



FINAL DECISION
Evoenergy
Access Arrangement

2021 to 2026

Attachment 4
Regulatory depreciation

April 2021

© Commonwealth of Australia 2021

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the:

Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 4141, Canberra ACT 2601

or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165

Email: AERInquiry@aer.gov.au

AER reference: 65197

Note

This attachment forms part of the AER's final decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 7 – Corporate income tax

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

Contents

Note	2
Contents	3
4 Regulatory depreciation	4
4.1 Final decision	4
4.1.1 Standard asset lives for 2021–26	5
Evoenergy’s pipeline assets are shared between ACT and NSW....	7
Impact of the ACT Government’s climate change policy on Evoenergy’s customers in NSW	7
Consumer bill impacts and stakeholders’ submissions on Evoenergy’s revised proposal	10
4.1.2 Remaining asset lives as at 1 July 2021	11
4.2 Assessment approach	12
Shortened forms	13

4 Regulatory depreciation

When determining the total revenue for Evoenergy, we include an amount for the depreciation of the projected capital base (the 'return of capital').¹ Regulatory depreciation is used to model the nominal asset values over the 2021–26 access arrangement period and the depreciation amount in the total revenue requirement.²

This attachment outlines our final decision on Evoenergy's annual regulatory depreciation amount for the 2021–26 period. It also presents our final decision on the proposed depreciation schedules, including an assessment of the proposed standard and remaining asset lives used for forecasting depreciation.

4.1 Final decision

Our final decision determines a regulatory depreciation amount of \$50.1 million (\$ nominal) for Evoenergy for the 2021–26 period. This represents an increase of \$6.0 million (13.6 per cent) from Evoenergy's revised proposal of \$44.1 million. It is \$5.7 million (12.8 per cent) higher than the amount determined in the draft decision. The key reason for the increase compared to our draft decision is the lower expected inflation rate that resulted from our inflation review³ and was implemented in the most recent version of the post-tax revenue model (PTRM).⁴

The regulatory depreciation amount is the net total of the straight-line depreciation less the inflation indexation of the capital base. The straight-line depreciation is impacted by our decision on Evoenergy's opening capital base as at 1 July 2021 (Attachment 2), forecast capital expenditure (capex) (Attachment 5) and asset lives. Our final decision straight-line depreciation for Evoenergy is \$2.2 million lower than its revised proposal. This is mainly due to the lower opening capital base in our final decision.

The indexation on the capital base is impacted by our decision on Evoenergy's opening capital base (Attachment 2), forecast capex (Attachment 5) and the expected inflation rate (Attachment 3). Our final decision indexation on Evoenergy's projected capital base is \$8.1 million lower than its revised proposal. This is largely because we decided on an expected inflation rate of 2.00 per cent per annum for this final decision compared with the 2.37 per cent per annum that Evoenergy included 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.

In coming to our final decision on Evoenergy's straight-line depreciation:

¹ NGR, r. 76(b).

² The regulatory depreciation amount is the net total of the straight-line depreciation less the inflation indexation of the capital base.

³ AER, *Final position, Regulatory treatment of inflation*, December 2020.

⁴ AER, *Gas distribution PTRM (version 2)*, April 2021.

- We accept Evoenergy’s revised proposed straight-line method to calculate regulatory depreciation, which is consistent with our draft decision.
- We accept Evoenergy’s revised proposed weighted average method to calculate the remaining asset lives as at 1 July 2021 for depreciating its existing assets, which is consistent with our draft decision. In accepting the weighted average method, we have updated the revised proposed remaining asset lives as at 1 July 2021 due to our update for the 2020–21 actual inflation input to Evoenergy’s proposed roll forward model (RFM).
- We accept Evoenergy’s revised proposed standard asset lives for its asset classes, including its reductions to the standard asset lives associated with new capex for its high-pressure (HP) mains, medium-pressure (MP) mains and medium-pressure services asset classes. Our final decision differs from our draft decision because we now accept that Evoenergy should use shorter asset lives for its new pipeline assets in the NSW region as well as the ACT. In our draft decision we were not persuaded that shorter asset lives should be used in NSW.

Table 4.1 sets out our final decision on Evoenergy’s regulatory depreciation amount over the 2021–26 period.

