

# Final Decision

Essential Energy Electricity

Distribution Determination

2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 2

Regulatory asset base

April 2024

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AER reference: AER212495

#### **Amendment record**

<b>Version</b>	<b>Date</b>	<b>Pages</b>
1	30 April 2024	13

## List of attachments

This attachment forms part of the AER's final decision on the distribution determination that will apply to Essential Energy for the 2024–29 period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The final decision attachments have been numbered consistently with the equivalent attachments to our draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 7 – Corporate income tax

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 16 – Alternative control services

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment 20 – Metering services

Attachment A – Contingent projects

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## 2 Regulatory asset base

Our distribution determination includes Essential Energy's (Essential) opening regulatory asset base (RAB) value as at 1 July 2024 and the projected RAB value for the 2024–29 regulatory control period (period).<sup>1</sup> The value of the RAB substantially impacts Essential's 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.<sup>2</sup> This final decision sets out:

- the opening RAB value as at 1 July 2024
- the forecast closing RAB value as at 30 June 2029
- that depreciation based on forecast capital expenditure (capex) is to be used for establishing the RAB as at the commencement of the 2029–34 period.<sup>3</sup>

### 2.1 Final decision

#### 2.1.1 Opening RAB as at 1 July 2024

Our final decision is to determine an opening RAB value of \$10,332.3 million (\$ nominal) as at 1 July 2024 for Essential. This amount is \$4.9 million (0.05%) lower than Essential's revised proposed opening RAB value of \$10,337.2 million (\$ nominal) as at 1 July 2024.<sup>4</sup> It reflects our update to the roll forward model (RFM) for actual consumer price index (CPI) for 2023–24. This final decision is \$67.1 million (0.7%) higher than our draft decision value for Essential's opening RAB of \$10,265.2 million (\$ nominal).<sup>5</sup>

To determine the opening RAB value as at 1 July 2024, we have rolled forward the RAB over the 2019–24 period to arrive at a closing RAB value at 30 June 2024 in accordance with our RFM. This roll forward includes an adjustment at the end of the 2019–24 period to account for the difference between actual 2018–19 capex and the estimate approved in the 2019–24 determination.<sup>6</sup>

Table 2.1 sets out our final decision on the roll forward of Essential's RAB for the 2019–24 period.

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<sup>1</sup> National Electricity Rules (NER), cl. 6.12.1(6).

<sup>2</sup> 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.

<sup>3</sup> NER, cl. 6.12.1(18).

<sup>4</sup> Essential Energy, *2024–29 Revised Regulatory Proposal*, November 2023, p. 18.

<sup>5</sup> This is mainly driven by the updates to the capex for 2022–23 (to reflect actual values) and the capex for 2023–24 (to reflect more up-to-date estimated values). The net impact of these updates is an increase to the opening RAB value as at 1 July 2024 by about \$72.0 million compared to the draft decision, all else being equal.

<sup>6</sup> The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2019–24 determination. See NER, cl. S6.2.1(e)(3).

