PRELIMINARY DECISION
AusNet Services distribution determination 2016 to 2020

Attachment 2 – Regulatory asset base

October 2015

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's preliminary decision on AusNet Services' revenue proposal 2016–20. It should be read with all other parts of the preliminary decision.

The preliminary 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

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced metering infrastructure
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
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
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
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 AusNet Services' opening regulatory asset base (RAB) as at 1 January 2016.[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 preliminary decision on the opening RAB value as at 1 January 2016 for AusNet Services and roll forward of the forecast RAB over the 2016–20 regulatory control period.

2.1 Preliminary decision

We do not accept AusNet Services' proposed opening RAB of $3547.2 million ($ nominal) as at 1 January 2016.[2] We instead determine an opening RAB value of $3423.3 million ($ nominal) as at 1 January 2016. This is because we have amended AusNet Services' proposed roll forward model (RFM) to correct a number of input errors. These amendments include:

- correcting the annual actual inflation rates for RAB indexation
- removing the half-year WACC allowance for 2010 actual net capex
- removing the proposed addition of Advanced Metering Infrastructure (AMI) IT and communication assets transferred from alternative control services to the standard control services opening RAB at 1 January 2016
- using gross proceeds from asset sales instead of their written down values for the value of asset disposals.

These amendments reduced the opening RAB as at 1 January 2016 by $123.8 million (or 3.5 per cent) compared to that proposed.

To determine the opening RAB as at 1 January 2016, we have rolled forward the RAB over the 2011–15 regulatory control period to determine a closing RAB value at 31 December 2015. This roll forward includes an adjustment at the end of the 2011–15 regulatory control period to account for the difference between actual 2010 capex and the estimate approved at the 2011–15 determination.[3]

Table 2.1 sets out our preliminary decision on the roll forward of the RAB values for the 2011–15 regulatory control period.

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1 NER, cl. 6.12.1(6).

2 AusNet Services, *Regulatory proposal*, April 2015, Table 14.7, p. 378.

3 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2011–15 determination.

Table 2.1 AER's preliminary decision on AusNet Services' RAB for the 2011–15 regulatory control period ($ million, nominal)

	2011	2012	2013	2014	2015[a]
Opening RAB	2093.4	2294.4	2541.5	2841.7	3167.3
Capital expenditure[b]	274.6	316.1	379.7	401.0	366.1
Inflation indexation on opening RAB	73.7	46.0	54.9	65.6	73.1
Less: straight-line depreciation	147.4	114.9	134.4	140.9	146.5
Closing RAB	2294.4	2541.5	2841.7	3167.3	3460.0
Difference between estimated and actual capex (1 January 2010 to 31 December 2010)					–23.2
Return on difference for 2010 capex					–13.5
Closing RAB as at 31 December 2015					**3423.3**

Source: AER analysis.

(a): Based on estimated capex. We will update the RAB roll forward in the substitute decision.

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

We determine a forecast closing RAB value at 31 December 2020 of $4668.3 million ($ nominal). This is $267.3 million (or 5.4 per cent) lower than the amount of $4935.6 million ($ nominal) proposed by AusNet Services.[4] Our preliminary decision on the forecast closing RAB reflects the amended opening RAB as at 1 January 2016, and our preliminary decisions on forecast capex (attachment 6), forecast regulatory depreciation (attachment 5), and forecast inflation (attachment 3).

Table 2.2 sets out our preliminary decision on the forecast RAB values for AusNet Services over the 2016–20 regulatory control period.

[4] AusNet Services submitted an updated PTRM for the 2016–20 regulatory control period on 6 July 2015, after the submission of its initial proposal. The updated PTRM includes a number of adjustments to account for a ruling from the Australian Tax Office (ATO) that alters the tax liability associated with power line replacement works being undertaken by AusNet Services and funded by the Victorian Government's Powerline Replacement Fund. AusNet Services, *ATO Ruling on liabilities from Victorian Government's Powerline Replacement Fund contributions – amendments to 2016-20 revenue proposal*, 6 July 2015.

