FINAL DECISION
Endeavour Energy
Distribution Determination

2019 to 2024

Attachment 2
Regulatory asset base

April 2019

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Endeavour Energy for the 2019–2024 regulatory control 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 attachments have been numbered consistently with the equivalent attachments to our longer draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

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Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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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
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
WACC	weighted average cost of capital

2 Regulatory asset base

As part of our distribution determination, we make a decision on Endeavour Energy's (Endeavour) opening regulatory asset base (RAB) as at 1 July 2019 and the projected RAB value for the 2019–24 regulatory control period.[1]

The RAB is the value of those assets that are used by Endeavour to provide standard control services. We use the RAB at the start of each regulatory year to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

This final decision sets out that depreciation based on forecast capital expenditure is to be used for establishing the RAB as at the commencement of the 2024–29 regulatory control period.[2]

2.1 Final decision

Opening RAB as at 1 July 2019

Our final decision is to determine an opening RAB value of $6526.1 million ($nominal) as at 1 July 2019 for Endeavour. This amount is $3.4 million (or 0.1 per cent) lower than Endeavour’s revised proposed opening RAB of $6529.5 million ($nominal) as at 1 July 2019.[3] It reflects the update to the roll forward model (RFM) for 2018–19 actual CPI that is now available. This final decision is $14.0 million (or 0.2 per cent) higher than our draft decision value for Endeavour's opening RAB of $6512.1 million ($nominal).

To determine the opening RAB as at 1 July 2019, we have rolled forward the RAB over the 2014–19 regulatory control period to determine a closing RAB value at 30 June 2019 in accordance with our roll forward model (RFM).[4] This roll forward includes an adjustment at the end of the 2014–19 regulatory control period to account for the difference between actual 2013–14 capex and the estimate[5] approved at the 2014–19 determination.[6]

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1 NER, cl. 6.12.1(6).

2 NER, cl. 6.12.1(18).

3 Endeavour Energy, *Revised regulatory* proposal, January 2019, p. 5.

4 AER, *Electricity distribution network service providers: Roll forward model (version 2)*, 15 December 2016.

5 While 2014–15 was a transitional year for Endeavour, we were unable to account for actual capex for 2013–14 in the 2014–19 final decision. Instead, an estimated capex for that year was included in Endeavour's opening RAB at 1 July 2014. This is discuss further in section 2.3 of our draft decision. The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2014–19 determination.

6 Although our 2015 determination for the 2014–19 period was set aside during the appeal process, the approved 2013–14 capex estimate was not varied as part of our remade determination.

In the draft decision, we accepted Endeavour's proposed opening RAB of $6512.1 million ($nominal) as at 1 July 2019.[7] No revisions were made to Endeavour's proposed opening RAB as we were satisfied with Endeavour's approach which included adjustments made from the remittal final decision for the 2014–19 regulatory control period.

We noted in the draft decision that the roll forward of Endeavour's RAB included estimated capex for 2017–18 and 2018–19, and estimated inflation for 2018–19, because these values were not yet available. Endeavour's revised proposal updated its 2017–18 capex with actuals and retained the 2018–19 capex estimates.[8]

We have checked the 2017–18 actual capex in the revised proposal and are satisfied it reconciles with the values presented in Endeavour's annual reporting regulatory information notice (RIN) for that year. We also accept Endeavour's 2018–19 net capex estimate of $409.2 million ($nominal).[9] This amount is consistent with the initial proposal and our draft decision. We note that the financial impact of any difference between actual and estimated capex for 2018–19 will be accounted for at the next reset. Our final decision also updates the 2018–19 inflation input in the RFM with actual CPI for this year, which became available after Endeavour submitted its revised proposal.

We also consider the extent to which our roll forward of the RAB to 1 July 2019 contributes to the achievement of the capital expenditure incentive objective.[10] As discussed in the draft decision, the review period for this distribution determination is limited to 2015–16 and 2016–17 capex.[11] Consistent with our draft decision, the requirements for an efficiency review of past capex are not satisfied.[12] Accordingly, we consider the capex incurred in those years are consistent with the capital expenditure criteria and can therefore be included in the RAB—this is discussed further in attachment 5 of our draft decision.[13]

For the purposes of this final decision, we have included Endeavour's actual capex for 2017–18 and estimated capex for 2018–19 in the RAB roll forward to 1 July 2019. At the next reset, the 2017–18 and 2018–19 actual capex will form part of the review

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7 AER, *Draft Decision Endeavour 2019–24 Distribution Determination Attachment 2: Regulatory Asset Base*, November 2018, p. 5

8 Endeavour, *0.04 Revised Roll Forward Model*, January 2019.

9 This amount includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB. The 2018–19 net capex in this final decision is $409.1 million due to updates for actual CPI in 2018–19.

