Draft Decision

Ausgrid Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 2
Regulatory asset base

September 2023

AUSTRALIAN ENERGY REGULATOR

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2 Regulatory asset base

The regulatory asset base (RAB) is the value of the assets used by Ausgrid to provide standard control services, comprising of its distribution and transmission (dual function assets) networks.[1] Ausgrid's dual function assets are high voltage assets which support the broader NSW/ACT transmission network owned and operated by Transgrid. The AER has decided to continue applying transmission pricing to these assets.[2]

Our distribution determination specifies the RAB as at the commencement of the regulatory control period and the appropriate method for the indexation of the RAB.[3] The indexation of the RAB is one of the building blocks that form the annual revenue requirement for each year of the 2024–29 regulatory control period.[4] We set the RAB as the foundation for determining a distributor's revenue requirements and use the opening RAB for each regulatory year to determine the return on capital and return of capital (regulatory depreciation) building blocks.[5]

This attachment presents our draft decision on the opening RAB value as at 1 July 2024 for Ausgrid and our forecast of its RAB values over the 2024–29 period. It also presents our draft decision for establishing the RAB as at the commencement of the 2029–34 period using depreciation that is based on forecast capital expenditure (capex).[6]

2.1 Draft decision

We determine opening RAB values of $15,926.9 million and $2,486.7 million ($ nominal) as at 1 July 2024 for Ausgrid's distribution and transmission networks respectively. These values are $117.9 million (or 0.7%) and $14.3 million (or 0.6%) lower than Ausgrid's proposed opening RAB values of $16,044.9 million and $2,501.0 million ($ nominal).[7] These decreases are largely due to the updates we made to the consumer price index (CPI) inputs for 2022–23 and 2023–24 in the roll forward model (RFM) to reflect more up-to-date values:

- We have updated the actual CPI for 2022–23 to 7.83%, reflecting the 2022 December quarter CPI published by the Australian Bureau of statistics (ABS), which became available after Ausgrid submitted its proposal. This compares to Ausgrid's proposed estimated CPI of 8.00%.
- We have also updated the estimated CPI for 2023–24 with the latest Reserve Bank of Australia (RBA) forecast published in its *Statement on Monetary Policy* to reflect the latest economic conditions.[8] For our draft decision, we adopt an estimated CPI value of

1 NER, cl. 6.5.1(a).

2 AER, *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales), Regulatory control period commencing 1 July 2024*, July 2022, p. 54.

3 NER, cll. 6.3.2(a)(1) and (2).

4 NER, cll. 6.4.3(a)(1) and (b)(1).

5 NER, cll. 6.4.3(a)(2) and (3).

6 NER, cl. 6.12.1(18).

7 Ausgrid, *Att. 4.1.a - RFM for distribution*, January 2023; Ausgrid, *Att. 4.1.c - RFM for transmission*, January 2023.

8 RBA, *Statement on Monetary Policy, Appendix: Forecasts*, August 2023.

4.10% for 2023–24, compared to Ausgrid's proposed 4.75%.[9] The CPI input for 2023–24 will be updated again to reflect the actual CPI published by the ABS for our final decision.

As the RAB must be maintained in real dollar terms by indexing for inflation,[10] the combined effect of our above amendments to CPI results in reductions to the opening RAB values as at 1 July 2024 by $127.0 million (or 0.8%) and $17.8 million (or 0.7%) for Ausgrid's distribution and transmission networks respectively, compared to Ausgrid's proposal.

We largely accept Ausgrid's proposed method for calculating the opening RAB. However, we have made the following amendments in the proposed inputs in the RFMs (in addition to the CPI updates discussed above):

- We updated the nominal vanilla weighted average cost of capital (WACC) for 2023–24. This update is required to reflect the 2023–24 return on debt update in the post-tax revenue model (PTRM) for the 2019–24 period, which became available after Ausgrid submitted its proposal.
- We removed expenditures related to capitalised leases for 2019–20 distribution capex and 2021–22 distribution and transmission capex to reflect our approach to address mid-period changes in accounting standards.[11] We also amended the final year asset adjustments associated with capitalised lease costs rolled into the distribution and transmission RAB as at 30 June 2024.
- We updated the asset disposal values for 2022–23 and the final year asset adjustment reallocation of a negative residual closing RAB amount associated with these disposals to reflect our draft decision distribution and transmission closing RABs as at 30 June 2024.[12]
- We made minor updates to the final year asset adjustment values for various distribution and transmission asset classes associated with Ausgrid's proposal to reallocate some portion of its distribution assets to its transmission RAB, to reflect changes in those assets that meet the definition of a dual function asset in accordance with the National Electricity Rules (NER).[13]

The net total impact of all these amendments is an increase of $9.1 million and $3.5 million ($ nominal) to the distribution and transmission opening RAB values respectively.

To determine the opening RAB as at 1 July 2024, we have rolled forward the RAB over the 2019–24 period to determine a closing RAB value at 30 June 2024 in accordance with our RFM.[14] This roll forward process includes an adjustment at the end of the 2019–24 period to

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9 RBA, *Statement on Monetary Policy, Economic Outlook Table 5.1*, November 2022.

10 NER, cll. 6.4.3(b)(1) and 6.5.1(e)(3).

11 Ausgrid, *Response to information request IR046*, 7 July 2023. Forecast costs related to leases will only begin being treated as capex from the start of the 2024–29 period.

12 The negative RAB is reallocated from the existing 'Land (non-system)' asset class to a new 'Land (non-system) depreciation' asset class for reverse depreciation purposes. This is a RAB reallocation and does not affect the total value of the opening RAB as at 1 July 2024.

13 NER, cl. 6.24.2. Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 6. This reallocation does not affect Ausgrid's total combined distribution and transmission opening RAB value as at 1 July 2024.

14 AER, *Electricity distribution network service providers: Roll forward model (version 3.1)*, May 2022.

account for the difference between actual 2018–19 capex and the estimate approved in the 2019–24 determination.[15]

Table 2.1 and Table 2.2 set out our draft decision on the roll forward of Ausgrid's RABs over the 2019–24 period for its distribution and transmission networks respectively.

Table 2.1 AER's draft decision on Ausgrid's RAB for the 2019–24 period – distribution ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[b]
Opening RAB	13,779.4	14,105.0	14,093.1	14,230.0	15,340.3
Capital expenditure[c]	497.3	328.6	133.5	523.8	661.7
Inflation indexation on opening RAB[d]	253.6	121.4	493.0	1,114.5	629.0
Less: straight-line depreciation[e]	425.3	461.8	489.6	528.0	562.5
Interim closing RAB	14,105.0	14,093.1	14,230.0	15,340.3	16,068.4
Difference between estimated and actual capex in 2018–19					55.6
Return on difference for 2018–19 capex					20.7
Final year asset adjustment[f]					–217.8
Closing RAB as at 30 June 2024					**15,926.9**

Source: AER analysis.
(a) Based on estimated capex provided by Ausgrid. We will update the RAB roll forward with actual capex in the final decision.
(b) Based on estimated capex provided by Ausgrid. We expect to update the RAB roll forward with a revised capex estimate in the final decision, and true-up the RAB for actual capex at the next distribution determination.
(c) Net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.
(d) We will update the RAB roll forward for actual CPI for 2023–24 in the final decision.
(e) Adjusted for actual CPI. Based on forecast capex.
(f) Reflects inclusion of capitalised lease costs for existing leases and dual function asset re-classification adjustment as at 30 June 2024.

[15] The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2019–24 determination.

Table 2.2 AER's draft decision on Ausgrid's RAB for the 2019–24 period – transmission ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[b]
Opening RAB	1,901.7	1,944.2	1,949.2	1,992.5	2,146.3
Capital expenditure[c]	63.1	48.8	39.6	67.3	88.3
Inflation indexation on opening RAB[d]	35.0	16.7	68.2	156.0	88.0
Less: straight-line depreciation[e]	55.6	60.5	64.5	69.6	75.1
Interim closing RAB	1,944.2	1,949.2	1,992.5	2,146.3	2,247.4
Difference between estimated and actual capex in 2018–19					15.5
Return on difference for 2018–19 capex					5.8
Final year asset adjustment[f]					218.0
Closing RAB as at 30 June 2024					**2,486.7**

Source: AER analysis.
(a) Based on estimated capex provided by Ausgrid. We will update the RAB roll forward with actual capex in the final decision.
(b) Based on estimated capex provided by Ausgrid. We expect to update the RAB roll forward with a revised capex estimate in the final decision, and true-up the RAB for actual capex at the next distribution determination.
(c) Net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.
(d) We will update the RAB roll forward for actual CPI for 2023–24 in the final decision.
(e) Adjusted for actual CPI. Based on forecast capex.
(f) Reflects dual function asset re-classification adjustments as at 30 June 2024.

