



Draft Decision

ActewAGL distribution determination

2015–16 to 2018–19

Attachment 2: Regulatory asset base

November 2014

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Inquiries about this document 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

AER reference: 52254

Note

This attachment forms part of the AER's draft decision on ActewAGL's 2015–19 distribution determination. It should be read with other parts of the draft decision.

The draft 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 methodology

Attachment 19 – Pricing methodology

Contents

Note	2-3
Contents.....	2-4
Shortened forms	2-5
2 Regulatory asset base.....	2-7
2.1 Draft decision.....	2-7
2.2 ActewAGL's proposal	2-9
2.3 AER's assessment approach.....	2-11
2.3.1 Interrelationships	2-13
2.4 Reasons for draft decision.....	2-15
2.4.1 Opening RAB as at 1 July 2014	2-15
2.4.2 Forecast closing RAB as at 30 June 2019	2-16
2.4.3 Application of depreciation approach in RAB roll forward for next reset.....	2-17

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	aggregate service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
CPI-X	consumer price index minus X
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

Shortened form	Extended form
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
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue 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 ActewAGL's opening regulatory asset base (RAB) as at 1 July 2014.¹ 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 draft decision on ActewAGL's opening RAB as at 1 July 2014 and roll forward of the RAB over the 2014–19 period.

2.1 Draft decision

We do not accept ActewAGL's proposed opening RABs as at 1 July 2014 of \$696.1 million and \$154.2 million (\$ nominal) for its distribution and transmission networks respectively. We instead determine opening RAB values as at 1 July 2014 of \$695.6 million and \$154.1 million (\$ nominal) for its distribution and transmission networks respectively. These small differences are caused by a correction to the remaining asset life of the opening asset class for both distribution and transmission RABs.

Although transmission assets are to be regulated as dual function assets from 1 July 2014, the transmission asset base has been established from 1 July 2009. To determine the opening RABs at 1 July 2014, we have rolled forward the separate RABs over the 2009–14 regulatory control period to determine closing values as at 30 June 2014. The roll forwards include an adjustment at the end of the 2009–14 regulatory control period to account for the difference between actual 2008–09 capex and the estimate approved at the 2009 determination.² The actual and estimated 2008–09 capex has been split between the distribution and transmission networks consistent with the split of the opening RAB.

¹ NER, cl 6.12.1(6).

² The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2009–14 determination.

Table 2.1 and Table 2.2 set out our draft decision on the roll forward of the RAB values over the 2009–14 regulatory control period for ActewAGL's distribution and transmission networks respectively.

Table 2.1 AER's draft decision on ActewAGL's RAB for the 2009–14 regulatory control period – distribution (\$ million, nominal)

	2009–10	2010–11	2011–12	2012–13	2013–14 ^a
Opening RAB	523.3	559.6	603.6	640.9	662.0
Capital expenditure ^b	53.5	57.5	49.2	45.0	66.6
Inflation indexation on opening RAB	9.5	15.9	20.5	11.3	16.2
Less: straight-line depreciation	26.7	29.4	32.4	35.2	38.6
Closing RAB	559.6	603.6	640.9	662.0	706.2
Difference between estimated and actual capex (1 July 2008 to 30 June 2009)					–7.0
Return on difference for 2008–09 capex					–3.6
Opening RAB as at 1 July 2014					695.6

Source: AER analysis.

(a): Based on estimated capex. We will update the RAB roll forward in the final decision. (b): Net of disposals and capital contributions, and adjusted for CPI.

Table 2.2 AER's draft decision on ActewAGL's RAB for the 2009–14 regulatory control period – transmission (\$ million, nominal)

	2009–10	2010–11	2011–12	2012–13	2013–14 ^a
Opening RAB	75.4	86.0	99.2	117.4	136.3
Capital expenditure ^b	13.1	15.1	19.9	22.7	20.8
Inflation indexation on opening RAB	1.4	2.4	3.4	2.1	3.3
Less: straight-line depreciation	3.9	4.4	5.0	5.8	6.8
Closing RAB	86.0	99.2	117.4	136.3	153.7
Difference between estimated and actual capex (1 July 2008 to 30 June 2009)					0.2
Return on difference for 2008–09 capex					0.1
Opening RAB as at 1 July 2014					154.1

Source: AER analysis.

