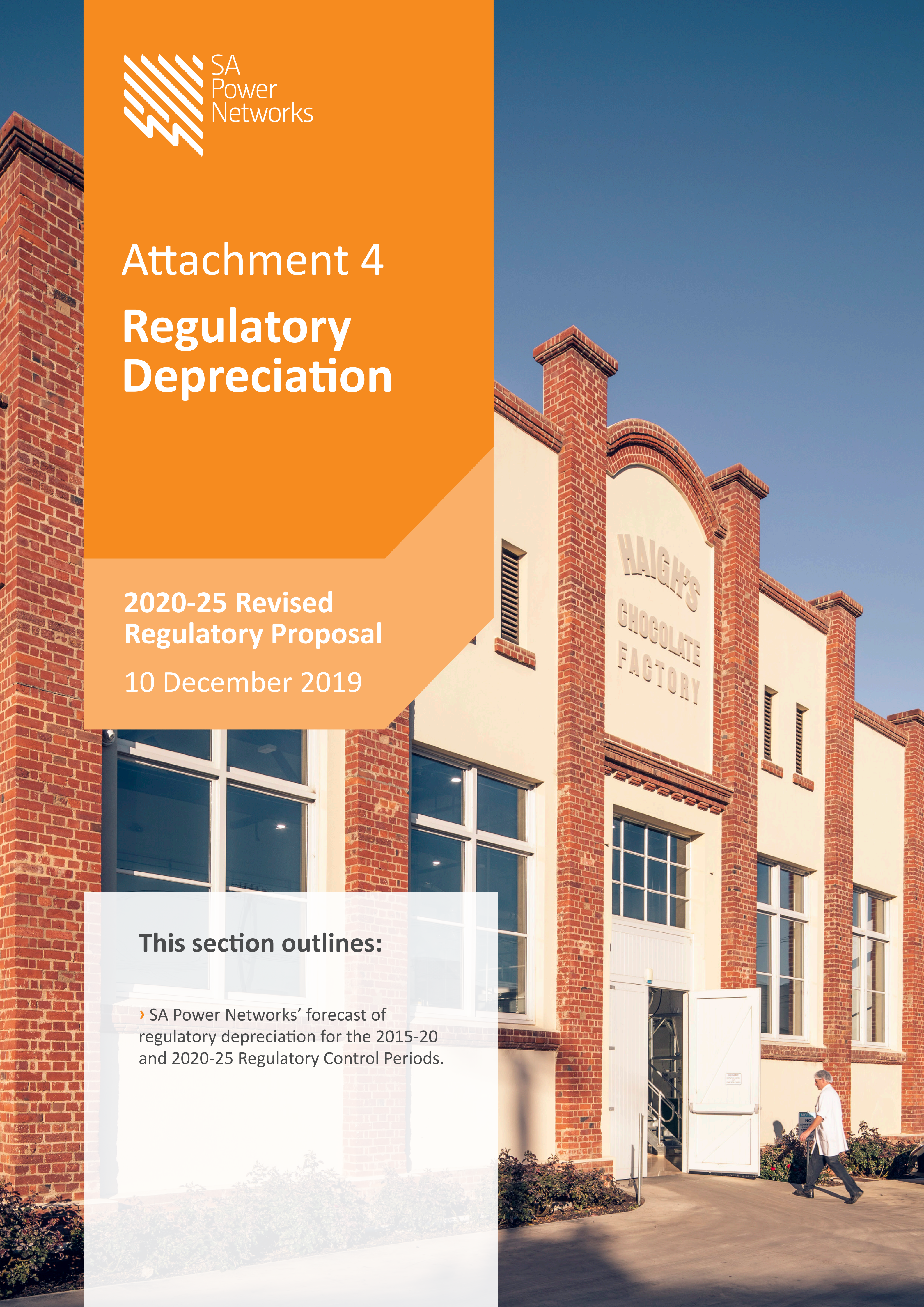

SA Power Networks

Attachment 4
Regulatory Depreciation

2020-25 Revised Regulatory Proposal

10 December 2019

This section outlines:

- SA Power Networks' forecast of regulatory depreciation for the 2015-20 and 2020-25 Regulatory Control Periods.

Company information

SA Power Networks is the registered Distribution Network Service Provider for South Australia. For information about SA Power Networks visit sapowernetworks.com.au

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Disclaimer

This document forms part of SA Power Networks' Regulatory Proposal to the Australian Energy Regulator for the 1 July 2020 to 30 June 2025 regulatory control period. The Proposal and its attachments were prepared solely for the current regulatory process and are current as at the time of lodgement.