We determine forecast closing RAB values of $18,133.0 million and $2,647.2 million ($ nominal) as at 30 June 2029 for Ausgrid's distribution and transmission networks respectively. These are $717.7 million and $63.9 million lower than Ausgrid's proposed closing RAB values of $18,850.7 million and $2,711.1 million ($ nominal) for its distribution and transmission networks respectively.[16] The reductions are mainly due to our draft decision on forecast capex (Attachment 5). Our draft decisions on the opening RAB as at 1 July 2024, the expected inflation rate (Attachment 3), forecast depreciation (Attachment 4) also affect the forecast closing RAB value as at 30 June 2029.[17]

Table 2.3 and Table 2.4 set out our draft decision on the forecast RAB values for Ausgrid over the 2024–29 period for its distribution and transmission networks respectively.

16 Ausgrid, *Att. 4.1.b - PTRM for distribution*, January 2023; Ausgrid, *Ausgrid - Att. 4.1.d - PTRM for transmission*, January 2023.

17 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. Therefore, our draft decision on the forecast RAB also reflects our amendments to the rate of return for the 2024–29 period (Attachment 3).

Table 2.3 AER's draft decision on Ausgrid's RAB for the 2024–29 period – distribution ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29
Opening RAB	15,926.9	16,453.3	16,909.1	17,344.0	17,737.0
Capital expenditure[a]	600.3	557.1	566.5	536.1	525.1
Inflation indexation on opening RAB	445.9	460.7	473.4	485.6	496.6
Less: straight-line depreciation	519.9	561.9	605.1	628.7	625.8
Closing RAB	**16,453.3**	**16,909.1**	**17,344.0**	**17,737.0**	**18,133.0**

Source: AER analysis.
(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the 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.

Table 2.4 AER's draft decision on Ausgrid's RAB for the 2024–29 period – transmission ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29
Opening RAB	2,486.7	2,534.3	2,562.4	2,585.6	2,618.1
Capital expenditure[a]	54.7	39.1	38.5	49.5	43.8
Inflation indexation on opening RAB	69.6	71.0	71.7	72.4	73.3
Less: straight-line depreciation	76.8	82.0	87.0	89.4	87.9
Closing RAB	**2,534.3**	**2,562.4**	**2,585.6**	**2,618.1**	**2,647.2**

Source: AER analysis.
(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the 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.

We determine that the forecast depreciation approach is to be used to establish the opening RABs at the commencement of the 2029–34 period for Ausgrid's distribution and transmission networks.[18] We consider this approach is consistent with the capital expenditure incentive objective in that it will provide sufficient incentives for Ausgrid to achieve capex efficiency gains over the 2024–29 period. This approach is also consistent with our *Framework and approach* (F&A) paper.[19]

2.2 Ausgrid's proposal

Ausgrid used our RFM to establish opening RAB as at 1 July 2024 and our PTRM to roll forward the RAB over the 2024–29 period.

18 NER, cl. 6.12.1(18).

19 AER, *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales), Regulatory control period commencing 1 July 2024,* July 2022, p. 53.

Ausgrid proposed opening RAB values of $13,779.4 million and $1,901.7 million ($ nominal) as at 1 July 2019 for its distribution and transmission networks respectively. Rolling forward these opening RAB values with actual/estimated capex and using depreciation based on forecast capex approved for the 2019–24 period, Ausgrid proposed closing RAB values of $16,044.9 million and of $2,501.0 million ($ nominal) as at 30 June 2024 for its distribution and transmission networks respectively.

In rolling forward its RAB, Ausgrid's 2019–20 distribution capex and 2021–22 distribution and transmission capex included actual expenditure related to capitalised leases to reflect a change in accounting standards (AASB 16).[20] Ausgrid proposed a final year asset adjustment as at 30 June 2024 to reallocate the associated capitalised distribution lease cost of $0.6 million and $7.3 million ($ nominal) to the new 'Distribution leases (network)' and 'Distribution leases (non-network)' asset classes respectively; and capitalised transmission lease cost of $0.6 million ($ nominal) to the new 'Transmission leases (non-network)' asset class.[21]

For the final year (end of period) asset adjustment,[22] Ausgrid also proposed to:

- reallocate a negative residual closing RAB value of $282.8 million (for distribution) and $39.5 million (for transmission) ($ nominal) as at 30 June 2024 from its existing 'Land (non-system)' asset class to a new 'Land (non-system) depreciation' asset class. This treatment provides for reverse depreciation by returning the negative amounts to customers in the 2024–29 period. This is a RAB reallocation and does not affect the total value of the opening RABs at 1 July 2024, and implements Ausgrid's proposed 'Property sales strategy to help with affordability' program.[23]
- reallocate $219.9 million ($ nominal) of its distribution assets to its transmission RAB as at 30 June 2024, to reflect changes in those assets that meet the definition of a dual function asset in accordance with the NER.[24]

Table 2.5 and Table 2.6 set out Ausgrid's proposed roll forward of its RABs during the 2019–24 period for its distribution and transmission networks respectively.[25]

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20 AASB 16 changes were expected to apply from 1 July 2019.

21 Ausgrid, *Att. 4.1.a - RFM for distribution*, January 2023; Ausgrid, *Att. 4.1.c - RFM for transmission*, January 2023.

22 The final year asset adjustment section in the RFM is primarily for recording asset adjustments at the end of the current regulatory control period. This section is used when the distributor needs to adjust its closing RAB by removing or adding assets (such as for a change in service classification) in the final year of the regulatory control period.

23 Ausgrid, *2024–29 Regulatory Proposal*, January 2023, p. 52.

24 NER, cl. 6.24.2. Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 6.

25 Ausgrid, *Att. 4.1.a - RFM for distribution*, January 2023; Ausgrid, *Att. 4.1.c - RFM for transmission*, January 2023.

Table 2.5 Ausgrid's proposed RAB for the 2019–24 period – distribution ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[a]
Opening RAB	13,779.4	14,105.5	14,093.6	14,237.0	15,358.2
Capital expenditure[b]	497.8	328.6	140.0	510.1	663.7
Inflation indexation on opening RAB	253.6	121.4	493.0	1,139.0	729.5
Less: straight-line depreciation[c]	425.3	461.8	489.6	528.0	563.4
Interim closing RAB	14,105.5	14,093.6	14,237.0	15,358.2	16,187.9
Difference between estimated and actual capex in 2018–19					55.6
Return on difference for 2018–19 capex					21.2
Final year asset adjustment[d]					–219.9
Closing RAB as at 30 June 2024					**16,044.9**

Source: Ausgrid, *Att. 4.1.a - RFM for distribution*, January 2023.
(a) Based on estimated capex.
(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.
(d) Reflects dual function asset re-classification adjustment as at 30 June 2024.

Table 2.6 Ausgrid's proposed RAB for the 2019–2024 period – transmission ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[a]
Opening RAB	1,901.7	1,944.2	1,949.2	1,993.0	2,144.5
Capital expenditure[b]	63.1	48.8	40.1	61.7	88.6
Inflation indexation on opening RAB	35.0	16.7	68.2	159.4	101.9
Less: straight-line depreciation[c]	55.6	60.5	64.5	69.6	75.3
Interim closing RAB	1,944.2	1,949.2	1,993.0	2,144.5	2,259.7
Difference between estimated and actual capex in 2018–19					15.5
Return on difference for 2018–19 capex					5.9
Final year asset adjustment[d]					219.9
Closing RAB as at 30 June 2024					**2,501.0**

Source: Ausgrid, *Att. 4.1.c - RFM for transmission*, January 2023.
(a) Based on estimated capex.
(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.
(d) Reflects dual function asset re-classification adjustment as at 30 June 2024.