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

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

We determine forecast closing RAB values at 30 June 2019 of \$751.6 million and \$184.5 million (\$ nominal) for ActewAGL's distribution and transmission networks respectively. This represents a reduction from ActewAGL's proposal of \$98.7 million (or 11.6 per cent) and \$49.9 million (or 21.3 per cent) for its distribution and transmission networks respectively. Our draft decision RABs reflect the amended opening RABs as at 1 July 2014 and our draft decisions on forecast capex (attachment 6) and forecast regulatory depreciation (attachment 5).

Table 2.3 and Table 2.4 set out our draft decision on the forecast RAB values over the 2014–19 period for ActewAGL's distribution and transmission networks respectively.

Table 2.3 AER's draft decision on ActewAGL's RAB for the 2014–19 period – distribution (\$ million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19
Opening RAB	695.6	720.3	729.8	738.3	743.9
Capital expenditure ^a	51.7	39.7	39.2	37.6	39.5
Inflation indexation on opening RAB	17.4	18.0	18.2	18.5	18.6
Less: straight-line depreciation	44.4	48.3	48.9	50.4	50.5
Closing RAB	720.3	729.8	738.3	743.9	751.6

Source: AER analysis.
(a) Net of disposals and capital contributions.

Table 2.4 AER's draft decision on ActewAGL's RAB for the 2014–19 period – transmission (\$ million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19
Opening RAB	154.1	159.2	164.6	176.8	183.8
Capital expenditure ^a	9.3	10.4	17.3	12.4	5.9
Inflation indexation on opening RAB	3.9	4.0	4.1	4.4	4.6
Less: straight-line depreciation	8.1	8.9	9.2	9.9	10.2
Closing RAB	159.2	164.6	176.8	183.8	184.2

Source: AER analysis.
(a) Net of disposals and capital contributions.

We determine that the forecast depreciation approach is to be used to establish the opening RABs at the commencement of the 2019–24 regulatory control period for ActewAGL.³ This will apply to the full 2014–19 period, including the 2014–15 transitional regulatory control period. We consider this approach will provide sufficient incentives for ActewAGL to achieve efficiency gains over those periods, and for benefits to be shared with users over future periods. ActewAGL is not currently subject to a capital expenditure efficiency scheme (CESS). However, the CESS will apply to ActewAGL over the subsequent (2015–19) period.

2.2 ActewAGL's proposal

ActewAGL used our roll forward model (RFM) to establish opening RABs as at 1 July 2014 and our post-tax revenue model (PTRM) to roll forward the RABs over the 2014–19 period. ActewAGL separated the opening RAB values for distribution and transmission assets as at 1 July 2009.⁴ ActewAGL proposed opening asset values as at 1 July 2009 of \$523.3 million and \$75.4 million (\$ nominal) for its distribution and transmission networks respectively. Rolling forward these RABs, it proposed closing RABs as at 30 June 2014 of \$696.1 million and \$154.2 million (\$ nominal) for its distribution and transmission networks respectively. Table 2.5 and Table 2.6 present ActewAGL's

³ NER, cl 6.12.1(8).

⁴ ActewAGL, *Regulatory proposal*, June 2014, pp. 245–246.

proposed roll forward of the RABs over the 2009–14 regulatory control period for its distribution and transmission networks respectively.

Table 2.5 ActewAGL's proposed RAB for the 2009–14 regulatory control period – distribution (\$million, nominal)

	2009–10	2010–11	2011–12	2012–13	2013–14 ^a
Opening RAB	523.3	559.6	603.8	641.1	662.4
Capital expenditure ^b	53.5	57.5	49.2	45.0	66.6
Inflation indexation on opening RAB	9.5	15.9	20.5	11.3	16.2
Less: straight-line depreciation	26.7	29.3	32.3	35.1	38.5
Closing RAB	559.6	603.8	641.1	662.4	706.7
Difference between estimated and actual 2008–09 capex					–7.0
Return on difference for 2008–09 capex					–3.6
Opening RAB as at 1 July 2014					696.1

Source: ActewAGL, *Regulatory proposal*, June 2014, Attachment B1 RFM Distribution.

