



FINAL DECISION
Energex determination 2015–16
to 2019–20

Attachment 2 – Regulatory
asset base

October 2015

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Note

This attachment forms part of the AER's final decision on Energex's 2015–20 distribution determination. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

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 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanism

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

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Shortened forms

Shortened form	Extended form
ABS	Australian Bureau of Statistics
ACS	alternative control services
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for electricity distribution
F&A	framework and approach
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
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
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SCS	standard control services
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

2 Regulatory asset base

We are required to make a decision on Energex's opening regulatory asset base (RAB) as at 1 July 2015.¹ We use the RAB at the start of each regulatory year to determine the return of capital (regulatory depreciation) and return on capital building block allowances. This attachment presents our final decision on the opening RAB value as at 1 July 2015 for Energex and roll forward of the forecast RAB values over the 2015–20 regulatory control period.

2.1 Final decision

We determine an opening RAB value of \$11 172.5 million (\$ nominal) as at 1 July 2015 for Energex. Energex adopted our preliminary decision amendments in its revised proposal.² We made two changes to the preliminary decision:

1. updating 2014–15 capex with more recent estimates
2. updating the RAB roll forward with the actual inflation input for 2014–15.

For this final decision, we maintain our preliminary decision position on the use of forecast depreciation for establishing the RAB at the commencement of the regulatory control period from 1 July 2020. We note Energex's revised proposal did not discuss this issue.

Table 2.1 sets out our final decision on the roll forward of the RAB values for the 2010–15 regulatory control period.

We determine a forecast closing RAB value at 30 June 2020 of \$13 591.5 million (\$ nominal). This is \$120.5 million (or 0.9 per cent) lower than the amount of \$13 712.0 million (\$ nominal) in Energex's revised proposal. Our final decision on the forecast closing RAB reflects our adjustments to Energex's opening RAB as at 1 July 2015, forecast capex (attachment 6), and forecast regulatory depreciation (attachment 5).

Table 2.2 sets out our final decision on the forecast RAB values for Energex over the 2015–20 regulatory control period.

¹ NER, cl. 6.12.1(6).

² Energex, *Revised regulatory proposal*, July 2015, p. 75.

Table 2.1 AER's final decision on Energex's RAB for the 2010–15 regulatory control period (\$ million, nominal)

	2010–11	2011–12	2012–13	2013–14	2014–15 ^a
Opening RAB	7867.3	8856.5	9645.6	10462.1	11178.3
Capital expenditure ^b	1004.9	965.7	921.9	789.0	758.1
Inflation indexation on opening RAB	277.7	316.5	346.6	379.3	403.7
Less: straight-line depreciation	262.0	139.9	241.1	306.5	148.7
Closing RAB	8856.5	9645.6	10462.1	11178.3	11681.4
Difference between estimated and actual 2009–10 capex (1 July 2009 to 30 June 2010)					–32.7
Return on difference for 2009–10 capex					–18.8
Closing RAB as at 30 June 2015					11629.8
Assets moved to ACS and unregulated assets removed					–457.3
Opening RAB as at 1 July 2015					11172.5

Source: AER analysis.

(a): Based on revised estimated capex. We will update for actual capex at the next reset.

(b): Net of disposals and adjusted for CPI.

Table 2.2 AER's final decision on Energex's RAB for the 2015–20 regulatory control period (\$ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20
Opening RAB	11172.5	11678.7	12189.4	12650.7	13119.0
Capital expenditure ^a	578.1	595.3	558.6	572.5	590.7
Inflation indexation on opening RAB	279.3	292.0	304.7	316.3	328.0
Less: straight-line depreciation	351.2	376.6	402.0	420.4	446.2
Closing RAB	11678.7	12189.4	12650.7	13119.0	13591.5

Source: AER analysis.

(a): Net of forecast disposals and capital contributions.

2.2 Energex's revised proposal

Energex's revised proposal submitted an opening RAB value as at 1 July 2015 of \$11 333.7 million (\$ nominal), which is consistent with our preliminary decision.

