



Response to QCA's discussion paper: "Electricity Distribution: Valuation of Easements"

1 Introduction

The April 2003 discussion paper by the Queensland Competition Authority (QCA) "Electricity Distribution: Valuation of Easements" invites submissions on the methodology for the valuation of easements to be used for Queensland electricity distributors. As a network service provider, Powerlink Queensland welcomes the opportunity to put forward its views.

2 Fundamental Principles

The basic principles are that the network service provider:

- ❖ should be able to recover all efficient costs incurred
- ❖ is given an appropriate rate of return on their investment.

Upholding these principles is essential to ensure that adequate investment occurs and maintaining fairness, consistency and transparency in the regulatory process.

3 Powerlink's view

It is Powerlink's view that, in light of the above principles, there are only two choices for the valuation methodology of easements:

- ❖ Depreciated Optimised Replacement Costs (DORC)
- ❖ Indexed cost of acquisition

Factors which differentiate easements from other network assets do not sufficiently validate a move away from DORC. A market for easements is not required to assess a 'modern equivalent' cost of acquiring an easement. The absence of such a market does not preclude a DORC valuation.

There is also the argument that "easements do not depreciate like other assets and are generally not replaced". However, the fact that easements have a different depreciation rate (0%) to overhead lines (for example) does not imply that their valuation should be different.

Powerlink contends that **the correct methodology is to value easements using DORC**. This is supported by the ACCC's draft regulatory principles – although a DORC easement valuation has not yet been applied to any TNSP in ACCC's jurisdiction. The main reason cited to date by the ACCC for this approach however, is that it has been bound by the State Jurisdictional valuations rather than disregarding the DORC methodology.

Some participants and regulators want to move away from DORC for easements because of the magnitude of the values that arise from such an assessment and the price shocks for customers that would follow.

Hence, a pragmatic (second-best only) solution is to use the acquisition cost indexed appropriately to take account of inflationary effects to maintain the value of the investment in real terms. That is, if DORC cannot be considered for reasons of price path, then the pragmatic approach is to use an indexed cost methodology.

It is acknowledged that gaps may exist in the available records of the cost base of easements. However, if we are to take a pragmatic approach with easement valuation, then the pragmatic view here is to use an appropriate proxy where records are unavailable. The proxy could be:

- ❖ the current book value of the easement, or
- ❖ a value calculated using the cost of similar easements (appropriately adjusted for length, location and acquisition time).

In any such pragmatic approach, where DORC is not used, it is clear that **zero would not be adequate compensation** for the investment made by the network service provider even in the cases where records are unavailable.