(a): Based on estimated capex.

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

Table 2.6 ActewAGL's proposed RAB for the 2009–14 regulatory control period – transmission (\$million, nominal)

	2009–10	2010–11	2011–12	2012–13	2013–14 ^a
Opening RAB	75.4	86.0	99.2	117.4	136.3
Capital expenditure ^b	13.1	15.1	19.9	22.7	20.8
Inflation indexation on opening RAB	1.4	2.4	3.4	2.1	3.3
Less: straight-line depreciation	3.8	4.4	5.0	5.8	6.7
Closing RAB	86.0	99.2	117.4	136.3	153.8
Difference between estimated and actual 2008–09 capex					0.2
Return on difference for 2008–09 capex					0.1
Opening RAB as at 1 July 2014					154.2

Source: ActewAGL, *Regulatory proposal*, June 2014, Attachment B4 RFM Transmission.

(a): Based on estimated capex.

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

ActewAGL proposed forecast closing RABs as at 30 June 2019 of \$850.2 million and \$234.1 million (\$ nominal) for its distribution and transmission networks respectively. These values reflect its proposed opening RABs, forecast capex, forecast inflation and depreciation (based on forecast capex) over the 2014–19 period. Its projected distribution and transmission RABs over the 2014–19 period are shown in Table 2.7 and Table 2.8 respectively.

Table 2.7 ActewAGL's proposed RAB for the 2014–19 period – distribution (\$million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19
Opening RAB	696.1	737.6	765.1	792.7	818.9
Capital expenditure ^a	68.5	58.1	58.8	58.8	64.0
Inflation indexation on opening RAB	17.6	18.6	19.3	20.0	20.7
Less: straight-line depreciation	44.6	49.2	50.5	52.6	53.4
Closing RAB	737.6	765.1	792.7	818.9	850.2

Source: ActewAGL, *Regulatory proposal*, June 2014, Attachment B2 PTRM Distribution.

(a): Net of disposals and capital contributions.

Table 2.8 ActewAGL's proposed RAB for the 2014–19 period – transmission (\$million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19
Opening RAB	154.2	161.7	174.8	206.1	226.6
Capital expenditure ^a	11.8	18.1	36.5	26.0	13.4
Inflation indexation on opening RAB	3.9	4.1	4.4	5.2	5.7
Less: straight-line depreciation	8.1	9.1	9.6	10.8	11.5
Closing RAB	161.7	174.8	206.1	226.6	234.1

Source: ActewAGL, *Regulatory proposal*, June 2014, Attachment B5 PTRM Transmission.

(a): Net of disposals and capital contributions.

ActewAGL proposed to apply a forecast depreciation approach to establish the RAB at the commencement of 2019–24 regulatory control period, consistent with the approach set out in our Stage 2 framework and approach paper.⁵

2.3 AER's assessment approach

We are required to roll forward the service provider's RAB during the current regulatory control period to establish the opening RAB for the next regulatory control period. 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.⁶

To determine the opening RAB for a distribution determination, we have developed an asset base RFM in accordance with the requirements of the NER.⁷ A service provider must use the RFM in preparing its regulatory proposal. The RFM rolls forward the RAB from the beginning of the final year of the 2004–09 regulatory control period, through the 2009–14 regulatory control period, to the beginning of the next period. The five regulatory years between 2014–19 are split over two regulatory control periods (a transitional regulatory control period of 2014–15 and then a subsequent regulatory control period of 2015–19). However, the NER expressly provides that when we determine the

⁵ ActewAGL, *Regulatory Proposal*, June 2014 (resubmitted 10 July 2014), p. 249.

⁶ NER, cl 56.2.1 and 11.56.4(f).

