# FINAL DECISION

## Directlink
## Transmission Determination
## 2020 to 2025

## Attachment 2
## Regulatory asset base

June 2020

AUSTRALIAN ENERGY REGULATOR

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# Note

This attachment forms part of the AER's final decision on Directlink's 2020–25 transmission determination. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Directlink transmission determination 2020–25

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment A – Pricing methodology

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# 2 Regulatory asset base

Our revenue determination includes Directlink's opening regulatory asset base (RAB) value as at 1 July 2020 and the projected RAB value for the 2020–25 regulatory control period.[1] The value of the RAB substantially impacts Directlink'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 revenue determination.[2] This final decision sets out:

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

## 2.1 Final decision

### *Opening RAB as at 1 July 2020*

Our final decision is to determine an opening RAB value of $146.9 million ($nominal) as at 1 July 2020 for Directlink. This amount is $0.2 million (or 0.2 per cent) lower than Directlink's revised proposed opening RAB of $147.1 million ($nominal) as at 1 July 2020.[4] It reflects our update to the roll forward model (RFM) for 2019–20 actual inflation that is now available. This final decision is $1.8 million (or 1.2 per cent) higher than our draft decision value for Directlink's opening RAB of $145.1 million ($nominal).

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

In the draft decision, we reduced Directlink's proposed opening RAB as at 1 July 2020 by correcting minor input issues and updating various inputs such as the actual 2018–19 CPI in the RFM.[7] We noted the roll forward of Directlink's RAB included estimated

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1 NER, cl. 6A.14.1(5D).

2 The size of the RAB also impacts the benchmark debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

3 NER, cl. 6A.14.1(5E).

4 Directlink, *Attachment 5-1 – Directlink – Transmission roll forward model*, December 2019. This RAB value is based on as-incurred capex.

5 AER, *Electricity transmission network service providers: Roll forward model (version 3)*, October 2015.

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

7 AER, *Directlink 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, pp. 14–15.

capex and estimated inflation for 2019–20, because these actual values were not yet available.

Our draft decision also updated the initial proposed 2018–19 estimated capex for actuals, as provided by Directlink in its response to our information request.[8] We noted, however, that these figures would be reviewed for the final decision when the audited regulatory accounts for 2018–19 would be available.[9] In its revised proposal, Directlink adopted our draft decision changes and has updated its 2019–20 estimated capex.[10] We have subsequently checked the 2018–19 actual capex in the revised proposal and are satisfied it aligns with Directlink's regulatory accounts for that year.

We accept Directlink's revision to the 2019–20 net capex estimate of $9.7 million ($nominal).[11] This amount is 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 2019–20 will be accounted for at the next reset. Our final decision also updates the 2019–20 inflation input in the RFM with actual CPI for this year, which became available after Directlink submitted its revised proposal.

Further, our final decision corrects for a minor modelling issue to the opening RAB as at 1 July 2020 in the PTRM. While the RAB values reconciled in aggregate between Directlink's revised proposed PTRM and RFM, we identified that the opening RAB values at the asset class level in the PTRM did not reconcile with the closing RAB values as calculated in the RFM. In its response to our information request, Directlink agreed that the opening RAB values in the revised proposed PTRM should align with the RFM's output at the asset class level.[12] We have therefore used the correct opening RAB values (by asset class) as at 1 July 2020 in the PTRM, which reconcile with those values determined in the RFM.

We also consider the extent to which our roll forward of the RAB to 1 July 2020 contributes to the achievement of the capital expenditure incentive objective.[13] As discussed in the draft decision, the review period for this transmission determination is limited to 2015–16, 2016–17 and 2017–18 capex.[14] Directlink's aggregated actual capex incurred for the three year period of 2015–18 is above the forecast allowance set for that period at the 2015–20 transmission determination. Therefore, the overspending requirement for an efficiency review of past capex has been satisfied.[15]

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8 Directlink, *Response to AER Information Request #012 – Capital expenditure sharing scheme*, August 2019, p. 1.

