Electricity Distribution: The Valuation of Easements
Queensland Competition Authority

A. Introduction
TXU's position on the appropriate valuation for easements is that it supports a historical valuation indexed for inflation.

Let me outline four reasons why

- There are strong benefits associated with valuing easements at historic cost.
- The problems associated with managing easements at historic costs are manageable.
- There are major problems associated with valuing easements at market value, even though this is consistent with the Depreciated Optimised Replacement Cost (DORC) methodology.
- Consistent decisions regarding easement valuation by regulators in jurisdictions throughout Australia re-affirm this position.

B. The benefits of valuing easements at historic cost
Historic cost measures the cost of acquiring easements as its value. An indexed historic cost adjusts the purchase price for inflation. TXU supports the CPI as an appropriate tool for indexing the value of easements. TXU believes

- Indexed historic cost valuation for easements are easily identifiable. Records of purchased easements document the amount paid. As such, this approach avoids the costs & subjectivity associated with determining current asset values.

- It provides compensation to the owner of the easement by providing a rate of return on the investment. A return on the indexed historic cost evaluation is necessary to maintain the value of the firm's financial capital.

- It is simple to administer & data is comparable across assets.

C. The problems associated with using historic cost valuation do not apply in the case of easements.
Some regulators have avoided asset valuations based on a historic cost approach in the past favouring valuations based on DORC. Some reasons for this include

- Historic asset valuations have developed in an environment with different accounting rules regarding the extent to how much an asset is capitalised. Hence, comparisons will be difficult.
- The view that historic asset values have no relevance with current market values.
- The fact that simular assets in different jurisdictions have been allocated different historical values.

- Attempts to inflate historical values to current costs have created problems with asset values resulting in higher values than DORC valuations.

The problems associated with the historic cost approach to asset valuation do not exist when applied to valuing easements. Hence, they are irrelevant to this debate.

D. Major problems exist associated with valuing easements at market value.

There are problems associated with easement valuation at market value that include

- Economists argue the rationale for the use of current market value applied to the valuation of easements is that the asset will be put to its highest value. If it is not, the opportunity cost of the land will be greater than the value of its current use. This is consistent with the cost to a new entrant to enter the market. Hence, a market value approach provides a value which better reflects the opportunity cost of the asset. However, in reality the opportunity cost of an easement is difficult to observe because it has a limited alternative economic use.

- An asset valuation methodology should generate a revenue stream equal to the present value of the efficient long run costs of supply. This is consistent with the objective of maintaining the value of a firm's financial capital. A market valuation of easements that leads to a wind-fall gain will deliver access prices in excess of the efficient long run costs of supply. This may lead to unnecessary price shocks to consumers.

- The use of a current market value like DORC is inappropriate as applied to easements because easements do not depreciate and are not usually replaced.

E. Australian regulatory decisions on easement values reaffirm the use of a historical based the use of a historic cost approach.

Australian regulators have applied a consistent approach when considering the complex issues associated with the valuation of easements. The Queensland Competition Authority (QCA) has provided a summary of some of these cases. In response to this,

- TXU supports IPART's approach to the valuation of easements in NSW distribution networks that accounts for easements at historic cost rather than at replacement cost. However, TXU would support the indexation of historic costs by CPI.

- The QCA consultation paper refers to a report quoted by the ACCC (p.6) from consultants SKM which notes that easements are granted in perpetuity and do not need to be replaced or depreciated. It argues a market valuation for easements will provide network owners with windfall gains that don't reflect the risk adjusted cash flow rates of return appropriate for the efficient operation of the business. TXU supports this view in this paper.

- In its draft decision on the Victorian Transmission Network Revenue caps 2003-2008, the ACCC valued easements on the basis of historical costs indexed by CPI. TXU supported the ACCC's decision on the basis the re-valuation of the easements would give the transmission company a "wind-fall" gain with price shocks to customers.

- In its decision on the South Australian Transmission Revenue Cap 2003-2008, the ACCC considered it inappropriate to value easements at deprival value. It indicated this approach was inappropriate given the special characteristics of easements. The ACCC valued easements at actual costs suitable indexed for timing differences. TXU supports the ACCC's decision to value easements at actual cost.

F. Conclusion

TXU's position on the appropriate valuation for easements is that it supports a historical valuation indexed for inflation.

This paper has outlined the four reasons why that include

- There are strong benefits associated with valuing easements at historic cost.
- The problems associated with managing easements at historic costs are manageable.
- There are major problems associated with valuing easements at market value, even though this is consistent with the Depreciated Optimised replacement Cost (DORC) methodology.
- Consistent regulatory decisions by different regulators in jurisdictions throughout Australia have re-affirmed this position.