FINAL DECISION

Power and Water Corporation Distribution Determination 2019 to 2024

Attachment 2 Regulatory asset base

April 2019

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Power and Water Corporation for the 2019–2024 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Return on debt transition

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

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Shortened forms

Shortened form	Extended form
ACS	alternative control services
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
NT	Northern Territory
NT NER or the rules	National Electricity Rules As in force in the Northern Territory
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
SCS	standard control services
WACC	weighted average cost of capital

2 Regulatory asset base

As part of our distribution determination, we make a decision on Power and Water's opening regulatory asset base (RAB) as at 1 July 2019 and the projected RAB value for the 2019–24 regulatory control period.[1] The RAB is the value of those assets that are used by Power and Water to provide standard control services. 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 final decision sets out that depreciation based on forecast capital expenditure is to be used for establishing the RAB as at the commencement of the 2024–29 regulatory control period.[2]

2.1 Final decision

Opening RAB as at 1 July 2019

Our final decision is to determine an opening RAB value of $962.0 million ($nominal) as at 1 July 2019 for Power and Water.[3] This amount is $5.4 million (or 0.6 per cent) lower than Power and Water's revised proposed opening RAB of $967.4 million ($nominal) as at 1 July 2019.[4] It reflects the update to the roll forward model (RFM) for 2018–19 actual CPI that is now available as well as a number of minor modelling corrections. This final decision is $4.4 million (or 0.5 per cent) lower than our draft decision value for Power and Water's opening RAB of $966.4 million ($nominal).

To determine the opening RAB as at 1 July 2019, we have rolled forward the RAB over the 2014–19 regulatory control period to determine a closing RAB value at 30 June 2019 in accordance with our RFM.[5] This roll forward includes an adjustment at the end of the 2014–19 regulatory control period to account for the difference between actual 2013–14 capex and the estimate approved by the Utilities Commission[6] in the 2014 NT network price determination.[7]

In the draft decision, we reduced Power and Water's proposed opening RAB as at 1 July 2019. In coming to that decision we:[8]

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1 NT NER, cl. 6.12.1(6).

2 NT NER, cl. 6.12.1(18).

3 This opening RAB value is for Power and Water's assets providing standard control services (SCS). We have determined an opening RAB value of $14.1 million ($nominal) as at 1 July 2019 for Power and Water's alternative control service (ACS) RAB, which is further discussed at attachment 15.

4 Power and Water, *Revised regulatory proposal 1 July 2019 to 30 June 2024,* November 2018, p. 46.

5 AER, *Electricity distribution network service providers Roll forward model (version 2)*, 15 December 2016.

6 Utilities Commission, *Part B–Network price determination*, April 2014.

7 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2014–19 determination.

8 AER, *Draft Decision Power and Water 2019–24 Determination Attachment 2: Regulatory Asset Base*, September 2018.

- accepted Power and Water's proposal to reduce the value of its opening RAB as at 1 July 2014 to $860.65 million[9] ($2013–14) from $928.34 million as determined by the Utilities Commission and set out in the NT NER (a reduction of $67.7 million).[10] This is due to an error correction to the approved RAB value in the Utilities Commission's 2014 NT network price determination for Power and Water (and subsequently set out in the NT NER).[11] Our draft decision was contingent on the NT Government correcting the value of the opening RAB in the NT NER prior to the release of our final decision in April 2019.
- accepted the proposed remapping of the asset classes, and amended the standard and remaining asset lives applying to the opening RAB at 1 July 2014 at the asset class level to better reflect the values approved by the Utilities Commission in the 2014 NT network price determination.
- updated the inflation rate inputs for 2014–15 to 2017–18 to reflect the December quarter CPI for indexation in the RAB roll forward to be consistent with the inflation rates used in the annual pricing for those years.
- applied the actual depreciation approach for the RAB roll forward instead of the forecast depreciation approach as proposed by Power and Water, consistent with the 2014 NT network price determination.
- reallocated the $19.6 million ($nominal) written down value for the roll-in of corporate assets into the RAB from the estimated capex for 2018–19 to a final year adjustment in the RFM.