9 AER, *Directlink 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, p. 15.

10 Directlink, *Revised transmission determination proposal*, December 2019, pp. 22–23.

11 This amount includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB.

12 Directlink, *Response to AER information request #017 – PTRM opening RAB values*, January 2020, p. 2.

13 NER, cll. 6A.14.2(b) and 6A.5A(a).

14 AER, *Directlink 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, p. 15.

15 NER, cl. S6A.2.2A(c).

However, for the reasons discussed in attachment 5 of our draft decision, we consider the capex incurred in those years to be consistent with the capital expenditure criteria and can therefore be included in the RAB.[16]

For this final decision, we have included Directlink's actual capex for 2018–19 and estimated capex for 2019–20 in the RAB roll forward to 1 July 2020. At the next reset, the 2018–19 and 2019–20 actual capex will form part of the review period for whether past capex should be excluded for inefficiency reasons.[17] Our RAB roll forward applies the incentive framework approved in the previous transmission determination, which included the use of a forecast depreciation approach in combination with the application of the capital expenditure sharing scheme (CESS).[18] As such, we consider that the 2015–20 RAB roll forward contributes to an opening RAB (as at 1 July 2020) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.[19]

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

## Table 2.1 AER's final decision on Directlink's RAB for the 2015–20 regulatory control period ($million, nominal)

| | 2015–16 | 2016–17 | 2017–18 | 2018–19 | 2019–20 [a] |
|---|---|---|---|---|---|
| Opening RAB | 129.4 | 130.8 | 130.9 | 138.2 | 141.4 |
| Capital expenditure[b] | 4.0 | 3.4 | 10.2 | 6.4 | 9.7 |
| Inflation indexation on opening RAB | 2.2 | 1.9 | 2.5 | 2.5 | 2.6 |
| *Less:* straight-line depreciation[c] | 4.9 | 5.3 | 5.4 | 5.6 | 5.8 |
| Interim closing RAB | 130.8 | 130.9 | 138.2 | 141.4 | 147.9 |
| Difference between estimated and actual capex in 2014–15 | | | | | –0.9 |
| Return on difference for 2014–15 capex | | | | | –0.2 |
| **Closing RAB as at 30 June 2020** | | | | | **146.9** |

Source: AER analysis.

(a) Based on estimated capex provided by Directlink.

(b) As-incurred, net of disposals, and adjusted for actual CPI and half-year WACC.

(c) Adjusted for actual CPI. Based on forecast as-commissioned capex.

16 AER, *Directlink 2020–25 - Draft decision - Attachment 5 - Capital expenditure,* October 2019, pp. 32–37; NER, cl. S6A.2.2A(f).

17 Here, 'inefficiency' of past capex refers to three specific assessments (labelled the overspending, margin and capitalisation requirements) detailed in NER, cl. S6A.2.2A. The details of our ex post assessment approach for capex are set out in AER, *Capital expenditure incentive guideline*, November 2013, pp.12–20.

18 AER, *Directlink transmission determination 2015–20*, April 2015, p. 10.

19 NER, cll. 6A.5A(a), 6A.6.7(c) and 6A.14.2(b).

### *Forecast closing RAB as at 30 June 2025*

Once we have determined the opening RAB as at 1 July 2020, we roll forward that RAB by adding forecast capex and inflation, and reducing the RAB by depreciation to arrive at a forecast closing value for the RAB as at the end of the 2020–25 regulatory control period.[20]

For this final decision, we determine a forecast closing RAB value at 30 June 2025 of $152.2 million ($nominal) for Directlink. This is $0.7 million (or 0.5 per cent) lower than Directlink's revised proposal of $152.9 million ($nominal).[21] Our final decision on the forecast closing RAB reflects the amended opening RAB as at 1 July 2020, and our final decisions on the expected inflation rate (section 2.2 of the Overview), forecast depreciation (attachment 4) and forecast capex (attachment 5).[22]

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

**Table 2.2 AER's final decision on Directlink's RAB for the 2020–25 regulatory control period ($million, nominal)**

| | 2020–21 | 2021–22 | 2022–23 | 2023–24 | 2024–25 |
|---|---|---|---|---|---|
| Opening RAB | 146.9 | 148.3 | 151.2 | 152.6 | 153.2 |
| Capital expenditure[a] | 5.0 | 6.9 | 5.9 | 5.5 | 4.4 |
| Inflation indexation on opening RAB | 3.3 | 3.4 | 3.4 | 3.5 | 3.5 |
| *Less:* straight-line depreciation[b] | 7.0 | 7.4 | 7.9 | 8.4 | 8.8 |
| **Closing RAB** | **148.3** | **151.2** | **152.6** | **153.2** | **152.2** |

Source: AER analysis.

(a) As-incurred, and net of forecast disposals. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling.

(b) Based on as-commissioned capex.