**Table 2.1 AER’s final decision on Essential’s RAB for the 2019–24 period (\$ million, nominal)**

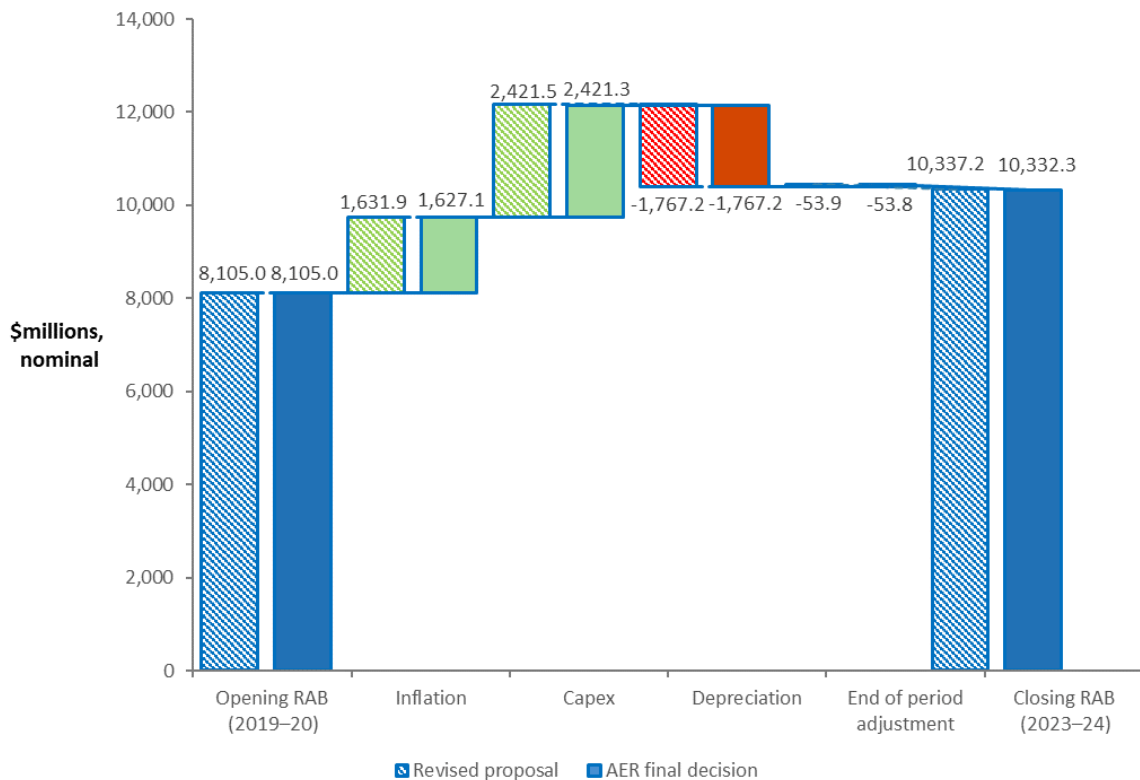
	2019–20	2020–21	2021–22	2022–23	2023–24 <sup>a</sup>
Opening RAB	8,105.0	8,449.7	8,610.0	9,004.3	9,843.3
Net capex <sup>b</sup>	480.3	412.4	444.2	522.9	561.5
Indexation on opening RAB	149.2	72.7	301.2	705.2	398.8
Less: straight-line depreciation <sup>c</sup>	284.7	324.9	351.1	389.1	417.5
Interim closing RAB	8,449.7	8,610.0	9,004.3	9,843.3	10,386.2
Difference between estimated and actual capex in 2018–19	-	-	-	-	-39.2
Return on difference for 2018–19 capex	-	-	-	-	-14.7
<b>Closing RAB as at 30 June 2024</b>	-	-	-	-	<b>10,332.3</b>

Source: AER analysis.

- (a) Based on estimated capex provided by Essential. We will true-up the RAB for actual capex at the next distribution determination.
- (b) Net of disposals and capital contributions and adjusted for actual CPI and half-year weighted average cost of capital (WACC).
- (c) Adjusted for actual CPI. Based on forecast capex.

Figure 2.1 shows the key drivers of change in Essential’s RAB value over the 2019–24 period for this final decision. Overall, the closing RAB value at the end of the 2019–24 period is 27% higher than the opening RAB value at the start of that period, in nominal terms. New capex increases the RAB value by 30%, while inflation indexation increases it by 20%. End of period adjustments also increases the RAB value by less than 1%. Depreciation, on the other hand, reduces the RAB value by 22%.

**Figure 2.1 Key drivers of change in the RAB over the 2019–24 period—Essential’s revised proposal compared with the AER’s final decision**  
 (\$ 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.