In its revised proposal, Power and Water adopted our draft changes in full.[12] In addition, it has updated 2017–18 capex with actuals and revised its 2018–19 capex estimate with the latest figures. We have checked the 2017–18 actual capex in the revised proposal against the values presented in Power and Water's annual reporting RIN for that year and identified an issue. Power and Water's revised proposed RFM has recorded gross capex net of customer contributions, which has the effect of understating the gross capex for 2017–18. We have raised this issue with Power and Water and it has acknowledged this was a transposition error in its revised proposal RFM.[13] Subsequent to this, Power and Water has resubmitted its 2017–18 annual reporting RIN, removing a number of opex-related overheads that have been incorrectly allocated to capex.[14] We have reviewed the information and are satisfied with Power and Water's clarification of this issue. Therefore for this final decision, we have updated the 2017–18 actual capex in the RFM to $54.7 million ($nominal),

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9 This reduction was to correct an error in the previous SKM valuation, relied on by the Utilities Commission in its previous determination, which incorrectly included some unregulated assets in the opening RAB.

10 NT NER, cl.S6.2.3A.

11 NT NER, cl. S6.2.3A. See https://legislation.nt.gov.au/Search/~/link.aspx?_id=AB11B29F0D864A0BBB59F7A7C7E311B0&_z=z.

12 Power and Water, *Revised regulatory proposal 1 July 2019 to 30 June 2024,* November 2018, p. 45.

13 Power and Water, *Response to information request #045*, January 2019.

14 Power and Water, *Email to the AER: PWC - RIN & RFM error*, dated 5 March 2019.

reflecting the corrected value. This amount is $0.3 million (0.5 per cent) higher than the revised proposal.

Further, we accept Power and Water's revision to the 2018–19 net capex estimate of $43.6 million ($nominal).[15] This amount is lower than the draft decision reflecting more recent data. We note that the financial impact of any difference between actual and estimated capex for 2018–19 will be accounted for at the next reset. Our final decision also updates the 2018–19 inflation input in the RFM with actual CPI for this year, which became available after Power and Water submitted its revised proposal.

For this final decision, we confirm our approach to accept Power and Water’s proposal to reduce the value of its opening RAB as at 1 July 2014 to $860.65 million[16] ($2013–14) from $928.34 million as set out in the NT NER as the time of the draft decision. We have since received confirmation from the NT Government that clause S6.2.3A of the NT NER was amended on 19 December 2018 to correct the value of Power and Water’s opening RAB as at 1 July 2014.[17]

We also consider the extent to which our roll forward of the RAB to 1 July 2019 contributes to the achievement of the capital expenditure incentive objective.[18] As discussed in the draft decision, under the NT NER, the review of past capex does not apply to Power and Water for the purposes of establishing the opening RAB for the first year of the first regulatory control period.[19] Given this, the review period is not applicable for the 2014–19 regulatory control period. At the next reset, the 2019–20 to 2021–22 actual capex will form part of the review period for whether capex should be excluded from the RAB for inefficiency reasons.[20] Further, our RAB roll forward applies the incentive framework approved by the Utilities Commission in the 2014 NT network price determination, which included the use of an actual depreciation approach.[21] As such, we consider that the 2014–19 RAB roll forward contributes to an opening RAB (as at 1 July 2019) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.[22]

Table 2-1 sets out our final decision on the roll forward of the RAB values for Power and Water over the 2014–19 regulatory control period.

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15 This amount includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB.

16 This reduction was to correct an error in the previous SKM valuation, relied on by the Utilities Commission in its previous determination, which incorrectly included some unregulated assets in the opening RAB.

17 NT NER cl. S6.2.3A. See https://legislation.nt.gov.au/Search/~/link.aspx?_id=AB11B29F0D864A0BBB59F7A7C7E311B0&_z=z.

18 NT NER, cll. 6.12.2(b) and 6.4A(a).

19 AER, *Draft Decision Power and Water 2019–24 Attachment 2: Regulatory Asset Base,* September 2018, p. 11.

20 NT NER, cl. S6.2.2A(a2); Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NT NER, cl. S6.2.2A. The details of our ex post assessment approach for capex are set out in AER, *Capital expenditure incentive guideline*, November 2013, pp. 12–20.

