



2 June 2003

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

Dear Gary,

The valuation of easements

SPI PowerNet recognises that the valuation of easements is a difficult issue for a regulator given the need to reconcile the economic principles that have been used to value other types of assets (usually optimised depreciated replacement cost) with the price outcomes that would result from this if used on a Company's easement portfolio. Therefore, SPI PowerNet welcomes the opportunity to discuss some of the issues raised in the QCA's Discussion Paper entitled *Electricity Distribution: Valuation of Easements*.

This letter does not attempt to address the merits of ODRC vs historic cost approaches to valuation for the purposes of price setting for regulated businesses, rather it seeks to make some observations on some practical implementation issues not necessarily unique to any particular valuation methodology. Many of the observations are drawn from the experiences of electricity transmission regulation but are likely to be applicable to distribution as well.

Regulatory consistency

Regulatory consistency between regulators and between decisions is important, however, in the area of easement valuation this consistency has not been largely absent. This is best illustrated by an examination of the easement valuations used in each of the ACCC TNSP Revenue Decisions.

Despite the ACCC's stated intent to consistently use indexed historical cost for the valuation of easements, it has in fact used a different methodology or implementation of that methodology for each Decision for the four major TNSPs in the NEM (see Table below).

Decision	RAB Value (2001 \$m)	Method of valuation	Historic transaction costs accepted
TransGrid	354	Synthetic Historic Cost – in fact ODRC (1996)	ODRC value of transaction costs
Powerlink	123	Book Value – Synthetic Indexed Historic Cost	Synthetic transaction costs
SPI PowerNet	90	Indexed Historic Cost	Very limited actual extrapolated costs
ElectraNet SA	3	Book Value – (unknown methodology, likely based on Unindexed Historic Cost)	None

Accounting for the size of each TNSPs easement portfolio, this has resulted in widely different relative values to that which would occur under a consistent approach.

In particular, a consistent regulatory approach with regard to the inclusion of transaction costs and the valuation of those costs in the absence of records would likely prevent much of the current variation in treatment occurring in future regulatory decisions.

SPI PowerNet believes the following approaches to these issues would greatly contribute to future valuation consistency.

Transaction costs

It must be recognised in any valuation methodology that transaction costs are incurred during the purchase of an easement portfolio over and above the compensation paid to landowners for the easement rights themselves. Historically, these transaction costs have included the reimbursement of affected land owners' costs and the internal costs incurred by the business for surveying, valuation, registration, disputes and management of the acquisition process. More recently transaction costs will have included environmental and native title assessments.

Importantly, it should be noted that none of these costs are capitalised into line costs and are not included in modern ODRC valuations of lines. The reason for this is that easements are commonly purchased well before (sometimes decades before) the construction of the lines on the easement.

These costs must not be confused with the costs of vegetation clearing and access track construction (quoted from an SKM report in the QCA Discussion Paper) associated with the construction of a line on an easement and capitalised into the line value during construction.

Therefore, SPI PowerNet considers the value of transaction costs must be included in any complete valuation of an easement portfolio regardless of the valuation methodology chosen.

Quality of records

If a historical cost methodology is to be used, SPI PowerNet feels strongly that a Company should not be penalised for lack of records when assessing the costs associated with purchase of easements.

Easement portfolios are accumulated over a very long period of time. For example, in SPI PowerNet's case large easements purchases began in the 1920s. Thus records are quite commonly incomplete or non-existent. In the Company's experience, compensation paid to the land owner is more likely to be recorded as many values are included on registration documents (this may not be the case in every jurisdiction), however, records of transaction costs tend to be incomplete or nonexistent until advent modern electronic record keeping.

Where records of transaction costs are incomplete, extrapolation can be used to generate the likely transaction cost for the entire portfolio or synthetic costs can be constructed. Indeed, present day transaction costs for similar activities can be used as a reasonable proxy of indexed transaction historical costs, as they have not tended to rise at faster than the rate of inflation (if anything, these costs have tended to decrease in real terms over time). This avoids the concern regulators have for using modern

replacement costs for the compensation component of an easement purchase where underlying values of the land will have far outpaced inflation.

Therefore, SPI PowerNet considers that the regulator must be prepared to extrapolate costs across the entire easement portfolio from limited existing records and be prepared to synthesise costs where records do not exist but costs would clearly have been incurred.

If you have any questions regarding this letter, please don't hesitate to contact me on telephone 03 8635 7335.

Yours sincerely,

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