Final Decision

Essential Energy Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 4
Regulatory depreciation

April 2024

AUSTRALIAN ENERGY REGULATOR

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Version	Date	Pages
1	30 April 2024	10

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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4 Regulatory depreciation

Depreciation is the amount provided so capital investors recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by Essential Energy (Essential), we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Essential's 2024–29 regulatory control period (period).[1] The regulatory depreciation amount is the net total of the straight-line depreciation less the inflation indexation adjustment of the RAB.

This attachment sets out our final decision on Essential's regulatory depreciation amount, including the standard and remaining asset lives used for forecasting depreciation.

4.1 Final decision

Our final decision is to determine a regulatory depreciation amount of $675.7 million ($ nominal) for Essential for the 2024–29 period. This amount represents an increase of $73.7 million (12.2%) to the $602.1 million ($ nominal) in Essential's revised proposal.[2] It is $81.5 million (13.7%) higher than the regulatory depreciation amount determined in our draft decision. This increase compared to our draft decision is primarily driven by a lower RAB indexation amount.[3]

The regulatory depreciation amount is the net total of the straight-line depreciation, less the inflation indexation of the RAB. The straight-line depreciation is impacted by our decision on Essential's opening RAB as at 1 July 2024 (Attachment 2), forecast capital expenditure (capex) (section 2.4 of the Overview to this final decision) and asset lives. Our final decision straight-line depreciation for Essential is $9.9 million ($ nominal) lower than its revised proposal.[4]

The indexation on the RAB is impacted by our decision on Essential's opening RAB (Attachment 2), forecast capex (section 2.4 of the Overview to this decision) and the expected inflation rate (section 2.2 of the Overview). Our final decision indexation on Essential's forecast RAB is $83.5 million lower than its revised proposal. This is largely due to applying a lower expected inflation rate of 2.66% per annum for this final decision compared with the 2.80% per annum that Essential applied in its revised proposal. The lower indexation has more than offset the decrease in straight-line depreciation (since indexation is deducted from the straight-line depreciation), which has resulted in a higher regulatory depreciation amount compared to the revised proposal.

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1 NER, cll. 6.12.1 and 6.4.3.

2 Essential Energy, *Revised Regulatory Proposal – 3.04 Post Tax Revenue Model*, November 2023.

3 This is due to a lower expected inflation for the 2024–29 period compared to the draft decision.

4 This is mainly due to the lower expected inflation applied in our final decision which is used to convert the straight-line depreciation amounts from real terms into nominal terms. In real terms, our final decision straight-line depreciation amount is slightly lower compared to the revised proposal driven by a slight decrease to the opening RAB value as at 1 July 2024 for Essential in our final decision.

In coming to this final decision on Essential's straight-line depreciation, we accept the revised proposal with respect to the following matters, each of which is consistent with our draft decision:

- the straight-line method to calculate the regulatory depreciation as set out in our post-tax revenue model (PTRM)
- asset classes and standard asset lives, subject to some minor input corrections in the PTRM (section 4.1.1)
- the continuation of applying the weighted average remaining life (WARL) method to calculate the remaining asset lives as at 1 July 2024 for implementing straight-line depreciation of Essential's existing assets. In accepting the weighted average method, we have updated Essential's remaining asset lives to reflect our adjustments to its revised proposed roll forward model (RFM) (section 4.1.1).

Table 4.1 sets out our final decision on the forecast regulatory depreciation amount for Essential over the 2024–29 period.

Table 4.1 AER's final decision on Essential's regulatory depreciation for the 2024–29 period ($ million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Straight-line depreciation	380.2	413.8	447.2	452.7	474.0	2,168.0
Less: inflation indexation on opening RAB	274.8	286.8	298.5	310.1	322.1	1,492.3
Regulatory depreciation	**105.4**	**127.0**	**148.7**	**142.7**	**152.0**	**675.7**

Source: AER analysis.

4.1.1 Standard and remaining asset lives

For this final decision, we accept Essential's revised proposed standard asset lives for depreciating its forecast capex for the 2024–29 period, subject to some minor error corrections in the PTRM. We updated Essential's remaining asset lives as at 1 July 2024 to reflect our amendments in the RFM (Attachment 2).