10 NER, cll. 6.12.2(b) and 6.4A(a).

11 AER, *Draft Decision Endeavour 2019–24 Distribution Determination Attachment 2: Regulatory Asset Base*, November 2018, p. 15; NER, cl. S6.2.2A(a1).

12 Endeavour's actual capex incurred in 2015–16 and 2016–17 are below the forecast allowance set at the previous regulatory determination; NER, cl. S6.2.2A(b).

13 AER, *Draft Decision: Endeavour Energy distribution determination 2019–24, Attachment 5, Capex*, November 2018.

period for whether past capex should be excluded for inefficiency reasons.[14] 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).[15] As such, we consider that the 2014–19 RAB roll forward contributes to an opening RAB (as at 1 July 2019) that includes capex that reflects prudent and efficient costs, in accordance with the capital expenditure criteria.[16]

Table 2.1 sets out our final decision on the roll forward of Endeavour's RAB for the 2014–19 regulatory control period.

Table 2.1 AER's final decision on Endeavour's RAB for the 2014–19 regulatory control period ($ million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19[a]
Opening RAB	5581.3	5895.3	5979.9	6015.3	6255.5
Capital expenditure[b]	377.4	216.4	195.3	365.8	409.1
Inflation indexation on opening RAB	138.9	88.9	76.4	117.2	119.6
Less: straight-line depreciation[c]	202.3	220.8	236.2	242.8	252.9
Interim closing RAB	5895.3	5979.9	6015.3	6255.5	6531.3
Difference between estimated and actual 2013–14 capex (1 July 2013 to 30 June 2014)[d]					–3.9
Return on difference for 2013–14 capex[d]					–1.3
Closing RAB as at 30 June 2019					**6526.1**

Source: AER analysis.

(a) Based on estimated capex provided by Endeavour.

(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) Despite 2014–15 being a transitional year for Endeavour, there is still a true-up required for 2013–14. This is discussed further in section 2.3 of our draft decision.

Forecast closing RAB as at 30 June 2024

Once we have determined the opening RAB as at 1 July 2019, we roll forward the RAB by adding forecast capex and inflation, and reducing by depreciation to arrive at a

14 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, November 2013, pp. 12–20.

15 AER, *Final decision Endeavour Energy distribution determination – Overview*, April 2015, p. 23.

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

forecast closing value for the RAB at the end of the 2019–24 regulatory control period.[17]

For this final decision, we determine a forecast closing RAB as at 30 June 2024 of $7771.4 million for Endeavour. This is $13.7 million (or 0.2 per cent) lower than Endeavour's revised proposal of $7785.2 ($nominal). Our final decision on the forecast closing RAB reflects the updated opening RAB as at 1 July 2019 and our final decisions on forecast depreciation (attachment 4).[18] Table 2.2 sets out our final decision on the forecast RAB for Endeavour over the 2019– 24 regulatory control period.

Table 2.2 AER's final decision on Endeavour's RAB for the 2019–24 regulatory control period ($ million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	6526.1	6793.4	7024.8	7258.3	7512.6
Capital expenditure[a]	375.0	352.8	365.6	394.6	394.5
Inflation indexation on opening RAB	158.2	164.7	170.3	176.0	182.2
Less: straight-line depreciation	265.9	286.2	302.4	316.3	317.9
Closing RAB	6793.4	7024.8	7258.3	7512.6	7771.4

Source: AER analysis.

