FINAL DECISION
Directlink transmission determination
2015−16 to 2019−20

Attachment 5 − Regulatory depreciation

April 2015

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on Directlink's revenue proposal 2015–20. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – maximum allowed revenue

Attachment 2 – regulatory asset 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 benefit sharing scheme

Attachment 10 – capital expenditure sharing scheme

Attachment 11 – service target performance incentive scheme

Attachment 12 – pricing methodology and negotiated services

Attachment 13 – pass through events

Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider

Shortened form	Extended form
NTSC	negotiated transmission service criteria
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

5 Regulatory depreciation

The AER is required to decide on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Directlink's 2015–20 regulatory control period.[1] We use regulatory depreciation to model the nominal asset values over the regulatory control period, and set the depreciation allowance in the annual building block revenue requirement. The regulatory depreciation allowance (or return of capital) is the net total of the straight-line depreciation (negative) and the indexation of the RAB (positive).

This attachment sets out our final decision on Directlink's regulatory depreciation allowance. It also presents our final decision on the revised proposed depreciation schedules, including the revised proposed standard and remaining asset lives to be used for forecasting depreciation allowances.

5.1 Final decision

We determine Directlink's regulatory depreciation allowance is $10.7 million ($ nominal) for the 2015–20 regulatory control period. This is a reduction of $0.5 million (or 5.5 per cent) from Directlink's revised proposal.

We accept Directlink's proposed depreciation method set out in its revised proposal. However, our final decision on Directlink's regulatory depreciation allowance for the 2015–20 regulatory control period differs from its revised proposal. This is because our determinations on other components of Directlink's revised proposal affect the forecast regulatory depreciation allowance—for example, the opening RAB value (attachment 2) and forecast capital expenditure (capex) (attachment 6).[2]

Table 5-1 sets out our final decision on the annual regulatory depreciation allowance for Directlink's 2015–20 regulatory control period.

Table 5-1 AER's final decision on Directlink's depreciation allowance for the 2015–20 regulatory control period ($ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Straight-line depreciation	5.0	5.4	5.6	5.8	6.1	27.7
Less: inflation indexation on opening RAB	3.3	3.4	3.4	3.4	3.5	17.1
Regulatory depreciation	**1.7**	**1.9**	**2.1**	**2.4**	**2.6**	**10.7**

Source: AER analysis.

1 NER, cl. 6A.5.4(a)(1) and (3).

2 NER, cl. 6A.6.3(a)(1).

5.2 Directlink's revised proposal

Directlink's revised proposal submitted a forecast regulatory depreciation allowance over the 2015–20 regulatory control period of $11.3 million ($ nominal). Directlink's methodology for determining its regulatory depreciation allowance is unchanged from its initial proposal. We accepted the approach in our draft decision. To calculate the depreciation allowance, Directlink's revised proposal used:[3]

- The straight-line depreciation method employed in the AER's post-tax revenue model (PTRM).
- The revised closing RAB value as at 30 June 2015 derived from the AER's roll forward model (RFM).
- The standard and remaining asset lives accepted in the draft decision for depreciating new and existing assets respectively.
- The revised proposed forecast capex for the 2015–20 regulatory control period.

Directlink's revised proposal adopted our draft decision inflation forecast used to index the RAB over the 2015–20 regulatory control period.[4]

Table 5-2 sets out Directlink's revised proposed depreciation allowance for the 2015–20 regulatory control period.

Table 5-2 Directlink's revised proposed depreciation allowance for the 2015–20 regulatory control period ($ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Straight-line depreciation	5.1	5.6	5.9	6.2	6.6	29.4
Less: inflation indexation on opening RAB	3.3	3.6	3.6	3.7	3.7	18.0
Regulatory depreciation	**1.7**	**2.0**	**2.3**	**2.5**	**2.8**	**11.3**

Source: Directlink, *Revised revenue proposal*, January 2015, p. 46.

5.3 AER's assessment approach

We did not change our assessment approach for the regulatory depreciation allowance from our draft decision. Section 5.3 of our draft decision details that approach.

5.4 Reasons for final decision

We accept Directlink's proposed depreciation method set out in its revised proposal. However, we reduced Directlink's proposed forecast regulatory depreciation allowance

3 Directlink, *Revised revenue proposal*, January 2015, p. 46

4 Directlink, *Revised revenue proposal*, January 2015, p.13

by $0.5 million (or 5.5 per cent) to $10.7 million. Our amendment is driven by our determinations on other components of Directlink's revised proposal, such as the opening RAB value (attachment 2) and forecast capex (attachment 6), which affect the forecast regulatory depreciation allowance.

5.4.1 Standard and remaining asset lives

Consistent with our draft decision, we accept Directlink's proposed standard and remaining asset lives for its 'Substations' and 'Transmission line' asset classes.

In the draft decision, we accepted Directlink's proposal to align the remaining asset life of the ‘Transmission line’ asset class with that of the ‘Substations’ asset class. This is because the transmission line will have no useful life when the substation ceases to operate. We also accepted Directlink's proposal to change its standard asset lives for depreciating new capex over the 2015–20 regulatory control period. We considered the proposed forecast capex are for 'stay in business' and ancillary equipment purposes and should have the same remaining life as the substation assets. Therefore, we were satisfied that it was reasonable to change the standard asset life of the ‘Transmission line’ asset class and 'Substations' asset class to 26 years to better reflect the expected economic life of Directlink's forecast capex.[5]

For this final decision, we are satisfied these proposed standard and remaining asset lives reflect the nature of the assets over the economic lives of the asset classes.[6]

Table 5-3 sets out our final decision on Directlink's standard and remaining asset lives for the 2015–20 regulatory control period.

Table 5-3 AER's final decision on Directlink's standard and remaining asset lives as at 1 July 2015 (years)

Asset class	Standard asset life	Remaining asset life as at 1 July 2015
Substations	26.2	26.2
Transmission line	26.2	26.2
Easements	n/a	n/a

Source: AER analysis.
n/a: Not applicable.

5 AER, *Draft decision, Directlink transmission determination 2015-16 to 2019-20, Attachment 5: Regulatory depreciation*, November 2014, p. 14.
6 NER, cl. 6A.6.3(b)(1).