Ausgrid proposed forecast closing RAB values of $18,850.7 million and $2,711.1 million ($ nominal) as at 30 June 2029 for its distribution and transmission networks respectively.[26] These values reflect its proposed opening RAB, forecast capex, expected inflation, and depreciation (based on forecast capex) over the 2024–29 period. Ausgrid's projected RABs over the 2024–29 period are shown in Table 2.7 and Table 2.8 for its distribution and transmission networks respectively.

[26] Ausgrid, *Att. 4.1.b - PTRM for distribution*, January 2023; Ausgrid, *Att. 4.1.d - PTRM for transmission*, January 2023.

Table 2.7 Ausgrid's proposed RAB for the 2024–29 period – distribution ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29
Opening RAB	16,044.9	16,665.8	17,244.9	17,801.7	18,323.1
Capital expenditure[a]	687.3	674.9	683.4	662.4	656.5
Indexation on opening RAB	461.2	479.1	495.7	511.7	526.7
Less: straight-line depreciation	527.5	575.0	622.4	652.7	655.6
Closing RAB	**16,665.8**	**17,244.9**	**17,801.7**	**18,323.1**	**18,850.7**

Source: Ausgrid, *Att. 4.1.b - PTRM for distribution*, January 2023.
(a) Net of forecast disposals and capital contributions. Inclusive of half-year WACC to account for the timing assumptions in the PTRM.

Table 2.8 Ausgrid's proposed RAB for the 2024–29 period – transmission ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29
Opening RAB	2,501.0	2,556.5	2,595.1	2,627.9	2,671.0
Capital expenditure[a]	61.2	48.5	47.2	59.8	54.6
Indexation on opening RAB	71.9	73.5	74.6	75.5	76.8
Less: straight-line depreciation	77.6	83.4	89.0	92.1	91.3
Closing RAB	**2,556.5**	**2,595.1**	**2,627.9**	**2,671.0**	**2,711.1**

Source: Ausgrid, *Att. 4.1.d - PTRM for transmission*, January 2023.
(a) Net of forecast disposals and capital contributions. Inclusive of half-year WACC to account for the timing assumptions in the PTRM.

2.3 Assessment approach

We roll forward Ausgrid's RAB over the 2019–24 period to arrive at an opening RAB value at 1 July 2024. This value must be adjusted for any differences in estimated and actual capex.[27] It may also be adjusted to reflect any changes in the use of the assets, with only assets used to provide standard control services to be included in the RAB.[28]

To determine the opening RAB at 1 July 2024, we developed an asset base RFM that a distributor must use in preparing its regulatory proposal.[29] We used the RFM to roll forward

[27] NER, cl. S6.2.1(e)(3).

[28] NER, cl. S6.2.1(e)(7). See also NER, cl. 6.24.2(b) where services provided by means of dual function assets are deemed to be standard control services.

[29] NER, cll. 6.5.1(b), 6.5.1(e), S6.1.3(7); AER, *Electricity distribution network service providers: Roll forward model version 3.1*, May 2022.

Ausgrid's RAB from the beginning of the final year of the 2014–19 period,[30] through the 2019–24 period, to the beginning of the 2024–29 period.

The roll forward for each year of the above period occurs by:

- adding actual inflation (indexation) adjustment to the opening RAB for the relevant year. This adjustment is consistent with the inflation factor used in the control mechanism[31]
- adding actual or estimated capex to the RAB for the relevant year.[32] We review a distributor's past capex and may exclude past capex from being rolled into the RAB where total capex exceeds the regulatory allowance.[33] The details of our assessment approach for capex overspending are set out in the *Capital expenditure incentive guideline*.[34] We note that our review of past capex does not include the last two year of the 2019–24 period—these will instead be reviewed at the next distribution determination.[35] We check actual capex amounts against audited annual reporting regulatory information notice (RIN) data and generally accept the capex reported in those RINs in rolling forward the RAB.[36] However, there may be instances where adjustments are required to the annual reporting RIN data[37]
- subtracting depreciation from the RAB for the relevant year, calculated in accordance with the distribution determination for Ausgrid's 2019–24 period.[38] Depreciation based on forecast or actual capex can be used to roll forward the RAB.[39] For this draft decision, we use depreciation based on forecast capex for rolling forward Ausgrid's RAB over the 2019–24 period.[40] Depreciation based on forecast capex will also be used for the 2024–29 period RAB roll forward at the next distribution determination[41]
- subtracting any gross proceeds for asset disposals for the relevant year from capex to be added to the RAB.[42] We check these amounts against audited annual reporting RIN data.

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30 NER, cl. S6.2.1(e)(3).

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

32 NER, cl. S6.2.1(e)(4).

33 NER, cl. S6.2.2A. Under the NER, cl. S6.2.2A(b), the exclusion of inefficient capex could only come from three areas: 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.

34 AER, *Capital expenditure incentive guideline for electricity network service providers*, April 2023, pp. 13–21.

35 NER, cl. S6.2.2A(a1). The two year lag ensures that actual capex (instead of estimated capex) is available when the review of past capex commences.

36 We will update any estimated capex with actual capex at the time of the next distribution determination.

37 For example, we make adjustment for movements in capitalised provisions if the actual capex amounts reported in the RIN include capitalised provisions.

38 NER, cl. S6.2.1(e)(5).

39 NER, cl. 6.12.1(18).

40 The use of forecast depreciation is consistent with the depreciation approach established in the 2019–24 distribution determination for Ausgrid. See AER, *Final decision, Ausgrid distribution determination 2019 to 2024, Attachment 2, Regulatory asset base*, April 2019, p.12.

41 Refer to section 2.4.3 for the reasons.

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

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 2019–24 period. The PTRM, which is used to calculate the annual revenue requirement for the 2024–29 period, generally adopts the same RAB roll forward approach as the RFM. However, in the PTRM, the annual adjustments to the RAB are based on forecasts, rather than actual amounts.[43]

The opening RAB for the 2029–34 period can be determined using depreciation based either on forecast or actual capex incurred during the 2024–29 period.[44] To roll forward the RAB using depreciation based on forecast capex, we would use the forecast depreciation contained in the PTRM for the 2024–29 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 2024–29 period.

Our decision on whether to use actual or forecast depreciation must be consistent with the capex incentive objective.[45] This objective is to ensure that increases to the RAB through capex only occur where that capex reasonably reflects the capex criteria.[46] In deciding between actual and forecast depreciation, we have regard to:[47]

- 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
- the capex incentive guideline
- the capex 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 amounts.[48] 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 amounts.

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)

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43 NER, cl. S6.2.3.

44 NER, cl. S6.2.2B.

45 AER, *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales), Regulatory control period commencing 1 July 2024,* July 2022, p. 53.

46 NER, cl, 6.4A(a).

47 NER, cl. S6.2.2B(b) and (c).

48 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.

- net capex[49]
- depreciation
- indexation adjustment – so the RAB is presented in nominal terms, consistent with the rate of return.

The opening RAB at the start of a regulatory control period 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 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 regulatory year.

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

We maintain the RAB in real terms by indexing for inflation.[50] A nominal rate of return (WACC) is multiplied by the opening RAB to produce the return on capital building block.[51] To prevent the double counting of inflation through the nominal WACC and indexed RAB,[52] the regulatory depreciation building block has an offsetting reduction for indexation of the RAB.[53] Indexation of the RAB and the offsetting adjustment made to depreciation results in smoother revenue recovery profile over the life of an asset than if the RAB was un-indexed. If the RAB was un-indexed, there would be no need for an offsetting adjustment to the depreciation calculation of total revenue. This alternative approach provides for overall revenues being higher early in the asset's life (as a result of more depreciation being returned to the distributor) and lower in the future—producing a steeper downward sloping profile of total revenue.[54] The implications of an un-indexed RAB are discussed further in Attachment 4.

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49 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-year WACC to arrive at an end of year value. It then begins depreciating the following year.