Table 4.1 AER’s final decision on Evoenergy’s forecast depreciation for the 2021–26 access arrangement period (\$ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Straight-line depreciation	15.3	16.8	17.9	18.8	19.7	88.5
Less: indexation on opening capital base	7.5	7.7	7.8	7.8	7.7	38.4
Regulatory depreciation	7.7	9.1	10.1	11.1	12.0	50.1

Source: AER analysis.

4.1.1 Standard asset lives for 2021–26

Our final decision is to accept Evoenergy’s revised proposal for shorter standard asset lives for its new pipeline assets. This applies to its forecast expenditure for pipeline assets which are chiefly located in the ACT but also to other pipeline assets in the NSW region.

In our draft decision, we accepted Evoenergy’s proposed shorter standard asset lives for pipeline assets in the ACT region. This was because we considered that there was sufficient evidence to justify that new pipeline assets in the ACT would have shorter economic lives than their technical lives due to the ACT Government’s policies to move

away from gas use even though there were still some uncertainties regarding the path the ACT Government would choose to achieve net zero emissions.⁵

However, we did not accept Evoenergy’s proposed shorter standard asset lives for pipeline assets in the NSW region in our draft decision. Accordingly, we created three new asset classes for allocating forecast pipeline assets located in the NSW region of Evoenergy’s gas network and maintained the longer standard asset lives for these new asset classes. This was because we considered Evoenergy had a positive outlook for consumer growth in NSW, with builders in the NSW part of Evoenergy’s network wanting to connect gas to new estates. Further, NSW consumers are not eligible to receive ACT Government rebates (offered to ACT consumers) to switch their gas appliances to electric appliances. Therefore, we considered that there were no incentives for NSW consumers to not connect or start disconnecting from the gas network, unless it became too costly for them to remain on Evoenergy’s network.

Evoenergy’s revised proposal did not adopt our draft decision to partially accept its shortened standard asset lives. Instead, it sought full acceptance of its initial proposal to apply accelerated depreciation by way of assigning shorter standard asset lives to all new capex in pipeline asset classes whether it is located in the ACT or NSW. Table 4.2 sets out Evoenergy’s revised proposed changes to the standard asset lives for its pipeline assets and shows its total revised proposed forecast capex for the 2021–26 period allocated to these asset classes.

Table 4.2 Evoenergy’s revised proposed reductions to standard asset lives for pipeline assets and forecast capex allocations

Asset class	Current standard asset lives	Revised proposal standard asset lives	Total forecast capex allocated to asset class (\$2020–21)
HP mains	80 years	50 years	\$1.3 million
MP mains	50 years	30 years	\$8.5 million
MP services	50 years	30 years	\$5.4 million

Source: Evoenergy, *2021–26 Access Arrangement Revised Proposal - Attachment 5.2 - PTRM*, January 2021.

For our final decision, we accept Evoenergy’s revised proposal to apply shorter standard asset lives for all its new pipeline assets, and therefore not separate ACT and NSW assets for regulatory depreciation purposes. This is because we consider the shorter asset lives are better estimates of the economic lives of these asset classes than their technical lives.⁶ We have changed our draft decision position as a result of carefully assessing the information provided in Evoenergy’s revised proposal and the

⁵ AER, *Draft decision, Evoenergy 2021–26 Access arrangement, Attachment 4 – Regulatory depreciation*, November 2020.

⁶ NGR, r. 89(1)(b).

advancement of the ACT Government's climate change policy following the October 2020 ACT election. Our detailed reasoning for applying the shorter asset lives to Evoenergy's pipeline assets in NSW is set out below.

Evoenergy's pipeline assets are shared between ACT and NSW

Evoenergy submitted in its revised proposal that allocating assets to discrete NSW and ACT sections is unworkable because the cross-jurisdictional nature of its network promotes economies of scale. Moreover, major network assets located in both NSW and the ACT serve end-users in both jurisdictions, making geographic distinctions arbitrary.⁷ Therefore, Evoenergy submitted that it is not possible to divide assets, based on their physical location, into an ACT network and a NSW network.