Energex adopted all our preliminary decision adjustments to roll forward the opening RAB from 1 July 2010 to 30 June 2015.³

Energex's revised proposal submitted a forecast closing RAB as at 30 June 2020 of \$13 712.0 million (\$ nominal). This value reflects its revised forecast capex and forecast depreciation (based on forecast capex) over the 2015–20 regulatory control period. Energex's projected RAB over the 2015–20 regulatory control period is shown in table 2.3.

Table 2.3 Energex's revised proposed RAB for the 2015–20 regulatory control period (\$million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20
Opening RAB	11333.7	11845.7	12361.5	12825.0	13266.6
Capital expenditure ^a	583.2	599.7	561.8	548.7	564.8
Inflation indexation on opening RAB	283.3	296.1	309.0	320.6	331.7
Less: straight-line depreciation	354.4	380.1	407.4	427.7	451.1
Closing RAB	11845.7	12361.5	12825.0	13266.6	13712.0

Source: Energex, *Revised proposed PTRM*, July 2015.

(a) Net of disposals and capital contributions.

2.3 AER's assessment approach

We have not changed our assessment approach for the RAB from our preliminary decision. Section 2.3 of our preliminary decision details that approach.⁴

The CCP has raised concerns with having both the weighted average cost of capital (WACC) and RAB measured in nominal terms.⁵ It appears to question whether inflation is accounted for twice in the building block framework. This matter was addressed in our preliminary decision for Energex.⁶ Maintaining the RAB in real terms by adding inflation is required by the NER⁷ and generally helps to promote smoother prices over the life of an asset. The regulatory depreciation building block is adjusted for the inflation indexed component of the RAB so that there is no double counting of inflation. If the RAB was unindexed for inflation, the offsetting indexation adjustment applied to

³ Energex, *Revised regulatory proposal*, July 2015, p. 75.

⁴ AER, *Preliminary decision, Energex determination 2015–16 to 2019–20: Attachment 2 – Regulatory asset base*, April 2015, pp. 9–13.

⁵ CCP, Mr Bruce Mountain CCP2, *Advice on AER preliminary decisions and revised proposals from Energex, Ergon Energy and SA Power Networks*, July 2015, pp. 6–7; CCP, Mr Hugh Grant CCP2, *AER preliminary 2015–20 revenue determinations – Energex and Ergon Energy revised revenue proposals*, September 2015, pp. 2, 9–11.

⁶ AER, *Preliminary decision, Energex determination 2015–16 to 2019–20: Attachment 2 – Regulatory asset base*, April 2015, section 2.3.1.

⁷ NER, cl. 6.5.1(e)(3).

depreciation would also have to be removed. On balance, this means more depreciation would be returned to the distributor resulting in higher prices early in an asset life and lower prices later in its life.⁸ Even if allowed under the NER, moving to an unindexed RAB would lead to a price increase over the short to medium term and when new lumpy assets are added to the RAB.⁹

2.4 Reasons for final decision

We determine Energex's opening RAB value to be \$11 172.5 million (\$ nominal) as at 1 July 2015. This amount is \$161.2 million (or 1.4 per cent) lower than the opening RAB in Energex's revised proposal. This difference is due to our update of the 2014–15 inputs in the RAB roll forward for a revised estimate of capex and actual inflation.

Based on the approved opening RAB we forecast a closing RAB value of \$13 591.5 million (\$ nominal) by 30 June 2020. This represents a reduction of \$120.5 million, or 0.9 per cent compared to the revised proposal. The reasons for our decision are discussed below.

2.4.1 Opening RAB as at 1 July 2015

We determine Energex's opening RAB value as at 1 July 2015 to be \$11 172.5 million (\$ nominal). This amount is \$161.1 million (or 1.4 per cent) lower than Energex's value of \$11 333.7 million in its revised proposal. This is because we updated:

- The inflation input for 2014–15 using actual March 2015 consumer price index (CPI) published by the Australian Bureau of Statistics.¹⁰
- The capex inputs for 2014–15 using revised estimates from Energex.

In the preliminary decision, we made certain amendments to Energex's proposed roll forward of its RAB over the 2010–15 regulatory control period including corrections for input errors in remaining asset lives and adjustments for capitalised provisions and other asset classification changes. We noted the roll forward of Energex's RAB included an estimated capex value for 2014–15. We stated we would update the 2014–15 estimated capex value for the final decision.