In the draft decision, we reduced Essential’s proposed opening RAB value as at 1 July 2024 by \$10.3 million (0.1%). This reduction was largely due to the updates we made to the CPI inputs for 2022–23 and 2023–24 in the RFM to reflect more up-to-date values. We also amended the following inputs which also affected the opening RAB value:<sup>7</sup>

- We updated the nominal vanilla weighted average cost of capital (WACC) for 2023–24, equity raising costs and the forecast straight-line depreciation inputs to be consistent with the values in our 2023–24 return on debt updated post-tax revenue model (PTRM).
- We corrected some minor input errors, such as the nominal vanilla WACC for 2021–22, the average remaining life for the asset class of ‘Other non-system assets’, the actual as-incurred capital contribution amounts in 2020–21 for the ‘Sub-transmission lines and cables’ and ‘Substations’ asset classes.
- We adjusted the actual as-incurred capex amounts in 2022–23 and 2023–24 for the ‘Buildings’ asset class by netting off the insurance proceeds from the North Coast Floods for the Lismore depot.

<sup>7</sup> AER, *Draft decision: Essential Energy distribution determination 2024–29 – Attachment 2 – Regulatory asset base*, September 2023, pp. 1–2.

We noted the roll forward of Essential's RAB included estimated capex for 2022–23 and 2023–24, and estimated inflation for 2023–24, because these actual values were not yet available at the time of the draft decision.<sup>8</sup>

In its revised proposal, Essential adopted most of our draft decision changes. However, it proposed to treat the insurance proceeds from the North Coast Floods for Lismore depot as capex disposals which is inconsistent with our draft decision.<sup>9</sup>

In addition, Essential has updated the estimated capex for 2022–23 with actuals and revised the capex estimate for 2023–24 with latest figures. We have checked the 2022–23 actual capex in Essential's revised proposed RFM and are satisfied it reconciles with the values presented in Essential's annual reporting Regulatory Information Notice (RIN) for that year. We also accept Essential's revision to the 2023–24 net capex estimate of \$561.5 million (\$ nominal) for this final decision.<sup>10</sup> This amount is \$48.9 million (9.5%) higher than what 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 2023–24 will be accounted for at the next distribution determination.

We accept Essential's treatment of the insurance proceeds from the North Coast Floods for Lismore depot related capex items as capex disposals. In the draft decision, we netted off the insurance proceeds from the gross capex for 2022–23 and 2023–24. Although the revised proposed approach is different from our draft decision, the net capex amounts for 2022–23 and 2023–24 remain unchanged. Therefore, we accept Essential's revised proposed approach for the purposes of this final decision.<sup>11</sup>

We received no submissions on our approach to calculating the opening RAB. Our position in the final decision is limited to updates for more recent data and corrections to minor input errors in the RFM:

- We updated the 2023–24 estimated inflation input with actual CPI of 4.05% based on the December 2023 CPI from the Australian Bureau of Statistics (ABS), which became available after Essential submitted its revised proposal.
- We corrected Essential's minor input errors in its revised proposed RFM, such as average remaining asset life for the asset class 'other non-system assets' and movements in capitalised provisions. These corrections do not materially affect the

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<sup>8</sup> AER, *Draft decision: Essential Energy distribution determination 2024–29 – Attachment 2 – Regulatory asset base*, September 2023, pp. 1 and 3.

<sup>9</sup> Essential Energy, *Revised Regulatory Proposal – 3.02 Roll Forward Model*, November 2023; AER, *Draft Decision – Essential Energy 2024-29 – SCS RFM*, September 2023

<sup>10</sup> This amount includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB. It reflects the updated actual inflation rate for 2023–24 in our final decision.

<sup>11</sup> We note that insurance proceeds do not meet the definition of disposals in our RIN. However, we have accepted Essential's approach for the purposes of RAB roll forward for this final decision given the total insurance proceeds amount of \$1.5 million is relatively small. If similar cases occur in the future, we will apply our judgment and RIN requirements and assess on a case-by-case basis.



opening RAB value and have been accepted by Essential in its response to our information request.<sup>12</sup>

## 2.1.2 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 capex incentive objective.<sup>13</sup> The review period of past capex for this distribution determination is over 2017–18 to 2021–22.<sup>14</sup> As discussed in the draft decision, we consider that the capex incurred in those years are consistent with the capex criteria and can therefore be included in the RAB.<sup>15</sup>