We agree that some assets such as high-pressure mains are shared assets among the whole customer base. This is because high-pressure mains assets transport gas from supply points to major points of consumption and are not considered as connection assets for residential or small business customers. The capacity of these assets is built to supply all customers, the majority of which reside in the ACT. Evoenergy has explained in response to our information request that without consumption from the ACT, these high value assets will be over-capacity to provide gas to a small number of consumers in NSW, leading to a high depreciation charge per customer and higher network charges.⁸ Therefore, we accept that we should only have a single high-pressure mains asset class with an asset life of 50 years. We note that Evoenergy is proposing \$1.3 million of new expenditure in the high-pressure mains asset class over the 2021–26 period, which represents a significant reduction from historical spending.

On the other hand, medium-pressure mains and services assets may be separated by location as these are connection assets to residential and small business customers which are built to provide service to a specific location. We have assessed whether the economic life of these assets vary significantly between the ACT and NSW (Queanbeyan/Palerang) regions. We consider that Evoenergy's assets in NSW are likely to have their economic life aligned with its assets in the ACT due to the indirect impact of the ACT Government's climate change policy on Evoenergy's customers in NSW, and given it operates as a single integrated network. This is explained in detail below.

Impact of the ACT Government's climate change policy on Evoenergy's customers in NSW

At the time of the draft decision, we expected the ACT Government's decision on the path to net zero emissions from gas use to be made in 2024 (close to the next review) as per the timeline set out in its *Climate Change Strategy 2019–2025*.⁹ We expected

⁷ Evoenergy *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 26.

⁸ Evoenergy, *Response to AER information request IR020*, February 2021, p. 2.

⁹ *ACT Climate Change Strategy 2019–25*, 2019: <https://www.environment.act.gov.au/cc/act-climate-change-strategy>.

further clarity on the impact of this pathway on Evoenergy's customers located in NSW at that time.

However, following the October 2020 ACT election, the returned ACT Government has published an agreement which provides more certainty and clarity about its intentions and planned initiatives to phase out natural gas in the ACT.¹⁰ These include prohibiting new gas connections in newly developed estates and in new infill developments within existing areas in the ACT from 2023. Further, the agreement also commits to, among other measures, interest-free loans of up to \$15,000 for households to help with the cost of replacing gas appliances with electric alternatives.¹¹

We consider that the ACT Government's climate change policy has advanced considerably in the time between our draft decision and when we received the revised proposal. It is now more certain that Evoenergy's customer base in the ACT would start declining after 2023 as no new brownfield connections would be allowed. Existing customers in the ACT who have gas appliances installed in their homes would be more likely to switch to electricity once their appliances need to be replaced due to the rebates available to them and the marketing campaign to move away from gas use in the ACT.

We expect that this advancement in climate change policy in the ACT would also have implications on the future behaviour of Evoenergy's gas customers located in the NSW (Queanbeyan/Palerang) region and, hence, an impact on the economic life of Evoenergy's assets in NSW. We consider that as demand for gas in the ACT declines in future periods, the costs per customer would rise. Further, greater accelerated depreciation on existing capital base assets in future periods would also increase the costs to all customers. These factors could combine to make gas less competitive for NSW (Queanbeyan/Palerang) customers. Since these customers make up only 10 per cent of Evoenergy's total customer base, we do not expect that customer growth in the NSW (Queanbeyan/Palerang) region will be able to offset the expected decline in the ACT customer base. Therefore, even though forecast demand for new customer connections in NSW (Queanbeyan/Palerang) is stable in the 2021–26 period,¹² this could change in future periods as the costs associated with running Evoenergy's network rise, which could send a price signal to NSW (Queanbeyan/Palerang) customers to also leave the network.

In the draft decision, we noted that in the scenario of a potential closure of the ACT gas network, it may be possible for Evoenergy to technically maintain the NSW side of the

¹⁰ ACT Government, *Parliamentary and Governing Agreement for the 10th Australian Capital Territory Legislative Assembly, November 2020*, p. 7:
https://www.cmtedd.act.gov.au/__data/assets/pdf_file/0003/1654077/Parliamentary-Agreement-for-the-10th-Legislative-Assembly.pdf.

¹¹ Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 24.

¹² AER, *Final decision, Evoenergy 2021–26 Access arrangement, Attachment 12 – Demand*, April 2021, table 12.3.

network with a transmission pipeline passing through the ACT to connect NSW to the gas supply.