This document contains certain predictions, estimates and statements that reflect various assumptions concerning, amongst other things, economic growth and load growth forecasts. The Proposal includes documents and data that are part of SA Power Networks' normal business processes and are therefore subject to ongoing change and development.

Whilst care was taken in the preparation of the information in this Regulatory Proposal, and it is provided in good faith, SA Power Networks, its officers and shareholders accept no responsibility or liability for any loss or damage that may be incurred by any person acting in reliance on this information or assumptions drawn from it for a different purpose or in a different context.

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Note

This attachment forms part of our Proposal for the 2020-25 Regulatory Control Period. It should be read in conjunction with the other parts of the Proposal.

Our Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 18:

Document	**Description**
	Regulatory Proposal overview
Attachment 1	Annual revenue requirement and control mechanism
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 11	Demand management incentives and allowance
Attachment 12	Classification of services
Attachment 13	Pass through events
Attachment 14	Alternative Control Services
Attachment 15	Negotiated services framework and criteria
Attachment 16	Connection Policy
Attachment 17	Tariff Structure Statement Part A
Attachment 17	Tariff Structure Statement Part B - Explanatory Statement
Attachment 18	List of Proposal documentation

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4 Regulatory Depreciation

4.1. Overview

Original Proposal	AER Draft Decision	Revised Proposal
$1,233.3 million (nominal)	$1,187.7 million (nominal)	$1,219 million (nominal)
Proposed additional asset categories and lives	Accepted proposed changes to asset categories and lives	
	Recalculated with Draft Decision capital expenditure (**capex**) and inflation	Revised for updated regulatory asset base (**RAB**) at 2020 and Revised Proposal capex

Depreciation is the allowance provided so capital investors recover their investment over the economic life of the asset (ie the return of capital). The regulatory depreciation allowance is the net total of the depreciation (negative) and the indexation (positive) of the RAB.

4.2. Original Proposal

SA Power Networks proposed a total forecast regulatory depreciation allowance of $1233.3 million (nominal) in our regulatory proposal for the 2020–25 regulatory control period (**RCP**) (**Original Proposal**).

The proposed depreciation allowance was calculated using:

- the straight line depreciation method employed in the Australian Energy Regulator's (**AER**) post-tax revenue model (**PTRM**);
- the closing RAB value at 30 June 2020 derived from the AER's roll forward model (**RFM**);
- proposed forecast capex for the 2020–25 RCP;
- an expected inflation rate of 2.47% per annum for the 2020–25 RCP;
- the year-by-year tracking depreciation model, which implements the straight line method to calculate the forecast depreciation (over the 2020–25 RCP) of the opening RAB value at 1 July 2020; and
- three new (additional) asset classes—'Sub-transmission and distribution lines - short life', 'Substations and transformers - short life' and 'Electronic network assets', with standard asset lives of 25 years, 20 year and 15 years respectively.

4.3. AER's Draft Decision

In its draft decision on our Original Proposal (**Draft Decision**), the AER determined a regulatory depreciation allowance of $1187.7 million ($ nominal) for the 2020-25 RCP.

In making this determination, the AER:[1]

- accepted our proposed existing asset classes, straight line depreciation method and standard asset lives (with the exception of the standard asset life for the 'Equity raising costs' asset class);
- accepted our proposal to introduce three new asset classes and approved our proposed standard lives for those asset classes, for the calculation of capex from 1 July 2020 (and agreed that forecast capex for many of the proposed refurbishment activities should be allocated to those new asset classes);
- did not approve certain activities (eg low voltage two way network) and reallocated other activities to other existing asset classes;

[1] *AER, Draft Decision for SA Power Networks Distribution Determination 2020-2025, Attachment 4: Regulatory Depreciation (**Attachment 4**), page 5.*

- accepted that our proposed year-by-year tracking approach to calculate depreciation on existing assets meets the requirements of clause 6.5.5(b) of the National Electricity Rules (**NER**);
- made minor changes to the standard life of the 'Equity raising costs' asset class and the application of the year-by-year tracking calculations;
- as part of implementing changes from the AER's *Regulatory tax approach review 2018* (**Tax Review**), reallocated forecast capex for buildings and IT to two new asset classes:[2]
  - Buildings – capital works (40 year standard asset life); and
  - In-house software (5 year standard asset life);
- made determinations of the opening RAB value as at 1 July 2020 (Attachment 2 – Regulatory asset base), expected inflation (Attachment 3 – Rate of return) and forecast capex (Attachment 5 – Capital expenditure) which affect the calculation of our regulatory depreciation allowance; and
- made minor amendments (to which we agreed)[3] in the depreciation model (eg substituting nominal WACC with real WACC).