For this final decision, we have included Essential's actual capex for 2022–23 and estimated capex for 2023–24 in the RAB roll forward to 1 July 2024. At the next distribution determination, the actual capex for 2022–23 and 2023–24 will form part of the review period for whether past capex should be excluded for inefficiency reasons.<sup>16</sup> 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).<sup>17</sup> 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 capex criteria.<sup>18</sup>

## 2.1.3 Forecast closing RAB as at 30 June 2029

Once we have determined the opening RAB value as at 1 July 2024, we roll forward that value by adding forecast capex and inflation, and reducing it by depreciation to arrive at a forecast closing value for the RAB as at the end of the 2024–29 period.<sup>19</sup>

For this final decision, we determine a forecast closing RAB value at 30 June 2029 of \$12,578.8 million (\$ nominal) for Essential. This is \$87.8 million (0.7%) lower than Essential's revised proposal of \$12,666.6 million (\$ nominal). This is mainly due to a lower expected inflation rate applied in our final decision compared to Essential's revised proposal (section 2.2 of the Overview to this final decision). Our final decision on the forecast closing RAB also reflects the amended opening RAB as at 1 July 2024, and our final decisions on forecast

<sup>12</sup> Essential Energy, *Response to Information Request #054 – Revised Proposal RFM and PTRM*, 21 December 2023.

<sup>13</sup> NER, cl. 6.12.2(b) and 6.4A(a).

<sup>14</sup> NER, cl. S6.2.2.A(a1).

<sup>15</sup> NER, cl. S6.2.1(f); AER, *Draft decision: Essential Energy distribution determination 2024–29 – Attachment 2 – Regulatory asset base*, September 2023, pp. 12–13.

<sup>16</sup> 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. 12–19.

<sup>17</sup> AER, *Final decision: Essential Energy distribution determination 2019–24 – Attachment 2 – Regulatory asset base*, April 2019, pp. 9–10.

<sup>18</sup> NER, cl. 6.4A(a), 6.5.7(a), 6.5.7(c) and 6.12.2(b).

<sup>19</sup> NER, cl. S6.2.3.

depreciation (Attachment 4) and forecast capex (section 2.4 of the Overview to this final decision).<sup>20</sup>

Table 2.2 sets out our final decision on the forecast RAB for Essential over the 2024–29 period.

**Table 2.2 AER’s final decision on Essential’s RAB for the 2024–29 period**  
(\$ million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29
Opening RAB	10,332.3	10,784.1	11,222.1	11,657.7	12,108.5
Net capex <sup>a</sup>	557.2	565.0	584.3	593.5	622.3
Indexation on opening RAB	274.8	286.8	298.5	310.1	322.1
Less: straight-line depreciation	380.2	413.8	447.2	452.7	474.0
<b>Closing RAB</b>	<b>10,784.1</b>	<b>11,222.1</b>	<b>11,657.7</b>	<b>12,108.5</b>	<b>12,578.8</b>