50 NER, cll. 6.3.2(a)(2), 6.5.1(e)(3).

51 NER, cl. 6.5.2; AER, *Rate of return instrument*, cll. 1, 3, 36(c), February 2023.

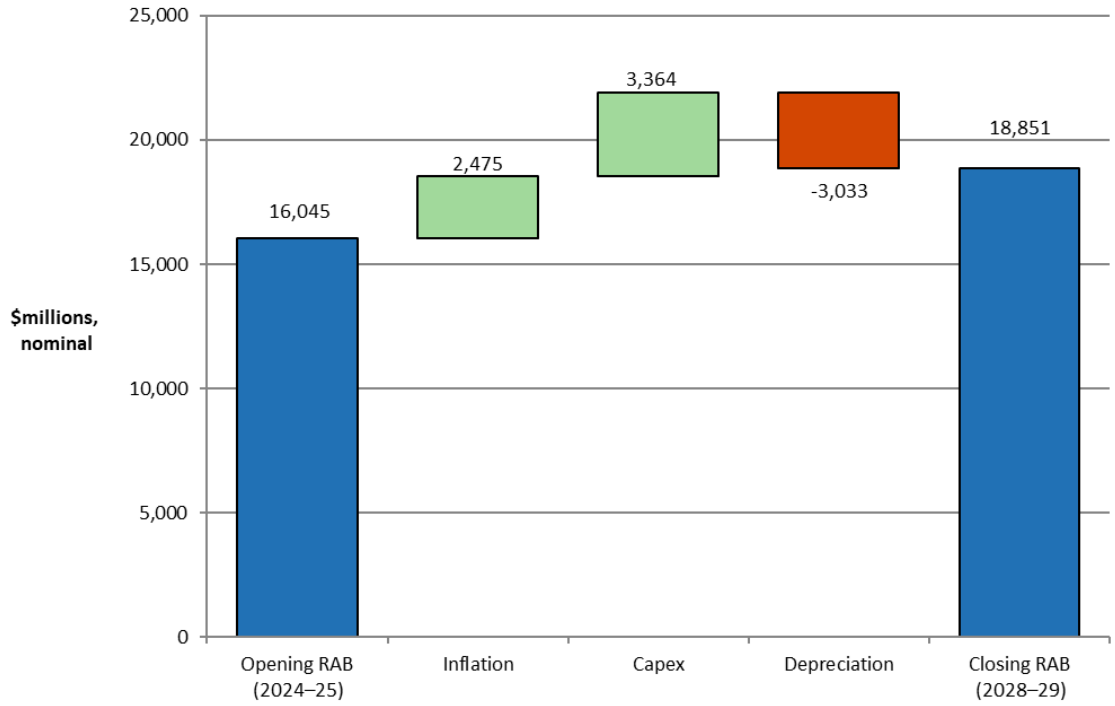
52 NER, cl. 6.4.3(b)(1)(ii).

53 If the asset lives are extremely long, such that the RAB depreciation rate is lower than the inflation rate, then negative regulatory depreciation can emerge. The indexation adjustment is greater than the RAB depreciation in such circumstances. Please also refer to section 4.3.1 of Attachment 4 of this draft decision for further explanation of the offsetting adjustment to the depreciation.

54 A change of approach from an indexed RAB to an un-indexed RAB would result in an initial step change increase in revenues to preserve NPV neutrality.

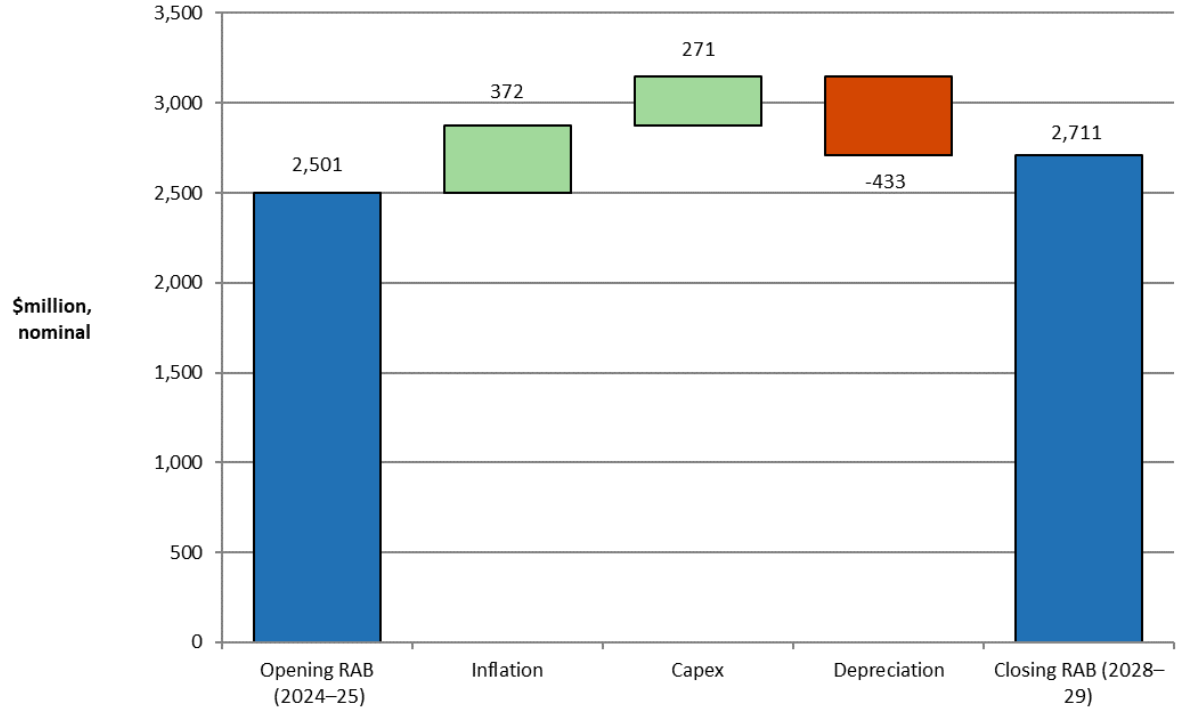
Figure 2.1 and Figure 2.2 show the key drivers of the changes in the RABs over the 2024–29 period as proposed by Ausgrid for its distribution and transmission networks respectively. Overall, the closing RABs at the end of the 2024–29 period would be 17% higher for the distribution network and 8% higher for the transmission network than the respective opening RABs at the start of that period based on the proposal, in nominal terms. The proposed forecast net capex increases the RAB by 21% for the distribution network and 11% for the transmission network. Expected inflation increases it by 15% for the distribution network and 15% for the transmission network. On the other hand, forecast depreciation reduces the RAB by 19% for the distribution network and 17% for the transmission network.

Figure 2.1 Key drivers of changes in the RAB proposed by Ausgrid – distribution ($million, nominal)



Source: Ausgrid, *Att 4.1.b PTRM for distribution*, January 2023.
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.

Figure 2.2 Key drivers of changes in the RAB proposed by Ausgrid – transmission ($million, nominal)



Source: Ausgrid, *Att 4.1.d PTRM for transmission*, January 2023.
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.

Ausgrid's proposed forecast straight-line depreciation amounts for the 2024–29 period are $3,033.1 million and $433.5 million ($ nominal) for its distribution and transmission networks respectively. We have accepted most aspects of Ausgrid's depreciation proposal, subject to some input updates in its depreciation tracking modules, as it satisfies the requirements of the NER in terms of the assigned asset lives.[55] However, following our review of Ausgrid's proposed capex for poles, we decided to introduce a new asset class for 'Composite poles' and assigned a standard asset life. This is discussed in Attachment 4. The depreciation amount largely depends on the opening RAB, which in turn depends on capex in the past.[56] Depreciation associated with forecast capex is a relatively smaller amount.

However, we do have concerns with the size of the forecast capex, the largest driver of the increase in the RAB over the 2024–29 period, proposed by Ausgrid. For this draft decision, we have reduced Ausgrid's proposed forecast capex by $579.2 million (17.2%) and $45.6 million (16.8%) ($ nominal) over the 2024–29 period for its distribution and transmission networks respectively.[57] Our review of Ausgrid's forecast capex is set out in Attachment 5 of this draft decision.

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55 NER, cl. 6.5.5(b).

56 At the time of this draft decision, the roll forward of Ausgrid's RAB includes estimated capex values for 2022–23 and 2023–24. We expect to update the 2022–23 estimated capex with actuals in the final decision. We may also update the 2023–24 estimated capex with a revised estimate in the final decision.