Figure 2.1 shows the key drivers of the change in Directlink's RAB over the 2020–25 regulatory control period for this final decision. Overall, the closing RAB at the end of the 2020–25 regulatory control period is forecast to be 3.6 per cent higher than the opening RAB at the start of that period, in nominal terms. The approved forecast net

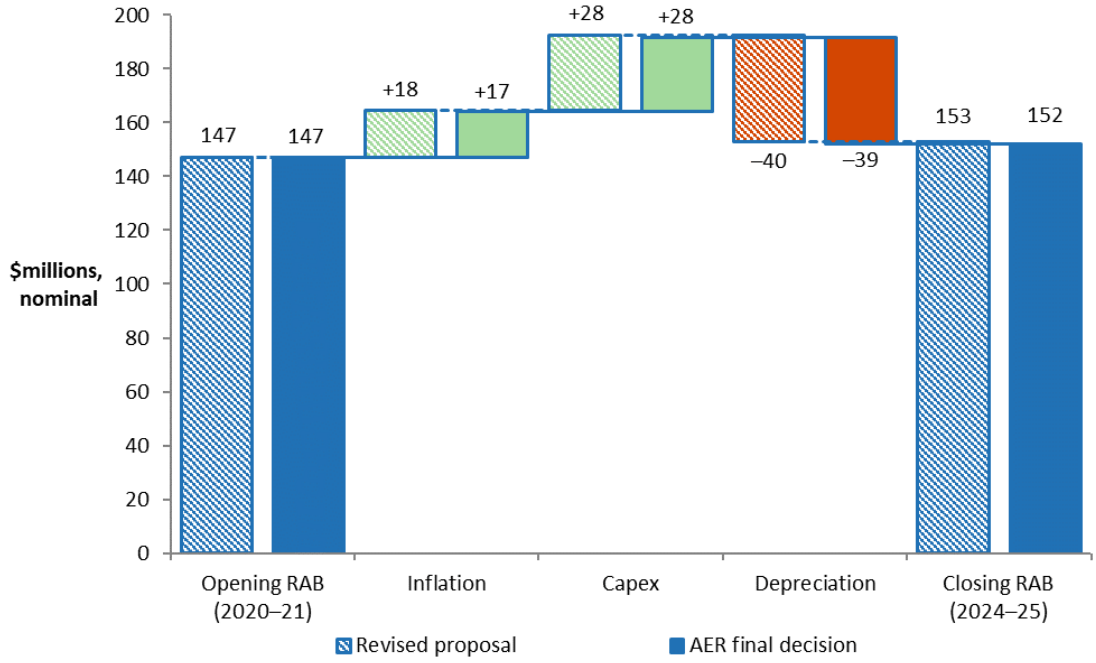
[20] NER, cl. S6A.2.4.

[21] This is due to our final decision having a lower forecast inflation than Directlink's revised proposal, as well as making minimal changes to the opening RAB as at 1 July 2020 and accepting Directlink's revised capex amounts. As a result, the lower indexation of the RAB is the primary difference for this final decision.

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

capex increases the RAB by 18.9 per cent, while expected inflation increases it by 11.6 per cent. Forecast depreciation, on the other hand, reduces the RAB by 26.9 per cent.

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




Source: AER analysis.

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

### *Application of depreciation approach in RAB roll forward for next reset*

When we roll forward Directlink's RAB for the 2020–25 regulatory control period at the next reset, we must adjust for depreciation. For this final decision, we determine that the depreciation approach to be applied to establish the RAB at the commencement of the 2025–30 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2020–25 regulatory control period.[23]

As discussed in section 3.2 of the final decision Overview, we will also apply the CESS to Directlink over the 2020–25 regulatory control period. We consider that the CESS will provide sufficient incentives for Directlink 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

[23] NER, cl. 6A.14.1(5E).

are sufficient to achieve the capex incentive objective.[24] Further, this approach is consistent with our draft decision and our *Framework and approach*.[25]

## 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.

[24] Our ex post capex measures are set out in the capex incentive guideline, AER, *Capital expenditure incentive guideline for electricity network service providers,* November 2013, pp. 13–19 and 20–21. The guideline also sets out how all our capex incentive measures are consistent with the capex incentive objective.

[25] AER, *Directlink 2020–25 – Draft decision – Attachment 2 – Regulatory asset base*, October 2019, pp. 17–18; AER, *Final framework and approach for Directlink – Regulatory control period commencing 1 July 2020*, July 2018, p. 23.

# Shortened forms

| Shortened form | Extended form |
|---|---|
| AER | Australian Energy Regulator |
| capex | capital expenditure |
| CESS | capital expenditure sharing scheme |
| CPI | consumer price index |
| NER | national electricity rules |
| opex | operating expenditure |
| PTRM | post-tax revenue model |
| RAB | regulatory asset base |
| RFM | roll forward model |
| WACC | weighted average cost of capital |