



FINAL DECISION

SA Power Networks Distribution Determination 2020 to 2025

Attachment 2 Regulatory asset base

June 2020

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to SA Power Networks for the 2020–25 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 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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2 Regulatory asset base

Our distribution determination includes SA Power Networks' opening regulatory asset base (RAB) value as at 1 July 2020 and the projected RAB value for the 2020–25 regulatory control period.¹ The value of the RAB substantially impacts SA Power Networks' revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and return of capital (depreciation) components of the distribution determination.² This final decision sets out:

- the opening RAB as at 1 July 2020
- the forecast closing RAB as at 30 June 2025
- that the depreciation based on forecast capital expenditure is to be used for establishing the RAB as at the commencement of the 2025–30 regulatory control period.³

2.1 Final decision

Opening RAB as at 1 July 2020

Our final decision is to determine an opening RAB value of \$4361.0 million (\$nominal) as at 1 July 2020 for SA Power Networks. This amount is \$4.0 million (or 0.1 per cent) higher than SA Power Networks' revised proposed opening RAB of \$4357.0 million (\$nominal) as at 1 July 2020.⁴ It reflects our update to the roll forward model (RFM) for 2019–20 actual inflation that is now available. This final decision is \$32.3 million (or 0.7 per cent) lower than our draft decision value for SA Power Networks' opening RAB of \$4393.3 million (\$nominal).

To determine the opening RAB as at 1 July 2020, we have rolled forward the RAB over the 2015–20 regulatory control period to determine a closing RAB value as at 30 June 2020 in accordance with our RFM.⁵ This roll forward includes an adjustment at the end of the 2015–20 regulatory control period to account for the difference between actual 2014–15 capital expenditure (capex) and the estimate approved in the 2015–20 determination.⁶

In the draft decision, we reduced SA Power Networks' proposed opening RAB as at 1 July 2020 by updating various inputs such as the actual 2018–19 consumer price

¹ NER, cl. 6.12.1(6).

² 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.

³ NER, cl. 6.12.1(18).

⁴ SA Power Networks, *Attachment 2 – Regulatory asset base*, December 2019, p. 10.

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

⁶ The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2015–20 determination.

index (CPI) in the RFM.⁷ We noted the roll forward of SA Power Networks' RAB included estimated capex for 2018–19 and 2019–20, and estimated inflation for 2019–20, because these actual values were not yet available.⁸

In its revised proposal, SA Power Networks adopted our draft decision changes in full.⁹ In addition, it has updated its 2018–19 estimated capex with actuals and revised its 2019–20 estimated capex.¹⁰

We have checked the 2018–19 actual capex in the revised proposal and are satisfied it reconciles with SA Power Networks' annual reporting regulatory information notice for that year. We accept SA Power Networks' revision to the 2019–20 net capex estimate of \$387.0 million (\$nominal).¹¹ This amount is lower than we approved in our draft decision, reflecting more recent data. We note that the financial impact of any difference between actual and estimated capex for 2019–20 will be accounted for at the next reset. Our final decision also updates the 2019–20 inflation input in the RFM with actual CPI for this year, which became available after SA Power Networks submitted its revised proposal.

We also consider the extent to which our roll forward of the RAB to 1 July 2020 contributes to the achievement of the capital expenditure incentive objective.¹² As discussed in the draft decision, the review period for this distribution determination is limited to 2014–15, 2015–16, 2016–17 and 2017–18 capex.¹³ SA Power Networks' aggregated actual capex incurred for the four year period of 2014–18 is below the forecast allowance set for that period at the previous distribution determinations. Therefore, the overspending requirement for an efficiency review of past capex has not been satisfied.¹⁴ Given this, we consider the capex incurred in those years to be consistent with the capital expenditure criteria and can therefore be included in the RAB.¹⁵

For this final decision, we have included SA Power Networks' actual capex for 2018–19 and estimated capex for 2019–20 in the RAB roll forward to 1 July 2020. At the next reset, the 2018–19 and 2019–20 actual capex will form part of the review period for

⁷ AER, *SA Power Networks 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, pp. 10–11.

⁸ AER, *SA Power Networks 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, p. 14–16.

