideline*, March 2009, pp. 61–62.