21 Utilities Commission, *Part B–Network price determination*, April 2014, p. 12.

22 NT NER, cll. 6.4A(a), 6.5.7(c) and 6.12.2(b).

Table 2-1 AER's final decision on Power and Water's RAB for the 2014–19 regulatory control period ($million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19[a]
Opening RAB	860.6	905.0	936.0	949.7	959.0
Capital expenditure[b]	81.3	70.5	51.0	44.0	43.6
Inflation indexation on opening RAB	14.8	15.3	13.8	18.1	17.1
Less: straight-line depreciation[c]	51.8	54.8	51.1	52.9	55.3
Interim closing RAB	905.0	936.0	949.7	959.0	964.4
Difference between estimated and actual capex in 2013–14					–5.8
Return on difference for 2013–14 capex					–2.1
Roll-in of corporate assets[d]					19.6
Closing RAB as at 30 June 2019 (ACS and SCS)					976.0
Closing RAB as at 30 June 2019 (ACS only)					14.1
Closing RAB as at 30 June 2019 (SCS only)[e]					**962.0**

Source: AER analysis.

(a) Based on estimated capex provided by Power and Water.

(b) Net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.

(c) Based on actual as-incurred capex.

(d) See section 2.4.1 of the draft decision for further information on the roll-in of corporate assets to the RAB.

(e) From 1 July 2019 metering will be classified as providing ACS and therefore metering assets are to be excluded from the SCS RAB.

Forecast closing RAB as at 30 June 2024

Once we have determined the opening RAB as at 1 July 2019, we roll forward that RAB by adding forecast capex and inflation, and reducing the RAB by depreciation to arrive at a forecast closing value for the RAB at the end of the 2019–24 regulatory control period.[23]

For this final decision, we determine a forecast closing RAB as at 30 June 2024 of $1194.0 million ($nominal) for Power and Water. This is $7.8 million (or 0.6 per cent) lower than Power and Water's revised proposal of $1201.7 million ($nominal). Our final decision on the forecast closing RAB reflects the amended opening RAB as at 1 July 2019 and our final decision on the forecast depreciation (attachment 4).[24]

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[23] NT NER, cl. S6.2.3.

[24] Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. We have accepted Power and Water's revised proposed forecast capex for the 2019–24 regulatory control period (section 2.4 of the

Table 2-2 sets out our final decision on the forecast RAB for Power and Water over the 2019–24 regulatory control period.

Table 2-2 AER's final decision on Power and Water's RAB for the 2019–24 regulatory control period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	962.0	1033.5	1082.8	1141.6	1170.3
Capital expenditure[a]	90.0	72.8	85.5	59.7	57.9
Inflation indexation on opening RAB	23.3	25.1	26.3	27.7	28.4
Less: straight-line depreciation	41.8	48.6	52.9	58.7	62.6
Closing RAB	1033.5	1082.8	1141.6	1170.3	1194.0

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling.

Figure 2-1 shows the key drivers of the change in Power and Water's RAB over the 2019–24 regulatory control period for this final decision. Overall the closing RAB at the end of the 2019–24 regulatory control period is forecast to be 24.1 per cent higher than the opening RAB at the start of that period, in nominal terms. The approved forecast net capex increases the RAB by 38.0 per cent, while expected inflation increases it by 13.6 per cent. Forecast depreciation, on the other hand, reduces the RAB by 27.5 per cent.

