



**FINAL DECISION
SA Power Networks
determination 2015–16 to
2019–20**

**Attachment 2 – Regulatory
asset base**

October 2015

© Commonwealth of Australia 2015

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications, Australian Competition and Consumer Commission, GPO Box 4141, Canberra ACT 2601 or publishing.unit@acc.gov.au.

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 SA Power Networks' 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

Attachment 18 – Connection policy

Contents

Note	2-2
Contents	2-3
Shortened forms	2-4
2 Regulatory asset base.....	2-6
2.1 Final decision	2-6
2.2 SA Power Networks' revised proposal.....	2-7
2.3 AER's assessment approach.....	2-8
2.4 Reasons for final decision	2-9
2.4.1 Opening RAB as at 1 July 2015	2-9
2.4.2 Forecast closing RAB as at 30 June 2020.....	2-9

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 SA Power Networks' 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 SA Power Networks and roll forward of the forecast RAB values over the 2015–20 regulatory control period.

2.1 Final decision

We accept SA Power Networks' revised proposed opening RAB value of \$3778.4 million (\$ nominal) as at 1 July 2015 for. We had accepted in the preliminary decision the opening RAB in SA Power Networks' initial proposal, noting some updates would be required for the final decision. SA Power Networks made the following changes in its revised proposal:²

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

SA Power Networks adopted the approach in our preliminary decision on the use of forecast depreciation for establishing the RAB at the commencement of the regulatory control period from 1 July 2020.³

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 \$4882.4 million (\$ nominal). This is \$107.8 million (or 2.2 per cent) lower than the amount of \$4990.2 million (\$ nominal) in SA Power Networks' revised proposal. Our final decision on the forecast closing RAB reflects our adjustments to SA Power Networks' forecast capex (attachment 6), forecast regulatory depreciation (attachment 5) and the forecast inflation rate (attachment 3).

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

¹ NER, cl. 6.12.1(6).

² SA Power Networks, *Revised regulatory proposal*, July 2015, p. 324.

³ SA Power Networks, *Revised regulatory proposal*, July 2015, p. 324.

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

	2010–11	2011–12	2012–13	2013–14	2014–15 ^a
Opening RAB	2900.0	3096.8	3287.9	3502.0	3674.4
Capital expenditure ^b	271.0	325.7	335.2	291.3	335.4
Inflation indexation on opening RAB	96.6	48.9	82.2	102.6	48.9
Less: straight-line depreciation	170.7	183.6	203.3	221.5	242.0
Closing RAB	3096.8	3287.9	3502.0	3674.4	3816.7
Difference between estimated and actual 2009–10 capex (1 July 2009 to 30 June 2010)					–24.3
Return on difference for 2009–10 capex					–14.0
Closing RAB as at 30 June 2015					3778.4

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 SA Power Networks' RAB for the 2015–20 regulatory control period (\$ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20
Opening RAB	3778.4	4064.1	4279.3	4482.8	4680.9
Capital expenditure ^a	402.6	404.1	397.5	400.6	416.5
Inflation indexation on opening RAB	94.5	101.6	107.0	112.1	117.0
Less: straight-line depreciation	211.3	290.4	301.0	314.6	332.0
Closing RAB	4064.1	4279.3	4482.8	4680.9	4882.4

Source: AER analysis.

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

2.2 SA Power Networks' revised proposal

SA Power Networks' revised proposal submitted an opening RAB value at 1 July 2015 of \$3778.4 million (\$ nominal). SA Power Networks revised proposed opening RAB is based on that accepted in our preliminary decision, with updates for 2014–15 capex and inflation.⁴

⁴ SA Power Networks, *Revised regulatory proposal*, July 2015, p. 324.

SA Power Networks' revised proposal submitted a forecast closing RAB at 30 June 2020 of \$4990.2 million (\$ nominal). This value reflects its revised forecast capex and forecast depreciation (based on forecast capex) over the 2015–20 regulatory control period. SA Power Networks' projected RAB over the 2015–20 regulatory control period is shown in Table 2.3.