Table 2.2 AER's preliminary decision on AusNet Services' RAB for the 2016–20 regulatory control period ($ million, nominal)

	2016	2017	2018	2019	2020
Opening RAB	3423.3	3642.3	3900.5	4146.9	4414.4
Capital expenditure[a]	315.5	321.5	322.6	331.3	322.7
Inflation indexation on opening RAB	85.6	91.1	97.5	103.7	110.4
Less: straight-line depreciation	182.2	154.3	173.7	167.4	179.2
Closing RAB	3642.3	3900.5	4146.9	4414.4	4668.3

Source: AER analysis.

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

We determine that the forecast depreciation approach is to be used to establish the opening RAB at the commencement of the 2021–25 regulatory control period for AusNet Services.[5]

2.2 AusNet Services' proposal

AusNet Services used our RFM to establish an opening RAB as at 1 January 2016 and our PTRM to roll forward the RAB over the 2016–20 regulatory control period.

AusNet Services proposed an opening RAB value as at 1 January 2011 of $2282.8 million ($ nominal).[6] Rolling forward this RAB and using depreciation based on actual capex, AusNet Services proposed an initial closing RAB as at 31 December 2015 of $3471.9 million ($ nominal).[7] AusNet Services then proposed to roll in $75.3 million ($ nominal) of AMI IT and communication assets transferred from the alternative control services to the standard control services RAB to arrive at the final closing RAB at 31 December 2015 of $3547.2 million ($ nominal).[8] Table 2.3 presents AusNet Services' proposed roll forward of its RAB during the 2011–15 regulatory control period.

5 NER, cl. 6.12.1(18).

6 AusNet Services, *Regulatory proposal*, April 2015, Table 14.7, p. 378.

7 AusNet Services, *Regulatory proposal*, April 2015, Table 14.7, p. 378.

8 AusNet Services, *Regulatory proposal*, April 2015, pp. 377–378. Please refer to attachment 16 for further details.

Table 2.3 AusNet Services' proposed RAB for the 2011–15 regulatory control period ($million, nominal)

	2011	2012	2013	2014	2015[a]
Opening RAB	2093.4	2281.8	2567.3	2857.5	3179.1
Capital expenditure[b]	272.8	317.8	373.9	400.5	366.1
Inflation indexation on opening RAB	58.6	80.35	51.45	61.75	73.36
Less: straight-line depreciation	142.8	113.6	135.1	140.7	145.6
Closing RAB	2282.8	2567.3	2857.5	3179.1	3473.0
Difference between estimated and actual 2010 capex (1 January 2010 to 31 December 2010)					–0.7
Return on difference for 2010 capex					–0.4
Roll in of AMI IT and communication assets[c]					75.3
Closing RAB as at 31 December 2015					**3547.2**

Source: AusNet Services, *Regulatory proposal*, April 2015, Table 14.7, p. 378.

(a) Based on estimated capex.

(b) Net of disposals and adjusted for CPI.

(c) Roll in of AMI IT and communication assets from alternative control service s to standard control services RAB.

AusNet Services' proposed a closing forecast RAB as at 31 December 2020 of $4935.6 million ($ nominal). This value reflects its proposed opening RAB, forecast capex, forecast inflation and depreciation (based on forecast capex) over the 2016–20 regulatory control period. Its projected RAB over the 2016–20 regulatory control period is shown in Table 2.4.

Table 2.4 AusNet Services' proposed RAB for the 2016–20 regulatory control period ($million, nominal)

	2016	2017	2018	2019	2020
Opening RAB	3547.2	3814.6	4084.8	4343.2	4641.5
Capital expenditure[a]	393.4	362.5	365.3	377.0	368.5
Inflation indexation on opening RAB	89.5	96.3	103.1	109.6	117.2
Less: straight-line depreciation	215.5	188.6	210.0	188.4	191.5
Closing RAB	3814.6	4084.8	4343.2	4641.5	4935.6

Source: AusNet Services, *Regulatory proposal*, April 2015, Supporting Model: *AST Distribution PTRM*.

