FINAL DECISION
ActewAGL Distribution Access Arrangement 2016 to 2021

Attachment 5 – Regulatory depreciation

May 2016

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

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

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

5 Regulatory depreciation

When determining the total revenue for ActewAGL, we must decide on the depreciation for the projected capital base (otherwise referred to as 'return of capital').[1] Regulatory depreciation is used to model the nominal asset values over the 2016–21 access arrangement period and the depreciation allowance in the total revenue requirement.[2] As discussed in the overview, this final decision includes a reconciliation (or 'true-up') of ActewAGL's revenue for the 2015–16 interval of delay. Consequently, we must also determine a regulatory depreciation allowance for 2015–16.

This attachment outlines our final decision on ActewAGL's annual regulatory depreciation allowance for 2015–16 and the 2016–21 access arrangement period. Our consideration of specific matters that affect the estimate of regulatory depreciation is also outlined in this attachment. These include:

- the standard asset lives for depreciating new assets associated with forecast capex[3]
- the remaining asset lives for depreciating existing assets in the opening capital base.[4]

5.1 Final decision

Consistent with our draft decision, we approve ActewAGL's revised proposal to use the straight-line method to calculate the regulatory depreciation allowance. However, we do not approve ActewAGL's revised proposed regulatory depreciation allowance of $39.6 million ($nominal) for 2015–16 and the 2016–21 access arrangement period.[5] This is mainly because of our amendments to other components of ActewAGL's revised proposal. Discussed in other attachments, these determinations include the forecast inflation (attachment 3) and the forecast capex (attachment 6). We determine a regulatory depreciation allowance of $39.4 million ($nominal) for 2015–16 and the 2016–21 access arrangement period. This is $0.3 million (or 0.6 per cent) lower than ActewAGL's revised proposed amount.

Consistent with our draft decision, we accept ActewAGL's weighted average method to calculate the remaining asset lives as at 1 July 2015. In accepting the weighted

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1 NGR, r. 76(b).

2 Regulatory depreciation allowance is the net total of the straight-line depreciation (negative) and the annual inflation indexation (positive) on the projected capital base.

3 The term 'standard asset life' is also referred to as 'standard economic life', 'asset life', 'economic asset life' or (in ActewAGL's revised proposal) 'standard life'.

4 The term 'remaining asset life' is also referred to as 'remaining economic life' or (in ActewAGL's revised proposal) 'remaining life'.

5 This reflects the total of the depreciation allowance for 2015–16 and the 2016–21 access arrangement period. The revised proposed regulatory depreciation allowance is $4.4 million ($nominal) for 2015–16 and $35.2 million ($nominal) for the 2016–21 access arrangement period.

average method, we have updated ActewAGL's revised proposed remaining asset lives as at 1 July 2015 to reflect the amended capital base roll forward for the 2010–15 access arrangement period (attachment 2). Also, we accept ActewAGL's standard asset lives assigned to each of its asset classes for 2015–16 and the 2016–21 access arrangement period, which are consistent with the draft decision.

Table 5.1 sets out our final decision on ActewAGL's regulatory depreciation allowance for 2015–16 and the 2016–21 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, Queanbeyan and Palerang gas distribution network 2016–2021*, which gives effect to this decision.

Table 5.1 AER's final decision on ActewAGL's regulatory depreciation allowance for 2015–16 and the 2016–21 access arrangement period ($million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21	Total
Straight-line depreciation	11.8	13.4	14.4	15.5	16.6	17.6	89.2
Less: indexation on capital base	7.4	8.0	8.3	8.5	8.8	8.9	49.9
Regulatory depreciation	**4.4**	**5.4**	**6.2**	**6.9**	**7.8**	**8.7**	**39.4**

Source: AER analysis.

5.2 ActewAGL's revised proposal

ActewAGL's revised proposal used the real straight-line approach approved in the draft decision to calculate the amount of annual regulatory depreciation for each asset class.

The inputs for the calculation are based on ActewAGL's:[6]

- revised proposed opening capital base as at 1 July 2015
- revised proposed remaining asset lives for depreciating existing assets in the opening capital base mainly due to updates made for 2014–15 conforming capex
- revised proposed capex forecasts for 2015–16 and the 2016–21 access arrangement period
- standard asset lives, consistent with those approved in the draft decision for depreciating new assets associated with forecast capex. ActewAGL's revised proposal adopted our draft decision standard asset lives.

[6] ActewAGL, *Response to the AER's draft decision - 2016–21 Queanbeyan and Palerang Gas Network Access Arrangement*, January 2016, pp. 30–31.

ActewAGL's revised proposed regulatory depreciation for 2015–16 and the 2016–21 access arrangement period is set out in Table 5.2.

Table 5.2 ActewAGL's revised proposed regulatory depreciation for 2015–16 and the 2016–21 access arrangement period ($million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21	Total
Straight-line depreciation	11.8	13.4	14.5	15.6	16.9	18.0	90.2
Less: indexation on capital base	7.4	8.0	8.3	8.6	8.9	9.3	50.6
Regulatory depreciation	**4.4**	**5.4**	**6.2**	**7.0**	**7.9**	**8.8**	**39.6**

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

Note: Numbers may not add due to rounding differences.