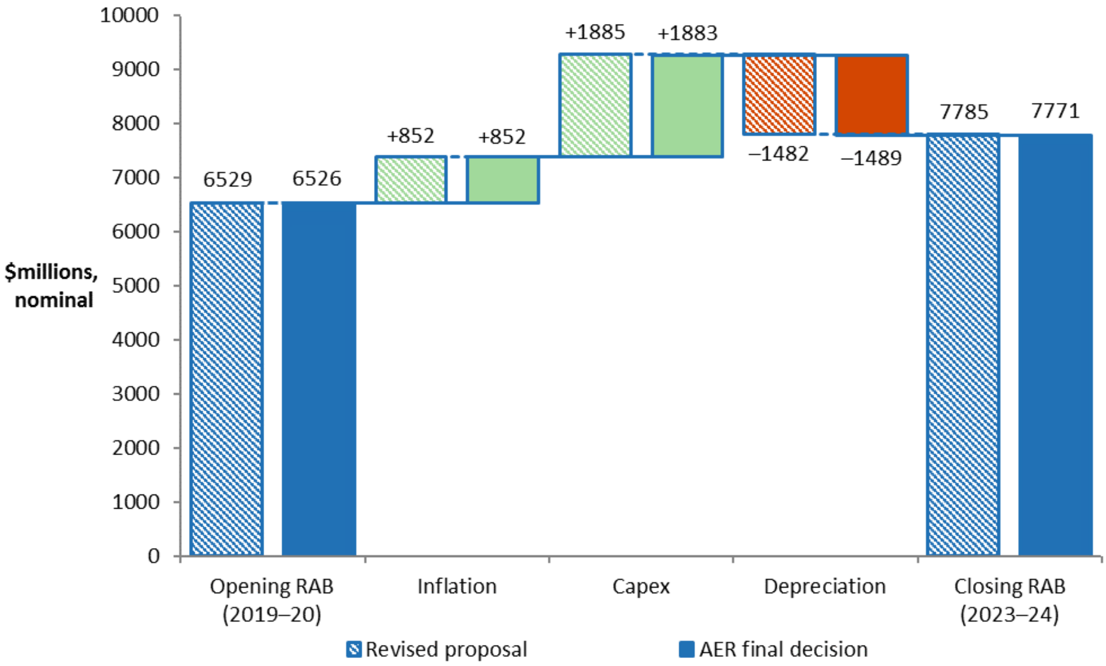
(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the post-tax revenue model (PTRM), the capex includes a half-year WACC allowance to compensate for the six month period before capex is added to the RAB for revenue modelling.

Figure 2.1 shows the key drivers of the change in Endeavour's RAB over the 2019–24 regulatory control period for this final decision. Overall the closing RAB at the end of the 2019–24 regulatory control period is forecast to be 19.1 per cent higher than the opening RAB at the start of that period, in nominal terms. The approved forecast net capex increases the RAB by about 28.8 per cent, while expected inflation increases it by about 13.0 per cent. Forecast depreciation, on the other hand, reduces the RAB by about 22.8 per cent.

17 NER, cl. S6.2.3.

18 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. We have accepted Endeavour's revised proposed forecast capex for the 2019–24 regulatory control period (attachment 5). However we have amended the revised proposed rate of return (section 2.2 of the overview). Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2019–24 regulatory control period.

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



Source: AER analysis.

Forecast net capex is a significant driver of the increase in the RAB. In our final decision, we are satisfied that Endeavour's revised proposed total forecast capex of $1715.1 million ($2018–19)[19] for the 2019–24 regulatory period reasonably reflects the capex criteria. We have therefore accepted Endeavour's revised proposed capex for the 2019–24 regulatory control period. Refer to attachment 5 for the discussion on forecast capex.

Application of depreciation approach in RAB roll forward for next reset

When we roll forward Endeavour's RAB for the 2019–24 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 2024–29 regulatory control period will be based on the depreciation schedules (straight-line) using forecast capex at the asset class level approved for the 2019–24 regulatory control period.[20]

As discussed in attachment 9, we will also apply the CESS to Endeavour over the 2024–29 regulatory control period. We consider that the CESS will provide sufficient

19 This amount is net of capital contributions, disposals and equity raising costs, and excludes the half-year WACC adjustment.

20 NER, cl.6.12.1(18).

incentives for Endeavour 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.[21] Further, this approach is consistent with our draft decision, Endeavour's initial proposal and our *Framework and approach*.[22]

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.

21 Our ex post capex measures are set out in the capex incentives 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.

22 AER, *Draft Decision Endeavour 2019–24 Distribution Determination Attachment 2: Regulatory Asset Base*, November 2018, p.17; Endeavour Energy, *Regulatory proposal 1 July 2019 to 30 June 2024*, April 2018, p. 92.; AER, *Framework and approach ActewAGL Regulatory control period commencing 1 July 2019*, July 2017, p. 13.