In the draft decision, we accepted Essential's proposed existing asset classes and standard asset lives, except for the 'Equity raising costs' asset class. We assigned a standard asset life of 'n/a' to 'Equity raising costs' on the basis that forecast capex determined for Essential did not meet a level to trigger any benchmark equity raising costs. We disaggregated Essential's proposed new asset class for Distributed energy resources (DER) into four separate asset classes to reflect the different categories of assets and provide a better grouping of asset lives.[5] We also introduced a new asset class for 'Composite poles' and

[5] AER, *Draft decision Attachment 04 - Regulatory depreciation - Essential Energy - 2024–29 distribution revenue proposal*, September 2023, pp. 8-10.

assigned a standard asset life of 80 years after our review of Essential's proposed capex for poles.[6]

Our draft decision also accepted Essential's proposal to continue using the WARL method to calculate the remaining asset lives as at 1 July 2024 for implementing straight-line depreciation of its existing assets. In accepting the WARL method, we updated Essential's remaining asset lives to reflect our draft decision amendments in the RFM. We noted that we would recalculate Essential's remaining asset lives as at 1 July 2024 to reflect revised capex inputs for the final decision.

Essential's revised proposal adopted our draft decision on the asset lives, except for some minor input errors in its revised proposed PTRM.[7]

For this final decision, we accept Essential's revised proposed standard asset lives for depreciating the forecast capex for the 2024–29 period. However, we have corrected some minor input errors associated with the equity raising costs (ERC) and DER asset classes in our final decision PTRM. Essential has agreed with these error corrections in its response to our information request.[8] We are satisfied that:[9]

- the standard asset lives and depreciation approach more broadly would lead to a depreciation schedule that reflects the nature of the assets over the economic lives of the asset classes, and
- the sum of the real value of the depreciation attributable to the assets is equivalent to the value at which the assets were first included in the RAB for Essential.

For this final decision, we accept Essential's revised proposed WARL method to calculate the remaining asset lives as at 1 July 2024. This is consistent with our draft decision and Essential's initial proposal. In accepting the WARL method, we have updated Essential's remaining asset lives to reflect our adjustments to the revised proposed RFM (Attachment 2). This is because some of the inputs in the RFM, such as capex and actual inflation, affect the value of assets in the RAB and in turn, the calculation of the remaining asset lives as at 1 July 2024.

Table 4.2 sets out our final decision on Essential's standard and remaining asset lives for the 2024–29 period.

Table 4.2 AER's final decision on Essential's remaining and standard asset lives as at 1 July 2024 (years)

Asset class	Remaining asset life	Standard asset life
Sub-transmission lines and cables	32.2	54.9
Distribution lines and cables	40.2	53.8

6 AER, *Draft decision Attachment 04 - Regulatory depreciation - Essential Energy - 2024–29 distribution revenue proposal*, September 2023, p. 1.

7 Essential Energy, *Revised Regulatory Proposal – 3.04 Post Tax Revenue Model*, November 2023.

8 Essential, *Response to Information Request #054*, 21 December 2023 and 11 January 2024.

9 NER, cll. 6.5.5(b)(1)–(2).

Substations	21.9	40.2
Transformers	26.4	45.8
Low voltage lines and cables	32.8	51.5
Customer metering and load control	18.7	25.9
Communications	4.9	7.0
Land	n/a	n/a
Easements	n/a	n/a
IT systems	4.6	5.0
Furniture, fittings, plant and equipment	9.3	13.0
Motor vehicles	5.6	8.0
Land (non-system)	n/a	n/a
Other non-system assets	3.4	15.0
Capitalised property lease	4.7	8.0
Batteries, inverters and control equipment	n/a	10.0
Solar panels	n/a	20.0
Generators	n/a	20.0
Civil infrastructure insulation & other	n/a	40.0
Composite poles	n/a	80.0
Buildings	42.5	50.0
In-house software	3.2	5.0
Equity raising costs[a]	32.1	n/a

Source: AER analysis.

n/a: not applicable. We have not assigned an asset life to the 'Land', 'Easements' and 'Land (non-system)' asset classes because the capex allocated to them are not subject to depreciation. The asset classes for 'Batteries, inverters and control equipment', 'Solar panels', 'Generators', 'Civil infrastructure installation & other' and 'Composite poles' are new and do not have opening RAB values as at 1 July 2024, so they have no remaining asset life at this time.

(a) For this final decision, the forecast capex determined for Essential does not meet a level to trigger any benchmark equity raising costs and is therefore not assigned a standard asset life.

4.2 Assessment approach

We did not change our assessment approach for regulatory depreciation from our draft decision. Attachment 4 (section 4.3) of our draft decision details that approach.[10]

[10] AER, *Draft Decision Attachment 04 – Regulatory depreciation – Essential Energy – 2024–29 Distribution revenue proposal*, September 2023, pp. 3–7.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
capex	capital expenditure
DER	distributed energy resources
ERC	equity raising costs
NER	National Electricity Rules
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
WARL	weighted average remaining life