(a) Net of disposals and capital contributions.

AusNet Services did not propose a depreciation approach to establish the opening RAB at the commencement of the 2021–25 regulatory control period.

2.3 AER's assessment approach

We are required to roll forward the service provider's RAB during the 2011–15 regulatory control period to establish the opening RAB at 1 January 2016. This value can be adjusted for any differences in the forecast and actual capex, disposals and capital contributions. It may also be adjusted to reflect any changes in the use of the assets, with only assets used in the provision of standard control services to be included in the RAB.[9]

To determine the opening RAB, we developed an asset base RFM in accordance with the requirements of the NER[10] a service provider must use the RFM in preparing its regulatory proposal.[11] The RFM rolls forward the RAB from the beginning of the final year of the 2006–10 regulatory control period, through the 2011–15 regulatory control period, to the beginning of the next period.[12] The roll forward occurs for each year by:

- Adding an inflation (indexation) adjustment to the opening RAB for the relevant year. This adjustment must be consistent with the inflation factor used in the control mechanism.[13]
- Adding capex to the RAB for the relevant year.[14] In future determinations, the NER allows us to review a service provider's past capex and exclude inefficient past capex from being rolled into the RAB where total capex exceeds the regulatory allowance.[15] The details of our assessment approach for inefficient capex are set out in the *Capital expenditure incentive guideline*.[16] We note that under the transitional rules, the review of past capex does not apply to AusNet Services prior to 1 January 2016.[17] Therefore, for the purposes of this preliminary decision, we will add AusNet Services' actual or estimated capex in the 2011–15 regulatory control period to the RAB. We check actual capex amounts against audited annual reporting RIN data and generally accept the capex reported in those RINs in rolling forward the RAB. However, there may be instances where adjustments are required to the annual reporting RIN data. This would include where it is not fit for purpose.
- Subtracting depreciation from the RAB for the relevant year, calculated in accordance with the relevant distribution determination for that year.[18] Depreciation

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9 NER, cl. S6.2.1.
10 NER, cl. 6.5.1.
11 NER, cl. S6.1.3(7).
12 NEL, s. 7A(4).
13 NER, cl. 6.5.1(e)(3).
14 NER, cl. S6.2.1(e)(4).
15 NER, cl. S6.2.2A.
16 AER, *Capital expenditure incentive guideline*, November 2013, pp. 12–20.
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 cll. S6.2.2A (c), (d) and (e) of the NER.
17 NER, cll. 11.60.5 and 11.62.
18 NER, cl. S6.2.1(e)(5).

based on forecast or actual capex can be used to roll forward the RAB.[19] By default the RFM applies the depreciation approach based on actual capex, although this can be modified to apply a depreciation approach based on forecast capex when necessary. For this preliminary decision, we use depreciation based on actual capex for rolling forward AusNet Services' RAB values over the 2011–15 regulatory control period.[20] However, depreciation based on forecast capex will be used for the 2016–20 regulatory control period at the next reset.[21]

- Subtracting any disposals from the RAB for the relevant year.[22] We check these amounts against audited annual reporting RIN data.

These annual adjustments give the closing RAB for any particular year, which then becomes the opening RAB for the following year. Through this process the RFM rolls forward the RAB to the end of the 2011–15 regulatory control period. The PTRM used to calculate the annual revenue requirement for the 2016–20 regulatory control period generally adopts the same RAB roll forward approach as the RFM, although the annual adjustments to the RAB are based on forecasts, rather than actual amounts.

