FINAL DECISION

TasNetworks
Distribution Determination
2019 to 2024

Attachment 2
Regulatory asset base

April 2019

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on TasNetworks' 2019–24 distribution determination. It should be read with all other parts of the 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 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment B – Negotiating framework

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
ERC	equity raising costs
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 TasNetworks' 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 TasNetworks 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 $1771.1 million ($nominal) as at 1 July 2019 for TasNetworks. This amount is $30.8 million (or 1.7 per cent) lower than TasNetworks' revised proposed opening RAB of $1801.8 million ($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 as well as a number of minor modelling corrections. This final decision is $24.1 million (1.4 per cent) higher than our draft decision value for TasNetworks' opening RAB of $1747.0 million ($nominal).

To determine the opening RAB as at 1 July 2019, we have rolled forward the RAB over the 2017–19 regulatory control period to determine a closing RAB value at 30 June 2019 in accordance with our RFM.[4] This roll forward includes an adjustment at the end of the 2017–19 regulatory control period to account for the difference between actual 2016–17 capex and the estimate approved at the 2017–19 determination.[5]

In the draft decision, we reduced TasNetworks' proposed opening RAB as at 1 July 2019 by updating various inputs such as the actual 2017–18 CPI in the RFM.[6] We noted the roll forward of TasNetworks' RAB included estimated capex for 2017–18 and 2018–19, and estimated inflation for 2018–19, because these actual values were not yet available.

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1 NER, cl. 6.12.1(6).

2 NER, cl. 6.12.1(18).

3 TasNetworks, *Transmission and Distribution Revised Revenue Proposals 2019-2024*, November 2018, p. 83.

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

5 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2017–19 determination.

6 AER, *Draft Decision: TasNetworks distribution determination 2019–24, Attachment 2, Regulatory asset base*, September 2018, pp. 14–17.

In its revised proposal, TasNetworks adopted our draft decision changes in full.[7] In addition, it has updated 2017–18 estimated capex with actuals and revised the 2018–19 estimate of capex with the latest figures.[8]

We have checked the 2017–18 actual capex in the revised proposal and are satisfied it reconciles with the values presented in TasNetworks' annual reporting regulatory information notice (RIN) for that year. However, we have identified an input error in TasNetworks' estimated capex for 2018–19 in the RFM. TasNetworks has recorded negative customer contributions for that year, which has the effect of overstating net capex.[9] We have raised this issue with TasNetworks through an information request, to which it has responded that this is a transcription error.[10] For this final decision, we have removed the negative sign from the inputs for 2018–19 customer contributions in the RFM, resulting in a net capex estimate for that year of $104.5 million ($nominal).[11] This corrected amount is lower 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 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 TasNetworks submitted its revised proposal.

Further, we corrected a minor modelling issue in TasNetworks' revised proposal RFM relating to 2017–18 equity raising costs (ERC). In the draft decision RFM we included an ERC value of $0.21 million ($nominal), which is equal to the benchmark ERC value calculated in the 2017–19 PTRM with an adjustment for a half-year actual CPI. However, TasNetworks' revised proposal RFM omitted this ERC value. In response to an information request on this issue, TasNetworks has acknowledged this is an input error.[12] We therefore reinstated the value for 2017–18 ERC in the RFM, consistent with our draft decision.

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.[13] As discussed in the draft decision, the review of past capex involves looking at the final two years of the 2012–17 regulatory control period.[14] Further, the length of TasNetworks' 2017–19 regulatory control period coincides with the two year period

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7 TasNetworks, *Transmission and Distribution Revised Revenue Proposals 2019-2024*, November 2018, p. 82.

8 TasNetworks, *Transmission and Distribution Revised Revenue Proposals 2019-2024*, November 2018, pp. 82–83; TasNetworks, *Revised roll forward model*, November 2018.

9 Customer contributions by definition are amounts customers pay to businesses, and therefore should not be included in the RAB for the purposes of earning a return. The RFM's net capex calculation therefore subtracts customer contributions from gross capex. However, TasNetworks' revised proposal net capex for 2018–19 adds, rather than subtracts, customer contributions.

10 TasNetworks, *Response to information request #043*, January 2019, p. 7.

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

12 TasNetworks, *Response to information request #043*, January 2019, p. 5.

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

14 AER, *Draft Decision: TasNetworks distribution determination 2019–24, Attachment 2, Regulatory asset base*, September 2018, p. 16.

which is excluded from the review period for this determination. Given this, the review period for this distribution determination is limited to 2015–16 and 2016–17 capex.[15]

TasNetworks' actual capex incurred for 2015–16 and 2016–17 are above the forecast allowance set at the 2012–17 distribution determination for that period. Therefore, consistent with our draft decision, the overspending requirement for an efficiency review of past capex has been satisfied.[16] However, for the reasons discussed in attachment 5 of our draft decision, we consider the capex incurred in those years is consistent with the capital expenditure criteria and can therefore be included in the RAB.[17]

For the purposes of this final decision, we have included TasNetworks' 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 period for whether past capex should be excluded for inefficiency reasons.[18] 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).[19] As such, we consider that the 2017–19 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.[20]

Table 2-1 sets out our final decision on the roll forward of TasNetworks' RAB for the 2017–19 regulatory control period.

Table 2-1 AER's final decision on TasNetworks' RAB for the 2017–19 regulatory control period ($million, nominal)

	2017–18	2018–19[a]
Opening RAB	1615.2	1725.2
Capital expenditure[b]	156.7	104.1
Inflation indexation on opening RAB	30.8	30.8
Less: straight-line depreciation[c]	77.5	98.3
Interim closing RAB	1725.2	1761.8

15 NER, cl. S6A.2.2A(a1).

16 NER, cl. S6.2.2A(c).

17 AER, *TasNetworks distribution determination 2019–24 – Attachment 5 – Capital expenditure*, September 2018, pp. 77–80; NER, cl. S6.2.2A(f).