4.4. SA Power Networks' response to the AER Draft Decision

SA Power Networks accepts the AER's decisions to:

- accept the existing asset classes and lives;
- accept the proposed three new asset classes and standard lives;
- accept the two new asset classes and standard lives for 'Buildings – Capital works' and 'In-house software', arising from the Tax Review; and
- continue to apply the year-by-year tracking approach to calculate depreciation on existing assets.

However, SA Power Networks has not incorporated the AER's Draft Decision in relation to the forecast regulatory depreciation allowance for the 2020-25 RCP in our Revised Proposal, because SA Power Networks does not accept the AER's Draft Decision in relation to:

- forecast capex for the 2020-25 RCP; or
- forecast inflation;

which have affected the AER's forecast regulatory depreciation allowance.

4.5. Revised Proposal

As discussed above, SA Power Networks has accepted the Draft Decision for asset classes, asset lives and the continued application of the year-by-year tracking approach.

In our Revised Proposal, we have calculated a different value for regulatory depreciation, due to the changes contained in other parts of this Revised Proposal for:

- forecast capex (as discussed in Attachment 5 – Capital expenditure);
- forecast Inflation for the 2020-25 RCP (as discussed in Attachment 3 – Rate of return); and
- forecast Inflation for 2019/20 (as discussed in Attachment 2 – Regulatory Asset Base).

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[2] We note that these two new asset classes are subject to straight line tax depreciation, as per the changes resulting from the AER's Tax Review.

[3] *AER, Attachment 4, page 12.*

4.5.1. Regulatory depreciation for the 2015–20 RCP

The recalculated depreciation for the 2015-20 RCP is shown in Table 4-1 below.

Table 4-1: Regulatory straight line depreciation for the 2015–20 RCP (nominal, $ million)

	2015/16	2016/17	2017/18	2018/19	2019/20
Straight line depreciation	208.9	284.8	292.2	303.7	318.3
Less: inflation indexation on opening RAB	63.8	57.3	75.1	73.0	74.1
Regulatory Depreciation – Standard Control Services	145.1	227.5	217.2	230.8	244.2

4.5.2. Forecast regulatory depreciation for the 2020–25 RCP

SA Power Networks has recalculated its depreciation forecast for the 2020–25 RCP for our Revised Proposal.

The total of the resulting regulatory depreciation allowance is shown in Table 4-2 below.

Table 4-2: Forecast regulatory straight line depreciation for the 2020-25 RCP (nominal, $ million)

	2020/21	2021/22	2022/23	2023/24	2024/25
Straight line depreciation	323.6	341.3	358.8	370.4	370.0
Less: inflation indexation on opening RAB	102.8	106.1	109.4	112.1	114.7
Regulatory Depreciation – Standard Control Services	220.8	235.2	249.4	258.3	255.3

4.5.3. Tax depreciation for the 2015–20 and 2020–25 RCPs

For the purposes of calculating the estimated cost of corporate income tax pursuant to clause 6.5.3 of the NER, SA Power Networks is required to calculate tax depreciation. Different asset lives apply for taxation purposes under Australian tax law.

In December 2018, the AER issued its final report for the Tax Review (**Final Tax Report**)[4]. The Final Tax Report included a number of recommendations and findings which impact upon tax depreciation. We addressed the Final Tax Report in Attachment 4 – Regulatory depreciation and Attachment 7 – Corporate income tax of our Original Proposal.

The AER's PTRM has historically been used to calculate tax depreciation on a straight line basis, using applicable straight line tax depreciation rates. Since issuing its Final Tax Report, the AER has made changes to the PTRM which apply:

- the AER's approach to immediate expensing of refurbishment capex set out in the Final Tax Report when determining the estimated cost of corporate income tax; and
- the AER's benchmark diminishing value depreciation approach for all new assets/capex with the exception of assets qualified under section 40.72 of the *Income Tax Assessment Act 1997* (Cth).

We have had regard to, and applied, those changes when determining our proposed tax depreciation in this Revised Proposal.

Tax depreciation is addressed in further detail in Attachment 7 - Corporate income tax.

[4] *AER, Final report – Review of regulatory tax approach, 17 December 2018.*

Shortened Forms

AER	*Australian Energy Regulator*
capex	*Capital expenditure*
Draft Decision	*AER's draft decision on SA Power Networks' Original Proposal*
NER	*National Electricity Rules*
Original Proposal	*Regulatory Proposal for the 2020-25 RCP*
PTRM	*Post-Tax Revenue Model*
RAB	*Regulatory Asset Base*
RCP	*Regulatory Control Period*
Revised Proposal	*Revised Regulatory Proposal for the 2020-25 RCP*
RFM	*Roll Forward Model*
Tax review	*AER's Regulatory tax approach review 2018*