We are required to decide whether depreciation for establishing the service provider's RAB as at the commencement of the 2021–25 regulatory control period is to be based on actual or forecast capex.[23]

The opening RAB for the 2021–25 regulatory control period can be determined using depreciation based either on forecast or actual capex incurred during the 2016–20 period. To roll forward the RAB using depreciation based on forecast capex, we would use the forecast depreciation contained in the PTRM for the 2016–20 regulatory control period, adjusted for actual inflation. If the approach to roll forward the RAB using depreciation based on actual capex was adopted, we would recalculate the depreciation based on actual capex incurred during the 2016–20 regulatory control period.

Our decision on whether to use actual or forecast depreciation must be consistent with the capex incentive objective. We must have regard to:[24]

- the incentives the service provider has to undertake efficient capex
- substitution possibilities between assets with different lives and the relative benefits of each
- the extent of overspending and inefficient overspending relative to the allowed forecast

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19 NER, cl. 6.12.1(18).

20 The use of actual depreciation is consistent with the depreciation approach established in the 2010 distribution determination for AusNet Services. See: AER, *Victorian distribution determination final decision 2011–2015*, October 2010, p. 462.

21 Refer to section 2.4.3 for the reasons.

22 NER, cl. S6.2.1(e)(6).

23 NER, cl. S6.2.2B.

24 NER, cl. S6.2.2B(c).

- the capex incentive guideline
- the capital expenditure factors.

2.3.1 Interrelationships

The RAB is an input into the determination of the return on capital and depreciation (return of capital) building block allowances.[25] Factors that influence the RAB will therefore flow through to these building block components and the annual revenue requirement. Other things being equal, a higher RAB increases both the return on capital and depreciation allowances.

The RAB is determined by various factors, including:

- the opening RAB (meaning the value of existing assets at the beginning of the regulatory control period)
- net capex[26]
- depreciation
- indexation adjustment – so the RAB is presented in nominal terms, consistent with the rate of return.

The opening RAB depends on the value of existing assets and will depend on actual net capex, actual inflation outcomes and depreciation in the past.

The RAB when projected to the end of the regulatory control period increases due to both forecast new capex and the indexation adjustment. The size of the indexation adjustment depends on expected inflation (which also affects the nominal rate of return) and the size of the RAB at the start of each year.

Depreciation reduces the RAB. The depreciation allowance depends on the size of the opening RAB and the forecast net capex. By convention, the indexation adjustment is also offset against depreciation to prevent double counting of inflation in the RAB and rate of return, which are both presented in nominal terms. This reduces the apparent depreciation building block that feeds into the annual revenue requirement.

Figure 2.1 shows the key drivers of the change in the RAB over the 2016–20 regulatory control period as proposed by AusNet Services. Overall, the closing RAB at the end of the 2016–20 regulatory control period would be 39 per cent higher than the opening RAB at the start of that period based on the proposal, in nominal terms. The proposed forecast net capex increases the RAB by about 53 per cent, while inflation

