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Mr Gary Henry
Director
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Mr Henry

Draft Determination on Regulation of Electricity Distribution

In its submission in response to the Authority's discussion paper on asset valuation prepared by Sinclair Knight Merz (SKM), AGL observed that SKM had not set out the conceptual basis and meaning of DORC. In the absence of such a foundation, the method of calculation of DORC becomes arbitrary and DORC can take, essentially, any value. There is no evidence that SKM has given consideration to this concern in its final valuation reports on Energex and Ergon, dated 18 November 2004. In each case, the statement is made simply that "The QCA indicated that the depreciated value of the optimised assets would be calculated using a straight line depreciation."

The generally accepted conceptual basis and meaning for DORC clearly does not support the straight line method. On the contrary it requires a NPV approach. This view is supported by the citations in AGL's December 2003 submission and is now confirmed by the Australian Competition Tribunal in its reasons published in the East Australian Pipeline Limited appeal in July 2004. The Authority apparently acknowledges that this is the case.

The clear conclusion from this is that it is no longer appropriate in the Australian regulatory context to refer to a value produced by straight line adjustment of the ORC as a DORC value.

In the end, the Authority proposes to reject the NPV approach in favour of straight line adjustment of ORC on the grounds that "A move to an annuity depreciation approach to derive DORC would mark a fundamental change if implemented. The Authority considers that asset owners should not benefit from, or be adversely impacted by, mid-term changes in an asset's depreciation profile, unless their actions have caused the change or unless their return on capital prospectively compensated them for the risk."

AGL notes the Authority's decision to continue using straight line adjusted ORC as the basis for the capital base. However, given current evidence, it is no longer sustainable for such a value to be referred to as "DORC". There is, therefore, a need for terminology that distinguishes clearly between the two approaches. This could be achieved by referring to the "Straight Line Adjusted ORC" as just that – or "SLORC" if it is necessary to resort to an acronym.

Yours sincerely

Robert Wiles
General Manager, Regulation and Policy