We note that Evoenergy has not yet analysed options to consider the technical and commercial feasibility of maintaining services to its NSW consumers in the event the ACT section of the network ceases to operate. In response to our information request,¹³ Evoenergy submitted that it is difficult to be definitive about the viability of the NSW portion of the network as a standalone network given:

- the impact on operational economies of scale of losing 90 per cent of the network's end-users currently located in the ACT
- the practicalities of operating a remnant network designed to serve a larger area with much of its major infrastructure situated well outside the operational area.

We expect that the nature of a standalone NSW portion of Evoenergy's network would be different to Evoenergy's current operational environment. However, there are too many uncertainties and costs associated with treating the NSW assets as standalone in the future as a probable option, which would justify keeping the standard asset lives of pipeline assets aligned with their technical lives. If in future periods, it becomes clear that the NSW portion can survive as a standalone network, we can reassess the asset lives at that time. The change to depreciation we are approving in this decision can be characterised as a prudent step on the evidence available. If circumstances change such that the network can operate beyond current expectations, depreciation could be adjusted in future decisions and customers would benefit from lower charges due to the reduced capital base. Similarly, further accelerated depreciation may be required in future periods if the usage of the network further decreases.

We recognise that Evoenergy's primary business is supplying gas to the ACT but there are economies of scale with also supplying gas to areas outside of the ACT, such as Queanbeyan. We consider if 90 per cent of Evoenergy's customer base which is in the ACT leaves the network over the next 30 years, then the whole network might be considered as stranded.

For these reasons, we consider that there is sufficient evidence that pipeline assets in the NSW region of Evoenergy's network would not reach the end of their technical life due to the possibility of a shut-down of the gas network in the ACT. Therefore, we are satisfied that a shorter asset life of 30 years is a more reasonable estimate of the expected economic life of the medium-pressure mains and medium-pressure services asset classes than their technical life.

¹³ Evoenergy, *Response to AER information request IR020*, February 2021, p. 1.

Consumer bill impacts and stakeholders' submissions on Evoenergy's revised proposal

Evoenergy's total revenue over the 2021–26 period increases by \$0.1 million due to our final decision to apply shorter asset lives for pipeline assets located in NSW, compared to if we had maintained our draft decision to keep the longer asset lives for NSW pipeline assets. This would have a negligible impact on consumer bills for this period.

The small revenue impact is largely because Evoenergy's forecast capex in pipeline assets in NSW for the 2021–26 period is approximately \$4.4 million, which is a small proportion of its \$54.0 million capex program. We have examined if connection contributions should increase for new customers in NSW to reflect a higher risk of asset stranding in Evoenergy's application of the incremental revenue test. We found that given the low capex cost per customer associated with connecting dwellings in NSW, the majority of connections are likely to pass the incremental revenue test.

We received stakeholder submissions from the Consumer Challenge Panel (CCP24), Energy Consumers Australia (ECA), ACT Council of Social Service (ACTCOSS), the Conservation Council ACT Region, Origin Energy and Red/Lumo Energy in response to our draft decision and Evoenergy's revised proposal on shortening the asset lives of its pipeline assets.

From a consumer perspective, we particularly note two contrasting views:

- The ECA's consultant TRAC partners supported our draft decision on Evoenergy's asset lives and submitted that it is not convinced by Evoenergy's revised proposal to extend accelerated depreciation to its assets in NSW as the NSW Government has not adopted the same policy initiatives as the ACT Government to reduce gas usage.¹⁴ We note that our reason for accepting Evoenergy's revised proposal relies on the impact of a future decline in the ACT consumer base on NSW consumers given the integrated operations of Evoenergy's network; rather than the impact of NSW Government policy on NSW (Queanbeyan/Palerang) consumers.
- On the other hand, CCP24 supported Evoenergy's proposal that the accelerated depreciation our draft decision accepted for ACT assets should extend to NSW assets on the basis that it better achieves the National Gas Objective (NGO) for all Evoenergy customers and prevents NSW customers from cross-subsidising the declining ACT customer base. It submitted that our threshold for accepting accelerated depreciation is too high and that greater flexibility with applying accelerated depreciation sooner would result in less intergenerational inequity.¹⁵ We note that in this final decision, we have fully accepted Evoenergy's proposal for accelerated depreciation, which is a small first step towards protecting the long term interests of its gas consumers from asset stranding risk. We will adapt our

¹⁴ ECA, *Submission on Evoenergy's revised proposal and AER's draft decision*, February 2021, pp. 6 and 15.