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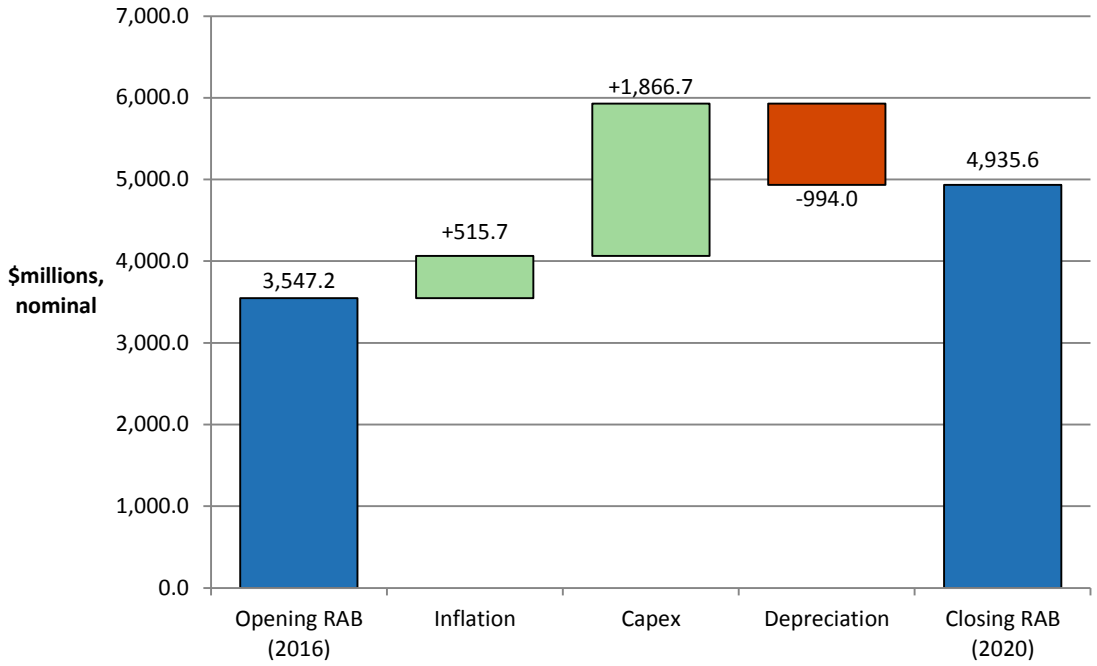
[25] The size of the RAB also impacts the benchmark debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

[26] Net capex is gross capex less disposals and capital contributions. The rate of return or WACC also influences the size of the capex. This is because the capex is not depreciated in the year it is first incurred, but added to the RAB at the end of the year. Instead, the capex amount is escalated by half a WACC to arrive at an end of year value. It then begins depreciating the following year.

increases it by about 15 per cent. Forecast depreciation, on the other hand, reduces the RAB by about 28 per cent.

Figure 2.1 Key drivers of changes in the RAB ($ million, nominal)



Source: AusNet Services, *Regulatory proposal*, April 2015, Supporting Model: *AST Distribution PTRM*.

Maintaining the RAB in real terms by adding inflation is required by the NER[27] and generally helps to promote smoother prices over the life of an asset. 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.[28]

The RAB would rise in real terms over the 2016–20 regulatory control period based on AusNet Services' proposal. We consider the depreciation amount to be generally reasonable and satisfy the requirements of the NER in terms of the assigned asset lives.[29] The depreciation amount is indicative as it also largely depends on the opening RAB (which in turn depends on capex). However, we consider the size of the forecast net capex to be a significant issue. Figure 2.1 shows forecast net capex is the largest driver of the increase in the RAB and we have considered whether it is appropriate that the forecast net capex exceeds depreciation as AusNet Services has proposed. Refer to attachment 6 for the discussion on forecast capex.

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27 NER, cl. 6.5.1(e)(3).

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

29 Refer to attachment 5 for the discussion on regulatory depreciation.

A ten per cent increase in the opening RAB causes revenues to increase by about 5.4 per cent. However, the impact on revenues of the annual change in RAB depends on the source of the RAB change, as some drivers affect more than one building block cost.[30]

2.4 Reasons for preliminary decision

We determine an opening RAB value for AusNet Services of $3423.3 million ($ nominal) as at 1 January 2016, a decrease of $123.8 million ($ nominal) or 3.5 per cent from the proposed value. We forecast a closing RAB value of $4668.3 million by 31 December 2020. This represents a reduction of $267.3 million, or 5.4 per cent compared to the proposal. The reasons for our decision are discussed below.