57 This amount is net of disposals and capital contributions, and inclusive of the half-year WACC adjustment.

A 10% increase in the opening RAB at 1 July 2024 causes revenues to increase by around 6% for Ausgrid's distribution and transmission networks respectively. 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.[58]

2.4 Reasons for draft decision

We determine opening RAB values of $15,926.9 million and $2,486.7 million ($ nominal) as at 1 July 2024 for Ausgrid's distribution and transmission networks respectively. These amounts are $117.9 million (0.7%) and $14.3 million (0.6%) lower than the proposal.

We forecast closing RAB values of $18,133.0 million and $2,647.2 million ($ nominal) as at 30 June 2029 for Ausgrid's distribution and transmission networks respectively. These amounts are $717.7 million (3.8%) and $63.9 million (2.4%) lower than the proposal. The reasons for our decision are discussed below.

2.4.1 Opening RABs as at 1 July 2024

We determine opening RAB values of $15,926.9 million and $2,486.7 million ($ nominal) as at 1 July 2024 for Ausgrid's distribution and transmission networks respectively. These amounts are $117.9 million (or 0.7%) and $14.3 million (or 0.6%) lower than Ausgrid's proposed opening RAB values of $16,044.9 million and $2,501.0 million ($ nominal) as at 1 July 2024 for its distribution and transmission assets respectively.[59] The reductions are mainly driven by updates to the CPI inputs for 2022–23 and 2023–24.

Figure 2.3 and Figure 2.4 show the key drivers of the change in Ausgrid's distribution and transmission RABs respectively over the 2019–24 period for this draft decision. Overall, the closing distribution and transmission RAB values at the end of the 2019–24 period are 16% higher and 31% higher, respectively, than the opening RABs at the start of that period, in nominal terms. The new net capex increases the distribution and transmission RABs by 16% and 16% respectively, while indexation increases the RABs by 19% and 19% respectively. Depreciation, on the other hand, reduces the RABs by 18% and 17% respectively. End of period adjustments also reduce the distribution RAB by 1%, but increase the transmission RAB by 13%.

In the following sections we discuss our assessment of Ausgrid's proposed inputs in the RFMs, its proposed treatment due to the property disposals affordability program, capitalisation of lease costs, dual function asset reclassifications and the ex post review of 2017–22 capex for RAB roll forward purposes.

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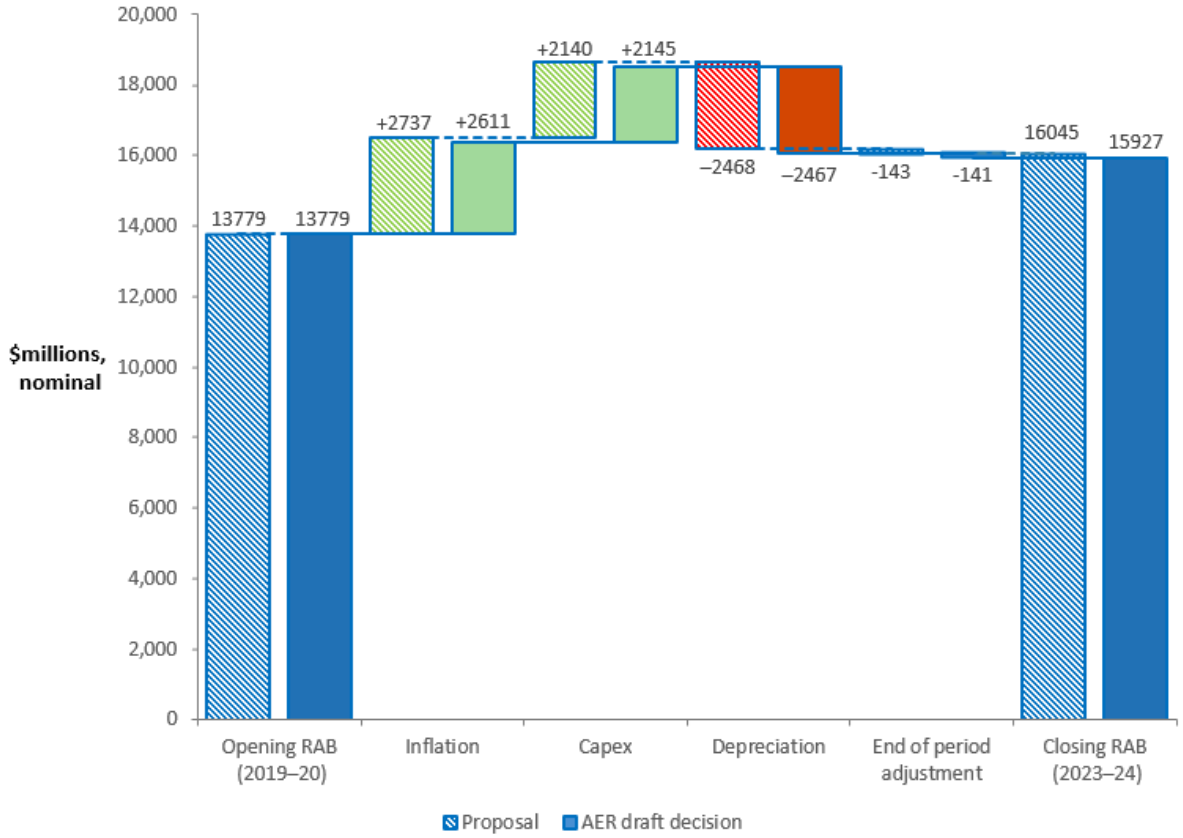
[58] If capex causes the RAB increase, return on capital, depreciation, and debt raising costs all increase too. If a reduction in depreciation causes the RAB increase, revenue could increase or decrease. In this case, the higher return on capital is offset (perhaps more than offset) by the reduction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

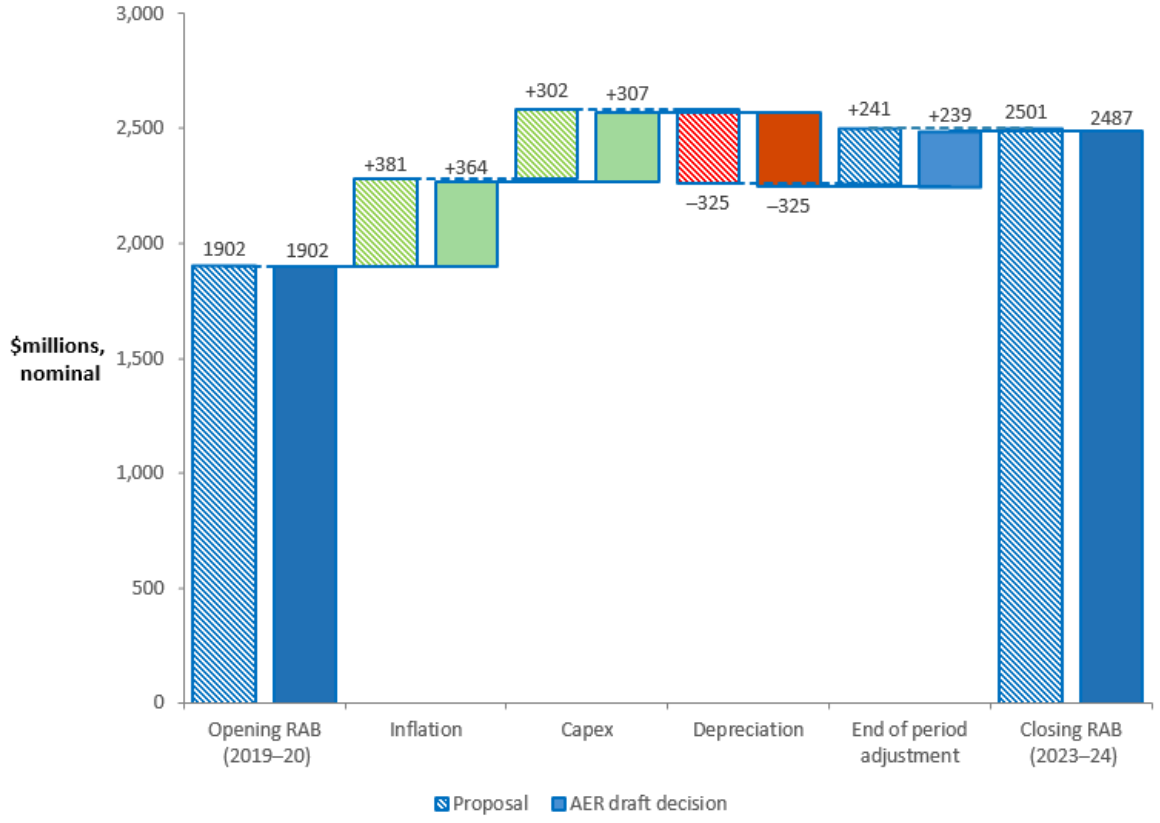
[59] Ausgrid, *Att 4.1.a RFM for distribution*, January 2023; Ausgrid, *Att 4.1.c RFM for transmission*, January 2023.