⁷ NER, cl 6.5.1 and 11.56.4(c) and (f).

opening value of the regulatory asset base for this five year period we should do so as if the two periods were combined.⁸ 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.⁹
- Adding capex to the RAB for the relevant year.¹⁰ The NER allows us to review a service provider's past capex and exclude inefficient past capex from being rolled into the RAB.¹¹ We note that under the transitional rules, the review of past capex does not apply to ActewAGL's current and transitional regulatory control periods.¹² Therefore, for the purposes of this draft decision, we will add ActewAGL's actual or estimated capex in the 2009–14 regulatory control period to the RAB. We check actual capex amounts against annual reporting regulatory information notice (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 because it is not fit for purpose due to a particular issue.
- Subtracting depreciation from the RAB for the relevant year, calculated in accordance with the distribution determination for the service provider's 2009–14 regulatory control period.¹³ Depreciation based on forecast or actual capex can be used to roll forward the RAB.¹⁴ By default the RFM applies the depreciation approach based on actual capex, although this can be modified to apply a forecast depreciation approach if necessary. For this draft decision, we use depreciation based on actual capex for rolling forward ActewAGL's RAB values over the 2009–14 regulatory control period.¹⁵
- Subtracting any disposals and capital contributions from the RAB for the relevant year.¹⁶ We will check these amounts against annual reporting RIN data.

These annual adjustments give the closing RAB for any particular year, this then becomes the opening RAB for the following year. Through this process the RFM rolls forward the RAB to the end of the 2009–14 regulatory control period. The PTRM used to calculate the annual revenue requirement for the 2014–19 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 2019–24 regulatory control period is to be based on actual or forecast capex.¹⁷

The opening RAB for the 2019–24 regulatory control period can be determined using depreciation based either on forecast or actual capex incurred during the 2014–19 period.¹⁸ To roll forward the RAB using depreciation based on forecast capex, we would use the forecast depreciation contained in the PTRM for the 2014–19 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 2014–19 period.

⁸ NER, cl 11.56.4(c)(4)-(6) and (f).

⁹ NER, cl 6.5.1(e)(3) and 11.56.4(f).

¹⁰ NER, cl S6.2.1(e)(4).

¹¹ NER, cl S6.2.2A.

¹² NER, cl 11.56.5 and 11.62.

¹³ NER, cl S6.2.1(e)(5).

¹⁴ NER, cl 6.12.1(8).

¹⁵ The use of actual depreciation is consistent with the depreciation approach established in the 2009 distribution determinations for ActewAGL.

¹⁶ NER, cl S6.2.1(e)(6).

¹⁷ NER, cl S6.2.2B.

¹⁸ NER, cl 6.12.1(8).

Our decision on whether to use actual or forecast depreciation must be consistent with the capex incentive objective. We must have regard to:¹⁹

- any other incentives the service provider has to undertake efficient capex
- substitution possibilities between assets with different lives
- the extent of overspending and inefficient overspending relative to the allowed forecast
- 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) allowances.²⁰ 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 capex²¹
- 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 or WACC) 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 distribution RAB over the 2014–19 period as proposed by ActewAGL. Overall, the closing RAB at the end of the 2014–19 period would be 22 per

¹⁹ NER, cl S6.2.2B(c).

²⁰ The size of the RAB also impacts the debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