¹⁵ CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 5.

approach in future access arrangement reviews for the key considerations and changing circumstances that are relevant for each jurisdiction, network businesses and consumers.

We note that all stakeholder submissions called for us to conduct a broader review of possible asset stranding risks in gas networks under the context of jurisdictional climate change policies.¹⁶

We recognise that gas networks and their consumers across Australia are facing an evolving landscape with growing support for reducing carbon emissions by moving away from natural gas use for homes and businesses. To this end, and in recognition of the importance of the gas market and our role in determining network access arrangements, we have elevated consideration of issues relating to the future regulation of gas networks in our strategic priorities list and will advance this discussion with consumers, industry, market bodies and government stakeholders this year.

4.1.2 Remaining asset lives as at 1 July 2021

For this final decision, we accept Evoenergy's revised proposed weighted average method to calculate the remaining asset lives as at 1 July 2021. Evoenergy's revised proposal adopted our draft decision, where we accepted its initial proposal's application of the approach as set out in our RFM. In accepting the weighted average method, we have updated Evoenergy's remaining asset lives to reflect our update to the revised proposed RFM for 2020–21 actual CPI. This is because some of the inputs in the RFM, such as actual inflation, affect the value of assets in the capital base and in turn, the calculation of the remaining asset lives as at 1 July 2021.

We have also amended the remaining asset lives as at 1 July 2021 for the 'Regulatory costs' and 'IT systems' asset classes as they have small negative residual values at the start of the 2021–26 period. There is no further capex allocated to these asset classes. We have therefore assigned a remaining asset life of one year to these asset classes so that the negative amounts are fully depreciated (returned to customers) over the 2021–26 period.

Table 4.3 sets out our final decision on the standard and remaining asset lives for Evoenergy over the 2021–26 period. We are satisfied that the asset lives approved in this final decision will result in a depreciation schedule that reflects the depreciation criteria of the NGR.¹⁷

¹⁶ CCP24, *Submission on Evoenergy's revised proposal and AER's draft decision*, February 2021, p. 12; ACTCOSS, *Submission: Evoenergy gas network 2021–26 access arrangement revised proposal and AER draft decision*, February 2021, p. 20; Energy Consumers Australia, *Response to Evoenergy and Australian Gas Networks (SA) revised proposals 2021–26*, February 2021, p. 5; Origin Energy, *AER Draft Decision and Revised Access Arrangement Proposal for Evoenergy 2021–26*, February 2021, p. 2; Red/Lumo Energy, *Evoenergy access arrangement 2021–26 draft decision*, February 2021, p. 2.

¹⁷ NGR, r. 89(1).

Table 4.3 AER's final decision on Evoenergy's standard and remaining asset lives as at 1 July 2021 (years)

Asset class	Standard asset life	Remaining asset life as at 1 July 2021
HP mains	50.0	60.2
HP services	50.0	30.1
MP mains	30.0	24.0
MP services	30.0	36.1
TRS & DRS - valves & regulators	15.0	8.3
Contract meters	15.0	14.1
Tariff meters	15.0	10.5
Regulatory costs	5.0	1.0
IT system	5.0	1.0
Land and easement	n/a	n/a

Source: AER analysis.

n/a: Not applicable. We have not assigned a standard or remaining asset life to the 'Land and easement' asset class because the assets are not subject to depreciation.

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.¹⁸

¹⁸ AER, *Draft decision, Evoenergy 2021–26 Access arrangement, Attachment 4 – Regulatory depreciation*, November 2020, pp. 7–13.

Shortened forms

Shortened form	Extended form
ACT	Australian Capital Territory
ACTCOSS	ACT Council of Social Service
AER	Australian Energy Regulator
Capex	Capital expenditure
CCP / CCP24	Consumer Challenge Panel, sub-panel 24
ECA	Energy Consumers Australia
HP	High pressure
MP	Medium pressure
NGO	National Gas Objective
NGR	National Gas Rules
NSW	New South Wales
Opex	Operating expenditure
PTRM	Post-tax revenue model
RFM	Roll forward model