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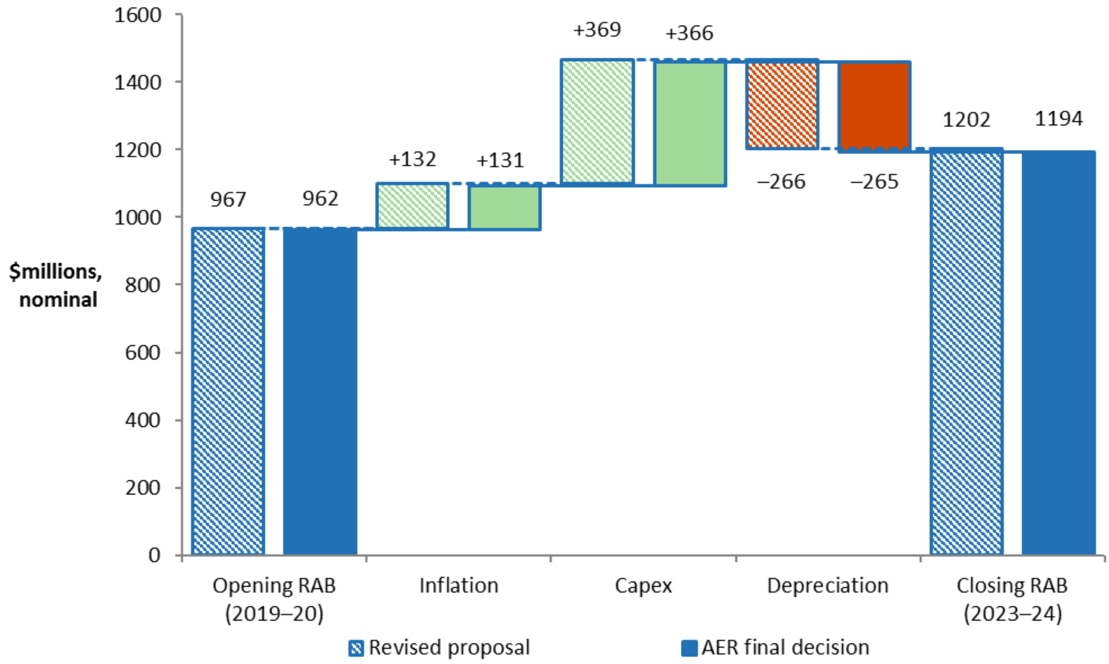
overview). However we have amended the revised proposed rate of return (section 2.2 of the overview). Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2019–24 regulatory control period.

Figure 2-1 Key drivers of changes in the RAB—Power and Water's revised proposal compared with AER's final decision ($million, nominal)



Source: AER analysis.

Forecast net capex is a significant driver of the increase in the RAB. In our final decision, we are satisfied that Power and Water's revised proposed total forecast capex of $338.4 million ($2018–19)[25] for the 2019–24 regulatory control period reasonably reflects the capex criteria. We have therefore accepted Power and Water's revised proposed capex for the 2019–24 regulatory control period. Refer to attachment 5 for the discussion on forecast capex.

Application of depreciation approach in RAB roll forward for next reset

When we roll forward Power and Water's RAB for the 2019–24 regulatory control period at the next reset, we must adjust for depreciation. For this final decision, we determine that the depreciation approach to be applied to establish the RAB at the commencement of the 2024–29 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2019–24 regulatory control period.[26]

As discussed in the overview to this final decision, we will begin applying the capital expenditure sharing scheme (CESS) to Power and Water over the 2019–24 regulatory control period. We consider that the CESS will provide sufficient incentives for Power

[25] This amount is net of capital contributions, disposals and equity raising costs, and excludes the half-year WACC adjustment.

[26] NT NER, cl.6.12.1(18).

and Water to achieve capex efficiency gains over that period. We are satisfied that the use of a forecast depreciation approach in combination with the application of the CESS and our other ex post capex measures are sufficient to achieve the capex incentive objective.[27] Further, this approach is consistent with our draft decision, Power and Water's initial proposal and our Framework and approach.[28]

2.2 AER's assessment approach

We did not change our assessment approach for the RAB from our draft decision. Attachment 2 section 2.3 of our draft decision details that approach.

27 Our ex post capex measures are set out in the capex incentives guideline, AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, pp. 13–19 and 20–21. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.

28 AER, *Draft decision – Attachment 2 – Regulatory asset base*, September 2018, pp. 22–23; Power and Water, *Regulatory proposal*, March 2018, p. 100; AER, *Framework and approach for Power and Water Corporation (NT) for the regulatory control period commencing 1 July 2019*, July 2017, p. 56.