Figure 2.3 Key drivers of changes in the RAB over the 2019–24 period – Ausgrid's proposal compared with the AER's draft decision – distribution ($million, nominal)



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

Figure 2.4 Key drivers of changes in the RAB over the 2019–24 period – Ausgrid's proposal compared with the AER's draft decision – transmission ($million, nominal)



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

2.4.1.1 Key inputs in the RFM

To determine the opening RAB for Ausgrid as at 1 July 2024, we have rolled forward the RAB over the 2019–24 period to determine a closing RAB value as at 30 June 2024. In doing so, we reviewed the key inputs of Ausgrid's proposed RFMs, such as actual inflation, rate of return, gross capex values, asset disposal values, capital contribution values, forecast depreciation and asset lives. We found these inputs were generally correct and reconcile with relevant data sources such as ABS data, annual reporting RINs and the 2019–24 decision models.[60] However, we consider that some of Ausgrid's proposed RFM inputs require updating with newly available data or corrections.

Therefore, we have made the following amendments to Ausgrid's proposed RFM inputs:

- Updated Ausgrid's estimate of the 2022–23 inflation of 8.00% with actual CPI of 7.83% published by the ABS, which became available after Ausgrid submitted its proposal. We also updated the estimated CPI for 2023–24 to better reflect the latest economic

[60] At the time of this draft decision, the roll forward of Ausgrid's RAB includes estimated capex values for 2022–23 and 2023–24. We expect to update the 2022–23 estimated capex with actuals in the final decision. We may also update the 2023–24 estimated capex with a revised estimate in the final decision.

conditions. Ausgrid's proposal used 4.75% as the estimated CPI input for 2023–24, reflecting the RBA's forecast published in November 2022.[61] For this draft decision, we have updated this value to 4.10%, reflecting the RBA's forecast published in August 2023.[62]

- Updated the nominal vanilla WACC for 2023–24 to reflect the 2023–24 return on debt update in the PTRM for the 2019–24 period, which became available after Ausgrid submitted its proposal.
- Removed expenditures related to capitalised leases for 2019–20 distribution capex and 2021–22 distribution and transmission capex to reflect our approach to address mid-period changes in accounting standards.[63] For the associated capitalised lease costs we also updated the following final year asset adjustments as at 30 June 2024 (discussed further in section 2.4.1.2 below):
  - For the distribution network leases, the proposed roll-in amount of $0.6 million was updated to $0.3 million ($ nominal) representing the remaining lease value as at 30 June 2024.
  - For the distribution and transmission non-network leases, the proposed roll-in values of $7.3 million and $0.6 million respectively were removed. This is because these leases will expire by 30 June 2024.
- Based on Ausgrid's response to our information request,[64] we updated the asset disposal values for 2022–23 and the final year asset adjustment reallocation of a negative residual closing RAB amount associated with these disposals to reflect our draft decision distribution and transmission closing RAB as at 30 June 2024.[65] This is discussed further in section 2.4.1.3 below and attachment 4.
- Updates to the final year asset adjustment values for various distribution and transmission asset classes associated with Ausgrid's proposal to reallocate some portion of its distribution assets to its transmission RAB, to reflect changes in those assets that meet the definition of a dual function asset in accordance with the NER.[66] This is discussed further in section 2.4.1.4 below.

These amendments have resulted in total reductions of $117.9 million (0.7%) and $14.3 million (0.6%) ($ nominal) to Ausgrid's opening RAB values as at 1 July 2024 for its distribution and transmission networks respectively.

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61 RBA, *Statement on Monetary Policy, Economic Outlook Table 5.1*, November 2022.

62 RBA, *Statement on Monetary Policy, Appendix: Forecasts*, August 2023.

63 Ausgrid, *Response to information request IR046*, 7 July 2023. Forecast costs related to leases will only begin being treated as capex from the start of the 2024–29 period.

64 Ausgrid, *Follow up response to information request IR019*, 21 June 2023.

65 The negative RAB value is reallocated from the existing 'Land (non-system)' asset class to a new 'Land (non-system) depreciation' asset class for reverse depreciation purposes. This is a RAB reallocation and does not affect the total value of the opening RAB at 1 July 2024.

66 NER, cl. 6.24.2. Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 6. This reallocation does not affect Ausgrid's total combined distribution and transmission opening RAB value as at 1 July 2024.

2.4.1.2 Capitalisation of lease costs

Ausgrid proposed to capitalise a combined total of $8.5 million of its distribution and transmission existing lease costs at the start of the 2024–29 period. This is to give effect to a change in the accounting standards (AASB 16).[67] Lease costs were previously treated as operating expenditure (opex).

In doing so, Ausgrid proposed to include actual capex associated with leases for 2019–20 distribution capex and 2021–22 distribution and transmission capex in the existing 'Land and easements' and 'Land (non-system)' asset classes. Ausgrid then proposed to reallocate these capitalised leases costs from these existing asset classes to two new distribution asset classes—'Distribution leases (network)' and 'Distribution leases (non-network)', and one new transmission asset class—'Transmission leases (non-network)' in the RFMs:

- It reallocated $0.6 million, $7.3 million, and $0.6 million to these asset class, respectively as at 30 June 2024.
- It assigned a remaining life of 11.4 years, 2 years, and 2 years to these asset classes, respectively, for depreciation purposes.

We have assessed Ausgrid's approach to capitalising lease costs. We do not consider it to be appropriate as there are potential windfall gains and losses under the incentive schemes associated with a change in capitalisation treatment mid-period for short-lived assets. Instead, our draft decision approach is to maintain the current capitalisation treatment for the 2019–24 period consistent with the basis approved in the 2019–24 determination and allocate capex and opex costs accordingly. We will then apply the new capitalisation changes from the start of the 2024–29 period.

Our draft decision approach for lease related expenditure is that we will continue treating it as opex for the 2019–24 period. The remaining value of these leases as at 30 June 2024, representing the present value of Ausgrid's existing leases at this point in time, is to be rolled into the RAB as a final year asset adjustment. A remaining life is also assigned, reflecting the average remaining term of the leases for Ausgrid to recover these costs.

This is consistent with the approach we have taken in our decisions for other network service providers to implement such a change for the capitalisation of lease costs.[68] We note this approach for leases is consistent with Ausgrid's treatment of Software as a Service (SaaS) related expenditures and its associated change in accounting standards due to new International Financial Reporting Standards (IFRS) guidance.[69] That is, Ausgrid has proposed to continue treating SaaS costs as capex for the 2019–24 period for regulatory

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67 AASB 16 was expected to apply from 1 July 2019.

68 AER, *Draft decision: Transgrid 2023–28, Attachment 2, Regulatory asset base*, September 2022, pp. 12-13; AER, *Draft decision: ElectraNet 2023–28, Attachment 2, Regulatory asset base*, September 2022, pp. 13-14; AER, *Draft decision: AusNet Services distribution access arrangement 2023–28, Attachment 2, Capital base*, December 2022, p. 10; AER, *Draft decision: AusNet Services transmission 2022–27, Attachment 2, Regulatory asset base*, June 2021, p. 16; AER, *Draft decision: AusNet Services distribution 2021–26, Attachment 2, Regulatory asset base*, September 2020, p. 16.

69 The IFRS guidance *'Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38)'* was published in April 2021.

purposes consistent with the basis approved in the 2019–24 determination, and change such treatment to opex for the 2024–29 period.[70]

In its response to our information request, Ausgrid agreed with our approach to apply capitalisation changes at the start of the 2024–29 period.[71] In doing so, Ausgrid has provided an updated roll-in value for its distribution network leases of $0.3 million as a final year asset adjustment, reflecting the present value of its existing leases as at 30 June 2024. For its distribution and transmission non-network leases, the proposed roll-in values of $7.3 million and $0.6 million respectively were removed. This is because these leases will expire by 30 June 2024.