Energex's revised proposal adopted our preliminary decision adjustments to roll forward the opening RAB from 1 July 2010 to 1 July 2015. Following an information

⁸ Such an impact would also be reflected if we were to switch methods midway through an asset's life.

⁹ The indexation of the RAB was a matter discussed extensively in the AER's final decision on APA GasNet's access arrangement. This matter also went before the Australian Competition Tribunal, who found in favour of the AER's reasoning in that final decision. See AER, *Access arrangement final decision, APA GasNet Australia (Operations) Pty Ltd, 2013–17, Part 2: Attachments*, 15 March 2013, pp.102–116.

¹⁰ The March quarter CPI is used as a proxy for the June financial year in the 2010–15 regulatory control period. As discussed in attachment 14, the December quarter CPI will be used as a proxy for the June financial year for the 2015–20 regulatory control period.

request from us, Energex provided a revised estimate of capex for 2014–15 (net of disposals).¹¹

We accept Energex's revision to the net capex estimate for 2014–15 of \$728 million.¹² This amount is lower than in the initial proposal and reflects more up-to-date data, and therefore is the best forecast available. We note that the financial impact of any difference between actual and estimated capex for 2014–15 will be accounted for at the next reset.¹³

Several submissions on the preliminary decision raised concerns with the size of Energex's opening RAB.¹⁴ The submissions suggested that there was potential for writing off some parts of the RAB. We note that the opening RAB reflects the capex incurred during the previous regulatory control periods. In the previous two regulatory control periods there was a significant increase in capex that only began to tail off in more recent years. We have no ability to adjust for past capex or to optimise/write down the opening RAB for efficiency considerations. Under the transitional rules, the review of past capex does not apply to Energex prior to 1 July 2015.¹⁵ Therefore, for the purposes of this final decision, we are required to add Energex's actual capex from the 2010–15 regulatory control period to the RAB. However, with rule changes in 2012, we will have the ability to exclude inefficient capex incurred during the 2015–20 regulatory control period in future resets if it exceeds the approved forecast and if we consider it does not reasonably reflect the capex criteria.¹⁶ The details of our assessment approach for inefficient capex are set out in the Capital Expenditure Incentive Guideline.¹⁷

2.4.2 Forecast closing RAB as at 30 June 2020

We forecast a closing RAB value of \$13 591.5 million by 30 June 2020 for Energex. This represents a reduction of \$120.5 million, or 0.9 per cent to Energex's revised proposal. This reduction reflects our final decision on the required inputs for determining the forecast RAB in the post-tax revenue model (PTRM). To determine the forecast RAB value, we have amended the PTRM inputs as a result of the following changes:

¹¹ Energex, E-mail: *AER Energex 058*, 17 July 2015.

¹² This amount is before adjusting for the half-WACC to account for the timing assumption in the PTRM.

¹³ NER, cl. S6.2.1(e)(3).

¹⁴ Alliance of Energy Consumers, *Submission to the AER's preliminary decision (Queensland)*; July 2015, p. 32; Energy Users Association of Australia, *Submission to AER draft determination and Energex's revised revenue proposal 2015 to 2020*, July 2015, p. 11; Queensland Farmers' Federation, *Submission to AER on the preliminary determination for the Ergon Energy and Energex regulatory proposals for 2015–2012*; July 2015, p. 2.

¹⁵ NER, cll. 11.60.5 and 11.62.

¹⁶ Under the NER, cl S6.2.2A(b), the exclusion of inefficient capex could only come from three areas including overspend in capex, margin paid to third party and capitalisation of opex as defined in cl S6.2.2A(c), (d) and (e) of the NER.

¹⁷ AER, *Capital expenditure Incentive guideline*, November 2013, pp. 12–20.

- We reduced Energex's revised proposed opening RAB as at 1 July 2015 by \$161.1 million or 1.4 per cent (section 2.4.1).
- We decreased Energex's revised proposed forecast capex for the 2015–20 regulatory control period by \$134.3 million (\$ 2014–15) or 4.6 per cent (attachment 6).
- We reduced Energex's revised proposed forecast regulatory depreciation for the 2015–20 regulatory control period by \$3.8 million (\$ nominal) or 0.8 per cent (attachment 5).