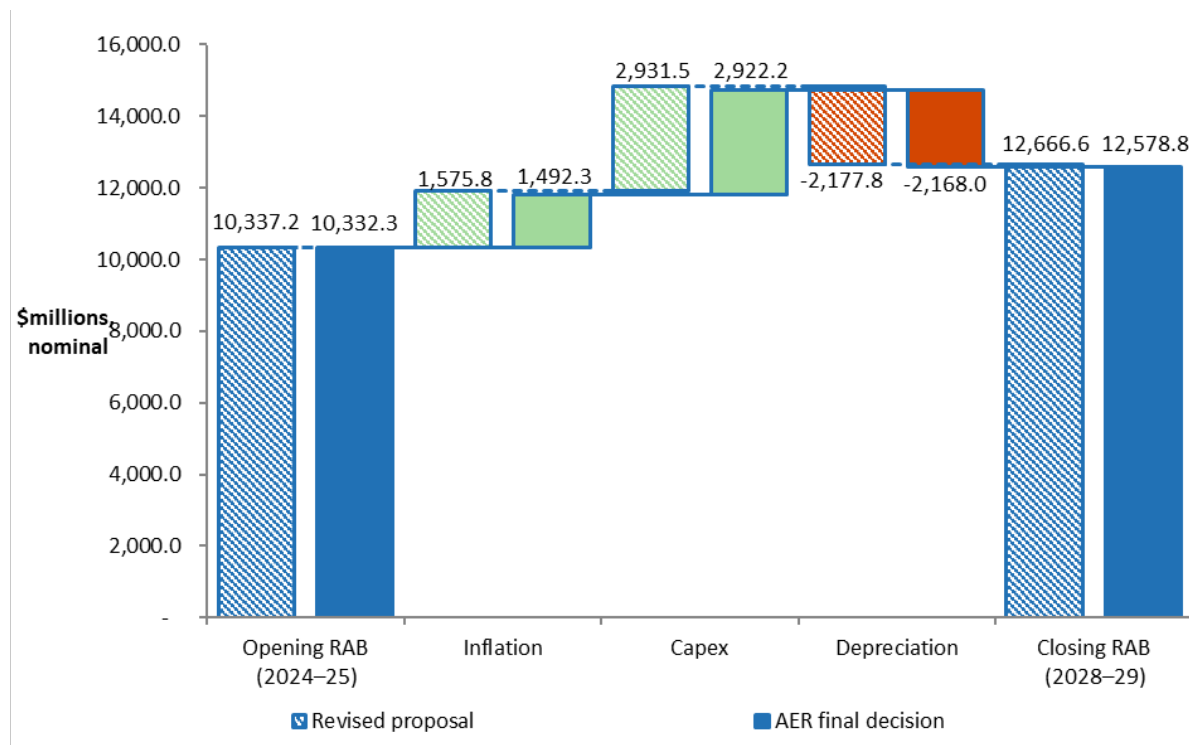
Source: AER analysis.

(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.

Figure 2.2 shows the key drivers of change in Essential's RAB value over the 2024–29 period for this final decision. Overall, the closing RAB value at the end of the 2024–29 period is forecast to be 22% higher than the opening RAB value at the start of that period, in nominal terms. The approved forecast net capex increases the RAB value by 28%, while expected inflation increases it by 14%. Forecast depreciation, on the other hand, reduces the RAB value by 21%.

<sup>20</sup> 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 2024–29 period (Attachment 3).

**Figure 2.2 Key drivers of change in the RAB over the 2024–29 period— Essential’s revised proposal compared with the 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 confirm our position to approve Essential’s revised proposed forecast net capex of \$2,655.4 million (\$2023–24)<sup>21</sup> for the 2024–29 period as we are satisfied that this amount reasonably reflects the capex criteria. This is consistent with our draft decision, which was adopted by Essential in its revised proposal. Refer to section 2.4 of the Overview to this final decision for the discussion on forecast capex.

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

When we roll forward Essential’s RAB for the 2024–29 period at the next distribution determination, we must adjust for depreciation. For this final decision, we determine that the depreciation approach to be applied to establish Essential’s opening RAB at the commencement of the 2029–34 period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2024–29 period.<sup>22</sup> This approach is consistent with our draft decision. Further, this approach is consistent with our

<sup>21</sup> This amount is net of forecast disposals and capital contributions and excludes the half-year WACC adjustment.

<sup>22</sup> NER, cl. 6.12.1(18).

Framework and approach.<sup>23</sup> Essential's revised proposal did not raise any issues with this approach.

As discussed in section 3.1 of the Overview to this final decision, we will also apply the CESS to Essential for the 2024–29 period. We consider that the CESS will provide sufficient incentives for Essential 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.<sup>24</sup>

## 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.<sup>25</sup>

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<sup>23</sup> AER, *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales), Regulatory control period commencing 1 July 2024*, July 2022, p. 53.

<sup>24</sup> Our ex-post capex measures are set out in the capital expenditure incentive guideline. This guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective. AER, *Capital expenditure incentive guideline for electricity network service providers*, April 2023, pp. 12–21.

<sup>25</sup> AER, *Draft decision: Essential Energy distribution determination 2024–29 – Attachment 2 - Regulatory asset base*, September 2023, pp. 5–10.

## Shortened forms

Term	Definition
ABS	Australian Bureau of Statistics
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

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