18 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.

19 AER, *TasNetworks 2017–19 – Final decision overview*, April 2017, p. 20; and AER, *Draft decision – TasNetworks distribution determination 2017–19 – Attachment 2 – Regulatory asset base*, September 2016, p. 17.

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

	2017–18	2018–19[a]
Difference between estimated and actual 2016–17 capex (1 July 2016 to 30 June 2017)		8.3
Return on difference for 2016–17 capex		0.9
Closing RAB as at 30 June 2019		**1771.1**

Source: AER analysis.

(a) Based on estimated capex provided by TasNetworks.

(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.

Forecast closing RAB as at 30 June 2024

Once we have determined the opening RAB as at 1 July 2019, 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 at the end of the 2019–24 regulatory control period.[21]

For this final decision, we determine a forecast closing RAB as at 30 June 2024 of $2139.6 million for TasNetworks. This is $84.5 million (or 3.8 per cent) lower than TasNetworks' revised proposal of $2224.0 million ($nominal). Our final decision on the forecast closing RAB reflects the amended opening RAB as at 1 July 2019 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 TasNetworks over the 2019–24 regulatory control period.

Table 2-2 AER's final decision on TasNetworks' RAB for the 2019–24 regulatory control period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24
Opening RAB	1771.1	1860.9	1938.2	1999.0	2067.7
Capital expenditure[a]	146.9	139.9	130.2	142.5	150.4
Inflation indexation on opening RAB	42.9	45.1	47.0	48.5	50.1
Less: straight-line depreciation	100.0	107.8	116.3	122.3	128.7
Closing RAB	1860.9	1938.2	1999.0	2067.7	2139.6

21 NER, cl. S6.2.3.

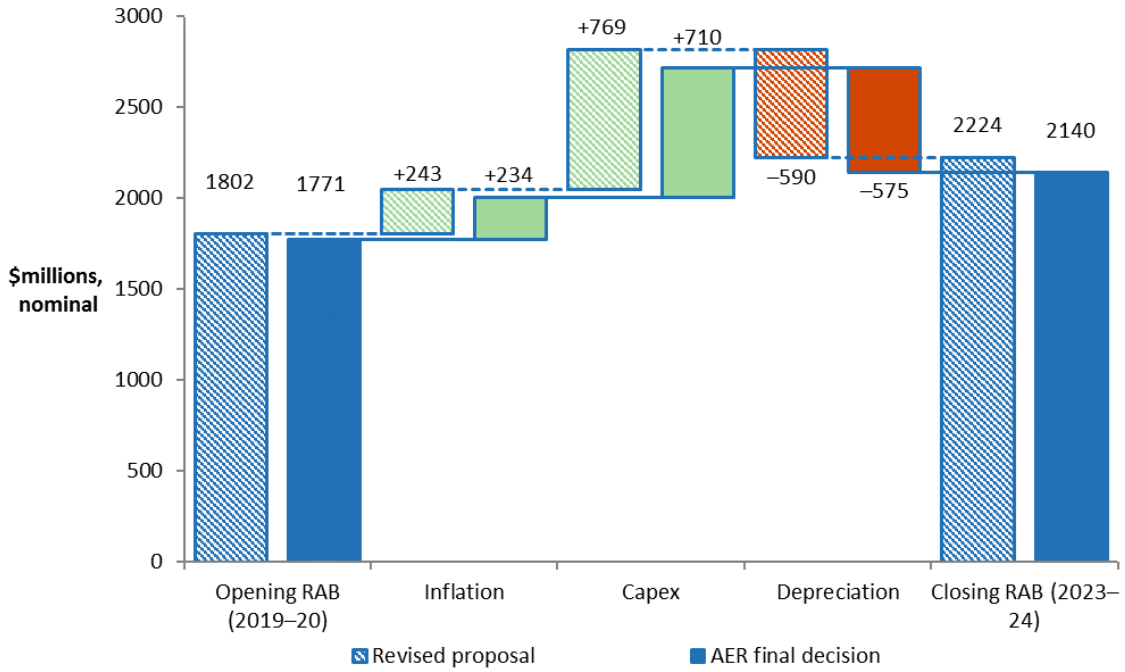
22 Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2019–24 regulatory control period (attachment 2 and section 2.2 of the Overview).

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 TasNetworks' 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 20.8 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 40.1 per cent, while expected inflation increases it by 13.2 per cent. Forecast depreciation, on the other hand, reduces the RAB by 32.5 per cent.

Figure 2-1 Key drivers of changes in the RAB—TasNetworks' 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 not satisfied that TasNetworks' revised proposed total forecast capex of $703.0 million ($2018–19)[23] for the 2019–24 regulatory control period reasonably reflects the capex criteria. We have therefore determined a total forecast capex of $651.1 million ($2018–19) for the 2019–24 regulatory control period. Refer to attachment 5 for the discussion on forecast capex.

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

Application of depreciation approach in RAB roll forward for next reset

When we roll forward TasNetworks' 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.[24]

As discussed in attachment 9, we will also apply the CESS to TasNetworks over the 2019–24 regulatory control period. We consider that the CESS will provide sufficient incentives for TasNetworks 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.[25] Further, this approach is consistent with our draft decision and our *Framework and approach*.[26]

2.2 AER's 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.

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[24] NER, cl. 6.12.1(18).

[25] 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.

[26] AER, *Draft decision – Attachment 2 – Regulatory asset base*, September 2018, p. 18; AER, *Final framework and approach for TasNetworks distribution and transmission*, July 2017, p. 71.