2.4.1 Opening RAB as at 1 January 2016

To determine the opening RAB as at 1 January 2016 we have rolled forward the RAB over the 2011–15 regulatory control period to determine a closing RAB value as at 31 December 2015. In doing so we reviewed the key inputs of AusNet Services' proposed RFM, such as asset lives, gross capex values, capital contributions and rate of return. We found these were correct and they reconcile with relevant data sources such as annual reporting RIN data and the 2011–15 decision models.[31] However, we consider there should be adjustments made to AusNet Services' proposed RFM inputs for actual inflation, rate of return input for the previous period, and the asset disposal values. We also consider AusNet Services' proposed transfer of AMI IT and communication assets from alternative control services to the standard control services opening RAB at 1 January 2016 should be removed. These adjustments are discussed below.

Actual inflation inputs

AusNet Services did not apply the established approach for recording actual CPI inflation rates in its proposed RFM. Our approach to RAB indexation in the template RFM is to apply a one year lagged inflation rate to net capex and straight-line depreciation consistent with the method of indexation used in the control mechanism.[32] The actual inflation rate for each year is used to index the opening RAB in the RFM. In order to do this, the RFM requires each actual CPI rate measured for a year to be recorded in that specific year (un-lagged).[33] These actual observations are converted

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30 If capex causes the RAB increase, return on capital, depreciation, and debt raising costs all increase too. If a reduction in depreciation causes the RAB increase, revenue could increase or decrease. In this case, the higher return on capital is offset (perhaps more than offset) by the reduction in depreciation allowance. Inflation naturally increases the RAB in nominal terms.

31 At the time of this preliminary decision, the roll forward of AusNet Services' RAB includes estimated capex values for 2015. We will update the 2015 estimated capex values for the final decision.

32 NER, cl. 6.5.1(e)(3).

33 AER, *Victorian distribution determination final decision 2011-2015*, 29 October 2010, p. 57. For AusNet Services, the September quarter CPI is used as a proxy for the calendar year in the 2011–15 regulatory control period. As

as part of coding within the RFM into a one year lagged index for use in the RAB roll forward process. This approach is consistent with the current RFM template developed in accordance with the NER and applied for other service providers.[34]

AusNet Services' proposed RFM contained actual inflation inputs that were already one year lagged observations. This results in the RAB being adjusted by a two year lagged inflation index.[35] This is not consistent with the NER.[36] Our preliminary decision is to apply our standard approach to RAB indexation, consistent with the template RFM and the NER.[37] As such, we have replaced AusNet Services' one year lagged CPI observations so that they are recorded in the year related to their measure. We have adopted AusNet Services' use of an estimate of CPI for 2015, as the actual inflation is not yet known. Our final decision will update this estimate for actual 2015 inflation.

Previous period rate of return input

AusNet Services proposed RFM includes a half-year WACC allowance for its 2010 actual net capex inputs. We do not consider that a half-year WACC allowance should be applied to 2010 capex. This assessment is consistent with the approach applied to 2010 capex in the revenue modelling by the Essential Services Commission for the 2006–10 regulatory control period.[38] Our preliminary decision is to remove the half-year WACC allowance by setting the 2010 nominal (fixed real time varying) WACC cell to zero in the RFM.[39] This is consistent with the approach adopted by other Victorian distributors in their proposals—CitiPower, Powercor and United Energy.

Value of asset disposals

AusNet Services did not apply the approach of recording the gross proceeds from asset sales for the value of asset disposals in its proposed RFM. Instead, AusNet Services proposed to use written down values to represent the amount for asset disposals. We consider the approach of using gross proceeds is appropriate. The approach of using written down value can result in over compensation for the service provider's investment if the proceeds from asset sales exceed their written down value.[40] This is not consistent with the requirements of the NER.[41] For this reason, our preliminary decision is to use the gross proceeds from asset sales for the value of asset disposals in the RFM. In response to an information request from us, AusNet

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discussed in attachment 14, the June quarter CPI will be used as a proxy for the calendar year for the 2016–20 regulatory control period.