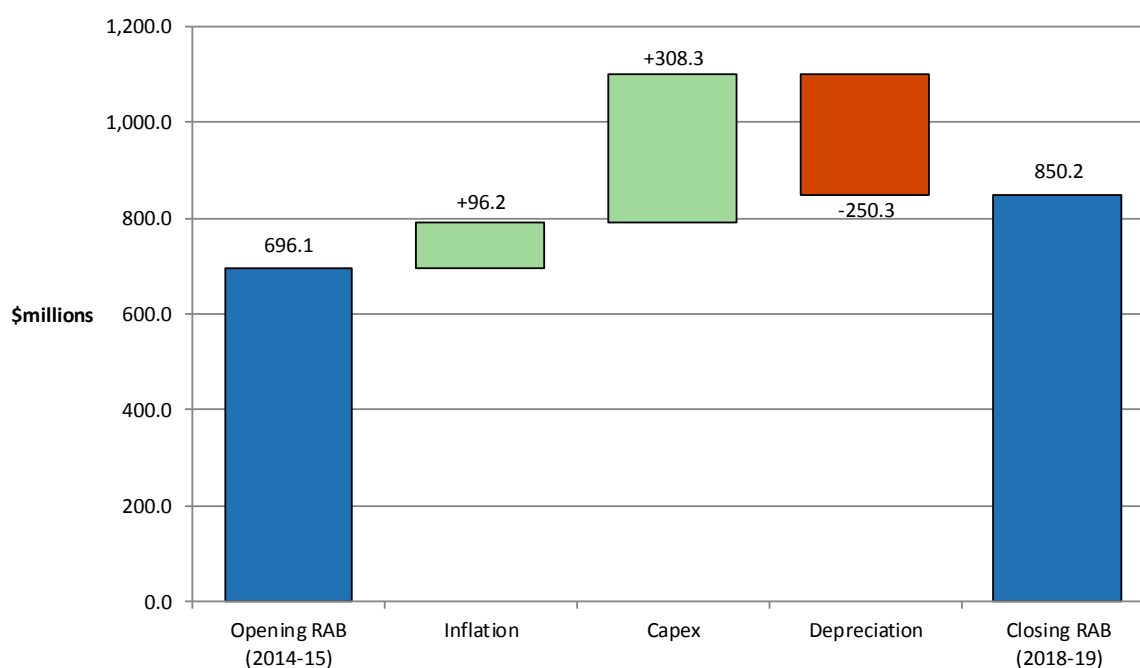
²¹ Net capex is gross capex less disposals and capital contributions. The WACC also influences the size of the capex. This is because the capex is not depreciated in the year it is first incurred, but added to the RAB at the end of the year. Instead, the capex amount is escalated by half a WACC to arrive at an end of year value. It then begins depreciating the following year.

cent higher than the opening RAB based on the proposal, in nominal terms. The proposed forecast net capex increases the RAB by about 44 per cent, while inflation increases it by about 14 per cent. Forecast depreciation, on the other hand, reduces the RAB by about 36 per cent.

Figure 2.2 shows the key drivers of the change in the transmission RAB over the 2014–19 period as proposed by ActewAGL. Overall, the closing RAB at the end of the 2014–19 period would be 52 per cent higher than the opening RAB based on the proposal, in nominal terms. The proposed forecast net capex increases the RAB by about 69 per cent, while inflation increases it by about 15 per cent. Forecast depreciation, on the other hand, reduces the RAB by about 32 per cent.

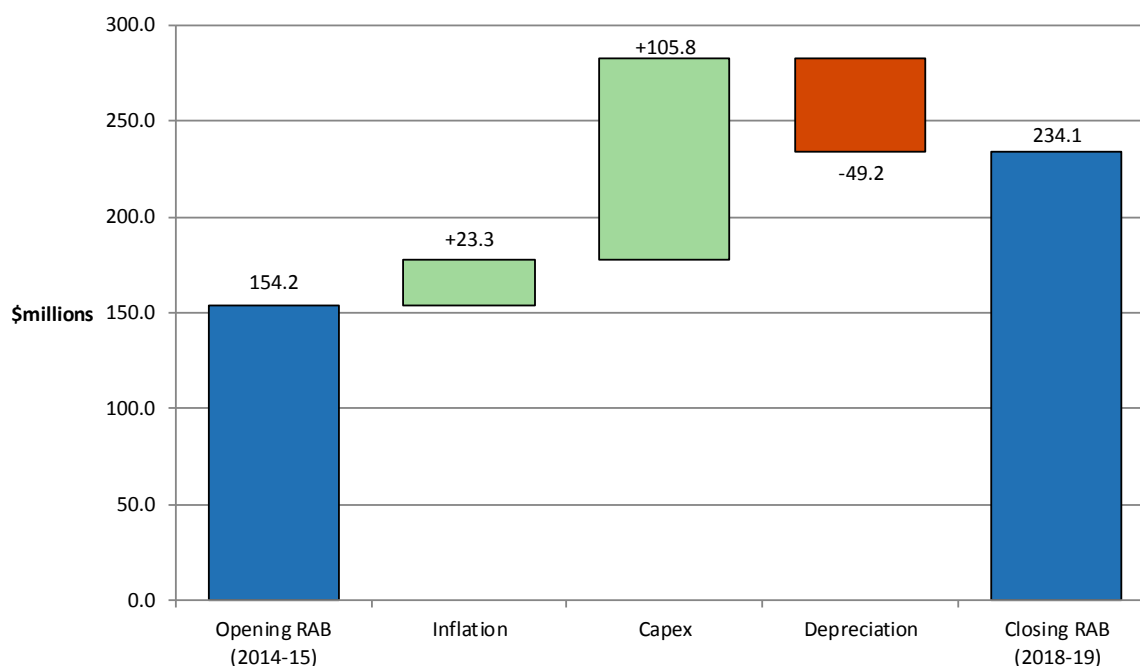
The RABs would rise in real terms over the 2014–19 period based on ActewAGL's proposal. We consider the depreciation amount to be generally reasonable, given that it largely depends on the opening RAB (which depends on capex in the past). However, we do have concerns with the size of the forecast net capex. Figure 2.1 and Figure 2.2 show forecast net capex is the largest driver of the increase in the RABs and we have considered whether it is appropriate that the forecast net capex exceed depreciation as ActewAGL has proposed. Refer to attachment 6 for the discussion on forecast capex.