⁹ *SA Power Networks, Attachment 2 – Regulatory asset base*, December 2019, pp. 9–11.

¹⁰ *SA Power Networks, Attachment 2 – Regulatory asset base*, December 2019, p. 9.

¹¹ This amount includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB. The 2019–20 net capex in this final decision is \$387.1 million due to updates for actual rather than estimated CPI in 2019–20.

¹² NER, cl. 6.12.2(b) and 6.4A(a).

¹³ AER, *SA Power Networks 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, p. 16.

¹⁴ NER, cl. S6.2.2A(c).

¹⁵ AER, *SA Power Networks 2020–25 – Draft decision – Attachment 5 – Capital expenditure*, October 2019, pp. 96–97; NER, cl. S6.2.1(f).

whether past capex should be excluded for inefficiency reasons.¹⁶ Our RAB roll forward applies the incentive framework approved in the previous distribution determination, which included the use of a forecast depreciation approach in combination with the application of the capital expenditure sharing scheme (CESS).¹⁷ As such, we consider that the 2015–20 RAB roll forward contributes to an opening RAB (as at 1 July 2020) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.¹⁸

Table 2.1 sets out our final decision on the roll forward of SA Power Networks' RAB for the 2015–20 regulatory control period.

Table 2.1 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 ^a
Opening RAB	3778.4	3884.9	3931.8	4088.9	4234.7
Capital expenditure ^b	251.7	274.3	374.2	376.6	387.1
Inflation indexation on opening RAB	63.8	57.3	75.1	73.0	77.9
Less: straight-line depreciation ^c	208.9	284.8	292.2	303.7	318.3
Interim closing RAB	3884.9	3931.8	4088.9	4234.7	4381.4
Difference between estimated and actual capex in 2014–15					–15.7
Return on difference for 2014–15 capex					–4.7
Closing RAB as at 30 June 2020					4361.0

Source: AER analysis.

- (a) Based on estimated capex provided by SA Power Networks. We will true-up the RAB for actual capex at the next reset.
- (b) Net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.
- (c) Adjusted for actual CPI. Based on forecast capex.

Forecast closing RAB as at 30 June 2025

Once we have determined the opening RAB as at 1 July 2020, 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 as at the end of the 2020–25 regulatory control period.¹⁹

¹⁶ Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NER, cl. S6A.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.

¹⁷ AER, *SA Power Networks distribution determination final Decision 2015–16 to 2019–20 – Attachment 2 – Regulatory asset base*, October 2015, p. 16.

¹⁸ NER, cll. 6.4A(a), 6.5.7(c) and 6.12.2(b).

¹⁹ NER, cl. S6.2.3.

For this final decision, we determine a forecast closing RAB value at 30 June 2025 of \$4854.9 million (\$nominal) for SA Power Networks. This is \$117.6 million (or 2.4 per cent) lower than SA Power Networks' revised proposal of \$4972.5 million (\$nominal). Our final decision on the forecast closing RAB reflects the amended opening RAB as at 1 July 2020, and our final decisions on the expected inflation rate (section 2.2 of the Overview), forecast depreciation (attachment 4) and forecast capex (attachment 5).²⁰

Table 2.2 sets out our final decision on the forecast RAB for SA Power Networks over the 2020–25 regulatory control period.

Table 2.2 AER's final decision on SA Power Networks' RAB for the 2020–25 regulatory control period (\$million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25
Opening RAB	4361.0	4478.4	4594.6	4682.9	4768.2
Capital expenditure ^a	341.9	354.4	340.1	345.1	342.4
Inflation indexation on opening RAB	99.2	101.8	104.5	106.5	108.4
Less: straight-line depreciation	323.7	340.1	356.2	366.2	364.2
Closing RAB	4478.4	4594.6	4682.9	4768.2	4854.9