We also assessed Ausgrid's proposed remaining asset lives for depreciating its existing leases. In its response to our information request, Ausgrid advised that the remaining asset lives need to be amended to reflect the weighted average remaining terms of the existing leases as at 30 June 2024.[72] For the reasons discussed in Attachment 4, we amended the proposed remaining asset life for depreciating the distribution network leases. Given the distribution and transmission non-network leases are to expire by 30 June 2024, there is no need to assign remaining assets lives.

2.4.1.3 Property disposals affordability program

As part of its 'Property sales strategy to help with affordability' program, Ausgrid proposed to return the benefits it received from its property sales in the 2019–24 period back to customers in the next period.[73] These property sales were treated as asset disposals and therefore removed from the RAB for various asset classes.[74]

For the 2019–24 period, Ausgrid proposed asset disposal values of $135.1 million and $18.6 million ($ nominal) in 2022–23 for its distribution and transmission networks respectively. This reflects Ausgrid's proposal to bring forward its property sales into the current period to return the benefits of the sale earlier back to its customers via a lower opening RAB as at 1 July 2024, rather than delaying the property sales into the 2024–29 period. However, in its response to our information request,[75] Ausgrid identified some of the property sales to be disposed of in 2022–23 would instead be deferred for sale in 2027–28 and 2028–29. Ausgrid also identified some additional properties for disposal in 2022–23 that was not part of its initial proposal's affordability strategy program. Our draft decision therefore updates the RFMs for asset disposal values of $121.7 million and $13.2 million ($ nominal) in 2022–23 for Ausgrid's distribution and transmission networks respectively. We consider these amounts better reflect the timing and additional property sales Ausgrid expects to incur in

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70 Ausgrid, *Att. 6.1 - Proposed operating expenditure,* January 2023, pp. 21–22.

71 Ausgrid, *Response to information request IR046*, 7 July 2023. Ausgrid proposed to resubmit updated annual reporting RINs reflecting updated reporting of lease costs from capex to opex.

72 Ausgrid, *Response to information request IR038*, 21 June 2023.

73 Ausgrid, *2024–29 Regulatory Proposal*, January 2023, p. 52.

74 Ausgrid's property sales affected the 'Land and easements' and 'Buildings (system)' distribution asset classes; and the 'Buildings (non-system)' and 'Land (non-system)' distribution and transmission asset classes. However, only the asset disposals for the 'Land (non-system)' asset class were large enough to result in a negative residual RAB value.

75 Ausgrid, *Follow up* r*esponse to information request IR019*, 21 June 2023.

2022–23. We note the 2022–23 asset disposal values are still estimates and will be updated for actuals in the final decision.

Ausgrid's property sales affected various asset classes, however, only the asset disposals for the existing distribution and transmission 'Land (non-system)' asset classes resulted in negative residual closing RAB values as at 30 June 2024. Ausgrid proposed to reallocate the negative residual closing RAB values to a new 'Land (non-system) depreciation' asset class for reverse depreciation purposes by returning the negative amounts to customers in the 2024–29 period.[76] This is discussed further in Attachment 4.

2.4.1.4 Dual function asset reclassification

Ausgrid proposed to reallocate $219.9 million ($ nominal)[77] of its distribution assets to its transmission RAB as at 30 June 2024, to reflect changes in those assets that meet the definition of a dual function asset in accordance with the NER.[78] This amount includes a correction of $214.2 million, in which a data error at the 2019–24 distribution determination resulted in a higher value of assets being moved from dual function assets (transmission) to distribution assets.[79]

We updated the total reallocated amount to $218.0 million ($ nominal) to reflect our draft decision opening RAB values as at 1 July 2024. This is because the reallocation amount for the affected asset classes is calculated as an apportion of its respective opening RAB values. That is Ausgrid's proposed reallocation amounts reflect an apportion of its proposed opening RAB values which have since been updated for this draft decision. We note that the reallocation amounts will also need to be updated to reflect our final decision opening RAB values. In its response to our information request, Ausgrid agreed with this approach.[80] We accept that the assets in Ausgrid's distribution RAB meets the definition of a dual function asset and therefore reclassify them as such.

2.4.1.5 Ex post review of 2017–22 capex

We also consider the extent to which our roll forward of the RAB to 1 July 2024 contributes to the achievement of the capital expenditure incentive objective.[81] In the 2019–24 distribution determination, we noted that the 2017–18 and 2018–19 capex would form part of the review period for whether past capex should be excluded for inefficiency reasons in this distribution determination.[82] The capex for 2019–22 also forms part of the review period.

Consistent with the requirements of the NER we have excluded the last two years of the 2019–24 period from the review of past capex for this distribution determination.[83] This

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76 This is a RAB reallocation and does not affect the total value of the opening RABs at 1 July 2024.

77 The $219.9 million reflects a net transfer to transmission from distribution. An amount of $1.7 million was transferred to distribution from transmission.

78 NER, cl. 6.24.2. Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 6.

79 Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 6.

80 Ausgrid, *Response to information request IR042*, 20 June 2023

81 NER, cl. 6.12.2(b).

82 AER, *Final decision, Ausgrid distribution determination 2019–24, Attachment 2 Regulatory asset base,* April 2019, p. 8.

83 NER, cl. S6.2.2.A(a1).

approach ensures that actual capex (instead of estimated capex) is available when the review of past capex commences.

Ausgrid's total actual capex incurred from 2017–18 to 2021–22 is below the forecast allowance set at the previous relevant distribution determinations. Therefore, the overspending requirement for an efficiency review of past capex is not satisfied.[84] For the reasons discussed in Attachment 5, we consider the capex incurred in those years is consistent with the capital expenditure criteria and can therefore be included in the RAB.[85]

Further, for the purposes of this draft decision, we have included estimated capex for 2022–23 and 2023–24 in the RAB roll forward to 1 July 2024. At the next distribution determination, the 2022–23 and 2023–24 capex will form part of the review period for whether past capex should be excluded for inefficiency reasons.[86] 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).[87] As such, we consider that the 2019–24 RAB roll forward contributes to an opening RAB (as at 1 July 2024) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.[88]

2.4.2 Forecast closing RAB as at 30 June 2029

We forecast closing RAB values of $18,133.0 million and $2,647.2 million ($ nominal) by 30 June 2029 for Ausgrid's distribution and transmission networks respectively. These are $717.7 million and $63.9 million lower compared to Ausgrid's proposal for its distribution and transmission networks respectively. These reductions reflect our draft decision on the inputs for determining the forecast RAB in the PTRM.

The change in the size of the RAB over the 2024–29 period depends on our assessment of its various components including expected inflation (Attachment 3), forecast depreciation (Attachment 4) and forecast capex (Attachment 5). Inflation and capex increase the RAB, while depreciation and disposals reduce it.

To determine the forecast RAB value for Ausgrid, we amended the following PTRM inputs:

- We reduced Ausgrid's proposed opening RAB values as at 1 July 2024 by $117.9 million (0.7%) and $14.3 million (0.6%) ($ nominal) for its distribution and transmission networks respectively (section 2.4.1).
- We updated Ausgrid's proposed expected inflation rate of 2.87% per annum to 2.80% per annum over the 2024–29 period (Attachment 3). Compared to the proposal, our draft decision results in a decrease to the indexation of the RAB component for the 2024–29

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84 NER, cl. S6.2.2A(c).

85 Please see appendix B of attachment 5 of this draft decision.

86 Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NER, cl. S6.2.2A. The details of our ex post assessment approach for capex are set out in AER, *Capital expenditure incentive guideline for electricity network service providers*, April 2023, pp. 13–21.