Figure 2.1 Key drivers of changes in RAB – distribution (\$ million, nominal)



Source: AER analysis.

Figure 2.2 Key drivers of change in RAB – transmission (\$ million, nominal)



Source: AER analysis.

A ten per cent increase in the opening RAB causes revenues to increase by about 5.9 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.²²

2.4 Reasons for draft decision

We have determined ActewAGL's opening distribution and transmission RABs to be \$695.6 million and \$154.1 million (\$ nominal) respectively, as at 1 July 2014. This represents decreases of \$0.5 million or 0.1 per cent and \$0.4 (\$ nominal) or 0.1 per cent from the proposed values respectively. We have forecast closing distribution and transmission RAB values of \$751.5 million and \$184.2 million (\$ nominal) respectively, as at 30 June 2019. This represents reductions of \$98.7 million or 11.6 per cent and \$49.9 million (\$ nominal) or 21.3 per cent compared to ActewAGL's proposal respectively. The reasons for our decision are discussed below.

2.4.1 Opening RAB as at 1 July 2014

We do not accept ActewAGL's proposed opening RABs for its distribution and transmission networks as at 1 July 2014. Instead we have determined opening RAB values of \$695.6 million and \$154.1 million (\$ nominal) as at 1 July 2014 for its distribution and transmission networks respectively.²³ This represents reductions to the opening distribution and transmission RABs as at 1 July 2014 of \$0.5 million and \$0.1 million (\$ nominal) respectively. This is because we amended the

²² 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. However, the real impact from changing the inflation forecast is inconsequential as revenues are updated annual by actual inflation and the X factor, which is generally unaffected by the assumed forecast inflation rate.

²³ At the time of this draft decision, the roll forward of ActewAGL's RAB includes estimated capex values for 2013–14. We will update the 2013–14 estimated capex values with the actual values for the final decision.

remaining asset life of the opening RABs as at 1 July 2009 to 20.42 years, consistent with that approved in the 2009 determination.²⁴

ActewAGL adjusted the remaining asset life input in its proposed RFM to reflect actual capex in 2008–09. Our RFM requires the remaining asset life input as at 1 July 2009 to reflect the value approved in the 2009 determination. This provides continuity in the roll forward of the RAB and ensures the depreciation schedules are consistent with those approved in the 2009 determination.²⁵ We also reviewed the other key inputs into ActewAGL's proposed RFMs, such as CPI, rate of return, gross capex and capital contributions values. We found these were correct and they reconcile with relevant data sources such as ABS data, annual reporting RIN data and the 2009–14 decision models.²⁶

2.4.2 Forecast closing RAB as at 30 June 2019

We forecast closing RAB values of \$751.5 million and \$184.2 million by 30 June 2019 for ActewAGL's distribution and transmission networks, respectively.