5.3 AER's assessment approach

We have not changed our assessment approach for regulatory depreciation from our draft decision. Section 5.3 of our draft decision details that approach.[7]

5.4 Reasons for final decision

Consistent with our draft decision, we approve ActewAGL's proposed method to calculate the regulatory depreciation allowance which is the straight-line depreciation less the annual inflation indexation on the projected capital base. However, we do not approve ActewAGL's revised proposed regulatory depreciation allowance of $39.6 million ($nominal) for 2015–16 and the 2016–21 access arrangement period. Our final decision on ActewAGL's regulatory depreciation allowance is $39.4 million ($nominal) over 2015–16 and the 2016–21 access arrangement period,[8] a reduction of $0.3 million ($nominal) or 0.6 per cent compared to the revised proposed amount. This reduction is mainly because of our determinations on other components of ActewAGL's revised proposal which affect the calculation of the regulatory depreciation allowance.[9] These include:

- a slight reduction to ActewAGL's forecast inflation for 2015–16 and the 2016–21 access arrangement period from 2.19 per cent per annum to 2.18 per cent per annum. Our assessment of the revised proposed forecast inflation is set out in the rate of return attachment 3.

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7 AER, *Draft decision: ActewAGL Distribution access arrangement 2016–21 - Attachment 5 – Regulatory depreciation,* November 2015.pp. 8-12.

8 This reflects the total of the regulatory depreciation allowance for 2015–16 and the 2016–21 access arrangement period. The final decision regulatory deprecation allowance is $4.4 million ($nominal) for 2015–16 and $35.0 million ($nominal) for the 2016–21 access arrangement period.

9 NGR, rr. 88–90.

- a reduction to ActewAGL's forecast net capex of $15.4 million ($nominal) or 11.5 per cent. Our assessment of the revised proposed forecast capex allowance is set out in capex attachment 6.

Consistent with our draft decision, we approve ActewAGL's standard asset lives assigned to each of its asset classes for 2015–16 and the 2016–21 access arrangement period. We also accept ActewAGL's proposed weighted average method to calculate the revised remaining asset lives as at 1 July 2015. However, we have updated ActewAGL's remaining asset lives as at 1 July 2015 to reflect the amended capital base roll forward for the 2010–15 access arrangement period.

In the draft decision, we rejected ActewAGL's proposal that its regulatory depreciation approach was contingent on meeting certain BBB to BBB+ credit metrics.[10] We considered that the proposed regulatory depreciation approach which we accepted allows reference tariffs to vary, over time, in a way that promotes efficient growth in the market for reference services.[11] We note ActewAGL's revised proposal adopted our draft decision and did not make further submissions on this matter.

5.4.1 Standard asset life

In accordance with our draft decision, we accept ActewAGL's proposed standard asset lives for its existing asset classes, because they are:

- consistent with our approved standard asset lives for the 2010–15 access arrangement period
- comparable with the standard asset lives approved in our recent determinations for other gas distribution service providers.[12]

In our draft decision we created a 'Land and easement' asset class for ActewAGL's forecast land capex in 2015–16 and the 2016–21 access arrangement period, which was not assigned a standard asset life as land assets do not depreciate. ActewAGL's revised proposal adopted our draft decision for this new asset class.[13]

We are satisfied the proposed standard asset lives reflect the requirements of rule 89(1) of the NGR.

Table 5.3 sets out our final decision on the standard asset lives for ActewAGL over 2015–16 and the 2016–21 access arrangement period.

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10 ActewAGL specifically mentioned the credit metric *Funds From Operations (FFO) to Debt*, which is a financial ratio used by credit rating agencies.

11 NGR, r. 89(1)(a).

12 AER, *Draft decision: Envestra (Victoria) access arrangement proposal 2013–17 Part 2: Attachments*, September 2012, p. 158; AER, *Draft decision: AusNet (SP AusNet) arrangement proposal 2013–17 Part 2: Attachments*, September 2012, p. 134; AER, *Draft decision: Multinet Gas arrangement proposal 2013–17*, September 2012, p. 126; AER, *Draft decision: Jemena Gas Network (NSW) access arrangement 2015–20: Attachment 5*, June 2015, p. 10.

13 ActewAGL, *Response to the AER's draft decision: 2016–21 Queanbeyan and Palerang Gas Network Access Arrangement*, January 2016, p. 30.

5.4.2 Remaining asset lives

Consistent with our draft decision, we accept ActewAGL's proposed weighted average method to calculate the remaining asset lives as at 1 July 2015. The revised proposed method is consistent with our preferred approach, as discussed in attachment 5 of our draft decision. In accepting the weighted average method, we have updated ActewAGL's revised proposed remaining asset lives as at 1 July 2015 to reflect the amended capital base roll forward for the 2010–15 access arrangement period (attachment 2).

In the draft decision, we noted that the remaining asset lives would be updated for the final decision because ActewAGL's revised proposal would include revisions for 2014–15 actual capex. This is because the capex is used to calculate the closing capital base as at 30 June 2015, which affects the calculation of remaining asset lives under the weighted average method. As discussed in attachment 2, we have updated ActewAGL's opening capital base at 1 July 2015 to reflect ActewAGL's updated revised actual capex for 2014–15. We also note that ActewAGL's revised proposal corrected an error in its RFM for the reported allocation of actual capex between the 'contract meters' and 'tariff meters' asset class, which causes a minor change to the remaining asset lives from the draft decision.

Table 5.3 sets out our final decision on the remaining asset lives as at 1 July 2015 for ActewAGL.

Table 5.3 AER's final decision on ActewAGL's standard and remaining asset lives as at 1 July 2015 (years)

	Standard asset life	Remaining asset life
HP mains	80	64.2
HP services	50	27.5
MP mains	50	27.3
MP services	50	37.6
TRS & DRS — valves & regulators	15	11.6
Contract meters[(a)]	15	1.0
Tariff meters	15	11.6
Regulatory costs[(a)]	5	1.0
IT system	5	5.4
Land and easement	n/a	n/a

Source: AER analysis.

(a) The remaining asset lives as at 1 July 2015 for the 'Contract meters' and 'Regulatory costs' asset classes are set to one year in order to fully depreciate the small residual capital base value for these asset classes within 2015–16 and the 2016–21 access arrangement period.

n/a Not applicable.