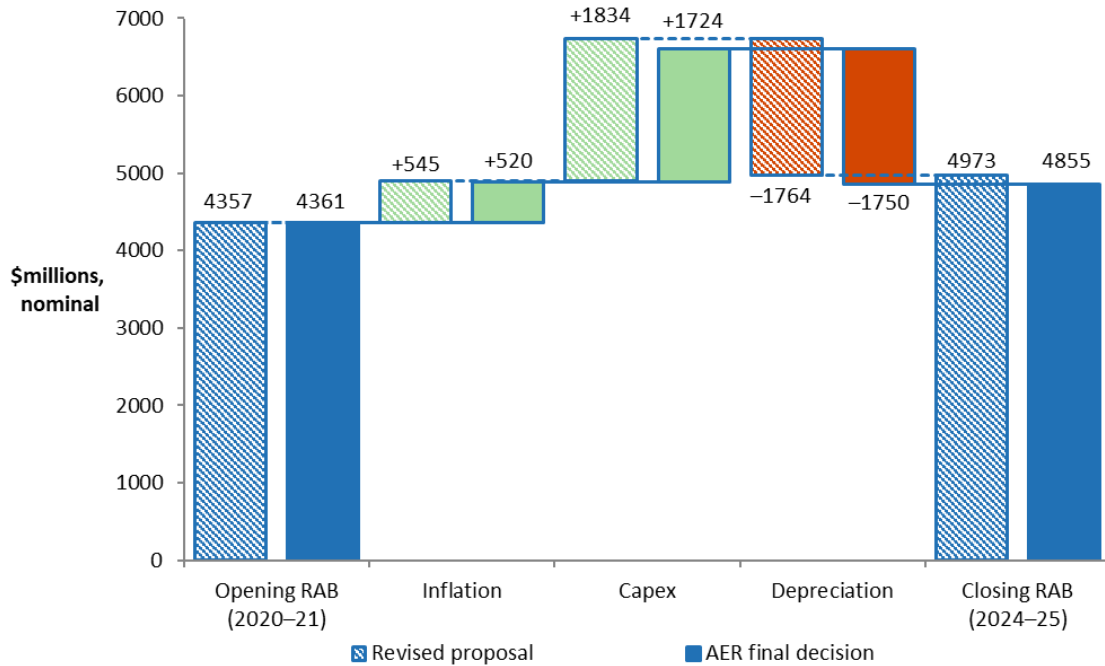
Source: AER analysis.

(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 SA Power Networks' RAB over the 2020–25 regulatory control period for this final decision. Overall, the closing RAB at the end of the 2020–25 regulatory control period is forecast to be 11.3 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 39.5 per cent, while expected inflation increases it by 11.9 per cent. Forecast depreciation, on the other hand, reduces the RAB by 40.1 per cent.

²⁰ Capex enters the RAB net of forecast disposals. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2020–25 regulatory control period (section 2.2 of the Overview).

Figure 2.1 Key drivers of changes in the RAB—SA Power Networks' revised proposal compared with AER's final decision (\$million, nominal)



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

Forecast net capex is a significant driver of the increase in the RAB. In our final decision, we are not satisfied that SA Power Networks' revised proposed total forecast capex of \$1693.4 million (\$2019-20)²¹ for the 2020-25 regulatory control period reasonably reflects the capex criteria. We have therefore amended SA Power Networks' revised proposed capex for the 2020-25 regulatory control period to \$1595.8 million (\$2019-20). Refer to section 5.3 of attachment 5 for the discussion on forecast capex.

Application of depreciation approach in RAB roll forward for next reset

When we roll forward SA Power Networks' RAB for the 2020-25 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 2025-30 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2020-25 regulatory control period.²²

²¹ This amount is net of capital contributions, disposals and equity raising costs, and excludes the half-year WACC adjustment.

²² NER, cl. 6.12.1(18).

As discussed in section 2.7 of the final decision overview, we will also apply the CESS to SA Power Networks over the 2020–25 regulatory control period. We consider that the CESS will provide sufficient incentives for SA Power Networks 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.²³ Further, this approach is consistent with our draft decision, SA Power Networks' initial proposal and our Framework and Approach.²⁴

2.2 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.

²³ Our ex post capex measures are set out in the capex incentive 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.

²⁴ AER, *SA Power Networks 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, pp. 18–19; SA Power Networks, *2020–25 Regulatory proposal – Attachment 2 – Regulatory asset base*, January 2019, p. 10; AER, *Final framework and approach for SA Power Networks – Regulatory control period commencing 1 July 2020*, July 2018, pp. 71–72.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
NER	National Electricity Rules
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
WACC	weighted average cost of capital