



## **GOVERNMENT & INDUSTRY RELATIONS**

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Paul Melville  
Gas Pipelines Inquiry  
Commerce Commission  
PO Box 2351  
WELLINGTON

Dear Paul

Telecom wishes to make some general comments in response to the Commerce Commission's Gas Control Inquiry Draft Report. Although there are obvious differences between the gas industry and the telecommunications industry, the two do share many similar characteristics. Telecom wishes to comment on those similarities that influence commercial decisions in both industries and the treatment of those by the Commission.

Both the telecommunications and gas industries require major investment in very large, extensive network assets that become sunk once the investment is made. As the Commission's valuation of gas suppliers' assets is based on the replacement cost of an optimised gas network, this is the same as calculating the value of the asset before the investment, say, to inform a decision to either invest in the network or not invest in the network at all. The Commission implies through this calculation that the investment will be made if the expected net present value of the investment is at least zero.

Investment in network assets are large and are not recoverable once they have been made, resulting in significant downside risk. Telecom recognises that there is a level of risk with any investment, however, the Commission must recognise that there is additional risks to those investing in sunk assets. Unlike other investments, sunk assets are not recoverable even if the investment does not earn any revenue, thus the investment becomes stranded. Prudent commercial practice is to take this risk into account when thinking about making an investment, and is generally achieved by incorporating it into a hurdle rate that the expected return from the proposed investment needs to meet before undertaking the investment.

If the Commission does not recognise the risk of asset stranding in its valuation of network assets then the result could seriously underestimate the cost faced by gas service providers in investing in gas transmission and distribution networks. This could occur within the regulatory context as a result of the modelling process for valuing assets. When carrying out an asset valuation based on an optimised network at regular intervals, the modelling process would strand an asset by including the asset in one valuation but not including it in the next, this could be due to a customer disconnecting during the interval between regulatory determinations. As pointed out above, within the commercial context it is prudent to factor this risk into the hurdle

rate before the investment is made, in order to determine the revenue sufficient to recover this cost. It is not clear, however, how the Commission intends to recover this cost of stranding as the cost of capital does not seem to include this additional risk.

Telecom would urge the Commission to take into account the risk of asset stranding into their calculations.

Any further enquiries with respect to this submission should be made in the first instance to:

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Yours sincerely

A handwritten signature in blue ink, appearing to read 'BP', is positioned below the 'Yours sincerely' text.

**Bruce Parkes**  
**General Manager**  
**Government & Industry Relations**