For ActewAGL's distribution RAB our decision results in a reduction of \$98.7 million (\$ nominal) or 11.6 per cent compared to ActewAGL's proposal. This reduction reflects our draft decision on the inputs for determining the forecast distribution RAB in the PTRM. To determine ActewAGL's forecast distribution RAB value, we amended the following PTRM inputs:

- We reduced ActewAGL's proposed opening RAB as at 1 July 2014 by \$0.5 million or 0.1 per cent.
- We reduced ActewAGL's proposed forecast capex for the 2014–19 period by \$100.6 million or 32.6 per cent (attachment 6).
- We reduced ActewAGL's proposed forecast regulatory depreciation allowance by \$2.3 million or 1.5 per cent (attachment 5).

For ActewAGL's transmission RAB our decision results in a reduction of \$49.9 million (\$ nominal) or 21.3 per cent compared to ActewAGL's proposal. This reduction reflects our draft decision on the inputs for determining the forecast transmission RAB in the PTRM. To determine ActewAGL's forecast transmission RAB value, we amended the following PTRM inputs:

- We reduced ActewAGL's proposed opening RAB as at 1 July 2014 by \$0.1 million or less than 0.1 per cent.
- We reduced ActewAGL's proposed forecast capex for the 2014–19 period by \$50.4 million or 47.7 per cent (attachment 6).
- We reduced ActewAGL's proposed forecast regulatory depreciation allowance by \$0.6 million or 2.4 per cent (attachment 5).

²⁴ AER, *Final decision Australian Capital Territory distribution determination*, 28 April 2009, p. 90.

²⁵ NER, cl 6.5.5(b)(3).

²⁶ In determining the value of ActewAGL's transmission RAB, we have accepted the methodology used by ActewAGL to allocate assets to its transmission RAB. ActewAGL's methodology results in its transmission RAB being a larger proportion of its total asset base than an alternative methodology may derive. However, our initial assessment is that the implications for customers are negligible. An alternative methodology may result in some asset value shifting from the transmission RAB to the distribution RAB. While this may marginally improve the alignment of transmission RAB with the related transmission services, it would have minimal impact on overall prices and no impact on ActewAGL's total revenues. We note also that ActewAGL's methodology is similar to that used by Ausgrid to determine its transmission RAB value. At this time, we propose to monitor ActewAGL's provision of transmission related services with a view to more closely assessing its transmission RAB value at the next reset.

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

Consistent with our Stage 2 framework and approach paper and ActewAGL's proposal, we determine that the forecast depreciation approach is to be used to establish the RAB at the commencement of ActewAGL's 2019–24 regulatory control period.²⁷ This approach will apply to both the transitional and subsequent regulatory control periods for ActewAGL.²⁸ We consider this approach will provide sufficient incentives for ActewAGL to achieve capex efficiency gains over the relevant regulatory control periods.

We had regard to the relevant factors in the NER in developing the approach to choosing the depreciation approach set out in our capex incentives guideline.²⁹ Our approach is to apply forecast depreciation except where:

- there is no CESS in place and therefore the power of the capex incentive may need to be strengthened, or
- a service provider's past capex performance demonstrates evidence of persistent overspending or inefficiency, thus requiring a higher powered incentive.

In making our decision on whether to use actual depreciation in either of these circumstances we have considered:

- the substitutability between capex and opex and the balance of incentives between these
- the balance of incentives with service outcomes
- the substitutability of assets of different asset lives.

We have chosen forecast depreciation because, in combination with the CESS, it will provide a 30 per cent reward for capex underspends and 30 per cent penalty for capex overspends, which is consistent for all asset classes. In developing our capex incentives guideline, we considered this to be a sufficient incentive for a service provider to achieve efficiency gains over the regulatory control period in most circumstances.

As discussed in attachment 10, ActewAGL is not currently subject to a CESS but we will apply the CESS to ActewAGL from 1 July 2015. The CESS does not apply to ActewAGL for the 2014–15 transitional regulatory control period. We consider the use of a forecast depreciation approach in combination with the application of CESS and our other ex post capex measures are sufficient to achieve the capex incentive objective.³⁰

²⁷ AER, *Stage 2 framework and approach paper*, January 2014, pp. 37-38.

²⁸ The transitional regulatory control period for ActewAGL is 2014–15. ActewAGL's subsequent regulatory control period is from 2015–16 to 2017–19.

²⁹ AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013, p. 12.

³⁰ 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.