87 AER, *Final decision, Ausgrid Distribution Determination, Attachment 2 – Regulatory asset base,* April 2019, p. 12.

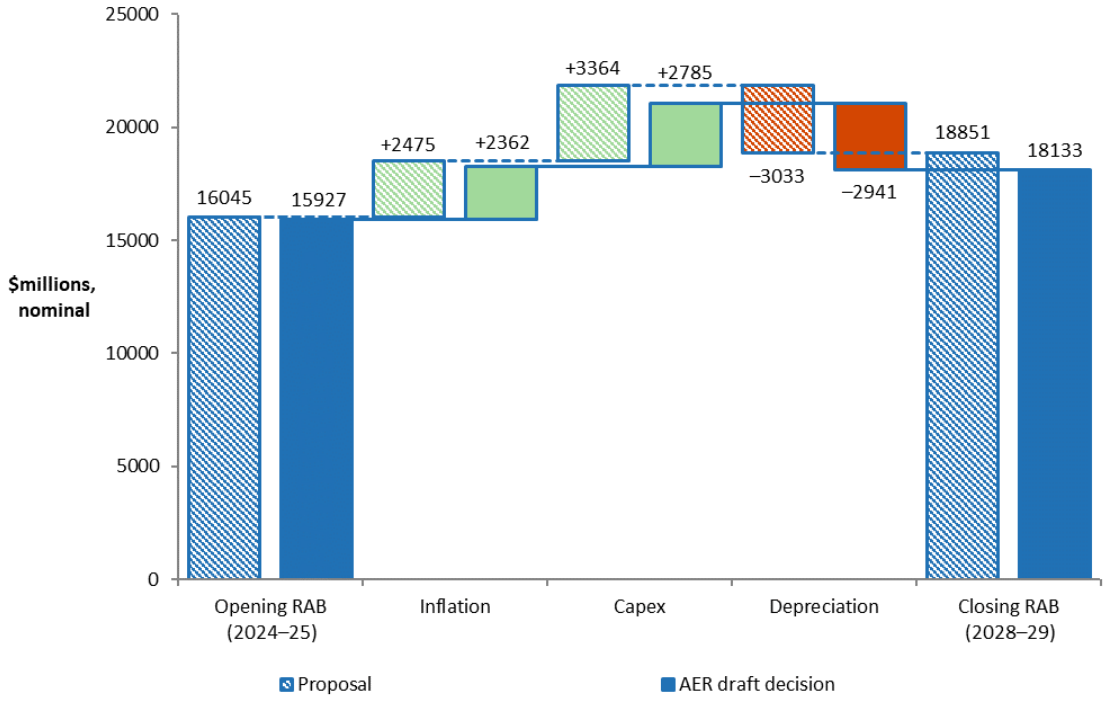
88 NER, cll. 6.4A(a), 6.5.7(a), 6.5.7(c) and 6.12.2(b).

period by $112.3 million (4.5%) and $14.3 million (3.8%) ($ nominal) for its distribution and transmission networks respectively.[89]

- We reduced Ausgrid's proposed forecast straight-line depreciation for the 2024–29 period by $91.7 million (3.0%) and $10.3 million (2.4%) ($ nominal) for its distribution and transmission networks respectively (Attachment 4).
- We reduced Ausgrid's proposed forecast capex for the 2024–29 period by $579.2 million (17.2%) and $45.6 million (16.8%) ($ nominal) for its distribution and transmission networks respectively (Attachment 5).[90]

Figure 2.5 and Figure 2.6 show the key drivers of the change in Ausgrid's distribution and transmission RABs respectively over the 2024–29 period for this draft decision. Overall, our draft decision closing distribution and transmission RAB values at the end of the 2024–29 period are forecast to be 14% higher and 6% higher, respectively, than the opening RABs at the start of that period, in nominal terms. The approved forecast net capex increases the distribution and transmission RABs by 17% and 9% respectively. Expected inflation increases the RAB by 15% for the distribution network and 14% for the transmission network. On the other hand, forecast depreciation reduces the RAB by 18% for the distribution network and 17% for the transmission network.

Figure 2.5 Key drivers of changes in the RAB over the 2024–29 period – Ausgrid's proposal compared with the AER's draft decision – distribution ($million, nominal)



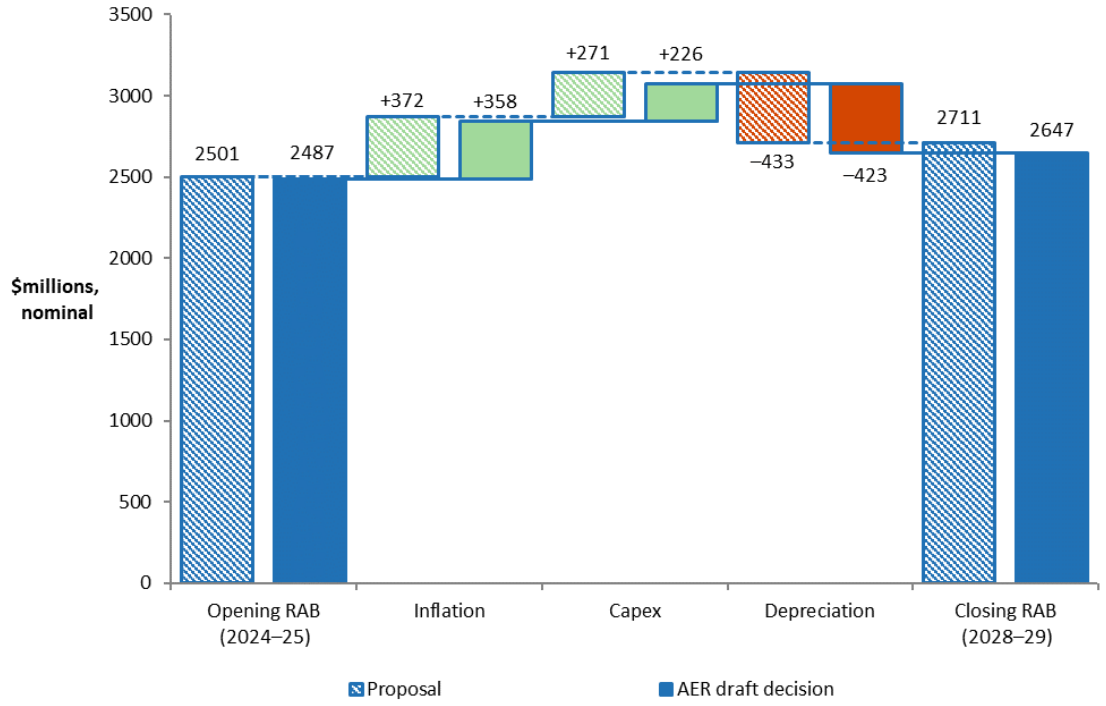
Source: AER analysis.

89 The decrease in the indexation of the RAB is largely due to the lower expected inflation rate. To a lesser extent, this is also contributed by a lower opening RAB value and reductions made to forecast capex in our draft decision.

90 Capex net of disposals and customer contributions, and inclusive of half-year WACC adjustment.

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.

Figure 2.6 Key drivers of changes in the RAB over the 2024–29 period – Ausgrid's proposal compared with the AER's draft decision – transmission ($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.

2.4.3 Application of depreciation approach in RAB roll forward for the next distribution determination

We determine that the depreciation approach to be applied to establish Ausgrid's opening RAB at the commencement of the 2029–34 period at will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2024–29 period. We consider this approach will provide sufficient incentives for Ausgrid to achieve capex efficiency gains over the 2024–29 period.[91]

Ausgrid's proposal did not specify what depreciation approach to use in the roll forward of the RAB for the commencement of its 2029–34 period. However, we consider that the forecast depreciation approach should be used to establish the opening RAB as at 1 July 2029. We note that this approach is consistent with our F&A paper.[92]

We have used forecast depreciation for this draft decision when rolling forward the opening RAB at the commencement of the 2024–29 period (section 2.4.1). The use of forecast

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91 NER, cll. 6.12.1(18) and S6.2.2B.

92 AER, *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales), Regulatory control period commencing 1 July 2024,* July 2022, p. 53.

depreciation to establish the opening RAB for the commencement of the 2029–34 period at the next distribution determination therefore maintains the current approach.

As discussed in Attachment 9, Ausgrid is currently subject to the CESS for the 2019–24 period. We will continue to apply the CESS to Ausgrid over the 2024–29 period. We consider that the CESS will provide sufficient incentives for Ausgrid 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.[93]

[93] Our ex post capex measures are set out in the capex incentives guideline, AER, *Capital expenditure incentive guideline for electricity network service providers*, April 2023, pp. 13–21. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.

Shortened Forms

Term	Definition
AASB	Australian Accounting Standards Board
ABS	Australia Bureau of Statistics
AER	Australian Energy Regulator
Capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
F&A	Framework and approach
IFRS	International Financial Reporting Standards
NER	National Electricity Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
SaaS	software as a service
WACC	weighted average cost of capital