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

	2015–16	2016–17	2017–18	2018–19	2019–20
Opening RAB	3778.4	4057.5	4347.2	4598.2	4819.8
Capital expenditure ^a	436.5	471.4	459.1	455.2	429.1
Inflation indexation on opening RAB	77.8	83.6	89.6	94.7	99.3
Less: straight-line depreciation	235.2	265.3	297.6	328.3	358.0
Closing RAB	4057.5	4347.2	4598.2	4819.8	4990.2

Source: SA Power Networks, *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.⁵

The CCP has raised concerns with having both the weighted average cost of capital (WACC) and RAB measured in nominal terms.⁶ It appears to question whether inflation is accounted for twice in the building block framework. This matter was addressed in our preliminary decision for SA Power Networks.⁷ Maintaining the RAB in real terms by adding inflation is required by the NER⁸ 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 depreciation would also have to be removed. On balance, this means more depreciation would be returned to the business resulting in higher prices early in an asset life and lower prices later in its life.⁹ Even if allowed under the NER, moving to an

⁵ AER, *Preliminary decision, SA Power Networks determination 2015–16 to 2019–20: Attachment 2 – Regulatory asset base*, April 2015, pp. 2–9.

⁶ 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.

⁷ AER, *Preliminary decision, SA Power Networks determination 2015–16 to 2019–20: Attachment 2 – Regulatory asset base*, April 2015, section 2.3.1.

⁸ NER, cl. 6.5.1(e)(3).

⁹ Such an impact would also be reflected if we were to switch methods midway through an asset's life.

unindexed RAB would lead to a price increase over the short to medium term and when new lumpy assets are added to the RAB.¹⁰

2.4 Reasons for final decision

We accept SA Power Networks' revised proposed opening RAB value of \$3778.4 million (\$ nominal) at 1 July 2015. Based on the approved opening RAB we forecast a closing RAB value of \$4882.4 million (\$ nominal) by 30 June 2020. This represents a reduction of \$107.8 million, or 2.2 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 accept SA Power Networks' revised proposed opening RAB value of \$3778.4 million (\$nominal) as at 1 July 2015.

In the preliminary decision, we accepted SA Power Networks' proposed opening RAB after being satisfied that it had correctly made all relevant inputs to the roll forward model (RFM). We noted the roll forward of SA Power Networks' RAB included an estimated capex value for 2014–15. We stated we would update the 2014–15 estimated capex value for the final decision.

SA Power Networks' revised proposed opening RAB is based on that accepted in our preliminary decision, with updates for 2014–15 capex and inflation.

We accept SA Power Networks' update to the net capex estimate for 2014–15 of \$282.6 million.¹¹ 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.¹² We are satisfied that SA Power Networks' update for the 2014–15 inflation input in the RFM reflects the actual March 2015 consumer price index (CPI) published by the Australian Bureau of Statistics.¹³

2.4.2 Forecast closing RAB as at 30 June 2020

We forecast a closing RAB value of \$4882.4 million by 30 June 2020 for SA Power Networks. This represents a reduction of \$107.8 million, or 2.2 per cent to SA Power Networks' revised proposal. This reduction reflects our final decision on the required

¹⁰ 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.

¹¹ This amount is before adjusting for the half-WACC to account for the timing assumption in the PTRM.

¹² NER, cl. S6.2.1(e)(3).

¹³ 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.

inputs for determining the forecast RAB in the post-tax revenue model (PTRM). We note the submission from UnitingCare Australia on the revised proposal raised concerns with the increase to the size of SA Power Networks' RAB over the 2015–20 regulatory control period. It suggested that there is no justification for the RAB to increase significantly higher than the rate of inflation during a period of declining demand and low network utilisation.¹⁴ The change in the size of the RAB depends on our assessment of its various components. Inflation and capex increase the RAB, while depreciation reduces it. To determine the forecast RAB value, we have amended the PTRM inputs as a result of the following changes:

- We reduced SA Power Networks' revised proposed forecast capex for the 2015–20 regulatory control period by \$230.1 million (\$ nominal) or 10.2 per cent (attachment 6). As part of this, we considered the forecast network demand and utilisation rate in our assessment of forecast capex.¹⁵
- We reduced SA Power Networks' revised proposed forecast regulatory depreciation for the 2015–20 regulatory control period by \$122.2 million (\$ nominal) or 11.8 per cent (attachment 5).
- We increased SA Power Networks' revised proposed forecast inflation rate of 2.1 per cent per annum to 2.5 per cent per annum (attachment 3).

¹⁴ UnitingCare Australia, *Submission on SA Power Networks' Revised Regulatory Proposal*, 24 July 2015, pp. 20–21.

¹⁵ Please see section 6.3 of attachment 6 for more details.