34 NER, cl. 6.5.1(b)–(d). Model published at: http://www.aer.gov.au/node/6908.

35 Actual inflation from September 2008 to September 2009 is used to index the RAB from 2010 to 2011.

36 NER, cl. 6.5.1(e)(3).

37 NER, cl. 6.5.1(e).

38 Essential Services Commission, *Electricity Distribution Price Review 2006-10*, October 2006, p. 252.

39 Cell H319 in the 'Input' sheet of the RFM.

40 Conversely, if the proceeds from asset sales were lower than their written down value the service provider will recover less than its investment.

41 NER, cl. 6.5.5(b)(2).

Services provided the gross proceeds for its asset disposals over the 2010–15 period for use in the RFM.[42]

Transfer of AMI IT and communication assets

AusNet Services proposed to transfer $75 million ($ nominal) of AMI IT and communication assets from alternative control services to the standard control services opening RAB at 1 January 2016. For the reasons discussed at attachment 16, our preliminary decision is to maintain these assets in the alternative control services RAB until the issue is considered further through the ring fencing guideline process. Accordingly, our preliminary decision is to remove the proposed addition of these assets from the 1 January 2016 opening RAB for standard control services. These assets remain as providing alternative control services.

2.4.2 Forecast closing RAB as at 31 December 2020

We forecast a closing RAB value of $4668.3 million ($ nominal) by 31 December 2020 for AusNet Services. This represents a reduction of 267.3 million, or 5.4 per cent to AusNet Services' proposal. This reduction reflects our preliminary decision on the required inputs for determining the forecast RAB in the PTRM. To determine the forecast RAB value, we amended the following PTRM inputs:

- We adjusted the opening RAB at 1 January 2016, as discussed in section 2.4.1.
- We reduced the proposed forecast inflation rate of 2.52 per cent per annum to 2.50 per cent per annum (attachment 3).
- We reduced the proposed forecast capex for the 2016–20 regulatory control period by $253.1 million or 13.6 per cent (attachment 6).
- We reduced the proposed forecast regulatory depreciation for the 2016–20 regulatory control period by $109.6 million or 22.9 per cent (attachment 5).

A submission from the Victorian Energy Consumer and User Alliance raised concern about the substantial growth in the value of the RAB for the Victorian DNSPs in recent years.[43] We have carefully reviewed the cost drivers of AusNet Services' forecast capex in terms of prudency and efficiency. We are not satisfied that AusNet Services' proposed augmentation capex reflects a realistic expectation of demand over the 2016–20 regulatory control period. Although a greater proportion of AusNet Services' network assets are nearing the end of their life—requiring an increased replacement capex to manage the deterioration in asset condition—our modelling estimates a lower amount of replacement expenditure than proposed is necessary to meet the capex objectives. Our preliminary decision is to reduce the proposed capex, a main driver of

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42 AusNet Services, *Email response to AER information request Vic. EDPR - AusNet - IR#009* , 16 July 2014.

43 Victorian Energy Consumer and User Alliance, *Submission to the AER Victorian distribution networks' 2016-20 revenue proposals*, 13 July 2015, pp. 22–24.

the increase in the value of AusNet Services' RAB, by $253.1 million. The details of our assessment of AusNet Services' capex are set out in attachment 6.

2.4.3 Application of depreciation approach in RAB roll forward for next reset

AusNet Services did not propose a depreciation approach to roll forward the RAB for the commencement of its 2021–25 regulatory control period.

We consider that the depreciation approach based on forecast capex (updated for actual inflation) should be used. This approach was signalled in the AER's framework and approach.[44] As discussed in attachment 10, AusNet Services is not currently subject to a capital expenditure sharing scheme (CESS) but we will apply the CESS to AusNet Services over the 2016–20 regulatory control period. We consider this scheme will provide sufficient incentives for AusNet Services 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.[45]

[44] AER, *Final Framework and Approach for the Victorian Electricity Distributors*, October 2014, pp. 121–126.

[45] 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, 20–21. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.